

**Increased competition in the transaction solutions insurance market is resulting in improvements, not only in pricing and policy coverage but also in the development of new products. Additionally, the speed of delivery has improved as new entrants attempt to catch up with the leading players and create a difference.**



**ALENA WATCHORN** has joined the Willis M&A Practice having previously headed up the corporate finance insurance advisory team at HSBC. Alena has over 12 years experience in developing and advising clients on transaction insurance products.  
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Willis' Mergers & Acquisitions practice is one of the fastest growing and successful insurance advisory teams, with over 80 highly qualified and experienced members providing M&A insurance advisory services globally. In 2007, the Willis M&A team acted on three of the largest European buy-outs and were engaged on over 1,800 assignments.

The transaction solutions unit, part of the M&A practice, provides bespoke and highly specialised advice on transaction products including warranty, tax and environmental insurance. Brian Hendry, practice head of the unit, commented that 2007 was one of the best years for the unit with significant product innovation and growth.

Building on the practice's success, Willis have recently invested in expanding the transaction solutions unit with the recruitment of highly experienced staff to strengthen the existing successful team.

### WHAT ARE TRANSACTION SOLUTIONS PRODUCTS?

**Warranty Insurance:** designed to protect buyer or seller against loss arising from breach of warranties and indemnities in the underlying transaction documentation. Back-to-back coverage protecting either buyer or seller for unknown loss discovered up to seven years after exchange and/or completion. Enables a clean exit for seller and/or enhanced protection for buyer.

**Tax Insurance:** bespoke policies for known tax exposures identified in a target (often during a due diligence process). Insures the financial impact of a successful challenge by a tax authority. Also, replacement tax deed insurance where no tax deed is offered by a seller.

**Contingent Risk Insurance:** bespoke solutions for specific risks typically identified during a sale process which, whilst contingent, may have an adverse effect on the transaction and/or erode enterprise value, e.g. litigation, planning consent issues, employment issues.

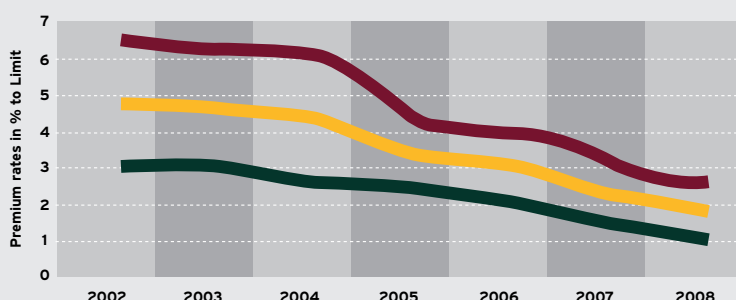
**Environmental Insurance:** protection of buyer, seller or target for environmental risk arising from sites.

“Alena is a fabulous addition to our business and her recruitment is another sign of Willis' commitment to bringing together the best talent.”

Alistair Lester, Head of Willis M&A Practice

## WARRANTY INSURANCE PREMIUM RATES REDUCE BY 50% SINCE 2004

### INDICATION OF AVERAGE PREMIUM RATES



A leading insurer of warranty insurance recently commented: “Our average rates reduced by 20% during 2007 on top of a 20% reduction in 2006...”. Our own experience shows that over the last three years, premiums charged by insurers for warranty insurance on most UK transactions have reduced by at least 50%, with rates recently even as low as 1.3% of the limit required.

Whilst in Europe, rates in certain territories have dropped less significantly than in the UK, as insurers' experience and expertise has increased the scope of cover offered has broadened. With the new underwriters also entering the European market we expect to see similar pressure on rates.

# RECENT MARKET TRENDS

During 2007, there have been significant changes in the insurance market driven by new underwriters and the increasing knowledge and expertise of the market leaders.

## WARRANTY INSURANCE

### “Back-to-Back” Cover

It had been widely regarded that AIG’s warranty insurance policy wording had the advantage of being more user friendly than competing insurers. Their in-house underwriting capability also offers flexibility which competing insurers are now seeking to match. As a result, new policy wordings by Ambridge and Chubb have recently been issued, offering some of the following enhancements:

- Policy Excess eroded by any warranty loss of the Buyer (whether insured or uninsured)
- Fines and penalties only excluded if they are uninsurable
- Emergency defence costs allowance
- Non-Disclosure Clause – a warrantor’s policy for non-disclosure can only be avoided if there has been fraud or intent to deceive by the warrantors
- Warranty spreadsheets included in the policy specify which warranties are specifically covered and which are excluded, offering greater clarity
- Severability of coverage for warrantors
- Coverage for standard tax deeds enhanced not to exclude matters disclosed, thereby matching a typical UK Tax Deed (Ambridge)

### Blanket Environmental Coverage

In addition, certain insurers are offering blanket environmental coverage for typical environmental warranties for mid-market transactions. Whilst this offers back-to-back coverage for sellers, for buyers it may still be best to consider bespoke coverage in order to protect from “known contamination” exposure identified in environmental due diligence reports and/or specific wider site risks.

