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FINPRO coverage considerations when your company is being acquired

FINPRO Spotlight Series

The acquisition or sale of your company may bring opportunities, but it can often raise complex insurance issues. It is critical that you properly plan for insurance protections that will remain available to your organization. This is particularly important for your board of directors upon the close of the deal.

How the coverages work

Amid being acquired — where you are the "seller" being acquired by the "buyer" — the following forms of insurance may be affected:

- Directors and officers (D&O) liability.
- Employment practices liability (EPL).
- Fiduciary liability.
- Cyber/errors and omissions (E&O) liability.

Generally, these coverages respond similarly when a company is being acquired. At the time of the close of the transaction:

- A "change in control" is triggered.
- The premium becomes fully earned.
- Policies automatically convert to runoff status — and likely become non-cancellable — for the remainder of the policy period. This means that coverage will only respond to claims made during the remaining policy period based upon wrongful acts that occur prior to the change in control.

In a purchase agreement, longer D&O runoff (usually 6 years) is typically the only coverage that is required to be secured. The agreement will outline who is responsible for obtaining and paying for it.

It is important to consider that:

- Runoff for the ancillary lines is usually optional, and whether to purchase it should be discussed with your insurance advisor. Keep in mind that the personal liability associated with the Employee Retirement Income Security Act (ERISA) may call for securing runoff coverage for fiduciary liability at a minimum.
- If runoff insurance is not purchased for the ancillary lines, you should confirm with the buyer that prior acts coverage has been added to their ongoing programs.

The likely merger objection claim

If your company is being acquired, you should expect a merger objection claim. Traditionally, plaintiffs would almost immediately file lawsuits once the acquisition is announced alleging that directors breached their fiduciary duties by agreeing to an unfair deal and failing to provide sufficient disclosures to shareholders. Merger objection litigation was mostly filed in state courts (primarily Delaware), but in light of recent rulings, plaintiffs have begun filing these suits in federal court instead. Oftentimes, plaintiffs also sue the buyer, alleging collusion and aiding and abetting with the seller with respect to the deal terms. With the shift to federal courts, we continue to monitor potential pattern changes with respect to the frequency and severity of these types of actions.

10 runoff tips

Amid the litigious environment, here are 10 tips to consider:

1. Due to the longevity of the runoff — typically three or six years, and sometimes as high as 10 years — the financial stability of insurers is critical. If seeking fiduciary liability runoff, keep in mind that the six-year statute of limitations for fiduciary breach related to an imprudent investment does not necessarily end six years from the date of the initial selection of the investment.
2. 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. While runoff programs typically remain with the incumbent insurers, new insurers may offer more competitive premiums.
3. The unearned premium often will be credited against the additional premium (assuming the runoff is placed with the same insurer). If it is with a different insurer, then a return premium on the in-force program should be requested before the deal closes.
4. Keep in mind that any foreign locally admitted policies may also need to be placed into runoff.
5. The runoff period is typically an extension of the current policy's aggregate limit. Be sure to determine if there are any claims that could erode the runoff limit — for example, the severity of the merger objection claim — and seek options for a fresh limit and/or additional limits, which may warrant marketing your program to other insurers.
6. A "successor in interest" endorsement should be added to the runoff policy when the indemnification obligation transfers to the buyer, which is typical. 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.
7. The standard extended reporting period (ERP) provision — a protection for a non-renewal or cancellation of the policy by the insured or insurer — is generally not applicable in the event of a transaction.
8. Most commercial crime (as opposed to financial institution bonds) and kidnap and ransom (K&R) policies typically do not have a change in control trigger as these are not claims-made coverages. As a result, you have the option to cancel your in-force policies and obtain a return premium because at post-close you should be covered by the buyer's policies (if they have coverage). A more prudent option may be to allow the crime policy to run its natural expiration, rather than canceling it for a typically nominal return premium.
9. Understand if you are on a "loss sustained" or "discovery" crime insurance form and what type of form the buyer has to ensure no gaps in coverage. If the buyer is on a "discovery" form, their program will likely pick up prior losses sustained by the newly acquired subsidiary (discovered after the acquisition). But be sure to confirm as the policy language could vary.
10. Negotiate the runoff terms prior to the transaction and oftentimes during the renewal process if the deal is pending but not yet closed. This can help you obtain better terms, market the runoff as appropriate, and maintain control of the runoff placements.

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