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Risk, Resilience
and Reputation

Focus on Funds | Risk, Resilience and Reputation

M&A Insurance

7 July 2022

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Presenting today

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What will we cover?

1. What is W&I insurance

2. How did we get there?

3. State of the market

4. Top tips

5. Hot topics

6. Claims

1 What is W&I insurance

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What is W&I insurance

- Warranty and Indemnity (W&I) insurance is a cost-effective risk transfer tool that can be utilised by a buyer (buy-side) or a seller (sell-side) in a transaction to protect either the buyer or the seller from unknown and unforeseen liabilities resulting in financial loss from a breach of the seller’s warranty (and/or indemnities) that are contained in a share sale agreement
- Bespoke W&I Policy is negotiated for each transaction
- RCA structures coverage that is back-to-back with (or enhance, if a Buyer’s W&I Policy) the liability regime in the SPA
- The insured party can be a buyer or the seller/warrantor

2 How did we get there?

How did we get there?

- Late 1990’s – some sell-side deals
- Early 2000’s – buyers became insureds
- 2002 – 2008 – gradual uptake by larger PE funds, and spread across Europe
- 2008 – 2010 – recovery mode and new entrants. Australia leading the way
- 2010 – 2015 – uptake by real estate funds, corporates and smaller PE funds, growth in Asia and the US
- 2015 – 2020 – huge growth in number of underwriters and brokers. Market maturity. Significant claims paid
- 2020 – 2021 – record number of deals insured, and record number of underwriters

3 State of the market

State of the market

- Around 25 underwriters offering W&I
- Not all are insurers using their own balance sheet – the majority are MGA's
- Smaller end of the market – limits below £5,000,000
- Larger end of the market – limits up to £100,000,000 per insurer
- Role of excess markets, and building a tower
- Standard pricing below 1% of limit
- Excess/retention – 0.5% of the deal value, down to 0.25%, and "tipping" retentions
- Insurers pushing for rate/price increases
- New players in the last 12 months – Hamilton, Everest, Berkshire Hathaway, Mosaic
- Broad appetite, with no sector off-limits

4 Top tips

Top tips

Common Pitfalls	
SPA	• Off-market warranty regime (including lack of market limitations and qualifications)
Due diligence	• Scope gaps • Materiality • Omission of international operations
Disclosure	• Adequacy of disclosure and data room
Deal/W&I structuring	• Impact on Insured and/or W&I Policy jurisdiction: ➢ Tax ➢ Regulatory ➢ Coverage
Restructurings	• Failure to consider legal and tax implications
Known issues	• Failure to identify and consider early *Note: other insurance solutions may cover e.g. Tax*
W&I Insurers	• Change of W&I insurer availability/appetite/capacity

Common Pitfalls	
Sell-side processes / Sell-buy flips	• Selection of W&I insurer ➢ failure to consider full range of criteria that well advised Buyer will query • Not managing bidders/Buyers ➢ Coverage issues ➢ Loss of W&I insurer availability/appetite/capacity • Running too many "preferred" bidders* ** Note that RCA can run 4 "trees" (+ 1 on sell-side) each led by a senior member, but W&I insurers will max at 2-3 trees each and break fees will be requested*

Contact RCA early in order to:

- Avoid/limit potential pitfalls
- Manage expectations and process
- Structure and implement practical solutions

5 Hot topics

Hot topics

- Synthetic Warranties – myth vs reality
- US-style or “hybrid” policies
- Contingent risks
- Intellectual Property risks
- Due Diligence reports exclusion
- Signing to Closing cover

6 Claims

Claims overview

Claims – what to do	
What to do	• Act in good faith and as if uninsured • Notify as soon as become aware
Typical analysis	• Has there been a Breach? • Any disclosure, limitation in SPA? • Any exclusion or qualification in the W&I Policy? • Does the alleged quantum meet the de minimis and or retention?
Quantifying "Loss" – key questions	• How has the Loss been calculated? ➢ e.g. do EBITDA multiples apply • Can the quantum be substantiated? • Forensic accountants often get involved on the valuation of "Loss" on complex claims
Contact CMS / RCA early	• CMS and RCA are very familiar with W&I insurers' approach to claims and applies commercial pressure where necessary to expedite resolution of issues

Claims - the numbers	
Frequency	• Claims of substance - circa 12-14% of W&I Policies • Some W&I Policies have 2+ claims
Where	• Claims relate to the following warranties: ➢ Accounts (20%) ➢ Compliance with laws (15%) ➢ Material contracts (14%) ➢ Tax (14%) ➢ Intellectual Property (8%) ➢ Employee related (8%) ➢ Other (eg. Fundamentals, Environmental, Litigation etc) (21%) *2020 AIG claims study
When	• 75% of claims are notified in first 18 months and 90% within the first 24 months
RCA current caseload	• 22 claims across 18 transactions, as at September 2021

