



Warranty & Indemnity (W&I) Insurance

W&I insurance (or Representations & Warranty insurance as it is also known) has become an established product in the M&A landscape allowing parties to a transaction to manage their risk and achieve their respective commercial goals.

WHAT IS IT?

W&I insurance policies cover loss incurred in relation to a valid breach of warranty pursuant to an acquisition agreement (SPA) or a claim under a tax indemnity.

WHEN WOULD YOU CONSIDER IT?

Both sellers and buyers have strong motivations to consider using W&I insurance. Sellers typically staple W&I insurance into a sale process to achieve a clean exit, to enable the unencumbered use or distribution of sale proceeds and / or simply to limit their exposure under the SPA. Buyers often consider using W&I insurance if caps are considered to be insufficient to their needs, there is a question of the security of the sellers, or when they are looking to differentiate their bid in a competitive auction.

WHO CAN USE IT?

The policy can be taken out by either the buyer or the seller. If the policy is taken out by the seller it will respond if the buyer makes a valid claim against the seller in accordance with the terms of the SPA and the seller subsequently claims against their W&I policy.

If the policy is taken out by the buyer (which is the more common route as the buyer has a direct contract with the insurer) the buyer has the option to claim against the seller (subject to the limitations in the SPA) and / or against the W&I insurance (up to the policy limit the buyer has selected to purchase).

WHY WOULD YOU USE IT?

The key benefits to using W&I insurance include:

Clean exit - insurance can replace liability otherwise held by the seller

Enhanced security - for the buyer as the long-term stability of sellers cannot always be guaranteed

Strategic tool in an auction process - to manage seller liability and / or enhance the profile of the buyer's bid

To increase quantum and period for the buyer - beyond the limitations available from a seller in a SPA

To protect ongoing management relationships - when management remain with the acquired business

To remove the need for an escrow - giving the seller access to a greater portion of the deal proceeds



HOW DOES IT WORK?

The W&I policy is a separate direct insurance contract between the insurer and the insured. The W&I policy commences when the deal signs or when the warranties are given. The coverage wraps around the warranties given in the SPA as far as possible. The policy has the following features:

Policy limit: A buy-side policy can cover any amount up to the transaction purchase price. A sell-side policy can insure against any sum up to a maximum of the cap on warranty liability under the SPA (plus defence costs).

Excess / Retention: This is the element of loss that is not covered by the W&I insurance policy and which is eroded by valid warranty claims. Typically, this is linked to the transaction as a percentage of the purchase price and numerous structures may be applied to the fit the needs of the transaction.

Time limits: W&I insurance policies typically last for two years in respect of non-tax warranties and seven years in respect of tax and fundamental warranties and the tax indemnity.

HOW MUCH DOES IT COST?

W&I insurance is a one-off premium payable after the completion of a transaction. Who pays the premium is usually a matter for negotiation between the buyer and the seller. Premium pricing varies depending on deal dynamics (sector, jurisdiction etc.). Other costs to consider are insurance premium taxes and most insurers charge a separate underwriting fee.

The Paragon M&A team have significant technical and transactional experience in working with all stakeholders to a transaction to efficiently and effectively implement W&I insurance. Paragon are experienced in working with advisors and underwriters to meet your transaction timetables by managing the W&I insurance process in parallel to your deal.

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We're an independently owned insurance broker, operating in the Lloyd's of London, Bermuda, European and International Specialty markets.

Our business is divided into teams who focus on complex risk management and risk transfer challenges within their specialist sector. This structure means we can provide a more personal, more professional service to your organisation than any other broker.

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