### Run-off Directors Liability

AIG is also offering an extension under their sell-side warrantors’ insurance policy for run-off directors liability insurance, which offers the management warrantors cover from claims (after the sale) from liability under the warranties as well as from third parties alleging wrongful acts of the directors in managing the target.

## WARRANTY INSURANCE: UPDATE AT A GLANCE

- Policy wordings designed to offer “back-to-back” coverage
- Premium rates have reduced by at least 50% over the last five years
- Deductible/excess levels have reduced. On buy-side policies, 1% of deal value is now achievable
- Swift and straightforward underwriting process for UK and European transactions driven by insurers’ recruitment of corporate lawyers into their teams
- New Market Entrants: Allied World Assurance, The Hartford, Zurich

## TAX INSURANCE

2007 has seen a number of deals in the UK and Europe where tax insurance for identified tax positions has been critical to the success of the transaction. These deals range from offshore domicile risk in property transactions, transfer pricing exposure in multi-national corporate deals and strategic risk transfer to enhance value.

### Tax Deed Replacement Insurance

Ambridge have to date dominated the bespoke tax insurance market. Capacity and product offering in this area have increased both in the USA and UK. Tax Deed Replacement Insurance is a new product where particularly strong demand is evident, offering the ability to replace a tax deed with an insurance policy. Other insurers, particularly some of the new entrants, are willing to provide market capacity which has increased significantly from €50m to over €100m for the right deals. We anticipate further developments in 2008 in this specialised market.



**We are now seeing more flexible products with a wider scope of coverage and a general softening in the insurer’s premium rates.**

**BARTOLINE**, a chemicals manufacturer based in Yorkshire, suffered a major fire in May 2003. The firefighters' foam and other chemicals washed off the site into local watercourses, causing pollution that the UK's Environment Agency subsequently dealt with. Bartoline was obliged to pay more than £770,000 (\$1.5 million) for clean-up costs, which the company sought to recover from its public liability (PL) insurance. Royal & Sun Alliance, one of the largest general liability insurers in the UK, argued successfully in court that these costs were outside the scope of its cover.

## ENVIRONMENTAL INSURANCE

Following the ruling on **Bartoline vs. Royal Sun Alliance** on 30 November, UK insurers have been reviewing their position on providing cover for sudden and accidental pollution incidents under a public liability policy. As a result, interest in Environmental Insurance Liability (EIL) coverage increased and a number of new product developments are being introduced, such as AIG's EnviroPro. The Willis environmental team, as part of the Willis Global Environmental Practice Group, produce a bespoke environmental report on the environmental insurance market with regular updates. Please let us know if you would like to be included on the mailing list for these updates.



### NEIL CAMERON

has joined the Willis Environmental team at the beginning of 2008, with responsibility for developing Environmental Insurance products throughout the UK and Europe in conjunction with the Global Environmental Practice Group. Prior to joining Willis, Neil spent the last eight years working for XL Insurance where he was responsible for promoting XL's Environmental Insurance Products to business and industry throughout the UK and Ireland.  
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### RICHARD WINBORN

joins the transactional solutions unit from the corporate department of a major City Law Firm. Richard has three years post qualified experience gained at a major City Law Firm and assisted on a number of private company acquisitions, as well as working on a number of property finance transactions with values from £5 million to over £200 million.  
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## SOLUTIONS FOR PROPERTY TRANSACTIONS

There has been increasing demand for warranty and tax insurance on property transactions which have been sold through a corporate vehicle. Due to various stamp duty saving schemes, a lot of property assets are owned by corporate special purpose vehicles (SPVs). The case study below serves to illustrate how transaction products are being utilised to assist property deals:

**Target:** property A is owned by an overseas SPV which was set up five years ago as part of a stamp duty saving scheme. The seller is a property investment trust, the ultimate beneficiaries of which are unnamed investors.

