

# RECENT DEVELOPMENTS IN M&A INSURANCE

Nigel Brand

20<sup>th</sup> June 2018



**NEON**  
SAPPHIRE

# AGENDA



- Introduction – how M&A insurance works and what it covers
- Recent developments in M&A Insurance
  - ▶ Changes in how and why M&A Insurance is used
  - ▶ Changes in the M&A Insurance Market
  - ▶ Pricing and Coverage
  - ▶ Claims experience

# HOW IS M&A RISK MANAGED?



- Due Diligence
- Supported by the seller giving warranties and indemnities to the buyer under the SPA
  - ▶ Warranties: a statement about the condition of the target business at the time of purchase
    - Accounts, tax, share and asset ownership, litigation and compliance and other business warranties
    - Seller can disclose against warranties (buyer uses disclosed information to validate/adjust valuation)
    - Buyer is protected against unknown liabilities
  - ▶ Indemnity: a promise to reimburse the buyer against a particular type of liability, should it arise
    - Tax indemnity, known specific risks (e.g. ongoing litigation)

# M&A CONSIDERATIONS



BUYER	SELLER
Fully understand the assets and liabilities of the target company	Receive all purchase monies as soon as possible/be free to distribute
Recourse in the event of breach	No long tail/contingent liabilities
Easy access to compensation	Transfer risk to Buyer



# SECURITY FOR BREACH



## TRADITIONAL MEANS OF BUYER PROTECTION

- Escrow – part of the consideration paid into an escrow account held jointly by Seller and Buyer
- Set off – any warranty claims are set-off against deferred consideration payments
- Retention – part of the consideration retained till expiry of the warranty period.
- Bank Guarantee (e.g. from individual seller)

## SELLER PROTECTION

- Disclosure of known issues against the warranties
- Time limits for claims
- Monetary limitations – threshold, cap
- Retention – part of the consideration retained

# M&A INSURANCE



- Escrow – part of the consideration paid into an escrow account held jointly by Seller and Buyer
- Set off – any warranty claims are set off against deferred consideration payments
- Retention – part of the consideration retained till expiry of the warranty period.
- Bank Guarantee (e.g. from individual seller)

Solution



M&A Insurance

# HOW DOES IT WORK?



- Matches the seller's liability in relation to a breach of warranty or indemnity in the SPA
- Retention, de minimis
- Buyer policy: claim directly against the insurance policy
- Buyer is protected against seller fraud
- Emergency defence costs
- Access: Insurer is regulated and in your jurisdiction

# TRADITIONALLY M&A INSURANCE IS USED WHEN:



- Required by buyers because recovery from sellers will be difficult or impossible
  - ▶ When the sellers are individuals who are likely to disperse or spend the proceeds
  - ▶ When there are multiple sellers and claiming may prove costly and time consuming
  - ▶ Credit Enhancement: Where the financial covenant of the seller is inadequate (e.g. highly indebted)
  - ▶ When sellers are in unattractive jurisdictions and enforcement or recovery may prove difficult
  - ▶ When the seller is a fund which will distribute the proceeds immediately
  - ▶ If the seller is likely to wind-up and distribute proceeds of sale
  - ▶ Where financial recourse may be difficult because the sellers are trustees and there is uncertainty over recovery in the event of a claim
  - ▶ When the seller is in a position to insist on nil recourse or a limited cap on its liability



# TRADITIONALLY M&A INSURANCE IS USED WHEN:



- Required by sellers to protect its/their position:
  - ▶ The fund manager wishes to distribute fund proceeds to investors immediately
  - ▶ Individual sellers wish to reinvest proceeds/distribute to family members without risk
  - ▶ The seller requires (or is in a position to demand) nil or limited liability
  - ▶ Protecting an Administrator (and his/her successors, heirs and estates)
  - ▶ Management Teams are forced into giving warranty and indemnity protection to the Buyer when receiving little or none of the purchase price
- Specific risks are identified by a buyer during its due diligence process (such as potential tax liabilities) and:
  - ▶ Neither party wants to bear that (low probability but high exposure) risk
  - ▶ The buyer requires a security such as a guarantee, indemnity, hold-back, or price adjustment to deal with an identified risk

