GSI Insurance Partners

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Run Off Insurance – Guidance Note

This publication/guidance note is focused on Professional Indemnity (PI) insurance, which is considered your number one risk, and often your largest insurance expense. Your insurance broker will be able to provide you with personalised advice about the retention (or not) of other policies, including but not limited to Directors & Officers Liability, Statutory Liability, and Cyber Liability.

Commentary from Glenn Stone

Glenn Stone (BBS, QIB, FIBANZ, ANZIIF Senior Associate) is no stranger to the survey and spatial industry. As Managing Director of GSI Insurance Partners, Glenn has worked closely with Survey and Spatial New Zealand for more than a decade.

Glenn's 25+ years of insurance experience allow him to develop innovative cover solutions that mitigate the unique risks and challenges of your industry.

What is Run Off Insurance?

Run off insurance is an insurance policy provision that covers claims made against entities for work they completed prior to being acquired, merged, or ceasing to operate, and prior to the policy being put into run off.

Once a policy is put into run off, any professional services provided after the policy has been placed into run off will not be covered.

In New Zealand, run off cover is usually purchased for periods ranging from 1-7 years, and we mainly have two options for run off cover, as follows:

1. The existing policy is placed into run off and annually renewed.
2. The existing policy is placed into run off and coverage is purchased in bulk, for periods normally ranging from 1 to 7 years.

Option One:
Run Off - Annually Renewed Policy

Some of the advantages of this option are:

- The policy can, in theory, be retained for longer periods than a bulk purchased cover, where the maximum period that can be purchased is normally 7 years.
- The cost of cover is spread out over the duration the policy is retained, as opposed to being incurred in one hit.

Some of the disadvantages of this option are:

- Lacks certainty of cover.
- The underwriter can reduce cover.
- The underwriter can increase the annual cost.
- The underwriter can increase the excess and/or change the structure of the excess.
- The underwriter can exit the market.
- All the above will be potentially amplified by claims incurred.

Option Two:
Run Off – Bulk Purchase of Cover for Multiple Years

Some of the advantages of this option are:

- Certainty of cover.
- The underwriter can not reduce cover, increase cost, change the excess or restructure the excess.
- If claims are incurred the cost can not be adjusted.

Some of the disadvantages of this option are:

- The cost of cover is incurred in one hit.
- The underwriter can exit the market.
- Often the limit of indemnity is shared/fixed for the full policy period, i.e. it is not reinstated each year.

How Long Should I Purchase Run Off Cover for?

When clients are considering run off cover, they invariably ask this question. Unfortunately, we can not predict when or if a loss may be incurred, so ultimately it is up to each individual client to make this decision. We recommend clients seek guidance from their advisers, most importantly their legal adviser, who is best placed and most suitably qualified to provide advice on this matter, the protection of your assets, and liabilities you may incur.

If the seller is a licensed cadastral surveyor (LCS) and they are not going on to work for the new entity they will need to consider the fact that liability imposed under the Cadastral Survey Act 2002 is not limited by time.

Number One Issue

The number one issue we come across with run off insurance is that it is very often addressed post sale, as opposed to being part of the sale process. This invariably leads to upset, as the financial rewards of selling have almost always been agreed and set in stone, which means the cost of run off cover reduces the agreed reward/price to the seller.

When a seller approaches us for run off terms as part of their sale process, preferably prior to, it gives them the benefit of knowing what the cost will be prior to negotiating the final sale price for their business.

Buyer Perspective

The cleanest transaction from an insurance point of view is for the buyer to purchase the assets of the seller, and not the liabilities.

It would be unusual for all of the seller's projects to be completed pre-sale, however if that was possible it would also make the transaction very clean from an insurance point of view.

If there are partially completed projects on the go post sale, ideally the seller would retain responsibility for those projects, fully complete the work, and retain professional indemnity insurance whilst the activities are ongoing followed by run off cover once all projects are fully completed.

If, as part of the purchase, the buyer is taking over uncompleted projects, with the intention of finishing the project, it is important for the buyer and the seller to clearly define, in writing and agreed by both parties, where the project is at upon transfer and who is responsible for what work has been completed (seller) and what work is still to be completed (buyer), so any claims and associated costs fall where they should.

It will also be important for the buyer to ensure the seller retains professional indemnity insurance for their risk's presale, which becomes even more important if, for example, the buyer is retaining the seller's trading name, which raises considerations around reputational risk and brand damage.

As the buyer, you don't want to be the last person standing with PI insurance.

Seller Perspective

For a seller, the best (and most likely cheapest) form of run off cover is a robust succession plan and/or sale of the company's shares, where the successors / purchasers of shares are contractually obligated to provide ongoing cover to the seller of shares, including but not limited to:

- a minimum period for ongoing coverage,
- with a policy wording (coverage) that is at least the same as that which was in place when the seller sold their shares, assuming that cover is still available.

This would negate the need for the seller to buy run-off cover, as ongoing cover will most likely be provided by the policy held by the company pre-sale.

Experience Tells Me

Technically the buyer's and seller's interests are in conflict, and accordingly each party should seek independent advice from an adviser focused on their needs only with regards to their ongoing insurance coverage.

In addition to the above mentioned, in practice what I have often seen when both parties are willing to participate in open conversation is that it can work very well to openly discuss the ongoing risks for all parties, the negatives and positives of each option, and work through solutions that both parties can commercially agree to.

Hot Tips:

1. Establish the cost of run off insurance before you lock in the sale price of your business.
2. Whether GSI is your broker or not, the hottest tip I can give you is to talk to your advisers, including your insurance broker, as early in the sale process as possible.
3. Obtain legal advice with regards to the liabilities you will be exposed to, including consideration of your level of asset protection.

Need to Know More?

For more information please contact us.

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