Facts to Know About Errors & Omissions in Relation to Mergers and Acquisitions

Utica National Insurance Group®

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MESSAGE

Each year since 2013 has been another record-setting year for mergers and acquisitions activity for independent agencies.

It seems a lot of agency owners and principles are involved in either sizing up merger or acquisition prospects or fielding a bevy of solicitations to buy their agency. Sometimes in the rush to finish valuations or consult with attorneys and accountants, addressing the critical issue of the Insurance Agents' Errors and Omissions (E&O) Coverage gets left to the end of the transaction, if at all.

That shouldn't happen. If you are selling, why put at risk what you are receiving for your agency because you followed the buyer's lead on how to address what is your E&O liability exposure? If you are buying, why risk even more than the investment you are making because you overlooked a key item relating to E&O?

The Insurance Agents' E&O experts at Utica National Insurance Group have developed the attached white paper to help you navigate through the key issues relating to E&O that you should be addressing, whether you are buying, selling, or merging.

As the longest standing Insurance Agents' E&O Program in the country, Utica National has a unique understanding of these issues.

Whether you are buying or selling, find more important information on key aspects of mergers and acquisitions in this white paper.

If you have any questions you can reach out to Utica National or one of the agency associations that they are affiliated with, which are listed on the last page of this document.

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I’m Thinking of Selling an Agency

- Identify the name of the purchasing agency and communicate it with your Agents’ Errors & Omissions (E&O) carrier.

- Secure the name of the purchasing agency’s E&O carrier and mention that you will be following your carrier’s process and advice.

- The option to purchase Extended Reporting Period Coverage or “tail” coverage is only offered once and should be given strong consideration. In most cases the buyer’s E&O coverage will not pick up the prior *acts* of the seller. The buyer’s E&O policy cannot be relied upon to pick up the seller’s prior acts exposure. The purchase of tail coverage may be your only option to cover this exposure.

- If the agency sale is definite and has been finalized, written cancellation needs to be submitted to your carrier with the effective date of cancellation listed.

- At Utica National, there are 60 days of tail coverage provided at no extra charge per the policy form. Optional tail coverage will begin on the 61st day.

- There are several tail options available for Agents’ E&O coverage. Typically, endorsements such as Employment Related Practices Liability Insurance (ERPLI) may have separate tail options.

- Payment in full is required for tail coverage to be in effect and must be mailed to your carrier with written request noting the desired tail option.

Checklist for E&O Policy Considerations

Read your E&O policy. Note that policies are not assignable to new owners, even if an agency is a corporation or if it is an ownership change within the agency, without the written approval of your E&O carrier.

- ☐ Is the buyer requiring that you purchase tail coverage?

If yes, consider buying the maximum allowable term for tail coverage and work the cost of that into the sale price. If you are not being required by contract to buy tail coverage, we recommend that you buy it anyway. The cost of defense alone even for an allegation of a wrongful act may prove to be a good investment.

- ☐ Chose the maximum term of tail coverage up front because you cannot purchase additional time at a later date.

- ☐ Contact your E&O carrier to discuss tail options or other details appropriate to the sale of the agency.

- ☐ Contact your carriers to advise them of the sale so they can make arrangements with the buyer to contract.

I’m Thinking of Buying an Agency

- When purchasing an agency, the buyer and seller do not have unlimited time to think about what changes need to be made to their insurance policies. Contacting your E&O carrier early on in the process is critical so the carrier can assist you in making the right decisions.
- The E&O policy provides 90 days of automatic coverage for an agency you acquire. It is very important to contact your Underwriter within that 90-day period to ensure that proper coverage is obtained.
- For the buyer of an agency, the E&O policy can be endorsed to provide for the agency being purchased through the Purchased Entity Endorsement. This will provide protection against any errors made by the purchasing agency beginning with the effective date of the purchase. There may be an additional premium for this endorsement, but in most instances, Utica National would look to address the additional exposure at renewal time. At Utica National, the Coverage for a Purchased or Merged Entity Application is necessary to write this endorsement.
- As the buyer, you do not want to pick up the prior acts of the agency that you purchased. A Prior Acts Limitation Endorsement would be added to the E&O policy if another named insured is added as a result of the purchase.

Checklist for E&O Policy Considerations

If you own an existing agency and are looking to purchase another agency, consider the following:

- ☐ Have you performed an E&O audit of their files/records to determine how their processes and documentation vary from your best practices so that your staff can be aware of work necessary to bring those accounts/records in alignment with your own E&O loss control/risk management practices?

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- ☐ Does the other agency carry E&O coverage? Ask for a certificate of insurance.

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- ☐ Have you asked the other agency for a five-year E&O loss run?

