Insurance Buyers' News

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Maroevich, O'Shea & Coghlan Insurance

Divisions of MOC Insurance Services
Farallon Associates Insurance Brokers
San Francisco Insurance Center

44 Montgomery Street, 17th Floor, San Francisco, CA 94104
Toll Free (800) 951-0600 | Main (415) 957-0600 | License # 0589960

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How to Create a Risk Management Plan

When we think of risk, the first thing that usually comes to mind is insurance. But insurance is just one component of a sound risk management plan.

A risk management plan includes insurance, plus all the other strategies you need for dealing with the risks associated with your business or organization.

The following steps outline the main components of a traditional risk management plan as practiced by professional risk managers all over the world. While large cor-

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This Just In…

Nature Conservancy and others are studying the concept of buying up lands prone to flooding to forestall commercial development and eventual claim payout due to flooding. "Every $1 spent buying flood lands could save $5 dollars in future flood damage losses," says a new report by The Nature Conservancy, the University of Bristol (United Kingdom) and flood analytics company Fathom.

Published in the journal Nature Sustainability on Dec. 9, the study identifies more than 104,000 square miles—an area roughly the size of Colorado—in "100-year" floodplains where conservation would be an economically sound way to avoid future flood damages.

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porations follow this procedure, it works just as well for all sizes of organization. Even a one-person retail operation will find following this procedure helpful for identifying, assessing and managing risks. (This version has been adapted from an article published by the Small Business Development Corporation of Australia):

1 **Identify the risk.** Some useful techniques include:

- Evaluating the functions of your business that could have a negative impact — for example, slips and falls in a store, harmful effects from a product you make, injuries to the public from your vehicles, etc.
- Reviewing your records such as safety incidents and complaints
- Identifying the external risks that could impact your business (weather, city planning decisions, etc.). Some of the ways to accomplish this include asking yourself and your staff questions like "what if":
    - you lost power
    - your premises were damaged or not accessible?
    - your suppliers went out of business?
    - there was a natural disaster in your area?
    - one of your key staff members resigned or was injured at work?
    - your computer system was hacked?
    - your business documents were destroyed?

2 **Assess the risk.** Next, assess each risk you've identified by establishing:

- the likelihood (frequency) of it occurring
- the consequence (impact) if it occurred

TIP: The level of risk is calculated using this formula: Level of risk = likelihood x consequence.

To determine the likelihood and consequence of each risk it is useful to identify how each risk is currently controlled. Controls may include:

- elimination
- substitution
- engineering controls
- administrative controls
- personal protective equipment.

The risk analysis matrix in the sidebar can help you to determine levels of risk. After you've assessed the risk, you need to determine how to:

3 **Manage the risk.** Managing risks involves developing cost effective options to deal with them including:

- avoiding
- reducing
- transferring (including insurance)
- accepting.

Avoid the risk – change your business process, equipment or material to achieve a similar outcome but with less risk.

Reduce the risk – if a risk can't be avoided, reduce its likelihood and consequence. This could include staff training,

This Just In

"For just over 21,000 square miles of this area, the benefits are at least five times the cost, meaning that a dollar invested in floodplain protection today returns at least $5 in savings from avoided flood damages in the future," said Kris Johnson, deputy director of agriculture for North America for The Nature Conservancy and co-author of the paper. "Not only would investing now to conserve undeveloped lands in floodplains likely save tens of billions of dollars in avoided flood damages, but protecting these lands would also provide a host of additional benefits for habitat, wildlife, water quality and recreation, further strengthening the economic rationale for floodplain conservation," she said.

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documenting procedures and policies, complying with legislation, maintaining equipment, practicing emergency procedures, keeping records safely secured and contingency planning.

Transfer the risk – transfer some or all of the risk to another party through contracting, insurance, partnerships or joint ventures.

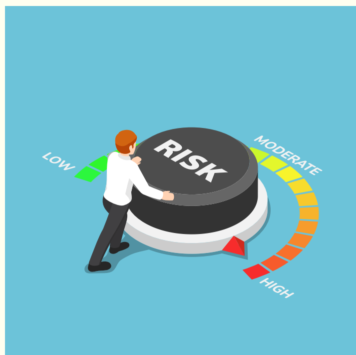
Accept the risk – this may be your only option.

Once you've evaluated your risks, by identifying, assessing and determining the best ways to manage them with a risk management plan, frequently:

4 **Monitor and review.** You should monitor and review your risk management plan regularly and ensure that the control measures and insurance coverages you've provided are adequate. Discuss your risk management plan with your broker regularly.

