

# Warranty and Indemnity Insurance – the ‘Clean Exit’ Solution

## Taking the Long-Tail Risk out of a Transaction

In a challenging Mergers & Acquisitions (M&A) climate, there has been a steady increase in the number of M&A deals where sellers are unwilling or unable to provide more than very basic warranties and indemnities. Escrow arrangements are often set in place to protect against unforeseen financial risk. However, escrows can be costly and have become less favourable in the current economic climate. An ideal alternative may be found in insurance solutions, which can offer a more cost effective route in a wide range of transactions. In essence, insurance solutions can help when it comes to closing M&A deals.

JLT handles a multitude of risks and our experienced brokers understand fully the underlying exposures of the M&A market, as well as its drivers and economics. Consequently, insurance cover is a suitable substitute for a warranty and indemnity catalogue backed partly or in full, by an escrow arrangement.

We have built a reputation for enabling private equity firms, industrial companies and individuals to make potential deals become reality. Whether you are a seller or a buyer, our participation in the transaction process could result in improved financial performance and a more productive business environment.

## ‘Clean Exits’ and Entries

With the benefit of the Warranty and Indemnity insurance we can provide, it is possible to make a truly ‘clean exit’ when selling a company. The cover can protect the seller from possible escrow entrapment and also safeguards against potential calls on underlying guarantees. Similarly, the buyer will no longer have to deal with issues such as the creditworthiness of guarantees, or potential problems with special purpose entities that are to be liquidated after the deal closes. Potential concerns over short indemnity periods, low indemnity caps or shortfalls in guarantees, are also removed.



Fundamentally, the success of the insurance solution lies in understanding the risks involved and formulating a tailor-made policy for each M&A scenario. This means that we provide a much broader insurance strategy than simply insuring traditional warranties and indemnities. It also means that specific indemnities, extending well beyond single issues such as environmental liability, can be part of an M&A driven insurance solution.

## Low risk, large exposures

The M&A transaction poses a unique problem since the low probability of a claim is stacked against the high severity of potential exposures. Sellers are directly exposed to a range of escrow-release 'triggers' and buyers may face issues with shortened indemnity periods or an indemnity cap resulting from a bidding war. Since the spread of exposures for any buyer or seller is limited to the number of transactions they undertake, it becomes far more economical to let a designated risk handler manage the risk. An insurance solution results in diversity, a strong balance sheet and reinsurance possibilities – in other words, safety in numbers.

## Competitive premiums

On average the premium cost for a typical transaction will be in the region of 1-4% of the limit of indemnity, however each deal will be rated according to its own specific risk factor. The alternative cost for securing cash in an escrow over the indemnity period is likely to be very much higher, bearing in mind the risk transfer required should the deal result in a claim.

## Vibrant Market Available for M&A Insurance

There are currently 6-7 underwriters which together offer capacity in excess of £100M for primary coverage.

This competitive market ensures attractive alternatives and more diversified risk management options for the insured as well as better terms, conditions and advantageous premiums. Heightened competition also helps the market to take a commercial approach should a claim occur.

## Wide variety of products

You have access to a broad spectrum of covers encompassing both traditional W&I Insurance and plans, which tackle both specific M&A problems and a raft of indemnity related issues.

- **Buyer's policy – Financially driven**

The buyer's policy is driven more by the financials and deal tactics rather than by risk. The preferred cover is 'first party,' meaning the claim will be made directly against the insurer for losses resulting from a warranties and indemnities breach. This product is increasingly being used in the market as buyers discover that the insurance solution can play a significant role in differentiating them from other bidders, as well as offering them a higher level of protection.

- **Seller's policy - Risk mitigation**

The seller's policy is a 'sleep-easy,' traditional risk-transfer policy. It is mainly used in situations where the buyer has insisted on a very high indemnity cap or for a specific warranty and indemnity. A typical W&I Insurance solution will provide cover between the escrow deposit and the agreed indemnity cap in the Sale & Purchase Agreement (SPA).

## Critical Timeline

The M&A environment can be a challenging time for both buyer and seller. Here at JLT, we understand the need for timely solutions and action, guaranteeing that we shall work to the same turnaround time scales expected from any professional advisors. Our input will streamline the transaction process and ensure that you secure the right terms for your M&A deal.

Day 1

### Engage the broker immediately

Following the necessary confidentiality undertakings, JLT will assist you, as buyer or seller, to bring all relevant parties up to speed with the W&I Insurance process. We prefer to be involved at an early stage to set the scene in relation to the insurance market. This also provides critical insight into how to close a transaction supported by an insurance solution and how, in an increasing number of cases, W&I Insurance can make the difference between closure or collapse

Day 3-4

### First quotes from the market

Once seller and buyer have negotiated a draft SPA, we will access the insurance market. Our brokers will immediately analyse the programme's insurability, looking at each deal on its merits and approaching the most appropriate insurance markets for a solution. As a result the insurers will present a non-binding quote, drawing together all the data, including draft warranties and indemnities, indemnity periods and caps, and general information on the parties and their advisors. The quote can, thereafter, be rapidly converted to a binding offer following the due-diligence process. Once you have the initial quotes from the market, our brokers will work hand in hand with your transaction teams to discuss with you the options for proceeding further.

Day 5-10

### Providing a binding insurance quote

The insurer of your choice is then engaged to provide a binding quote. An engagement letter allows the potential insurer to perform the due diligence for the transaction to be insured, normally through independent legal advisers. Following this, an independent law firm may sometimes be engaged, assisted by the broker and underwriter, which will scrutinise the deal terms and process data to the satisfaction of the insurers' underwriting requirements. In short, a DD on the DD. In most cases, if the underlying transaction gets an indicative quote at day 4, there is high probability that the quote will be converted to a binding offer, following the due diligence phase.

Day 11 to signoff

### Final SPA and insurance terms

The insurance team will work closely with the acquisition teams to update the offer and ensure its validity throughout the negotiation process. The insurance solution needs to be in force immediately when the final SPA is signed. If covenants are drawn up between signing and closing, the insurance solution is again updated at the time of closure, ensuring seamless cover throughout the process.

## The Next Move

For a discussion of any aspect of Warranty and Indemnity and M&A related insurance solutions please feel free to contact us. One of our specialist brokers will be happy to arrange a meeting with you and/or your legal and financial advisers.

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