Marsh

FINPRO Spotlight series

Are you confident?

FINPRO coverage considerations when your company is making an acquisition

When acquiring another company your organization may be weighing several issues, including costs, reputation, and the long-term impact on your employees. Amid such concerns, it is critical to understand how insurance plays a significant role throughout the acquisition process. This is especially important to your board of directors upon the closing of the deal.

How the coverages work

In an acquisition — where you are the "buyer"— it is important to understand the process for adding coverage to your existing programs and securing runoff coverage where needed. Runoff policies are most often associated with directors and officers (D&O) liability insurance and provided to the company being acquired to cover any prior acts.

During an acquisition, the following forms of management liability insurance may be affected:

- D&O liability.
- Employment practices liability (EPL).
- Fiduciary liability.
- Cyber/errors and omissions (E&O) liability.
- Crime, and kidnap and ransom.

These coverages generally have a provision for automatic coverage if the named insured is acquiring an entity below a certain size, for example, a company that has less than 20% of the buyer's assets. The thresholds under each type of policy can vary and may be calculated based upon a percentage of assets, revenues, employee count, or some combination thereof. Automatic coverage threshold percentages can range from 10% to 30% depending on the coverage and size of the named insured. Additionally:

- If the seller is below the threshold, automatic coverage is only for claims made for wrongful acts after the close of the deal.
- If the seller is above the threshold, then notice is typically required within 60 to 90 days from the deal close date and the underwriter has the right to charge an additional mid-term premium. It is important to note that this only pertains to post-close wrongful acts.

Prior acts coverage — Two approaches

It is common to cover the seller's prior acts with a runoff insurance placement, especially for D&O liability, as this is typically required by the purchase agreement. Runoff coverage for the ancillary lines is usually optional and the considerations for purchasing it should be discussed with your insurance advisor. Keep in mind that fiduciary liability coverage may be needed to address the personal liability associated with the Employee Retirement Income Security Act (ERISA).

You can also explore adding prior acts coverage to your program, sharing in the aggregate limit. Underwriters likely will request additional information such as exposure data and claims history, and an additional premium may be required. This approach may have entity versus insured exclusionary issues, should you need to sue the seller's directors and officers in the case of misrepresentation.

Transactional risk solutions

When buying a private company, you may want to consider securing transactional risk insurance, particularly representations and warranties (R&W) coverage. This generally provides coverage for all representations and warranties contained in an acquisition agreement. The policy protects the insured against financial loss, including defense costs, resulting from breaches of the representations and warranties made by the seller in a purchase agreement. Either the buyer or seller — but not both — can be the insured under the policy. The vast majority of policies are written for buyers. For the buyer, R&W insurance:

- Adds protection beyond the negotiated indemnity cap and survival periods in a purchase agreement.
- Distinguishes a bid in an auction (for example, requiring only minimal or no survival of the representations and warranties in a bidder's draft purchase agreement).
- Protects against collectability/ solvency risk of an unsecured indemnity (for example, financially distressed, non-US, or multiple sellers).
- Preserves key relationships by eliminating the need for the buyer to pursue claims against the seller's management who are still working for the buyer post-closing.

Runoff tips

Amid the litigious environment, here are four tips to consider as the buyer:

1. Confirm that a "successor in interest" endorsement is added to any runoff policy where you are assuming the indemnification obligation. This ensures the buyer receives the benefit of the Side B (indemnifiable) coverage. The insurer should not add the buyer as an insured on the runoff as this could create insured versus insured exclusion issues. You may also be able to obtain this endorsement for Side C entity coverage.
2. Ensure you have the most competitive pricing available as you may be paying for the runoff.
    a. Primary runoff factors can vary widely depending on the transaction — anywhere between 100% and 300% of the current annual premium. In this competitive insurance market, work with your insurance advisor to negotiate a lower factor for the excess and Side A layers.
    b. The unearned premium will often be credited against this additional premium, assuming the runoff is placed with the same insurer. If it is not, then a return premium on the in-force program should be requested before the deal closes.
3. Keep in mind that any foreign locally admitted policies may also need to be placed into runoff.
4. The runoff period is typically an extension of the current policy aggregate limit. Be sure to determine if there are any claims that could erode the runoff limit and seek options for a fresh and/ or additional limit, which may warrant marketing.

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PRIOR ACTS COVERAGE — SPECIAL CONSIDERATIONS FOR CYBER E&O

To help determine where prior acts coverage should be housed for cyber/E&O insurance programs, consider the following questions:

1. What types of services are being provided by the seller and do they align with the buyer's services?
2. What type of sensitive information will the buyer now be responsible for holding?
3. What contractual obligations, if any, with customers, vendors, or partners does the seller have and will those obligations transfer to the buyer? Do any of those obligations affect E&O/cyber insurance?
4. Are there any insurer commonalities between the buyer's and seller's insurance program? If the same insurer is on the program, companies may need to address limit aggregation issues if runoff is selected.
5. What potential straddle claims — those claims alleging wrongful acts that began prior to the acquisition and continued post-acquisition — may occur and how does the buyer insure such risk?

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