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- ☐ Does your purchase agreement require they purchase tail coverage? It should. Be sure to ask for a copy of the tail endorsement to keep with your E&O records.

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- ☐ Have you contacted your E&O carrier? Most E&O policy conditions require that you notify your E&O carrier prior to, or within a short time after, a purchase so that appropriate information about your CHANGE IN EXPOSURE can be collected and underwritten and that the appropriate endorsements are added to your E&O policy regarding the business you purchased.

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- ☐ Have you contacted all the carriers you have in common to confirm that you have binding authority on the business you acquired? Have you contacted all the carriers that you do not currently have contracts with to obtain a contract or arrange for temporary binding authority until the business can be placed elsewhere?

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I'm Thinking of Merging with Another Agency

Checklist for E&O Policy Considerations

- ☐ Contact your E&O carrier to discuss options for endorsing your E&O policy to reflect the exposure changes from the merger. (i.e., prior acts, named entities, DBAs or new doing business, locations, etc.) There will likely be a form you will be asked to complete.

- ☐ Whose policy will survive and whose will be canceled? If your E&O carriers are not the same, remember that the overall complexion of your exposure is changing so it may be a good time to review the options for moving forward.

- ☐ Will the E&O policy that is not surviving be leveraged to purchase tail coverage for that exposure or will the prior acts exposure be picked up by the surviving E&O policy? Picking up the prior acts is typically allowable in a merger, but the E&O carrier must decide that. Also, there may be reasons why you would want to leave that portion of your prior acts behind rather than carrying them forward.

- ☐ If your E&O policy will be the surviving form, obtain a copy of the other agency's E&O policy including any endorsements so the carrier for the surviving E&O policy can determine if any special endorsements need to be added.

- ☐ Is there any special arrangement for payment of the E&O deductible depending on where the wrongful act leading to the E&O claim originated from?

- ☐ Have you contacted all the carriers you have in common to confirm that you have the binding authority or new subcodes?

- ☐ Have you contacted all the carriers that you do not currently have contracts with to obtain a contract or arrange for a temporary binding authority until the business with those carriers can be placed elsewhere?

- ☐ Have you identified individuals or established a team from each of the respective operations that will coordinate your processes, procedures, and automation with emphasis on creating consistency and best practices as well as the training of staff members for the same?

What are Some Key Terms I Should Be Familiar with When Discussing E&O in a M&A Situation?

- **A purchase** is when the insurance assets of another agency are purchased and the former owner of that business no longer has an ownership interest in your ongoing operations.
- **A merger** is when two or more agencies combine to form one ongoing operation and the respective owners continue to have a common ownership interest.
- **An automatic extended reporting period** is the period of time granted (usually 60 days) to report claims for wrongful acts that took place after the retro date and prior to the termination of the E&O policy. (This does not "extend" the policy. It extends the period of time to report a claim.)

- **An extended reporting period, or tail,** is a period of time you can purchase to extend the reporting of an E&O claim after the E&O policy is terminated. This is actually an endorsement attached to the canceled policy.
- **The termination of coverage** is the date the E&O policy ends. Keep in mind that most E&O policies have conditions that will automatically terminate the E&O policy if the agency or the majority of assets or the majority of stock of a corporation are sold or merged with another business.

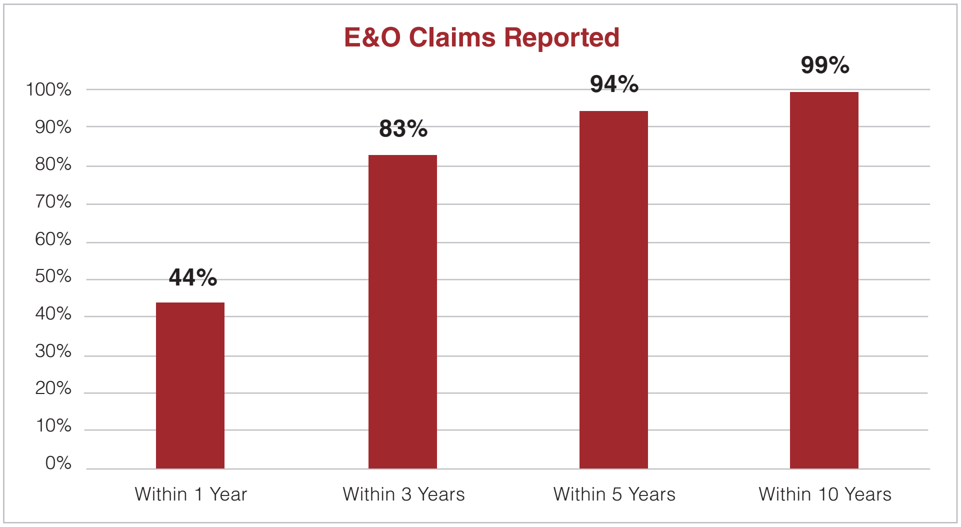
Buying Extended Reporting Coverage

What is Extended Reporting Coverage (or Tail Coverage) and What Length Reporting Period Should I Buy?

