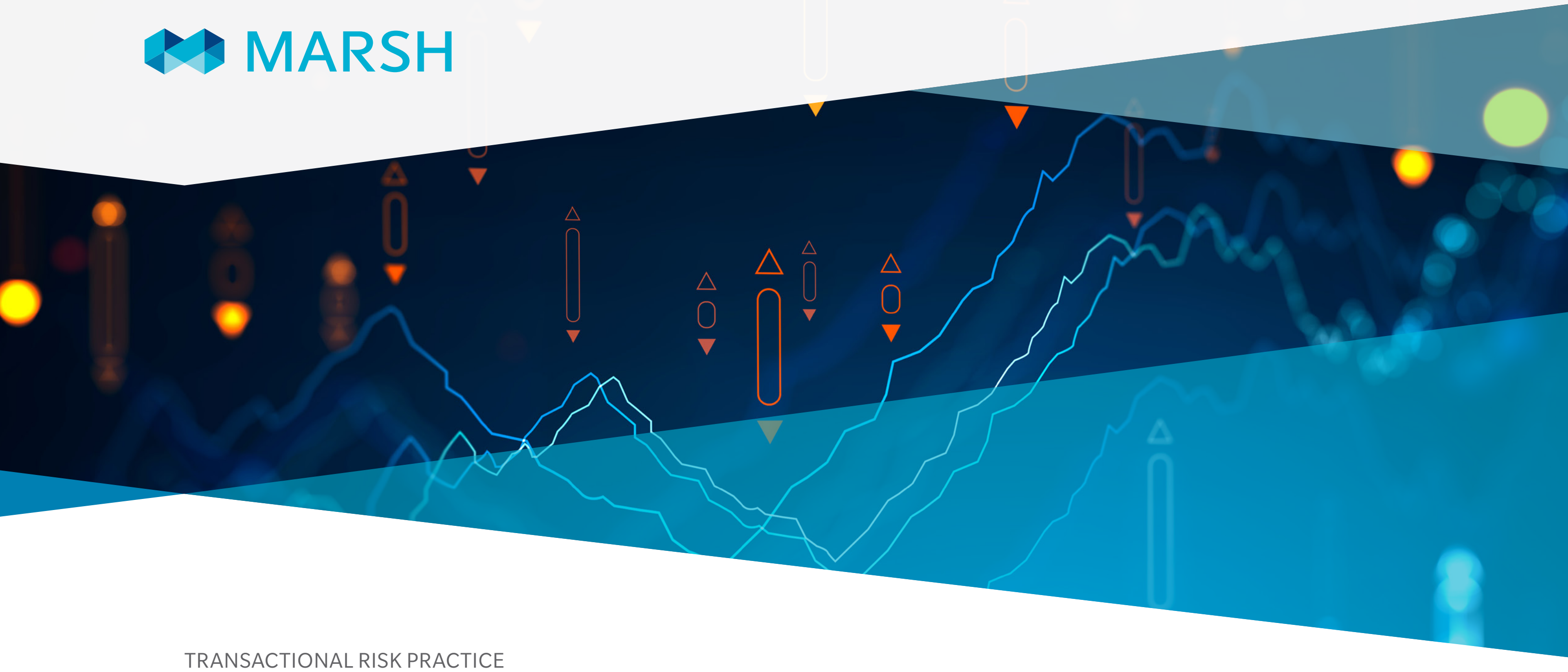


TRANSACTIONAL RISK PRACTICE

Transactional Risk Insurance: Reducing the Risk of Distressed M&A

The COVID-19 pandemic has disrupted virtually all aspects of life, economic and otherwise. With little certainty on the horizon, liquidity challenges for businesses are growing, and the ensuing financial distress may cause companies to consider the sale of non-core assets or force them into a restructuring or bankruptcy scenario to stave off creditors. Opportunistic buyers will also seek to acquire assets that were previously unavailable or seen as overvalued. The resulting increase in distressed M&A due the pandemic will undoubtedly increase risks and uncertainties for dealmakers.

At Marsh, we understand the unique risks faced by distressed companies and buyers of distressed assets, and can offer a unified suite of services to manage them, including — including representations and warranties insurance (R&W insurance or reps and warranties insurance), tax insurance, and contingent liability insurance. Our transactional risk specialists understand the changing deal dynamics for companies in distress and can help you navigate them and build robust R&W insurance and other transactional risk policies to protect your financial interests.

The Value of Representations and Warranties Insurance

While underlying deal dynamics may be changing, transactional risk insurance products remain readily available. In fact, the pandemic comes amid the most robust and competitive market for transactional risk products ever. R&W insurance has been ubiquitous in the private M&A landscape for many years, and insurers have paid hundreds of millions of dollars to policyholders for claims made under these policies.

