M&A Insurance - Enhancements

MERGERS AND ACQUISITIONS

M&A insurance has become a regular feature on transactions across the globe. Financial investors, corporates and M&A advisors are now familiar with the concept and readily apply it to transactions. It is frequently being used as a mechanism to achieve other benefits that can sit outside of the deal parameters agreed in an acquisition agreement (SPA). The following enhancements are now available on M&A insurance policies and can be beneficial to all parties to a transaction. Please note that certain enhancements may incur additional costs and are dependent on the general transaction dynamics.

Enhancement	Description
Zero / Nil Seller Recourse	It is commonplace for sellers to provide warranties capped at a euro, pound or dollar. Provided the sellers are materially engaged in the disclosure process and the buyer's due diligence is thorough, insurers are willing to stand behind the warranties irrespective of zero seller recourse in the SPA.
Tax gross-up	Policies now contain a gross-up provision as standard. This accounts for any tax payable as a result of claim payments made.
Retention / excess structures	There are a number of alternative policy retention / excess structures within the current market. These can be arranged to provide the best fit for the individual dynamics of each transaction: – **Flat Retention** - The amount of loss from nil to the agreed retention level is not covered by the policy. However, it is an aggregate retention and once eroded, it is gone. – **Tipping Retention** - Once an aggregated loss exceeds the policy retention, the claim paid by the insurer will tip to an agreed lower amount or nil, rather than only paying out for the part above the policy retention. – **Dropping Retention** - This structure allows the retention to move down to a lower figure once the non-tax warranty period in the W&I policy has expired, normally 12 - 24 months after completion. – **Nil Retention** - For transactions in certain sectors (such as real estate / renewables), some insurers are prepared to offer a nil excess policy.
Materiality scrape	Where there is a qualification as to materiality or similar qualification in any representation or warranty, certain insurers are prepared to disregard this for the purposes of determining whether a breach has occurred.
Awareness / knowledge scrape	Certain insurers are prepared to offer a 'knowledge scrape' of the warranties, save in respect of those warranties that would ordinarily be qualified by awareness (eg compliance with laws). This adds a further layer of comfort for the sellers but allows the buyer to have the ability to claim against the insurer under the policy on an unqualified and objective basis.
'Synthetic' warranties	W&I insurance typically sits back-to-back with the warranty catalogue that has been negotiated between the buyer and seller. However, in certain circumstances, sellers may not be prepared to give commercial warranties. For example, an administrator facilitating the sale of a distressed business would be reluctant to stand behind warranties. In this situation it may be possible to procure 'synthetic' warranties from the M&A insurance market. These are warranties that would sit within the W&I policy thereby allowing the buyer to gain some protection, which they ordinarily would not be able to achieve. Insurers would expect very robust diligence to be carried out by a buyer and insurers themselves may need to dive deeper into the business during their own underwriting process.
'Synthetic' tax deed	In the event that the sellers commercially agree not to provide a tax deed (which a lot of private equity sellers resist) then certain insurers are prepared to provide a standard 'synthetic' tax deed that the buyer can claim directly against from the insurer.
Survival periods extended out	Regardless of the periods agreed in the SPA, insurers are prepared to provide coverage for general warranties for two years from completion, however, certain insurers may extend this further to three years from completion. Tax deed, tax warranties and fundamental warranties are ordinarily covered for seven years from completion.

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Disclosure of data room	Certain insurers will follow the commercially agreed position in the SPA with regards to how the data room is being recognised provided they (i) understand what the buyer has done by way of its diligence and (ii) the Disclosure Letter and the disclosure process reflects the agreed position.
Buyer – side due diligence reports not 'disclosed'	Certain insurers are prepared to move away from applying a 'Disclosed' standard against the buyer's due diligence reports (an objective test) in the policy. Instead they will rely on the No Claims Declaration, and therefore the insured's 'Actual Knowledge' of breaches (ie a subjective test) making it a higher burden of proof / hurdle for the insurers to prove in the event of a claim.
'Other loss'	In the context of a transaction where the seller bears a sizable retention before the W&I insurance policy 'kicks in', it may be possible to agree that the policy retention can be eroded by matters not included within the definition of 'Loss' in the W&I policy (subject to certain exclusions).
Indemnity basis of loss	Usually insurers will follow the commercially agreed position with regards to how loss is assessed under the SPA. In certain circumstances they may be prepared to provide an indemnity basis of loss in the W&I policy if required by a purchaser.
Affirmative cover for 'low risk' matters	Assuming that external diligence has been carried out into these issues (and the results of that diligence is positive) certain insurers are prepared to include positive statements that certain identified 'low risk' items in the buyer's due diligence reports are not excluded in the policy.
Title to shares / title to property top-up coverage	It is common for a buyer to ask the seller to stand behind the full deal value when it comes to fundamental warranties (ie title to shares / capacity and in certain instances title to property). However, there is now a sophisticated insurance market to offer cover for title to shares and title to property at very competitive premium rates.
New breach cover	Warranties are typically given at the time the SPA is signed and repeated again at completion (if there is a split signing and completion dynamic). If the insured obtains knowledge of facts and circumstances giving rise to a breach of an insured obligation that occurred between signing and completion (and that breach did not constitute a breach of a signing warranty) the matter will be excluded from coverage (as the insured will be obliged to disclose this). This potentially leaves the insured exposed for 'new breaches' arising in the period between signing and completion. To bridge this gap certain insurers (depending on a range of factors including timings and risk profiles) are providing coverage to the insured for any breach of a warranty where the event first occurs and is discovered by the insured between signing and completion. New breach cover will often cover a specified number of days between signing and completion. There is also an option in the policy for the insured to extend the coverage period further for an additional premium.
Tax Liability Insurance (TLI)	TLI helps with liabilities from investments, transactions and company reorganisations. It has become increasingly important given the greater scrutiny and robust enforcement by tax authorities across the world. It can help manage risk and avoid potentially severe ramifications. Both standalone policies and bolt-on coverage (where W&I insurance is being used) are readily available.
Fund liquidation insurance	Fund liquidation insurance can be used to unlock capital held back in reserves for contingent liabilities where private investment funds are nearing or have reached the end of their intended investment lifespan, or a group company is winding down.

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