Claims – Common claims areas

- Non-payment or misclassification of long service leave or other employee entitlements
- Incorrect sub-contractor payments
- Unpaid bonuses or non-disclosure of the existence of bonus or incentive payments
- Non-exclusive distribution agreements
- Incorrect revenue recognition
- Incorrect application of accounting standards to liabilities in the warranted accounts
- Allegations of breach of third-party IP rights
- Wrongful classification of employees as contractors
- Incorrect application of VAT or other indirect taxes
- Incorrect Stamp Duty

Annexes

Annex 1: W&I insurance – Key features

Premium

Single payment for multi-year W&I Policy

Typically, payable at completion

Country of Target	Cost (% of Policy Limit)
Netherlands/Europe/UK	0.6 – 1.2
USA	3 – 4.5
Australasia	0.9 – 1.2
Hong Kong, Singapore	1.8 – 1.6
Japan, Korea Malaysia	1.7 - 2.2
Thailand, Taiwan, Indonesia, Vietnam, Philippines	1.8 – 2.5+
India, PRC	2 – 3+
Other jurisdictions	Please contact CMS / RCA for insurability and potential cost of W&I insurance

Sectors / Asset Classes

Very broad range: everything from Real estate (low risk) through to Financial Services

Other key features

Time limits	Up to 7 years for tax and title and capacity Ordinarily 3 years for general warranties
Retention	Typically 1% of Target enterprise value 0.5% fixed , or 1% tipping to 0-0.5% on certain deals. Expect Nil retentions on real estate transactions
De minimis	Typically 0.1% of Target enterprise value but often 0.05% can be secured (DD Report materiality is important here)

Key points for M&A professionals

Key factors impacting pricing and available insurance:

- Jurisdiction
- Retention and de minimis
- Sector / asset class
- Size of transaction
- Parties and their advisors
- SPA and disclosure – style (e.g. UK v US)

Key factors impacting coverage:

- SPA
- Warranties
- Due Diligence
- Disclosure
- M&A and underwriting process

Note: W&I Insurance is not a substitute for a proper M&A process or appropriate due diligence and fulsome disclosure

