

## **Buying, selling, and merging an agency - What should you do?**

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One of the biggest decisions of your professional insurance carrier comes when you decide to either sell the agency you've worked long and hard to create, or to buy another agency that someone else has worked long and hard to create. You've met with the owners of the agency, you've looked at the book of business, you've agreed on a price, hopefully you've contacted your attorney to help you draft the buy/sell agreement, and you're a few short days away from closing the deal when suddenly someone asks: what about the E & O coverage? Who's doing what? Are you going to pick up the prior acts or am I? Can we just transfer the E&O policy to the new owners? What kind of losses have you had? All of these questions should be asked at the beginning of the talks regarding the sale/purchase, but unfortunately they usually aren't discussed until the last minute and they can have a big impact on the deal.

Think about this, when you buy a new car or are selling your current one, one of the first things you should do is contact your insurance provider. It's no different when you are buying or selling an insurance agency. It also applies when you are only buying or selling a book of business. In most, if not all cases, your E&O policy states that you must notify your E&O provider within 90 days of a merger or acquisition (check your policy for verification of the time limits.) Failure to notify your carrier in a timely manner could result in a gap in coverage.

So let's go through the steps you should follow when you are making a life and business changing decision regarding your agency.

### **Buying an agency**

You've been talking with a fellow agent about buying their agency for some time and now you've both decided that the time is right. There are many details to consider and the first of which is to do your due diligence to review the other agencies operations, book of business, finances and E&O Policy. At this point it is advisable to retain an attorney to help you through the process. Remember, an attorney can only represent one party, not both. You and the seller should each seek separate counsel. It is a good idea to have a confidentiality agreement with the seller so that you can freely review all of the documents necessary to begin the change of ownership. After you have completed your due diligence and you and the seller are comfortable with all aspects of the agency, the attorney's will draft the buy/sell agreement. Included will be such things as the timing of the sale, the assets to be transferred, the price, and of particular importance is who is responsible for the liabilities of the selling agency. The cleanest way to do this is for each party to retain their own liabilities. In regard to the seller's E&O policy, they will purchase tail coverage and the buyer will add the new agency's book of business to their current E&O policy.

The reason this is the cleanest way to make the change, is because the seller will have the peace of mind of knowing that should a claim arise after the sale for acts while they owned the agency, their E&O policy will provide coverage for them. For the buyer, they know that they will not be responsible for any acts that may have occurred prior to the purchase of the agency. This is true whether or not the selling agency will continue as a separate entity or location for the buying agency. In most cases, even if the buyer maintains the new agency as a separate entity or location, it can be included on their current E&O policy for errors and omissions that are made after the sale.

Another option, while not the best way to transfer the ownership, is for the purchasing agency to agree to accept responsibility for prior acts. This is accomplished by adding the selling agency to the buying agency's E&O Policy. However, please remember that this must be approved by the E&O carrier before the sale is completed. It is imperative that you contact your E&O agent as soon as you begin the buy/sell process. You will be required to provide a loss history of the seller, and the carrier may require an application providing information about the mix of business, gross annual premium, commissions, staff, etc. In some cases the carrier may not agree to provide prior acts due to claims history, nature of the book of business, etc. In that case the seller should purchase tail coverage from their current E&O carrier.

One thing to keep in mind is that the cost of tail coverage or additional premium expense if the prior acts are provided by the buyer can, and should, be considered in determining the sale price of the agency.

### Selling an agency

As a seller of an agency, you may feel that it is important to maintain your agency's legacy. If this is important to you, be sure to discuss this with your attorney so that it is properly addressed in the agreement. If you have valued employees that you wish to provide for, you should include how they will be taken care of in the agreement. This may be a source of negotiation as the buyer may not wish to add any permanent staff, so make sure this is brought up in your discussions with the buyer.

An important aspect that was mentioned previously is protection for you if a claim should arise after the sale. As stated before, the best way to ensure this is to purchase tail coverage from your current E&O carrier. While you may not want to add the expense of tail coverage and you believe you are protected because of your agreement with the buyer that they will provide coverage for prior acts and will maintain an E&O policy, you have no guarantees that it will be done. It is not unheard of after an agency sale for the buying agency to either go out of business, sell their agency to another party who will not agree to provide prior acts, or have their E&O policy terminate either voluntarily or involuntarily. In each of these cases you could be left without coverage.

Another thing to consider should your agency be added as an additional insured on the buyers' policy is that any claims, whether they are for your agency or the buyer's agency, will be subject to the policy limit of the buyers' policy, regardless of whether there are multiple claims as a result of either agency. In other words, are you comfortable that the policy limits of the buyers E&O

policy are sufficient to cover both your and their claims? Also, it should be made clear who will be responsible for any deductible payment.

## Mergers

If you are merging with another agency to either form a new agency or be a continuation of one of the two, there are a couple of different ways to handle this in regard to your E&O coverage. One way is to have a new E&O policy for the newly created entity. This ensures a clean slate for all involved. If a new policy is created, each of the former agencies can purchase tail coverage or they can be added as additional insureds on the new entity policy. Again, keep in mind that any claims will be subject to the limits of the remaining policy and remember that this must be approved by the E&O provider prior to the completion of the agreement to ensure that the carrier can comply with your wishes. Another way to handle a merger is to terminate one policy and have that agency added as an additional insured to the policy of the “surviving” agency. The agency that is terminating their policy can either purchase tail coverage or be added as an additional insured upon approval by the E&O provider.

## Internal sale

Many times an owner has a key agency employee who they believe is qualified to take over the agency. Everything that has been stated before applies just the same in these situations. There should be due diligence by both parties, attorneys should be retained, agreements drafted and entered into, and all other aspects of the change of ownership should be carefully contemplated and resolved.

## Transfer of a book of business

Remember that even if all you are doing is transferring a book of business, either as a buyer or a seller, all of the things mentioned previously apply. While you might think that a transfer of only a small book of business should be uncomplicated, as soon as a claim is made it can become very complicated.

## Key points to remember

1. Consult your attorney and have a formal written agreement outlining the duties and responsibilities of all of the parties.
2. Contact your E&O provider as soon as you can to ensure that coverage can be provided as you intend and that there are no gaps in coverage.
3. Giving timely notice to your E&O provider is of utmost importance as many carriers may be unable to comply with your intent after the transaction has already been completed.

You spent your professional insurance career building a business that has provided you with a livelihood and personal fulfillment. If you are either growing or selling your agency, you want the peace of mind of knowing that you have adequately protected yourself.

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