Mergers & Acquisitions Insurance Group

Product Profile

Warranties & Indemnities Insurance

A breach of the warranties and indemnities given by the seller or the target company in connection with corporate transactions such as mergers, acquisitions and divestments can result in costly liabilities.

Warranties and Indemnities Insurance (W&I) responds to cover financial losses arising from such breaches. Supplementing the due diligence process, W&I serves as an additional and alternative risk management tool that transfers the risk of financial loss to the insurer, thereby reducing or removing the transaction parties' risk of financial loss arising due to a breach of warranty.

W&I can also be used strategically by either party in a transaction to achieve an optimal deal outcome:

Competitive auctions: a buyer can enhance or differentiate its bid by reducing a seller's potential exposure to warranty claims.

Distressed sale environment: a seller in a distressed financial situation may achieve a faster sale or better price by offering recourse against insurance for warranty claims.

Limited mark up of the acquisition agreement: buyers and sellers can minimise the risk of losing a critical deal by avoiding long and contentious negotiation over the scope of the warranty regime (e.g. expiry periods, limit of liability etc).

Achieve higher price: a seller may expand a pool of potential buyers and achieve a higher price by offering recourse against insurance above the limit of liability that it may otherwise be willing or able to provide without insurance.

Supplements the due diligence process: a buyer entering a new industry or jurisdiction enhances its level of protection for breach of warranty and the insurance may provide a limit of liability above that the seller can provide.

The use of W&I in the Australasian region is increasing. 2015 was AIG's most successful year in terms of premium written in respect of Australian M&A policies. While traditionally popular with private equity, the number of corporate or trade parties taking out W&I insurance has significantly increased.

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Insurance Drivers

W&I may be used to meet specific concerns of either the buyer or seller, including:

Insufficient warranty coverage:

- Increases warranty protection for a buyer, in terms of time periods or monetary limits, above that offered by the seller in the acquisition agreement
- Allows management sellers who give substantial warranties to increase their liability cap
- Facilitates passive sellers to give warranties beyond title and capacity

Enforcement difficulties:

- Eases buyer or financier concerns about the ability to collect on the seller's indemnification due to the seller's financial arrangements or where there are multiple, difficult to locate or geographically dispersed sellers
- Allows local buyers to avoid enforcement in a foreign jurisdiction
- Facilitates a clean exit for investors from investments

Protect key relationships:

- Protects relationships with sellers who become or remain key employees or commercial business partners after completion of the transaction
- Reassures shareholders or other investors/financiers by reducing the transaction risk

Financial considerations:

- Allows sellers to crystalise a return on investment and return funds to investors
- Avoids lock up of the purchase price in escrow and manages the risk of contingent liabilities
- Allows corporate sellers to immediately use sale proceeds to pay down existing debt or deploy to other operations
- Manages buyer's risk of significant unanticipated future expenditure

Key Features

Each policy is a bespoke policy tailored to meet the specific needs of each transaction.

Our aim is to make the coverage under the policy:

- back-to-back with the recourse and risk allocation regime agreed between the buyer and the seller in the acquisition agreement
- mirror the minimum claim provisions (de minimis and retention thresholds) and other limitation language in the acquisition agreement
- match the warranty survival period under the acquisition agreement (including any extended period for tax), but the policy term may be extended beyond if required by the client
- cover first and third party claims and associated defence costs. Cover on a buyer policy will also respond to fraud by the seller

A buyer-side policy allows the buyer to recover financial losses resulting from breach of the warranties and indemnities directly from AIG without first having to pursue recovery from the seller. A seller-side policy reimburses the seller for losses resulting from warranty claims by the buyer, protecting the seller from having to return a portion of the purchase price.

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Common Exclusions

Policy exclusions will include:

- Known issues (e.g. matters in the disclosure letter or identified in the due diligence)
- Fines and penalties
- Consequential loss
- Projections and forward looking warranties
- Seller fraud (seller policies only)
- Transaction specific issues

Known issues may be covered in some jurisdictions by other transactional insurance products that cap or transfer the risk for:

- Ongoing or threatened litigation or disputes
- Residual risks relating to known tax issues
- Known environmental risks

Our M&A professionals speak the language of deals and have the expertise and resources to get the deal done.

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