When Errors and Omissions (E&O) coverage is approaching termination, careful consideration should be given regarding options for purchasing **Extended Reporting Period Coverage**. In a recent study of Utica National's Agents' E&O claims reported from 2014-2017, the analysis focused on the date of the agent's error compared to the date the E&O claim was made against the agency. Less than half (44%) of the E&O claims reported were reported within 12 months of the actual date of the loss. Stretching the time period to three years increased the percentage to 83%. However, there is still a significant number of claims (17%) reported after three years.

Typically, when a loss occurs and is reported to the carrier, there is a lag time where the carrier is evaluating the claim and determining whether there is coverage for the loss or not. If there is no coverage, the claim is subsequently denied. At that time, the client typically starts to have some discussion with the agency as to why there was no coverage. This is when attorneys may get involved.

For the agencies looking to sell, there is a key provision that needs to be extensively considered. Most claims-made policies refer to this provision as an "**Extended Reporting Period**," also known as tail coverage. This coverage allows an insured to report claims that are made against the agency after a policy has expired or been canceled with the condition that the wrongful act that gave rise to the claim took place before the policy expired or was canceled.



Assigning My E&O Policy to the Buyer

Facts to Know When Considering Assignment of Your Errors & Omissions (E&O) Policy

Agency ownership transfers are at an all-time high. Utica National is frequently asked about "assigning" their in-force policy to the buyer of the agency.

Remember, the assignment of the policy must be agreed upon by all three parties: the seller, the buyer, and the insurance carrier.

Here are some scenarios highlighting the potential downside of assignment of the policy:

- The buyer lets coverage lapse, at that point the seller has waived his or her right to purchase extended reporting, or tail coverage, and sits exposed with no coverage in place for a claim brought against them arising during the time they owned the agency.
- The buyer sells the agency and does not purchase tail coverage, then the previous owner/seller has no ability to purchase extended tail coverage. Once again, they are exposed with no coverage for a claim brought against them.
- A claim arises from an error and omission caused by the previous ownership. The new owner and his or her policy are responsible for the loss, and it will reflect in the experience.

Simplicity is probably the biggest advantage. No new application is needed and coverage continues "as is." That's the upside, but it has to be weighed against the downside scenarios noted above.

Below is the relevant policy language from our Insurance Agents and Brokers' Errors and Omissions Insurance Policy coverage form (14-P-EOA Ed 9-2012):

Section VI-Conditions
13. Sale, Transfer, or Assignment
The controlling interest of any insured under this policy shall not be assignable to any other person without our written consent. In the event of the death or incompetency of the insured, this policy shall cover the insured's legal representative as an insured as respects any liability of that insured which is covered by this policy.

Coverage under this policy ends on the date ownership of (or stock which comprises a controlling interest in) any Named Insured is sold, transferred, or assigned unless our written consent is obtained before said date.

What are the Key Factors I Should Consider in Selecting an E&O Carrier?

Advantages

Customized Coverage
We offer choices based on your operation and risk appetite. Our customized coverage is tailored to meet the needs of growing networks and insurance affiliates.

Leading-Edge Risk Management
We offer resources on contemporary topics such as social media, cyber liability, and autonomous vehicle exposures so you can understand the hazards involved and take steps to prevent problems. In coordination with our state associations, our insureds get access to E&O education, webinars, learning events, articles, and more.

We focus our risk management efforts on E&O claim trends and industry dynamics and offer our insureds a dedicated Risk Management Specialist. Our risk management programs and services help improve your performance through reduced losses.

Flexible Payment Options
We offer flexible payment options with direct bill and electronic fund transfer (EFT) with no interest or fees. We can also customize payment and billing options to meet the needs of agency networks through either consolidated or individual billing.

Direct Access to E&O Team
You will have direct access to your Underwriter, Claim Specialist, and Risk Management Specialist. This personalized attention allows you real-time access and information, without having to go through a third party.

Claims Expertise
Our E&O claims team is 100% dedicated to E&O and includes experienced attorneys when needed. We engage the top litigators with proven track records of successful results.

We appreciate how hard you have worked to build your business and reputation.

Our approach is personalized. If you are faced with a potential claim situation or accusation, our E&O claims team will guide you through the process. Our team acts quickly through early intervention and to navigate the best solution.

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