

WARRANTY INSURANCE FOR MERGERS AND ACQUISITIONS

(Representations and Warranty Insurance (R&W Insurance) / Warranty and Indemnity Insurance (W&I Insurance))

WHY WOULD WARRANTY INSURANCE ADD VALUE TO OUR DEAL / INTEREST US?

Warranty insurance provides protection for losses which would fall within the scope of warranties in a share / asset purchase agreement (an Agreement). Coverage can be arranged for a seller or buyer:-

- Seller-side Policy:** Designed to provide cover to a seller and responds to claims made by a buyer. The Policy including defence and investigation costs.
- Buyer-side Policy:** Structured to provide coverage for a buyer where they require an enhanced level of protection through insurance, typically because the recourse against the sellers may be limited.

WARRANTY INSURANCE CAN ADD VALUE

- Individual sellers / warrantors giving warranties under the Agreement
- Corporate warrantors who seek a clean exit from the sale of a subsidiary
- Private Equity / Institutional Investors seeking to maximise the yield from the sale of their investment without exposure to their funds
- Buyers looking to secure direct access to insurance proceeds when the sellers want to (i) 'walk away' from the transaction (with limited warranty exposure) & / or (ii) where there are a diverse range of sellers and recovery would be difficult and expensive;
- Buyers seeking to enhance their security for a breach of warranty claim where the long-term financial strength of the seller is questionable
- Investors, Banks or Financiers looking to protect their investment where recourse against the warrantors would be limited e.g. in a management buy out
- Buyers looking to gain a strategic advantage in an auction situation by offering the sellers' a bid with low warranties and taking buyers warranty insurance to top-up their protection
- Sellers preparing a target for auction and proposing very limited warranty protection and proposing buyers insurance to increase the buyers warranty cover

WHAT DOES INSURANCE OFFER PROTECTION AGAINST?

WARRANTIES / REPRESENTATIONS

A standard insurance policy covers the Insured for loss which would fall within the scope of the (representations and) warranties in the Agreement. It is intended to provide protection for matters which the Insured was not aware of at the time of signing the Agreement / entering into the policy. Despite thorough due diligence there may remain unknown risks which could seriously damage the value of the business. Warranty insurance provides financial protection from such risks. In certain jurisdictions such representations and warranties are given on an indemnity basis either in entirety or for areas such as tax.

LEGAL COSTS

Coverage is usually provided for costs of investigating a loss and defending a claim. For sellers, these costs are incurred in defending the buyer's warranty claim. For buyers, these are incurred in defending a third party claim such as a tax authority. This is an important aspect of insurance protection as costs in this area can build up quickly and significantly.

POLICY PERIOD

The policy period normally mirrors the period provided in the Agreement. Insurers can offer buyers an extended period of coverage beyond those negotiated in the Agreement, for example in situations where sellers may have restricted their period of risk to less than what is normally negotiated.

RETENTION / EXCESS / DEDUCTIBLE

Most insurers require a policy retention / excess, whereby the policy coverage will not respond for the first amount of risk. The level of retention / excess is dependent on the deal size and claim limitations negotiated in the Agreement eg. baskets, thresholds or small claims and de minimis.

IS COVER FOR SPECIFIC INDEMNITIES OR MATTERS IDENTIFIED IN DUE DILIGENCE?

During due diligence, matters will be identified which will be managed through disclosure and would not therefore be covered by a standard warranty insurance policy. However, contingent risks are often identified which the buyer is not willing to accept and seeks specific protection through indemnities &/or escrows. If such risks are contingent, identifiable and assessable in quantum and likelihood, insurance cover may be available either within the warranty insurance policy or more typically separately as a bespoke product dependent on the nature of the risk.

As the insurance market has matured and insurers gained experience, they have become more sophisticated and there are now variations in the capabilities and products offered globally by insurers. Our global M&A Practice utilises years of experience, expertise and knowledge of the M&A market to guide you on policy coverage and the creation of bespoke solutions.

WHEN SHOULD WE INVOLVE THE WILLIS M&A PRACTICE?

We would be happy to assist and provide guidance at any stage in the M&A process.

CONCEPTUAL / FEASIBILITY STAGE:

During the early stages of the transaction, the scope of our engagement consists of providing estimates and broad feasibility assessments. These are based on our knowledge of the market and the current market trends. This can significantly assist the clients in early stage discussions and negotiations and the clients are able to realise the maximum benefit of the structure and scope of insurance available.

DOCUMENTATION STAGE:

As the transaction progresses and as and when the documentation becomes available we would guide you on approaching applicable insurers. It is a key part of our engagement that the presentation of the risk to insurers is conducted with a thorough knowledge of the transaction in order to obtain the best deal for our

clients. If we felt that documentation was at an early stage, and it might prejudice clients position, we would guide the clients on how best to manage this.

HOW LONG DOES IT TAKE TO ARRANGE COVER?

Once insurers have been instructed, the insurer will conduct its' own diligence exercise. This is not intended to be intrusive and is not dissimilar to the type of diligence a bank would undertake as part of its credit application. As a result, timescales need to accommodate this process and we can guide the client on the minimum time requirements. We would continuously update the clients and their advisers of progress in order to achieve a successful completion within the timescales.

We work together with clients, their deal team and insurers to deliver the required products within the tight time schedules required and across international time zones.

HOW OFTEN ARE THERE CLAIMS UNDER THESE POLICIES? DOES THE INSURANCE PAY-OUT?

Warranty Insurance has been underwritten in the insurance market for over 25 years but it is really in the last 5-10 years that it has become an established product utilised globally. Therefore, claims data is relatively new particularly in certain territories and often shrouded in secrecy due to the sensitivities of such claims. However, members of the Willis M&A team have actively been involved in handling claims where payments from insurance policies have exceeded seven figures.

In our experience, most claims that have been made under insurance policies have stemmed from third party claims or actions which neither party anticipated. The knowledge and experience of members of our team in handling claims under Warranty Insurance policies is utilised to guide the client through the process with the aim of achieving a satisfactory resolution and payment.

For further information, please contact your local Willis Associate or the London M&A Practice on +44 (0)20 3124 6000.