Likelihood		**Rare**. The event may occur in exceptional circumstances. (Less than once in 2 years)	**Unlikely**. The event could occur at some time. (At least once per year)	**Moderate**. The event will probably occur at some time. (At least once in 6 months)	**Likely**. The event will occur in most circumstances. (At least once per month)	**Certain**. The event is expected to occur in all circumstances. (At least once per week)
Consequence		1	2	3	4	5
Negligible. No injuries. Low financial loss.	0	0	0	0	0	0
Minor. First-aid treatment. Moderate financial loss.	1	1	2	3	4	5
Serious. Medical treatment required. High financial loss. Moderate environmental implications. Moderate loss of reputation. Moderate business interruption.	2	2	4	6	8	10
Major. Excessive, multiple long term injuries. Major financial loss. High environmental implications. Major loss of reputation. Major business interruption.	3	3	6	9	12	15
Fatality. Single death.	4	4	8	12	16	20
Multiple fatalities. Multiple deaths and serious long term injuries.	5	5	10	15	20	25

Small Business Development Corporation of Australia



Risk rating	Risk priority	Description
0	N	**No risk:** The costs to treat the risk are disproportionately high compared to the negligible consequences.
1 – 3	L	**Low risk:** May require consideration in any future changes to the work area or processes, or can be fixed immediately.
4 – 6	M	**Moderate:** May require corrective action through planning and budgeting process.
8 – 12	H	**High:** Requires immediate corrective action.
15 – 25	E	**Extreme:** Requires immediate prohibition of the work process and immediate corrective action.

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New Insurance Products: Warranty & Indemnity Insurance

The use of insurance in mergers and acquisitions is on the rise, according to a recent report by Aon. Since 2014, there has been a 35 percent increase in M&A deals where warranty and indemnity (W&I) insurance has been part of the transaction.

In a merger or acquisition, the seller makes certain representations and warranties. The buyer will find it favorable to have W&I insurance to protect against losses arising out of certain breaches to the acquisition agreement. But the insurance favors both buyers and sellers:

According to a recent article by attorneys Richard D. Harroch, David E. Weiss, and Richard V. Smith (quoted below), sellers benefit in several ways:

- It can reduce or eliminate the traditional seller's indemnity for breach of representations and warranties.
- It can reduce or eliminate an escrow or holdback that would otherwise reduce the proceeds received by the seller's shareholders at the closing of the acquisition.
- It can provide for a cleaner exit to the seller, with fewer contingent liabilities associated with the sale of the company.
- The seller (and seller's counsel) may feel it can give the more extensive representations and warranties the buyer will want in the acquisition agreement, without as many "materiality" and "knowledge" qualifiers, leading to a quicker resolution of the form of acquisition agreement.

For buyers, the benefits of representations and warranties insurance include:

- Making the buyer's bid look more attractive to a seller, since there would be no escrow or holdback required (as it's provided by the insurance).
- A way to give the buyer additional time to discover problems with the acquired business (since representations and warranties are often valid only until the transaction is completed).
- Enhanced protection for the buyer, in amounts greater than the seller might otherwise agree to.
- Improving the buyer's likelihood of prevailing on a claim under the policy, since the seller will likely give more extensive representations and warranties in the acquisition agreement.

For both parties, representations and warranties insurance usually simplifies and

speeds up the negotiation of the acquisition agreement since the seller has less interest in negotiating the scope of its representations, since the insurance exists. Further, in a deal where there will be some limited post-closing indemnification by the seller's stockholders, the seller has less interest in resisting materiality caveats where the insurance will cover all losses, and therefore this aspect of the deal negotiation also can be concluded relatively quickly.

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The Limits and Exclusions in Representations and Warranties Insurance Coverage

Buyers and sellers need to understand that representations and warranties insurance is not a black-and-white alternative to the traditional post-closing indemnification, escrow/holdback and survival of representations and warranties structure of private-company M&A deals. Importantly, representations and warranties insurance policies typically contain the following exclusions and limits:

- The policy covers up to a certain dollar amount for losses, typically 10 percent of the M&A deal consideration. Therefore, the buyer can be at risk for extraordinary losses.
- The policy does not cover breaches of the seller's covenants in the acquisition agreement.
- The policy does not cover purchase price adjustments (such as for working capital adjustments as of the closing date of the deal).
- The policy will exclude losses due to breach of representations and warranties of which the buyer had knowledge, typically defined as "actual knowledge" of certain identified deal team members. Given the extensive due diligence investigation buyers typically undertake (and insurers expect), this exclusion might result in non-coverage of material risks, such as the risk of patent infringement.
- The policy may exclude certain tax-related issues, including taxes accrued on the balance sheet for pre-closing periods, transfer taxes, taxes disclosed on the M&A Disclosure Schedule, and the availability to the buyer of net operating losses and R&D tax credits.
- The policy may include a carve out for liabilities associated with misclassification of employees/independent contractors and wage and hour laws.
- The policy may exclude liabilities related to asbestos or other environmental issues.
- The policy may exclude forward-looking representations and warranties (such as revenue projections).
- The policy may exclude certain types of losses (such as consequential or multiple damages).
- If the buyer has specific concerns about the limits or exclusions (for example, as to intellectual property infringement), some insurers are willing to negotiate coverage under an "excess coverage" rider to the policy or otherwise modify the policy in consideration of the payment of special additional premiums.

