Marsh

# FINPRO coverage considerations when your company is spinning off a subsidiary into a new public company

FINPRO Spotlight Series

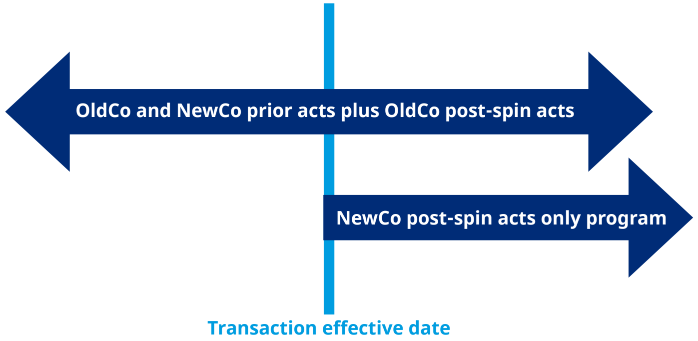

When your company is considering spinning off a subsidiary into a new and distinct public company, you must evaluate two significant categories of financial and professional insurance: Coverage for claims based upon alleged wrongful acts *before* the spinoff (prior acts) and for alleged wrongful acts *after* the spinoff (post acts). Solutions can vary widely depending on the separation agreement between the companies as well as management's preference for each specific transaction.[1]

## Prior acts coverage

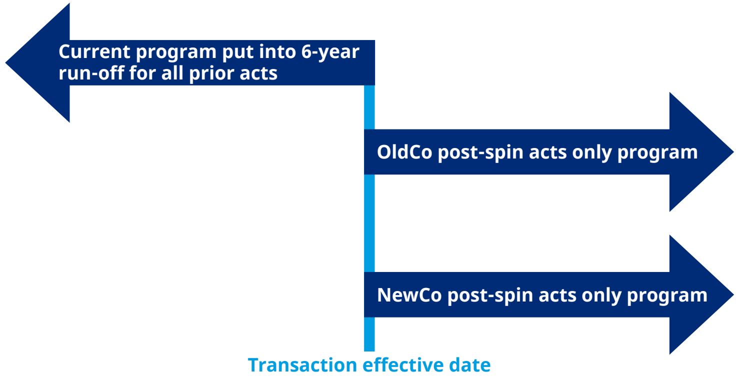
The prior acts of the company being spun off (NewCo) can generally be addressed in one of two ways:

- NewCo can remain covered under the original parent company's (OldCo) active and in-force programs (See Option 1). These include existing directors and officers liability (D&O), employment practices liability (EPL), fiduciary, and cyber/errors and omissions (E&O) programs.
- OldCo can put its existing program into runoff which would cover prior acts of both OldCo and NewCo. In this scenario, new standalone programs would be put into place for ongoing acts coverage (see Option 2).

**OPTION 1:** Purchase a separate insurance program for NewCo only for post-spin wrongful acts, and continue current OldCo policy for both pre- and post-spin wrongful acts.




**OPTION 2:** Place existing program into run-off and purchase two separate 'post-spin acts' only programs for each company.




[1] *Reverse spins are beyond the scope of this document. For information on insurance considerations for reverse spins, contact your Marsh representative.*

## Post-spinoff coverage

To design the most effective insurance program to meet its needs — including selecting proper structure, limits, retention, and pricing — NewCo should work with its insurance advisor to conduct benchmarking exercises. Estimates can be used for market capitalization, revenue, employee count, and plan assets to make appropriate decisions for each line of coverage.

For at least the first year following the spinoff, it will be helpful for both entities to purchase similar D&O coverage — for example, purchasing from the same primary insurer and using the same primary form. This will better ensure coverage for many common, interrelated claims. This approach can also mitigate potential disputes between insurers as to which program should provide coverage.

In many cases, management, board members, and other individuals who may have been involved in pre-spin decisions will move from OldCo to NewCo.  Accordingly, litigation arising within the first year following the spinoff may involve allegations that overlap both policies. These are known as “straddle” claims. Coverage for straddle claims can be addressed in several ways, including adding a common endorsement on both companies’ primary policies stipulating that any claims that might “straddle” the two programs will fall into one program or the other. Since “straddle” claims can be complex, it is important to work with your risk advisor to draft wording that best fits your particular situation and overall preferences.

Managing cyber and E&O programs post-spin will raise several additional questions (see sidebar). These should be considered before engaging in a transaction to ensure that risk is properly managed.

## Tax indemnity insurance

If the spinoff is a tax-free transaction and the parties involved have not obtained a private letter ruling from the Internal Revenue Service specifically affirming the tax-free status of the particular transaction, they may wish to consider tax indemnity insurance. Tax indemnity insurance can be used to insure a specific tax structure being used in the transaction and can cover tax liability (to statute limits), fines and penalties, interest, legal costs, and tax gross-up in the event the transaction is later deemed to be a taxable event.

## PRIOR ACTS COVERAGE — SPECIAL CONSIDERATIONS FOR CYBER/ E&O PROGRAMS

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 OldCo? Do these services align with NewCo’s services?
2. What type of sensitive information will NewCo now be responsible for holding?
3. What contractual obligations, if any, to customers, vendors, or partners does OldCo have? Will those obligations transfer to NewCo? Do any of those obligations affect cyber/E&O insurance coverage?
4. Are there any insurer commonalities between NewCo’s and OldCo’s programs?  If both companies use the same insurer, they may run into limit aggregation issues if runoff is selected.
5. What potential straddle claims — alleging wrongful acts that began prior to the acquisition and continue post-acquisition — could occur? How does NewCo choose to insure such risk?

For more information, please contact your Marsh representative or:

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