MARSH

PRIVATE EQUITY AND M&A PRACTICE

The Strategic Advantages of Buy-side Transactional risk solutions

In recent years there has been an increase in the number of clients seeking to use transactional risk solutions such as warranty and indemnity (W&I) insurance strategically. In its traditional form W&I insurance is used to respond to the cap on liability agreed between the seller and buyer in the sale agreement in relation to breaches of commercial warranties or calls under a tax covenant. When used strategically, however, the use of the insurance actually drives the limitation on liability negotiations.

Buyers using W&I insurance strategically typically introduce the concept when they submit a letter of intent or when they are reviewing and providing a mark-up of the first draft sale agreement. At this stage the buyer will make it clear that they will not be seeking a more typical level of liability cap (of perhaps 25%–50% of the transaction value) but rather will accept a much lower cap (sometimes as low as 1% of the transaction value). They will then arrange a buyer-side W&I policy to provide additional recourse up to a level that they are commercially comfortable with.

The Key Drivers for using W&I Insurance in this way

It can enhance a bid

In a competitive auction scenario a bidder will often look at different ways to enhance its bid, including the use of W&I insurance as a mechanism to propose and then accept a low seller cap on liability. This may make a bid more attractive compared to one at the same or perhaps even a higher price, if the alternative bidder is asking the seller to retain a considerable contingent liability in the form of a high liability cap.

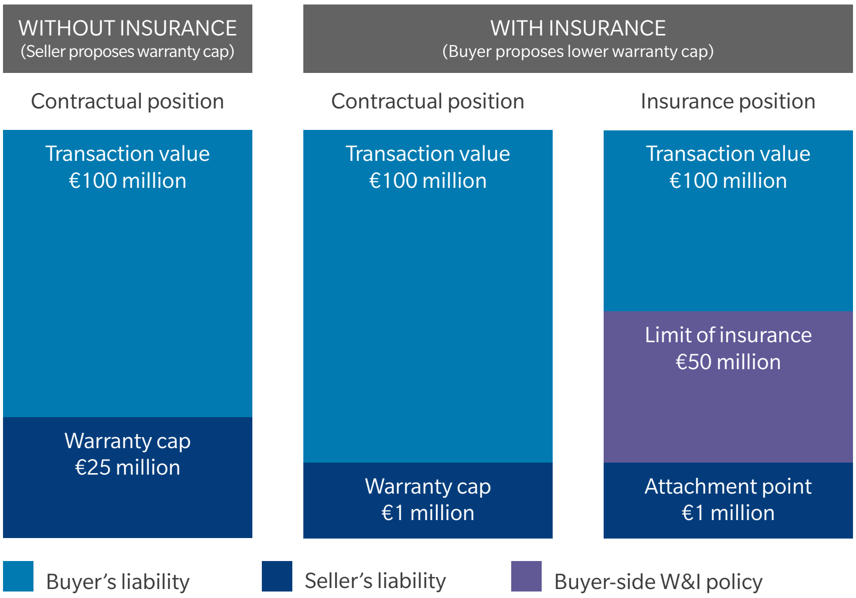
It can help maintain a strong relationship with management

Policies are typically structured such that there is no requirement for the buyer to pursue the warranting management before claiming under the insurance, even if the liability cap is set at a very low level. For example, a buyer-side policy might be arranged to respond above a liability cap of 1% of the transaction value. The buyer will not have to pursue the seller for this first 1% before it can claim under the policy and can instead choose to bear this amount itself.

Process

There is generally a heightened focus on W&I insurance when it is being deployed strategically, as it is providing the buyer with its main route of recourse in the event of a breach of warranty or a call under the tax covenant. The Marsh team is likely to become involved with the transaction at an early stage when our client (the buyer) is formulating its initial views on its bid. As part of our role, we will often provide briefing notes opining on the likely price and scope of insurance cover available to the buyer at this stage, before we have approached insurers for terms. As the transaction progresses and our client becomes the preferred bidder, we will then provide comprehensive coverage comments based on the policy wording of the chosen insurer.

The diagrams below show how W&I insurance deployed strategically drives the limitation of liability cap under the sale and purchase agreement (SPA):



Tax Liability Insurance

Identified issues such as tax matters often become a particular area of focus and negotiation in a transaction. Even if the likelihood of a tax charge crystallising is small, the potential quantum should this happen can be significant. This can cause a potential hurdle to bidders if they are still keen to go ahead with the transaction but are not prepared to take on the potential liability if the charge does crystallise. Asking the sellers for an indemnity on a specific issue during the transaction negotiations can often be unpopular and buyers may fear that doing so will make their bid uncompetitive. We have worked with a number of buyers over the last decade to put in place specific tax liability insurance policies to ringfence a particular identified tax issue and remove the need for them to seek an indemnity from the seller.

The Role of Marsh

Marsh is a global leader in insurance broking and risk management. The Private Equity and M&A Practice at Marsh has a specialist transactional risk team which comprises individuals from a variety of professional backgrounds including law and investment banking as well as insurance. The team is dedicated to arranging bespoke insurance solutions such as warranty and indemnity insurance and specific policies to ring-fence a particular contingent issue such as tax or litigation.

ABOUT MARSH

Marsh is a global leader in insurance broking and risk management. Marsh helps clients succeed by defining, designing, and delivering innovative industry-specific solutions that help them effectively manage risk. Marsh's approximately 30,000 colleagues work together to serve clients in more than 130 countries. Marsh GmbH has approximately 700 employees based in Baden-Baden, Berlin, Detmold, Dusseldorf, Frankfurt, Hamburg, Leipzig, Munich and Stuttgart.

Marsh is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), which is also the parent company of Guy Carpenter, Mercer and Oliver Wyman.

For further information go to www.marsh.de and www.mmc.com

Interested?

If you are interested in our services, we would be happy to provide you with further information in person. Just get in touch!

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