

M&A Insurance Due Diligence Checklist

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Read the Sales/Purchase Agreement and find out the following...

- ✓ Is this a purchase of stock or net assets?
- ✓ Will the business resume operations with current management (same tax EIN?) and operate on a stand alone basis?
- ✓ If stand alone, will a new insurance program have to be designed and placed?
- ✓ Or, will/can the insurance and employee benefits exposures be absorbed into the insurance programs of the buyer?
- ✓ What is the approximate value of the transaction?
- ✓ Will the seller provide indemnification to the buyer for self-insured or uninsured liabilities?
- ✓ What provisions are made for post-retirement health and welfare insurance benefits?

Before getting started, the risk management specialist should gain an understanding of the overall situation and the timeline. For example, if the proposed transaction is being conducted as an auction, you may have to get by with the documents in the data room. After the buyer has signs a letter of intent, you should insist on getting whatever reasonable information you think you'll need.

Five process planning items:

1. Sign a confidentiality agreement.
2. Obtain the index of the documents in the data room (get ID and PW if a virtual data room).
3. Make sure you know what your scope will be. (Who is doing the Employee benefits, environmental compliance, etc?)
4. Compile the names and contact information of those with whom you will be dealing (buy-out firm partners and associates, heads of risk management and employee benefits at the company, insurance broker(s) of the company and your client's attorney.
5. Decide if you will need to visit the business to be acquired to observe operations and conduct interviews.

Learn from the Information Memorandum and other available information about the company...

- ✓ In what business (es) is the company?
- ✓ What are its products/services?
- ✓ Where are its plants and offices located?
- ✓ How many does it employ and what are the occupational classifications?
- ✓ What were the revenues and EBITDA over the past three years?
- ✓ What is projected for the rest of this and next year?
- ✓ What are the approximate values of the raw materials, inventory, plant and equipment on the balance sheet?
- ✓ Who are the company's major customers and suppliers?
- ✓ Are there any disclosures in regarding to legal compliance, enforcement or tort litigation?

Look for potential deal-breakers, such as businesses with asbestos claim and product liability legacy issues. If necessary, search the Internet for information about the company, its competitors and the industry.

Other red flags to look for are unique exposures that may require special types of policies - or insurance for which there may be limited availability due to changing market conditions. These should immediately be discussed with the buyer.

Compile the financial information for later use in calculating the cost of insurance per \$1,000 of revenue, conducting the insurance benchmarking and testing the reasonableness of total insured values.

Review insurance company claim reports – or "loss runs"

- ✓ How many product liability losses have they incurred -- and how high or severe have they been?
- ✓ If a provider of professional services, how many errors & omissions claims have they had and how severe?
- ✓ How many workers compensation accidents do they incur annually?
- ✓ How many automobile and general liability accidents do they incur?
- ✓ Have they had any material property, crime, cargo and marine claims.

Copies of the actual loss runs are preferred, because they are primary sources of information about the seller's risks and financial obligations -- even if they show few or no claims. Use the loss runs to develop questions about large or unusual claims and losses.

If the company incurs enough claims, you should prepare to do some loss-trending, especially of the workers compensation claims.

Secondary sources include compiled loss statistics, often prepared by the seller's risk manager or broker, or projections prepared by a casualty actuary. Ask if these are available.

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| <p>Get a copy of the seller's insurance policy schedules <u>dating back at least three years</u> and get copies of all property/casualty insurance policies currently in force.</p> <p>The Schedules of Insurance should list the following for each policy:</p> <ul style="list-style-type: none"> ✓ What did/does the policy cover (e.g. commercial property)? ✓ Who was/is the insurance Company? ✓ What were/are the policy numbers? ✓ When did/will they expire? ✓ What were/are the per occurrence and aggregate limits of liability? ✓ What were/are the insured values for real and personal property and business interruption? ✓ What were/are the deductibles or self-insured retentions? ✓ What were/are the annual premiums? | <p>Often the data room will only have the current schedule of insurance. Always <u>ask for prior years'</u> schedules and <u>complete copies of each current insurance contract</u> -- and READ THEM!</p> <p>Look for...</p> <ul style="list-style-type: none"> ✓ Inadequate umbrella limits ✓ Claims-made policy forms. ✓ No management liability policies (D&O, EPLI, ERISA) ✓ Insurance companies with AM Best Ratings less than "excellent." ✓ Expired policies (or policies due to expire before closing) ✓ Gaps or lapses in insurance coverage. <p>Make a table summarizing their premium history. Calculate the cost of insurance per \$1,000 of revenues and submit to the RIMS Benchmarking Survey.TM</p> |
| <p>If the business is self-insured or insured by a retrospectively rated "retro" policy, obtain a five to seven year history of the following:</p> <ul style="list-style-type: none"> ✓ What are and were the retentions per claim or per occurrence? ✓ Standard Premium? ✓ Basic Premium? ✓ Loss Conversion Factor? ✓ Interstate Experience Modifier? ✓ MA, PA, NJ Experience Modifier(s)? ✓ Maximum Premium? ✓ Loss Limit? | <p>If a purchase of assets and the seller will be retaining the liabilities for workers compensation and other liability claims incurred prior to the sale, carefully read the indemnification agreements in the purchase agreement to see if there are any dollar amount or time limits.</p> <p>If a purchase of stock transaction, the buyer will usually be expected to retain the liability for self-insured losses and future retro premium payments. Estimate how much these losses and retros adjustments could cost. Ask how much management has accrued and determine if they may be undervalued.</p> |

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| <p>Employee Benefits Insurance Documentation</p> <ol style="list-style-type: none"> 1. Employee benefits handbook outlining human resources policies and procedures. 2. Sample insurance brochures and applications given to new employees. 3. Employee census 4. Health insurance plan documents 5. If applicable, 125 plan document 6. IRS form 5500 for each employee benefit plan 7. Health insurance company's monthly premium statements for the most recent month -- dating back three years (e.g. December 2003, 2004 and 2005) | <p>If the risk management specialist is not qualified to review employee benefits insurance, find out who will or can review this important aspect of the transaction.</p> <p>The principal issues are going to be:</p> <ul style="list-style-type: none"> ✓ Will we need to design a stand alone program? ✓ What have the company's health insurance premium rates been -- and are they vulnerable to a material change in their rates? ✓ What kinds of employee benefits insurance (e.g. long-term disability and life insurance) do they <u>not</u> offer or buy -- and how much will it cost to buy these? ✓ Does the company have adequate policies and procedures governing employee conduct in the workplace, responsibility for safety, etc.? |
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