

CLIENT ADVISORY

Important Insurance Considerations When Performing Due Diligence for Acquisitions

Although insurance brokers are highly skilled professionals with unsurpassed insurance market and product knowledge in their respective specialties, they are often overlooked as vital components of the standard business acquisition due diligence process.

Executive management routinely looks to lawyers and accounting/finance professionals to handle most of a due diligence exercise. This is because the legal and financial aspects of an acquisition are clearly the most important. But what many senior managers fail to recognize is that insurance issues impact *both* the legal and financial aspects of any sizeable deal, and by failing to include an insurance professional in the beginning of the process, the acquiring company is foregoing a valuable resource. In fact, in extreme cases, management of the acquiring entity may bring liability upon itself for failing to conduct due diligence in a thorough manner by not using the services of a qualified insurance expert. It is much easier to prevent headaches on the front end than be brought in after a merger to try to fix them.

No insurance professional is an expert in every area of the wide-ranging world of insurance. The focus of this article is to provide some essential guidelines (albeit not exhaustive, since every situation is unique and requires a specifically tailored solution) to help you perform due diligence on the professional lines insurance aspects of a company being acquired by your client. Your goal should be to help your client fully uncover all pertinent insurance facts about the target company – good and bad – so that your client can make an informed decision on the acquisition.

At the outset, it's essential to get copies of all of the relevant insurance policies within your area of practice. There's a very important point here: Be sure that you aren't over extending yourself by agreeing to review policies or products beyond your expertise. Sometimes clients try to spare expense by leaving the review to their existing broker, regardless of that broker's specialty. If you are not an expert in the appropriate area of insurance, however, it's best to make that fact known up front and facilitate the retention of a qualified expert in that area for your client.

Once you have complete copies of all the relevant policies, it's essential that you carefully review them to determine whether the policies meet current industry norms with respect to coverage terms and conditions. You should also investigate whether the carriers on the various programs meet the basic financial security requirements set by your brokerage (and your client, if they have such guidelines).

After familiarizing yourself with all of the relevant policies and program structures, you should arrange to meet with the person in charge of risk management at the target company. For smaller companies lacking a full-time risk manager, this will often be the CFO, Treasurer, General Counsel or, possibly, the CEO. You should inquire as to the target company's risk philosophies. For example, how do they like to structure retentions and limits? How do they handle claims? Do they believe that insurance is to be used solely in rare situations and only buy coverage above large retentions? Do they prefer to protect against even minor surprises to the balance sheet by purchasing low deductibles? Has the insured made coverage decisions based on cost rather than coverage, thereby leaving some risks uninsured? Getting a feel for the target company's risk philosophies through a face-to-face meeting will go a long way toward helping your client understand what they could be getting if they close the deal.

A thorough review helps you protect the financial interests of your client, the acquiring company. It is possible that the seller has reduced coverage in order to lower expenses and increase their deal price. You will need to be aware of any premium-bearing changes you would recommend and what that means to the price paid for the acquisition by your client. Also, if the post-merger insurance budget doesn't reflect the proper scope of coverage, there will inevitably be friction when premiums rise after the transaction.

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If you do not have a contact at AmWINS to help with your financial services risks, [click here for a list of brokers on our website](#).

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The logo for AmWINS Group, Inc. features the company name in a serif font with a star above the 'A' and 'W'.

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Even more important than reviewing the current coverage is conducting a thorough review of outstanding litigation and other claims (and potential claims). Many acquisitions have been torpedoed by the discovery of significant legal and claim issues at the target company.

To start this process, you should request a list of all judgments against the target company (including arbitration and mediation proceeding results) and settlements consummated during the previous six years (six years being, generally, the longest statute of limitations period for most civil causes of action). This should also include copies of any injunctions, consent decrees, memoranda of understanding or anything else that would legally bind the target company to any particular course of action.

It's also wise to ask for a list of all pending threats of litigation, including demands, arbitration/mediation requests, petitions, complaints or any similar documents that would indicate that a third party (including any employee) has a pending dispute with the target company.

After you've received and reviewed all of the above information, you should meet with the General Counsel (or other chief legal or litigation officer) to go through the list and obtain a thorough understanding of the status of each matter and its potential costs. This discussion should also focus on amounts paid by carriers in the past on claims and any potential future insurance recoveries on open matters. This will also give you a feel for the target company's relationships with various carriers and how it is perceived as an insured in the marketplace. Obviously, a company with a high amount of paid claims in relation to paid premiums will be considered a less attractive risk in the market going forward. You should also review all coverage correspondence between the carrier and the target company on open claims to get an idea of various coverage defenses and what might be expected in the future on these open matters. The tone of the letters may also clue you in as to the nature of the target company's relationships with its carriers, although many letters will simply consist of standard language.

This meeting would also be an opportune time to discuss the overall claims handling and litigation philosophy of the target company. For example, some businesses like to settle cases as soon as possible in order to avoid protracted distractions, possible bad publicity and significant legal bills, while others prefer to fight each claim to the end to prove their innocence and discourage potential plaintiffs from bringing similar claims. It's important for your client to know what kind of company they would be buying in this regard, especially since the claims/litigation philosophy impacts the general reputation of the target company in insurance and legal circles (and, possibly, with the public as well).

While you're conducting your review, don't be afraid to ask about anything that may appear unusual or improper. Many a "dumb" question during the due diligence process has led to significant revelations. During your interactions with personnel at the target company, you should be able to determine if they are being forthright and helpful, or if they seem uncooperative, as if they're hiding something.

As noted above, the points raised in this article are certainly not exhaustive. The due diligence process, when done properly, is a rigorous and work-intensive procedure that needs to be specifically tailored to each situation. Due diligence can provide a general framework for conducting some of the most important aspects of the insurance review in connection with an acquisition. And remember, if a particular task or area of specialty is beyond your expertise, the diversified team of specialists nationwide at AmWINS stands ready to assist you in any way.

Due Diligence Quick Reference:

- Get full information on all prior and pending litigation and/or demands.
- Get copies of all current insurance policies.
- Make sure a specialist is reviewing each type of insurance.
- Make sure the coverage terms are as broad as possible.
- Make sure the scope of coverage fits the exposure – Does the E&O policy cover all services provided, or a limited list?
- Establish the risk appetite of the new entity.
- Clean up any loose ends before any Extended Reporting Period is triggered.
- Determine if the current insurance should remain in force or be rolled into a master program for the combined entity.

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