

Newsletter

February 2010

Insurance implication when selling your business

As we leave the gloom of GFC behind, business acquisitions are surging back. Recently we have had a plethora of news alerts on potential mergers and acquisitions. No matter the size or complexity of the sale, the one item that is often overlooked by the seller is the implications for insurance, particularly the Professional Indemnity and Directors' & Officers' Liability Insurance. Do not assume the policy will automatically cover you once you sell – it won't.

Most people appreciate that liability for mistakes can extend beyond the life of the company. It can be several years before a client suffers a financial loss which can be traced back to the poor (actual or alleged) advice or performance of today. You could be retired on the Gold Coast only to be dragged back to courts for an alleged past mistake.

Professional Indemnity (PI) Insurance and Directors' & Officers' Liability (D&O) Insurance are arranged on a 'Claims Made' basis. This means you must have a policy in place the day a claim (e.g. demand for compensation) is made, not necessarily the day the alleged wrongful act occurred.

All PI and D&O policies contain a clause that states that in the event that the business is acquired, the cover ceases from that moment on.

Example:

The business purchases a PI policy for the period 30 June 2009 to 30 June 2010.

- The policy provides cover for claims made against you or your business during the period 30 June 2009 to 30 June 2010, for wrongful acts occurring anytime (assuming no restriction)

Your business is then acquired 28 February 2010.

- The policy will immediately stop covering claims made against you or your business for wrongful acts that occur after the 28 February 2010.
- Some policies will immediately stop covering claims made against you or business for wrongful acts that occurred before the 28 February 2010. Others will continue to provide this cover (on written request) but only for a limited period (e.g. 30 days) or up to expiring of the current policy e.g. 30 June 2010. There is no automatic protection beyond this date.

Remember the key issue: you must have a policy in place the day a claim is made.

This coverage response raises two questions:

1. What is in place to cover you for claims made after the acquisition for alleged wrongful acts that occurred prior to acquisition?
2. What is in place to cover you for claims made after the acquisition for alleged wrongful acts made after the acquisition

To address the first question, you must purchase 'run-off' cover. This provides on-going protection for any claims made against you that relate to any wrongful acts committed before the company was acquired. Not every Insurer can or will do this, so if you think that that it may be needed, you must ensure that it's within the capability of your insurer. This 'run-off' cover will need to be purchased for a period covering your liability (possibly up to 7 years). It is possible to arrange a once off 7 year run-off policy payable upfront, and typically cost somewhere between 2 to 3 times the last annual premium.

To address the second question, your new owner should provide this cover under their policy. This needs to be checked and confirmed. Firstly confirm that they have included you under their cover. Secondly review the quality of the cover: are you happy with the terms, conditions, limit of indemnity (which is now shared), deductible etc. You are now subject to their cover.

When should you start your renewal process?

At its most basic level insurance is very simple to arrange: collect information; submit to an Insurance company for assessment; negotiate terms; present and accept terms; complete the administration (invoice; policy documentation etc). For some classes of insurance this can take a matter of hours only (think car insurance; home insurance; office pack). For other classes it can take months.

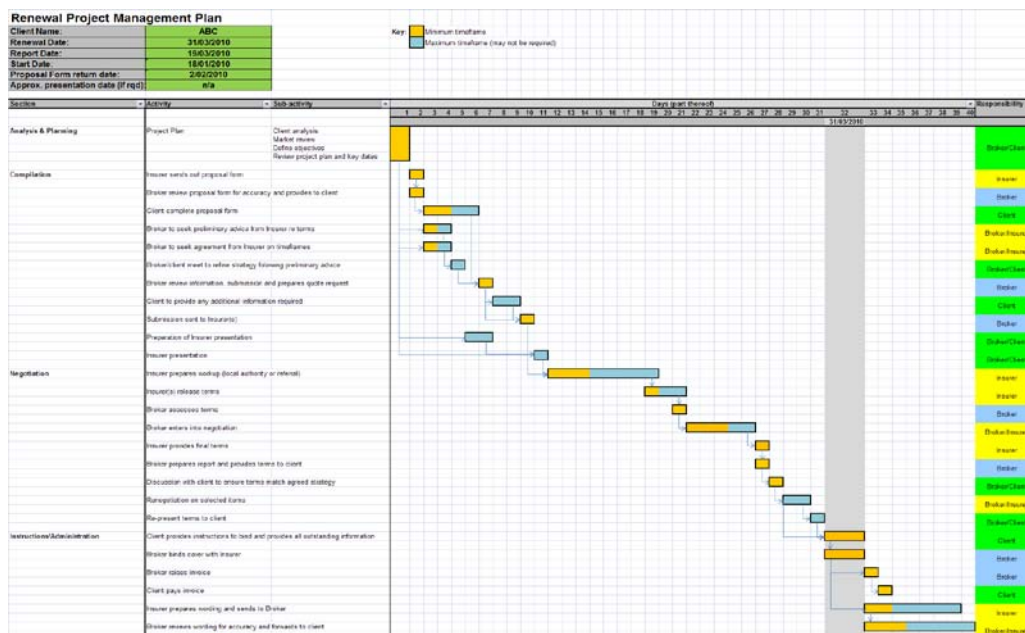
The timeframes depend on:

1. Class of insurance;
2. Industry profile/complexity (e.g. financial institutions are considered a complex industry);
3. Client specific details (e.g. claims history, overseas operations, product complexity);
4. State of market (e.g. in a hard market timeframes are longer because the underwriter needs to be more thorough in their risk assessment);
5. Time of year (in busy periods, your account has to 'wait its turn' – typically the financial quarters: March, June, Sept and Dec);
6. Insurance company you are dealing with (are they well resourced; who is on leave etc)

I favour a structured project plan that begins several months out (2 to 3 months out, and longer for some clients - sample project template below). The reason is simple – it provides maximum time to coordinate information and arrange terms on the best possible basis (coverage and price). If you leave things until last minute you run out of options, where a deal is just cobbled together rather than crafted, and that may end up compromising your outcome.

It can be very frustrating for a client to be presented with an insurance outcome with days/hours to go until the policy expires, and be told that this is the best deal and that you have to accept it.

If you have a structured process, then there should be no surprises. Therefore, for an Investment Manager with insurances due 31 March, you should be well underway by now, and have already completed the information gathering process.



It's a steal!!!

By Jayson Symonds – Financial Institutions Product Manager DUAL Australia Pty Ltd

We all hope that the worst of the financial crisis is behind us – and most of us do not want to look back. 2009 was a painful adjustment in the harsh conditions of recession. The prospects for 2010 look brighter, leaving us less inclined to focus on the mistakes that brought us to this pass.

Yet there is ample reason to cast a glance over our shoulders as we look forward to happier tasks of the new recovery. Fraud, corruption, and all that go with it may not have precipitated recession, but they certainly made its impact all the more painful. Losses, prosecution, litigation and bankruptcies, were all sparked or exacerbated by the actions of groups or individuals in the years before; actions that went undetected and unpunished until too late.

The conventional wisdom is that fraud goes up in a recession. That isn't necessarily correct, what goes up is the discovery of fraud. A lot of frauds have been discovered in the last 18 months as part of the GFC and they are being discovered because of a new focus on the bottom line and where money is leaving the business.

In October 2009 Fraud was in the spotlight when ING Australia hit the headlines reporting they were the victim of an internal fraud of potentially \$20m. Despite having some of the most advanced fraud detection systems in place, the fraudster still managed to circumvent the processes for an extended period of time.

Large institutions are not the only ones susceptible to fraud. The Australian institute of criminology estimate that fraud is an \$8.5bn a year problem in Australia, accounting for 40% of all identified crime. The KPMG 2008 Fraud Survey identified that 45% of financial services companies surveyed experienced at least one fraud incident.

Of the 220,000 incidents reported in the KPMG 2008 survey 158,447 were from financial services firms, with an average loss per organization of \$1,500,000. Could your organization sustain a \$1,500,000 loss?

Perhaps the most alarming statistic from the latest surveys is that employers on average only recover as little as 11% of the proceeds of the fraud. Due to an average time to discovery of fraud being 342 days and gambling being the major motivator of fraud (44% of incidents), the majority of proceeds have been gambled away by the time it is discovered.

A report by Ernst & Young in November found 85% of the worst fraud was committed by insiders, most commonly payroll or accounts payable functions were the most susceptible to accounting fraud, usually by the creation of fictitious payments.

Our typical fraudster is a 38 year old male with no known history of dishonesty. A non management employee of the victim organization for six years, he has held his current position for four years by the time of detection.

Poor internal controls remained the major factor allowing fraud to occur, identified as the most important precondition for 26% of frauds reported in the KPMG survey. Another 22% of frauds came from people overriding internal controls.

Conversely, internal controls are the most common method by which respondents detected their largest fraud, covering 42% of detected cases. With this in mind it is vital that company management take steps to

reduce the risk of fraud by implementing effective fraud detection strategies and discuss with their insurance broker their options available for insurance policies covering crime exposures.

Resources

KPMG 2008 Fraud Survey

Kroll Global Fraud Report 2009/10

PricewaterhouseCoopers Global Economic Crime Survey Nov 2009