

W&I insurance – Insurance cover in M&A transactions

WARRANTY & INDEMNITY (W&I) INSURANCE IS NOW AN ESSENTIAL PART OF THE M&A ADVISER'S TOOLKIT. INSURERS ARE CONSTANTLY BROADENING THEIR PRODUCT RANGE – WHAT WAS ONCE CONSIDERED UNINSURABLE CAN NOW BE FOUND IN THE PORTFOLIOS OF A GROWING NUMBER OF PROVIDERS. AT THE SAME TIME, INSURERS AND BROKERS ARE STREAMLINING THEIR PROCESSES TO ENABLE EVEN FASTER AND MORE FRICTIONLESS TRANSACTIONS. MEANWHILE, W&I INSURANCE IS ALSO BECOMING AN ATTRACTIVE OPTION FOR SMALLER TRANSACTIONS AND CAN MAKE THEM EASIER TO CARRY OUT. WE WILL SHOW YOU HOW W&I INSURANCE CAN BE USED EFFECTIVELY TO BRIDGE THE GAP BETWEEN THE SELLER'S AND BUYER'S POSITIONS IN A TRANSACTION, AND WHAT TO LOOK OUT FOR.



Features of W&I insurance

Warranty & indemnity (W&I) insurance is a specialised insurance product used in M&A transactions to cover the risks associated with warranties and indemnities provided by the seller. In simple terms: The insurance cover kicks in if a warranty or indemnity claim arises from the sale and purchase agreement.

This type of insurance therefore offers both buyers and sellers considerable advantages by covering potential liability risks.

For sellers, this means that they can make a “clean exit” without having to contend with the portions of the purchase price being withheld in escrow accounts or, in some cases, the threat of warranty or indemnity claims years down the line.

Buyers, on the other hand, can assert claims directly against the insurer instead of having to enforce them against the seller and bear the risk of recovery.



Basic mechanics of W&I insurance

The mechanics of W&I insurance are relatively straightforward: As is customary, the seller provides warranties in relation to the target company and enters into indemnification obligations as part of the SPA. The insurance policy usually reflects the catalogue of warranties and indemnities in the SPA. As a rule, the insurer waives any rights of recourse against the seller, except in cases of fraud.

In principle, insurance can only be taken out for what has also been verified as part of the due diligence (DD) and secured by warranties and indemnities under the SPA. However, there are now more and more exceptions to this principle – more on this later.

However, in order to secure the maximum insurance cover, it is always necessary to adjust the scope and depth of the DD to the desired scope of cover of the policy.

One major advantage of the insurance cover is that additional cover (“enhancements”) can be agreed which goes beyond the liability agreed in the SPA, e.g. with regard to maximum liability amounts, de minimis thresholds, limitation periods, definition of damage. Knowledge qualifiers can also be defined more broadly than in the SPA.

Process for taking out W&I insurance

It is advisable to start the process for taking out a W&I insurance policy as early as possible. In practice, however, this can sometimes happen quite late in the course of a transaction. Insurers and brokers are prepared for this, however, and can have a policy ready for signature within just one week of the broker being engaged.

In a first step, the DD reports and the draft SPA are provided to the broker. The broker summarises the key transaction data and the desired insurance cover and obtains “non-binding indications” from various insurers, which it presents to the customer in the form of an NBI report. This report provides the customer with a comparison of the conditions and scope of cover offered by the various providers to help them decide on a preferred insurer.

Underwriting calls, in which the insurer or broker asks questions about the scope and depth of the DD and tries to gain a better understanding of the DD results, used to be an integral part of the process. Increasingly, however, these calls are being dispensed with in favour of more streamlined processes where the customer only has to fill out a questionnaire.

Market trends

The market for W&I insurance has grown considerably in recent years. Depending on the jurisdiction and sector, the sums insured can be as high as EUR 1.5 billion per transaction. In Europe in particular, premiums are currently at historic lows.

Certain risks are typically excluded from insurance cover. This includes, for example, liability for circumstances of which the buyer has positive knowledge or which have been properly disclosed as part of the DD process. However, there has been some movement on the market with regard to these kinds of exclusions. Tax risks, for example, were long considered uninsurable. Today, this is no longer the case in such absolute terms. In other areas, such as contamination, indirect damage and consequential damage, it is now possible to obtain cover on a case-by-case basis.

A new trend is the use of “synthetic” warranties. These are an exception to the principle described above that the insurance cover must always reflect the scope of liability in the SPA.

In some cases, it is actually possible to obtain a completely “synthetic” catalogue of warranties from the insurer without any underlying warranties in the SPA. Originally used primarily for distressed transactions, this is still more of a niche product, but is now available for use in other contexts as well.

Another use case is for smaller transactions (up to an enterprise value of approx. EUR 15 million). In this case, the insurer carries out its own due diligence based on the seller’s disclosures and offers a ready-to-sign policy on this basis. This method can significantly streamline and simplify the execution of smaller transactions.



Role of (legal) advisers in the conclusion of W&I insurance policies

Apart from the special cases of synthetic cover, conducting a careful and effective due diligence is even more important if W&I insurance is to be taken out. Insurers generally expect legal, financial and tax due diligence to be carried out. Advisers should take this into account as early as possible in the DD process so that the insurance can be taken out as efficiently as possible and maximum cover can be obtained.

Red flag reports, for example, can be problematic because, understandably for reasons of efficiency, they only highlight identified risks. It must be ensured that the insurer is also clearly informed of the scope of the due diligence beyond these identified risks. The insurer will want to ensure that the information provided by the seller has not simply been assumed to be accurate, but has been verified by a thorough and independent DD.

The descriptions of risks and associated recommendations contained in the report must also be carefully formulated so that the insurer can offer maximum insurance cover on this basis.

Particularly in the case of transactions involving W&I insurance, experienced (legal) advisers are therefore essential to ensure that the process is efficient and that the maximum insurance cover is ultimately obtained.

Conclusion: Minimising risks, facilitating transactions

W&I insurance is a valuable tool to help minimise the risks of M&A transactions and facilitate the negotiation process. Thorough due diligence and the use of specialised insurance products can bridge the gap between the positions of buyers and sellers and ensure that transactions are successful and commercially attractive.

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