



De-Risking the Distressed: Risk and People Solutions for Distressed Companies

The COVID-19 pandemic's effect on the Australian economy has been severe and it is anticipated that Australian companies will operate under challenging economic conditions for many months, barring a breakthrough in treatment. Regardless, the pandemic will exert its influence on our economy for the foreseeable future and the associated downturn may place many companies in distress.

To assist stakeholders to navigate through distressed situations, Marsh & McLennan has created a dedicated taskforce to advise companies, directors, private equity funds, insolvency practitioners, lawyers and other advisors to manage the unique set of risks and costs arising from the COVID-19 pandemic across the critical areas of risk and people throughout each phase of the restructuring and turnaround lifecycle.

Phase 1: Financial Distress

Risk

When a company becomes financially distressed, directors and officers may find themselves facing unique personal asset risks, and consequently, needing to act swiftly to ensure they are well prepared for the next phase, whether it be a restructure, turnaround, administration or receivership. To help companies and their directors and officers, private equity funds or insolvency practitioners in their decision-making during this critical time, Marsh can impart our expertise in the following areas:

- Perform insolvency diagnostic analyses to ascertain how the company's existing Directors' and Officers' Liability Insurance ("D&O") program may respond to the unique risks arising out of distress and/or administration or receivership.
- Design and recommend program structures and policy language tailored to a distressed company's key risks, including potential litigation.
- Obtain personal liability coverage for interim management and their teams.
- Develop strategies to reduce insurance expenses while optimising coverage.
- Guidance on local regulatory implications for insurance and risk issues including relevant new or changing legislations, For example, the recently enacted *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth)* and its potential impact on directors and officers.
- Conduct independent tangible asset valuations assessing fair market value to achieve a desirable outcome during the next phase of potential restructuring.
- Undertake impairment testing of your tangible assets as part of your financial responsibilities.

People

When an organisation is in financial distress it is critical for leaders to communicate transparently and quickly, address employee concerns, drive stability across the business, and outline key financial and operational actions needed to accelerate results.

Mercer helps companies drive sustainable value creation in human capital aspects of the restructuring and turnaround process. During the financial distress phase, depending on the nature of the business, we may be able to deliver immediate-impact solutions, such as:

- Identify cost savings opportunities and review current operational challenges:
 - Evaluate strategic people priorities and determine most likely threats to the current operating model.
 - Develop strategy around potential large people cost drivers and address any inefficient spend. For example, assess, plan for and execute alternative strategies to manage workforce costs and review health and benefit programs for cost management opportunities.
- Define human capital aspects of turnaround strategy for distressed companies or discreet business units:
 - Assess the human capital risks of troubled business units, and determine go-forward feasibility.
- Create human capital aspects of turnaround strategies to optimise people cost and define governance changes. For example, review plans to identify people related aspects of turnarounds, opportunities and potential cost savings; conduct current operating model assessments and identify options for a turnaround organisational structure; design executive incentive plans and assess broad based compensation plans.
- Crisis communications & rapid change acceleration:
 - Develop communication and change management strategies.
 - Ensure clear and transparent ongoing communications.
 - Stay connected with employees via pulse checks conducted by Mercer.
 - Coach executives and managers on their leadership and how to deal with critical situations.



Phase 2: During Administration or Receivership

Risk

When a company enters into administration or receivership and appoints a formal insolvency practitioner, the company's existing insurance program may be impacted. For example:

- Insurance may be unpaid, inadequate or unenforceable.
- Automatic insolvency exclusions may apply.
- D&O insurance issues including any potential notifications will require effective management.
- Third party premium financiers with direct security over funds associated with the unexpired portion of cover.
- Regulator intervention on major self insurance aspects such as Workers Compensation licences and captives.

Marsh provides critical support to teams brought in to manage the restructure process by delivering risk management advice and insurance placement strategies.

INSURANCE COST OPTIMISATION REVIEW

We assist in achieving operational efficiency by conducting insurance due diligence which focuses on optimising insurance costs for parties who are seeking to boost liquidity and preserve cash.

Distressed companies are often over-insured. We can help businesses identify expense categories to target potential cost efficiencies and deploy strategies designed to reduce insurance costs.

SUPPORTING THE RESTRUCTURING TEAM

Building on the analysis performed during the cost optimisation review, we can help restructuring teams de-risk through:

- Securing D&O cover for the formal appointee through the duration of their engagements and associated run-off cover in line with statute of limitations.
- Developing strategies designed to ring-fence environmental, product liability and other long-tail exposures.
- Analysing critical cyber risks, including business interruption.
- Resolving complex claims. Marsh's experienced claims advocates regularly work with clients' in-house lawyers to develop strategies aimed at avoiding protracted disputes and driving positive and timely claims outcomes to support cash flow.
- Executing independent asset valuations to help drive best outcomes in the restructuring process.