Although distressed M&A transactions can present challenges to dealmakers, buyers and sellers can continue to rely on transactional risk insurance to facilitate deals by preserving value and solving for risks that may otherwise prevent a deal from getting done.

R&W insurance generally provides coverage for all representations and warranties of a target company and seller(s) contained in a purchase agreement in connection with an M&A transaction. The policy protects the insured against financial loss — including defense costs — resulting from breaches of such representations and warranties. R&W insurance can be used in both traditional change of control M&A transactions — whether public or private — and in non-control, minority investments made by a buyer.

The vast majority of R&W insurance policies are issued to buyers. However, either party — but not both — can be insured and can benefit from coverage in a distressed M&A transaction.

Benefits for Buyers	**Benefits for Sellers and Their Creditors**
Provides recourse for financial losses where an indemnity from the sellers is not readily available. This is the case when buying assets out of a formal bankruptcy proceeding where a buyer needs to protect against liabilities flowing from a breach discovered following a "363 sale" or similar process. For purchases outside of a formal process, sellers may be unwilling to stand behind their reps and warranties when most or all of the sale proceeds will go to the benefit of the sellers' creditors.	Helps maximize sale proceeds by removing the need for a buyer to escrow funds to secure an indemnity. Sellers can quickly realize the full sale price and deploy the cash where it is needed, with reduced post-closing risk to those proceeds.
Mitigates the credit risk of a seller indemnity. In a distressed M&A environment, a buyer may be worried about a seller's post-closing creditworthiness, diminishing the value of a typical seller indemnity where one can still be given. R&W insurance protects against this risk by providing the buyer with a secure, third-party source of recovery.	Increases sale values by attracting additional buyers who otherwise would be deterred by the lack of a seller indemnity, or by increasing the willingness of buyers to offer a higher price than they would if no protection were available.
Adds protection beyond the purchase agreement indemnity cap, and survival periods that can be negotiated from a distressed seller. With R&W insurance, buyers can choose the amount of protection they want and benefit from longer survival periods than are generally contained in underlying purchase agreements.	Helps to streamline the sale process by avoiding challenging negotiations on certain aspects of the purchase agreement, including the indemnity provisions and representations and warranties.

A significant number of well-established/specialist insurers with global capabilities underwrite R&W insurance. Despite the current macroeconomic challenges, the R&W insurance market remains competitive and well capitalized. Policies remain fully tailored for each deal and can still be obtained efficiently and on deal-driven timelines.

Tax Insurance

Tax insurance can protect a buyer against identified contingent tax risks presented by a target and/or support tax attributes that are an important value driver in a transaction. Unlike R&W insurance, which covers unknown issues, tax insurance is a bespoke solution that covers known tax issues, with each policy having a discrete "insured tax treatment," or known exposure, that a company wishes to insure. Tax insurance usage has grown tremendously over the past several years and is offered by a number of underwriters with a depth of capacity, even in this time of uncertainty.

When responding to financial distress, companies that are entertaining or exploring their options — including the divestiture of assets, restructuring, raising new debt, modifying existing debt, and seeking to access capital — can use tax insurance to provide certainty related to net operating losses, tax credits, interest expense deductions, and other debt-equity tax issues. Tax insurance is a cost-effective and flexible tool that can facilitate a transaction that might not otherwise occur given the severity of an adverse tax outcome or, at a minimum, may mitigate that latent tax exposure so it does not significantly reduce value for a distressed seller.

While documentation may vary from policy to policy, underwriters will typically request a tax opinion, memo, or buy-side tax due diligence report; tax exposure calculation, including interest, penalties, and a gross-up; draft transaction documents; and appraisals/valuation, to name a few critical items.

