Are You Buying or Selling an Agency?

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Recently, an article addressed the issue of mergers and acquisitions among insurance agencies. Surprisingly, the article stated that agency mergers and acquisitions actually doubled in the first half of 2004 as compared to the same period in 2003.

More surprising is how many agencies, whether they are buying or selling, fail to give any degree of consideration to the issue of E&O when negotiating and structuring the deal. While there are a lot of items to consider in determining whether to move forward with the deal or not, the failure to address how your E&O policy will respond can cause significant problems down the road.

First, for the buyers. As soon as you determine that the deal is likely to move forward, be sure to let your E&O carrier know. Contact them and find out what details they need to add coverage for the new agency to your policy. In most situations, they will ask you to complete some type of short form application on the new agency. This application will address the main elements of the agency (size, breakdown of personal and/or commercial lines and classes of business, carriers, loss history, etc.). In most cases, your carrier will include coverage from the date of the purchase forward but it is important to understand that there is no guarantee of acceptability. Of course, there may be a premium associated with the purchase. You may want to inquire about these issues ahead of time so you are not caught off guard.

With few, if any exceptions, coverage for the new agency will become effective the date that you close on the sale. Carriers will not pick up the prior acts of the agency so you need to be careful to buy only the assets, not the liabilities.

While this article is not designed to go into all of the due diligence that should be done, it is extremely important that you know what you are buying. In the 38 plus years that Utica National has been writing this coverage, many agencies discovered significant problems in the agencies they bought, surfacing after the fact. These resulted in claims, which then impacted the overall desirability of the agency from an E&O standpoint. No two agencies are the same, so be certain the agency you are buying is a good fit.

Now, for the agencies that are selling. As mentioned above, when you sell, most agencies are only going to buy the assets and thus you need to find a way to protect your liabilities moving forward. The appropriate way to accomplish this is through buying a "tail" on your existing policy; the technical term is “extended reporting period.” In most policies, a section addresses this subject. This tail coverage protects your agency from claims that come in after the date of the sale involving errors that occurred prior to the date of the sale. You can buy coverage for various lengths of time. Typically, the options range from 1-10 years with some states requiring “unlimited” as an option. Not only do the price tags vary based on the length of the tail but it is important to understand that you only get one chance to make the decision. You cannot buy three years and then when that time is up, buy three more. Tail coverage is important, but it is not cheap, so be sure to understand this when you make the decision to sell your agency.

We are often asked what length of the tail should be purchased. This is not a simple question to answer. Among the factors that should be considered is what type of agency you had as well as the length of the statute of limitations in your state. Claims do occur, so don’t think just because you have been claims-free for the last five years that this trend will continue.

In conclusion, whether you are buying or selling, don’t forget to think about the E&O ramifications. Addressing this properly will give you the peace of mind that you are well-protected. Failure to address it could result in your biggest nightmare.