People

During administration or receivership, the key human capital considerations are typically workforce retention, workforce engagement, and cost optimisation. Taking into account the company structure and operating model, Mercer can assist companies in:

- Capturing human capital cost savings and unlocking synergies:
 - Review operating model and detailed organisation design.
 - Synergy modelling.
 - Workforce transition strategy.
- Conducting separation diligence:
 - Assess separation readiness and conduct separation diligence.
 - Determine the human capital aspects of separation strategy and complete a detailed separation plan.





Phase 3: Emerging From Distress

Risk

As companies seek to emerge from administration or receivership and prepare for a potential sale, key risk considerations include transactional risk, warranties, contingent liabilities and/or tax liabilities. Marsh can help companies explore and secure relevant risk transfer solutions, such as:

- Securing warranties and indemnities insurance coverage to address third-party concerns around warranties, contingent liabilities or tax liabilities via synthetic warranties to address a buyer's desire to protect purchase price via warranty protection.
- Budgeting properly for potential asset sales, which are common in restructurings.
- Working with management and any prospective buyer to design go-forward insurance programs for carved-out assets and businesses.
- Implementing bespoke insurance coverage for specific tax liabilities that may crystallise in the future. In distressed situations where organisations undergo restructuring to optimise their capital structure and carve-out assets, unintended tax exposures may arise. Marsh's dedicated tax insurance team can design bespoke tax insurance solutions and work with insurers to help organisations transfer specific tax risks and the associated financial burden to the insurance market. This form of balance sheet protection is critically important for many distressed organisations.

Subject to a case-by-case analysis, examples of typical risks for which tax insurance can be an effective solution are:

- Capital gains tax and/or stamp duty when undertaking group restructuring and availability of related rollover relief or exemptions.
- Potential adverse outcomes when refinancing, undertaking a recapitalisation plan (for example debt-equity swaps and share buybacks), or extinguishing existing loans.
- Availability and utilisation of losses, including recognition of deferred tax balances.
- Adverse tax consolidation consequences due to high levels of indebtedness.
- Contingent liabilities on sale of business units or assets, and tax treatment of proceeds.

People

As organisations emerge from distress, numerous critical people-related considerations may need to be addressed. Mercer can help businesses navigate through the various options available to them including:

- Assisting with the new operating model to drive growth.
- Advising on human capital resource allocation, and performance metrics.
- Leadership selection, incentive plan design and governance design.

Restructuring and turnaround lifecycle



Financial Distress

Risk

KEY ISSUES:

- Directors and officers personal asset risks
- Optimisation of insurance costs to improve operational efficiency

SOLUTIONS/SERVICES:

- Insolvency diagnostic analyses on D&O coverage
- New program structures and tailored policy language
- Personal liability coverage for interim management
- Insurance cost reduction coverage optimisation strategies
- Local regulatory/legislation implications on directors and officers
- Tangible asset valuations

People

KEY ISSUES:

- Turnaround strategy
- Cost containment
- Communication
- Efficient leadership response

SOLUTIONS/SERVICES:

- Workforce cost management
- Compensation and benefits review
- Organisation plan and Operating model assessment
- Reward assessment
- Communication & change management advice
- Employee engagement through pulse surveys



During Administration or Receivership

Risk

KEY ISSUES:

- Unpaid insurance premiums
- Automatic insolvency exclusions
- Potential D&O notifications

SOLUTIONS/SERVICES:

- Insurance cost optimisation review
- Run-off cover in line with statute of limitations
- Ring-fence environmental, product liability and other long-tail exposures
- Cyber risks analysis including business interruption
- Complex claims resolution
- Tangible asset valuations

People

KEY ISSUES:

- Workforce harmonisation
- Divestiture considerations for the workforce

SOLUTIONS/SERVICES:

- Organisation design
- Synergy modelling
- Workforce strategy



Emerging From Distress

Risk

KEY ISSUES:

- Appropriate go-forward insurance program
- Transactional risk considerations – such as warranties and tax liability

SOLUTIONS/SERVICES:

- Warranties and indemnities (W&I) insurance
- Budgeting for potential asset sales
- Go-forward insurance program(s)
- Bespoke tax liability insurance

People

KEY ISSUES:

- Workforce optimisation for the future
- Joint venture considerations

SOLUTIONS/SERVICES:

- Assisting with workforce governance and planning
- Leadership selection
- Incentive plan design

Phase 1

Phase 2

Phase 3

The issues identified and potential solutions/services mentioned above are examples only and may vary on a case-by-case basis. The above lists are non-exhaustive.

We are here for you

The road ahead for companies going through voluntary or formal administration or receivership can be challenging. It is important to work with an advisor that knows the terrain and has deep expertise. Our team of M&A, insurance and people risk specialists has helped hundreds of companies navigate through all facets of the restructuring and turnaround lifecycle. If you have any questions or would like to discuss more about your unique situation, please reach out to us:

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