Risk, Resilience and Reputation

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M&A Insurance

Risk, Resilience and Reputation Webinar Series

The latest webinar in our ***Focus on Funds | Risk, Resilience and Reputation*** *series saw CMS partners* ***Chris Luck*** *and* ***Aaron Fairhurst*** *discuss the nature and implications of warranty and indemnity insurance with* ***Ben Brindle****, director at Risk Capital Advisers. The full recording is available here.*

Back in around 2002, a global insurance company would perhaps insure five deals in a year.

Fast forward two decades and such companies might insure the same number of transactions in a day.

The reason for this increase in insurance is that today, warranty and indemnity (W&I) insurance, also known as transactional risk insurance, is commonplace. It is a cost-effective risk transfer tool that protects either the buyer or the seller from unknown and unforeseen liabilities resulting in financial loss from a breach of the seller's warranties (and/or indemnities) that are contained in a share sale agreement.

It started in the late 1990s as a handy tool for sellers to manage risk. But, in the intervening period, the approach to insurance changed. Between around 2002 and 2008, a larger number of private equity and family sellers decided they did not want the liability.

This trend was taken up by insurers, who sensed the growing commercial opportunity with buyers. As infrastructure, real estate and smaller private equity funds started insuring their purchases in the 2010s, supply continued to flourish.

These days it is chiefly (but not exclusively) a buy-side product – based on the fact that at least some 95% of policies are sold to such entities. The seller has a low liability under insured transactions – typically £1 – and, ultimately, the insurance enables them to walk away if necessary. Under the 'old' system of uninsured deals, a seller giving warranties could incur liability for losses.

From a fund’s perspective, this means that every investment exit can see a minimised tail of liabilities, with exposure at portfolio level avoided.

Today’s market

In relatively short order we have arrived at a sophisticated, nuanced market that offers coverage almost across the board in terms of sectors and geographies.

Even a few years ago, a buyer might have struggled to find coverage for, say, a Polish real estate transaction. Not so today.

This sophistication is visible in the breadth of parties to each insured transaction. On the sell side, one sees lawyers, sellers and the target business or asset.

On the buy side, the purchaser and their legal advisers obviously play vital roles.

While from the insurance perspective, the broker sources, arranges and negotiates the policy and the insurer analyses, takes and prices the risk. Both insurers and brokers are likely to have experienced teams – and the insurer at least may also have retained legal counsel.

If the *dramatis personae* appear heavy on legal qualifications, it is because this is a business where legal experience counts. Many of the insurers and brokers are former lawyers, with a deep understanding of the market’s dynamics and deal timings – meaning that in this sector it is a rare thing indeed for the insurance process to drag.

Insured parties will find about 30 insurers in the market, with a track record of handling complex deals, and claims, in many countries.

Such insurers will be unlikely to see any sector as off limits – and in fact it is increasingly rare to see certain types of transactions such as Private Equity, or other fund sales, without W&I cover.

Insurance doesn't make a bad deal good

It is often said in this market that insurance will never be a substitute for a good, properly due diligenced deal.

There may be tax or regulatory issues that the insurance cannot address. Again, such items could be tackled in due diligence, and a commercial solution found between the parties

But in the main, insurers are significantly motivated by successful transactions. They want to see a good deal, commercially negotiated, with their role simply being to provide coverage for the potential, unknown issues.

Insuring in today's market

A purchaser's W&I insurance experience should be relatively benign. In a world where confrontation can be the norm, insurers have no incentives to be other than conciliatory – and to seek the most effective compromise. Pricing varies depending on several factors including size of deal, sector, geographic scope of target, and level of liability an insured takes itself before the policy responds, but a rough guide would be a cost of around 1% of the limit required.

Ultimately, this quality of insurance experience comes down to several items. First is a recognition that not everything can be insured – and if there are holes in the scope, disclosure and due diligence, there will be holes in coverage.

Secondly, purchasers can head off things that might come up later on, from intelligent deal structuring at the outset to known issues further down the line.

Above all, having a selection of insurers – assembled by a reputable and experienced broker – can make all the difference in an environment where accuracy and time are of the essence.