Nevertheless, for strategic buyers, representations and warranties insurance may be an attractive alternative to traditional post-closing remedies. ■

The full article by Harroch, Weiss, and Smith may be accessed at AllBusiness.com. https://www.allbusiness.com/mergers-and-acquisitions-representations-and-warranties-insurance-120127-1.html

Equipment Breakdown Insurance Is Much More than Insurance

Equipment Breakdown insurance — formerly called Boiler & Machinery insurance — covers much more than boilers and machinery.

Insurers introduced boiler and machinery coverage in the mid-1800s to cover valuable steam-powered machinery from explosion or breakdown, and to cover the equipment's owner from liability for resulting property damage or bodily injury. Today, few businesses use steam-powered machinery for business operations, but some still use steam-powered equipment for generating heat or power. Many states require these boilers to be inspected annually. If your boilers fall into this category, you may find equipment breakdown coverage a bargain, as coverage includes an inspection by the insurer along with protection from loss due to property damage or bodily injury. If you are relying solely on a governmental inspection for compliance, you may end up

paying more and not have the insurance protection.

To prevent business shutdowns or slowdowns, an organization might want to cover other kinds of valuable equipment from mechanical breakdown, too. In addition to boilers, today's equipment breakdown insurance can cover these types of equipment:

1. Equipment designed to operate under internal pressure or vacuum
2. Equipment designed to generate, transmit or use energy
3. Communications equipment and computers
4. Equipment owned by a utility and used to provide service to an insured's location.

Don't think you need this coverage? Consider the following examples of claims from Hartford Steam Boiler, an insurer that specializes in boiler and machinery insurance and equipment breakdown insurance:

1. Owners of an office building had to spend nearly $1.6 million to restore power to tenants — including an accounting firm on tax-season deadlines—after electrical arcing destroyed three electrical panels, leaving the building without power.
2. A medical clinic had to discard more than $21,000 worth of drugs when they froze after a controller on its refrigerator malfunctioned.
3. A printer spent more than $136,000 to repair a high-speed press after a bolt came loose and jammed the cylinder and gears.

Insurers typically write equipment breakdown coverage under a stand-alone policy; however, some will include the coverage under highly protected risks (HPR) policies or in business package policies. Most policies provide seven typical coverages.

Equipment breakdown policies are designed to cover your equipment from mechanical failure only, so they typically exclude damage from earth movement, flood, nuclear hazard, windstorm or hail. They also exclude "causes of loss" typically covered by other property policies, such as aircraft, vehicles, freezing, lightning and vandalism. Many other exclusions apply; however, you can modify many of these by adding an endorsement to your policy.

Equipment breakdown coverage is highly specialized and should be handled by an experienced broker. For more information on equipment breakdown coverage, please contact us.

What's Covered in a Typical Equipment Breakdown Insurance Policy?

The typical equipment breakdown insurance policy includes the following coverages:

1. Damage to "covered property" at the location named in the policy.
2. Expediting expenses, to cover the costs needed to get insured equipment operational as fast as possible, such as expedited shipping and making temporary repairs.
3. Business income and extra expense. Similar to coverage you should have under your property or business owners policy, many equipment breakdown policies will cover income lost due to the slowdown or stoppage caused by breakdown of the insured equipment. Extra expense coverage reimburses the insured for extra charges you incur to keep your business running while the equipment is not functioning, such as outsourcing or renting equipment. If your policy only lists extra expense coverage, it does not cover lost business income.
4. Utility interruption, which extends the policy's business income coverage to losses or spoilage caused by interruption of any utility service to the insured's premises, rather than just losses or spoilage caused by a breakdown of equipment at the insured premises.
5. Newly acquired premises, or premises unnamed in the policy, for the number of days shown in the policy's declaration page. The coverage only applies if equipment at the new location is of the same type covered by the policy.
6. Errors and omissions, which covers the insured for unintentional errors or omissions in describing or naming the insured property or location, and errors that cause cancellation of a covered premises.
7. Contingent business income and extra expense, which apply business income and extra expense coverage to breakdowns of equipment at a named "contingent location" not owned or operated by the insured. It can also include coverages to meet special needs, such as spoilage coverage, "brand and label" coverage, hazardous substance cleanup, and more.

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