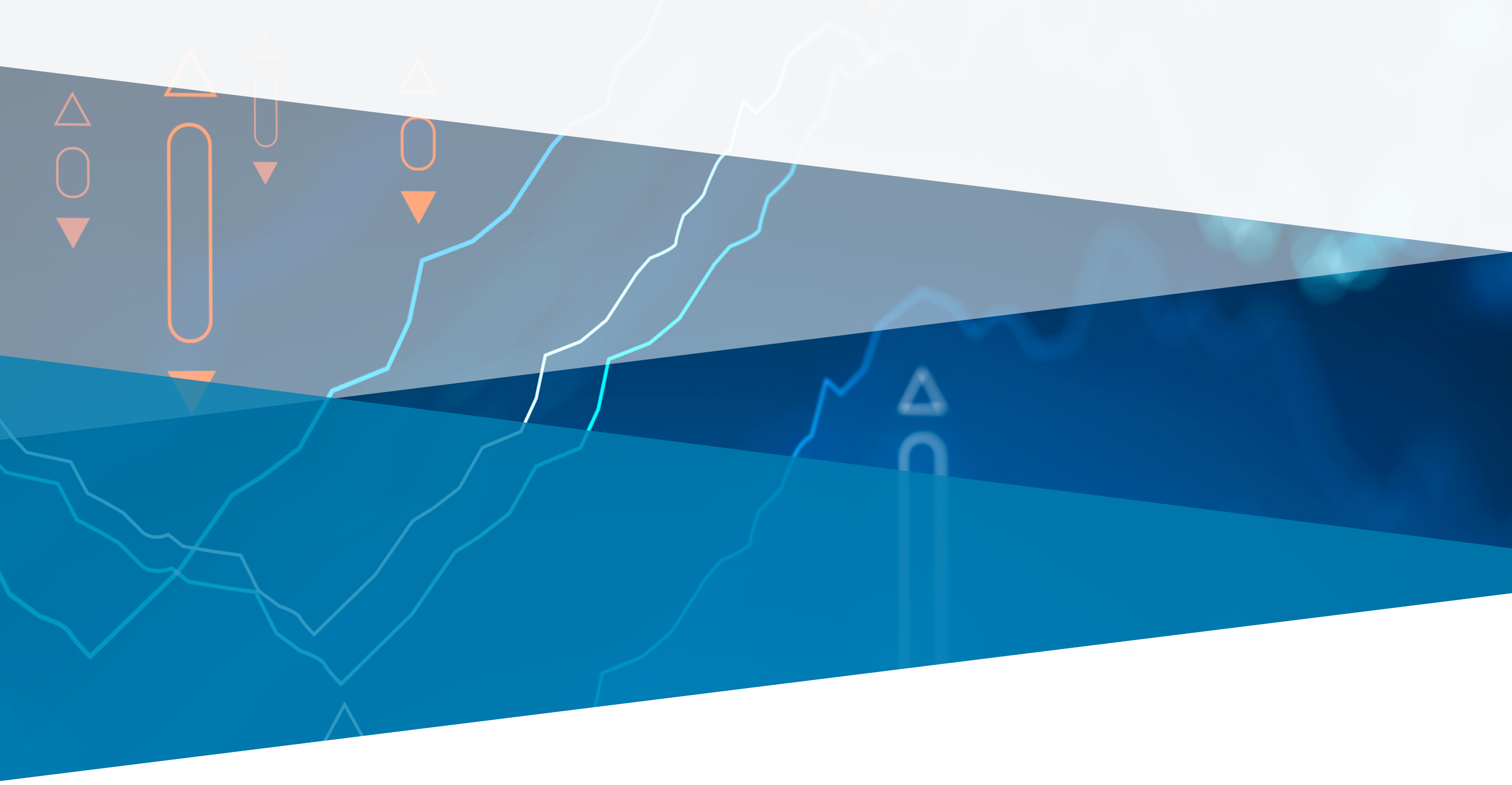
Contingent Liability Insurance

Contingent liability insurance can provide coverage for one-off, known exposures in an M&A transaction where a claim may arise immediately or sometime after the closing of a transaction, unlike R&W insurance, which does not cover known issues. In particular, for distressed M&A, areas of potential coverage may include fraudulent conveyance and successor liability risks where the likelihood of the relevant risk occurring is low, but the potential amount of the liability is so substantial relative to the size of the transaction that the parties cannot agree on the appropriate allocation of the risk.

In order to obtain contingent liability insurance, the risk must be quantifiable, a probability assessment must be possible, and no moral hazard can be present. Although this type of coverage can be more costly and time-consuming to obtain than other types of transactional risk insurance, brokers and insurers are usually able to provide feedback on potential coverage relatively quickly.

Why Marsh?

Marsh's North American Transactional Risk Practice placed nearly $20 billion in transactional risk insurance limits in 2019 for more than 500 deals. Our dedicated specialists have deep experience, with backgrounds in M&A, corporate law, taxation, and investment banking and accounting. They understand the critical risks parties can face during and after a transaction. We offer high-level access to leading transactional risk insurers and can deliver comprehensive and cost-effective solutions to meet your needs. Working with our international team, we can coordinate coverage globally to cover risks outside of North America. And our dedicated claims resources can navigate all aspects of the transactional risk claim process on your behalf.



For more information about transactional risk services and other solutions from Marsh, visit marsh.com, contact your Marsh representative, or contact:

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