

# INSTITUTE OF ACTUARIES OF INDIA

## EXAMINATIONS

17<sup>th</sup> May 2010

**Subject SA5 – Finance**

**Time allowed: Three hours (9.45\* - 13.00 Hrs)**

**Total Marks: 100**

### INSTRUCTIONS TO THE CANDIDATES

1. *Please read the instructions on the front page of answer booklet and instructions to examinees sent along with hall ticket carefully and follow without exception*
2. *\* You have 15 minutes at the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only, but notes may be made. You then have three hours to complete the paper.*
3. *You must not start writing your answers in the answer sheet until instructed to do so by the supervisor*
4. *The answers are expected to be India Specific application for the syllabus and corresponding core reading. However, substantially the core reading material is still taken from material supplied by Actuarial Education Company which are meant for UK Fellowship examination. The core reading also contains some material which is India Specific, mostly the IRDA regulation. In view of this, it should be noted that focal point of answers is expected to be India Specific application. However if application specific to any other country is quoted in the answer the same should answer the question with reference to Indian environment.*
5. *Attempt all questions, beginning your answer to each question on a separate sheet.*
6. *Mark allocations are shown in brackets.*

**AT THE END OF THE EXAMINATION**

**Please return your answer book and this question paper to the supervisor separately.**

- Q. 1)** Trust Consumer Products (TCP) is a listed large consumer products company specializing in two principal product categories: hair care & home care products. A quarter of its sales revenue comes from abroad.

TCP is on an acquisition drive to expand its hair care & home care business in the emerging markets in Asia, Africa and South America.

A close scrutiny of the acquisition strategy pursued by TCP reveals that it has brought products, brands as well as distribution networks. This has provided the company with the flexibility to move products across geogr faphies and use the trade channels to sell multiple products

Currently TPC is considering a Rs. 100 crore acquisition of a listed company in the Indian market called Keyline Hair Care which manufactures hair colours.

Hitherto TCP has been relying on term loans from financial institutions to finance its acquisitions. Some of the other financing options available to TCP for financing this acquisition are i) raising funds from the capital market; and ii) using mezzanine finance

- a) Evaluate the merits and demerits of raising finance from capital market vis –a- vis using term loans for financing acquisitions. (8)
- b) Briefly describe the features of mezzanine finance and evaluate its appropriateness in the context of this acquisition (8)
- c) TPC intends to offer its equity shares in exchange for the equity share of Keyline Hair Care. (9)

The three typical bases used for determining exchange ratio are:

- i) Earnings per Share
- ii) Market Price Per Share
- iii) Book value Per Share

Critically evaluate these bases for determining the exchange ratio; and recommend an appropriate basis in the context of this acquisition

- d) The CEO of TCP is concerned about the high chances of failure in an acquisition ; and wants you to develop an appropriate acquisition strategy which can minimise the chances of such failures.

Prepare a note addressed to the Chief Executive Officer (CEO) of TCP covering the key building blocks (key steps) of an appropriate acquisition strategy. Your note should, interalia, address the following aspects:

- Criteria for Acquisition
- Screening & Evaluating Potential Acquisition Candidates
- Process for Valuing an Acquisition
- Managing Post-Acquisition Issues

(12 marks including 2 marks for drafting)

[37]

**Q. 2) a)** Define Corporate Governance and explain how a company can demonstrate good corporate governance (8)

**b)** In a developing country, the insurance industry was opened for private participation about a decade ago with a condition that at least 33% of the total equity capital should be divested to the public. Many of the insurance companies are contemplating to come out with IPOs [Initial Public Offerings] even though they have not started making profits.

In this country, there are adequate regulations for listing of non-insurance companies on stock exchanges

The market regulator is contemplating develop regulations regarding listing of life insurance companies on the stock market including the disclosure norms for such companies

Discuss the key disclosures that the market regulator would ask life insurance companies to provide in the offer document in order to ensure transparency and good corporate governance.

(15)  
[23]

**Q. 3)** Maxima Mutual Fund (MMF) is planning to launch a close ended Max NAV fund. The salient features of this product are:

Limited contribution product with maximum contribution period of 3 years

The fund is free to invest in any financial securities

Term of 10 years and at maturity the policy holder is paid the units valued at the higher of NAV applicable at maturity or the highest NAV during first 7 years of the plan

The company plans to levy some extra charges due to investment guarantee

**a)** Suggest two approaches that can be used to structure the underlying portfolio to meet the investment guarantees. (8)

**b)** Explain the principal investment risks associated with each of your approaches in (i) and suggest how these risks may be mitigated. (12)

**c)** Explain the principal operational risks associated with this product and how they can be mitigated. (10)

**d)** You have filed the product with the regulator SEBI for approval. The regulator has send a list of questions including the following

How is this product fair to the investors and why is it needed from investors perspective?

Draft an appropriate reply to the regulator.

[10 marks including 2 marks for drafting]  
[40]

\*\*\*\*\*