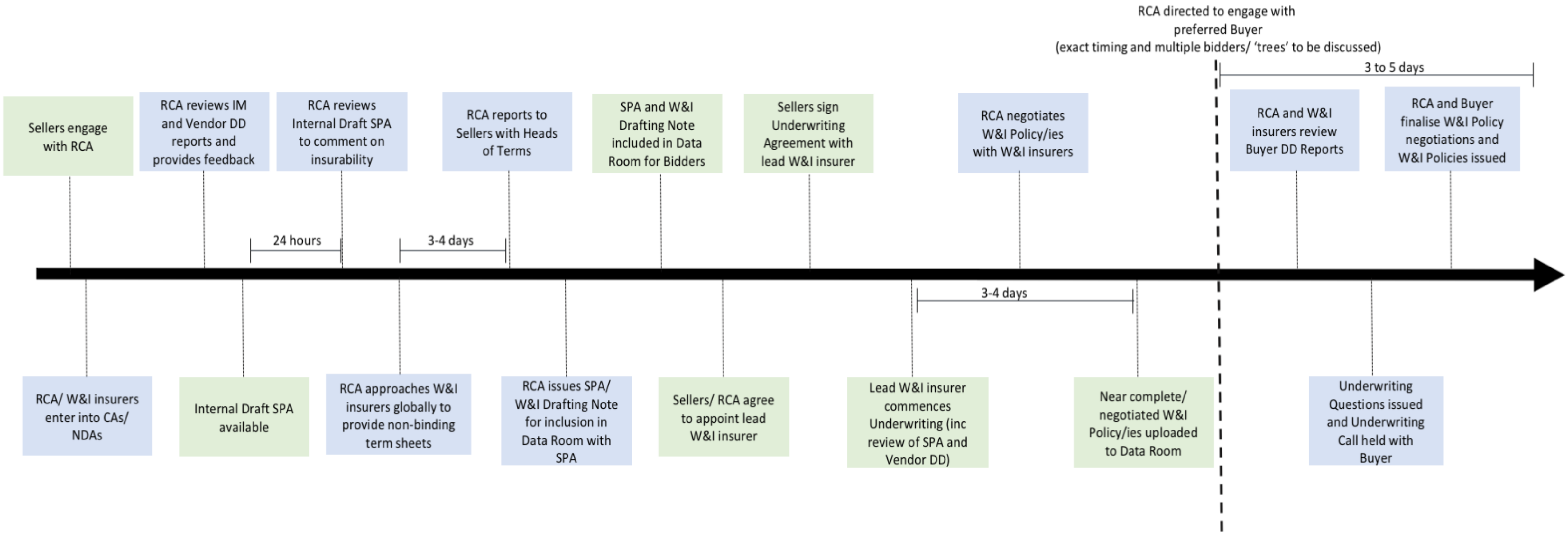
Types of target

Private (most common)
Non-listed public
Listed (occasionally): non-hostile

Annex 2: US style W&I policy coverage

US Style Coverage Concept	Comments
Removal of de minimis	No de minimis on claims.
Retention higher	Retention is often higher eg. 1.0% to 2% of EV but negotiable. Can ”drop down” after a certain period.
Due Diligence Reports not formally excluded	The W&I Policy will not contain a specific exclusion regarding matters which are fairly disclosed in the Buyer’s Due Diligence Reports. The NCD will however confirm that the Due Diligence Reports have been read and understood to avoid sandbagging. This is often secured on UK deals too.
No general disclosure of Data Room	The contents of the Data Room will not be deemed disclosed against the warranties or tax indemnity. However, a detailed Disclosure Schedule will be required.
Materiality/ MAC/ MAE Scrape	If the SPA includes a provision disregarding the materiality qualifications and/or material adverse change / event qualifications, the W&I Policy can mirror this.
Removal of Consequential Loss and Multiplied Damages exclusions	The consequential loss and multiplied damages (if applicable) exclusion can often be removed.
Pricing	Can depend but for a UK transaction implementing US style W&I Policy coverage, say between 2% and 4%.

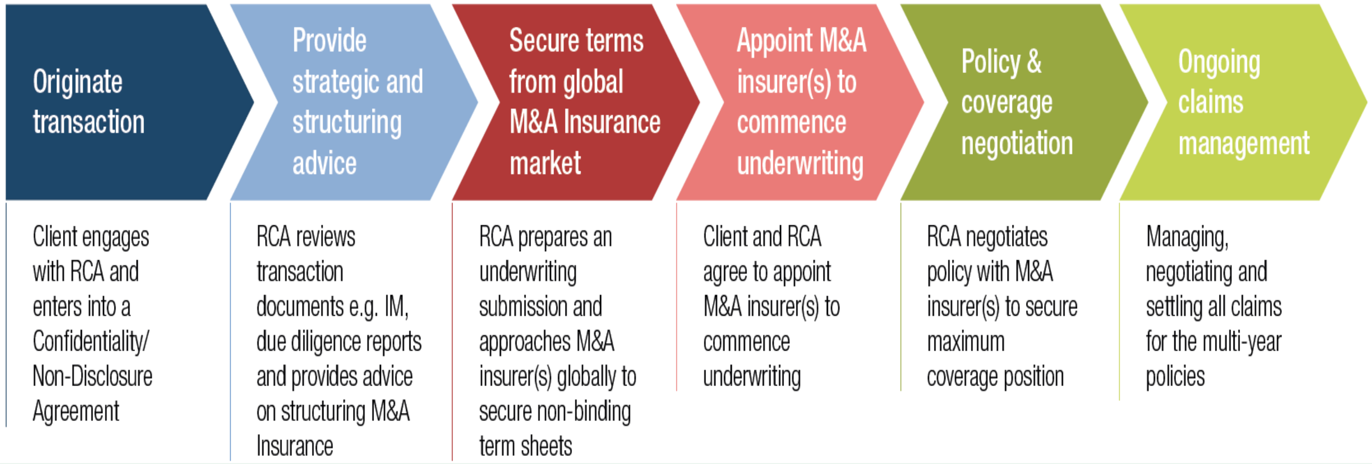
Annex 3: The RCA Sell-Buy flip process



Annex 4: W&I insurance – Timing & Process

Overview
W&I Insurance process usually takes approximately 2 weeks (including underwriting of 5 business days).
“Sell-buy flip” usually take 4+ weeks but early engagement is best
Shorter timeframes when required

Key factors impacting timing
M&A deal itself – W&I will adapt
Quality of the due diligence
W&I insurer capacity
Responsiveness of the Insured



Workstream	Action Items
Negotiation of warranty package	W&I insurance enables the parties to agree a balanced warranty package more easily
SPA drafting	RCA will review SPA and provide comments from a W&I insurance perspective
Due diligence and/or disclosure	Same as for non-insured deal but note W&I insurance is not a substitute for proper due diligence and disclosure. Prepare early with adequate scope to cover the warranties being requested
W&I process workload	Usually limited to: • Respond to W&I insurer’s underwriting questions and attending underwriting call • Attending to W&I insurer’s information requests • W&I Policy review RCA leads on policy negotiation. The deal team can focus on SPA/deal execution but will need to be involved
Competitive processes	Depends but usually the process is managed in conjunction with Sell-side M&A lawyer

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