**Problem:** the seller wants to sell the property through a sale of shares of the SPV. A bidder would prefer to buy the property and not the SPV. This is because during the bidder's initial due diligence, there were two areas of concern:

- Risk that the seller had not disclosed all matters relating to the SPV; and
- Risk that the tax authorities may challenge the SPV's off-shore status resulting in corporation tax being owed.

The bidder was advised to seek warranties from the seller in order to obtain full disclosure and provide recourse against the seller and an indemnity relating to the tax status of the SPV.

This was resisted by the seller.

**Solution:** The bidder sought warranties from the seller, capped at 1% of the deal value and limited to 12 months. Willis structured a bespoke insurance policy for the bidder which topped-up the level of warranty protection to 10% of the deal value. In addition, the policy was structured to include cover for the risk that the tax authorities may challenge the off-shore status of the SPV for six years after completion. The total cost of the combined policy was 0.35% of the deal value.

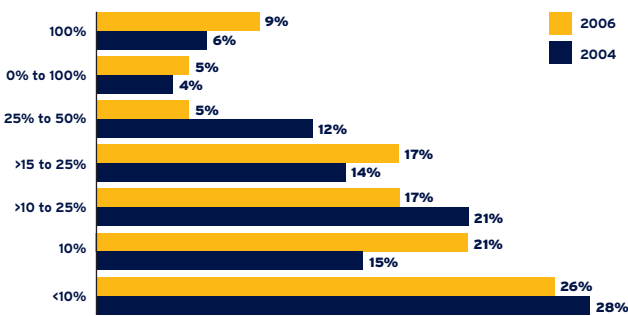
The bidder became the preferred bidder and was successful in concluding the deal.



## IMPACT OF THE CREDIT CRUNCH

Much has been and will continue to be written about the impact of the credit crunch on sale agreements. Investors will be looking closely at their portfolios to consider the impact on their investee companies and also their exit strategies. In the last couple of years, the prevalence of the auction process and the competition this created has resulted in seller-friendly sale agreements with resistance by the sellers' to any residual risk.

### CAP AMOUNTS AS PER 100% OF DEAL VALUE



An American Bar Association study showed that warranty caps as a percentage of deal value have decreased between 2004 and 2006. The warranty caps were the full asking price in less than 10% of transactions surveyed. Statistics for 2007 in the European market are likely have shown a similar trend with some secondary buy-out transactions having no warranty or extremely limited commercial business warranty exposure on the sellers. Will this trend continue? With perhaps more trade buyers who are used to getting full commercial warranty packages, there may be a greater expectation of recourse against the sellers and financial security to back this up through escrows and retentions.

## Will this increase demand for insurance or warranty claims?

Looking back at the last slow down in M&A activity in 2002/03 and the experience of the warranty insurance market, the number of notifications on warranty insurance policies materially increased during this period.

It is difficult to tell whether this was because 2000 had been a peak in M&A and, therefore, the pure volume drove the claims notifications one to two years after the sale, or whether it was because buyers' suddenly looked at their acquisitions more critically and their drop in value leading to more eager action taken against sellers.

However, the reality is that the experience of some of the members of the M&A team in a down turn in the market is that buyers and their financiers tend to seriously consider their recourse against sellers. As such, liability under warranties and escrows are genuinely at risk. Perhaps this will drive an increased demand for insurance alongside the banks and financiers funding some transactions looking critically at levels of recourse as part of their credit application process.

## WILLIS INTERNATIONAL NEWS

### NORTH AMERICAN \$100 MILLION POLICY VITAL TO DEAL COMPLETION

A private equity firm was purchasing a roll up to an existing portfolio company. One entire division of the target's workforce was derived from independent contractors, and the risk of these workers being misclassified would give rise to a potential exposure of just under \$115,000,000.

The buyer wanted to secure \$100million worth of coverage excess of the minimum loss scenario of \$15million which Willis was able to place using a bespoke contingent policy utilising a handful of insurers.

Despite the year end holidays, Willis was able to arrange for the policy to be placed within three weeks with a premium of just under \$7million.

### WILLIS ON THE MOVE!

Please note that we are now based in our new London building:

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**DOMINIC-VICTOR MASNY** joined the Willis M&A team in January 2008 as a Project Manager, working for both the transaction solutions unit and the Environmental Practice. Dominic has been at Willis since 2005, previously working on the Reinsurance side gaining experience in broking (Central & Eastern Europe) with particular focus on Enterprise Risk Management. Dominic is fluent in German, Polish and Japanese.  
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