# M&A INSURANCE

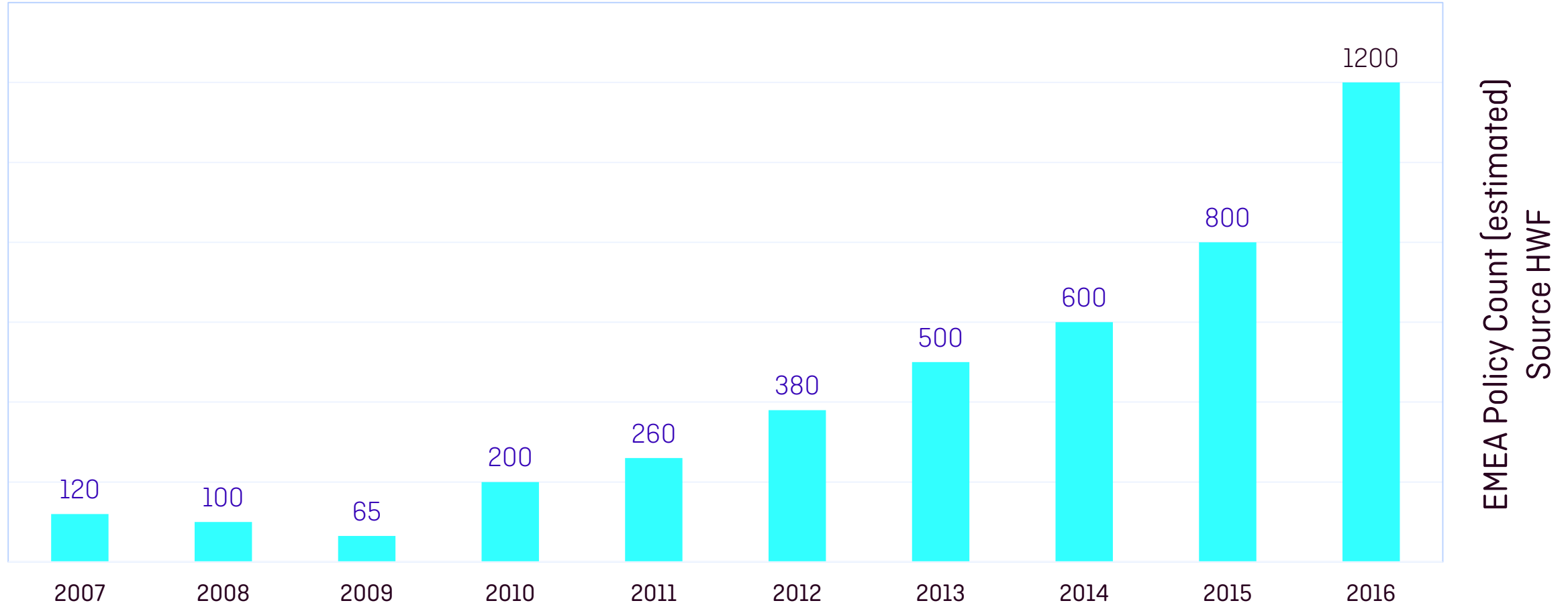


Now increasingly used when:

- The Buyer's Investment Committee requires M&A insurance as a matter of routine
- The Lending Bank routinely requires insurance as a condition to funding the deal
- The bidder in an auction wants to use the product to enhance its bid by using the insurance to protect itself without making additional demands of the seller (extending warranty periods, extending the limit of liability)
- The seller wants to achieve maximum price with minimum liability – seller arranges insurance for the buyer in exchange for capped liability – early input from insurers on warranties so present a fully insurable document
- Used strategically by the seller in a multi-bidder auction – structuring a transaction with a “pre-underwritten” insurance policy available to the winning bid in a very short time frame (particularly where need to deal with known issues)
- At the time of closure of a fund when the fund manager wishes to distribute fund proceeds to investors but faces potential liabilities from the prior disposal of the Fund's assets

# GROWTH OF THE M&A INSURANCE MARKET

SUBSTANTIAL GROWTH IN THE NUMBER OF M&A POLICIES ISSUED IN EMEA



# GROWTH IN CAPACITY



- Now **19** primary M&A insurance underwriters in the market
- Several new entrants, particularly MGAs
- M&A insurance brokers and underwriters have substantially increased their team sizes
- Growth in the number of tax specialists (brokers and underwriters) covering specific tax risks
- Market-wide insured limits of up to GBP £1bn for attractive transactions
- Broadening jurisdictional appetite

# IMPACT ON TERMS



- While the number of deals being insured has increased, the competition between underwriters is greater, which has substantially reduced pricing
  - ▶ average rate on line now 0.7% to 1.5% of limit
- Competitive pressure (and client demand) has led to excess/deductible being lowered. Traditionally excess/deductible was 1% of EV – now 0.5% or lower is frequently requested and nil excess common for real estate and renewables sector
- Some markets offering new/very generous coverage such as new breach cover in gap between signing and completion
- Some London/European markets offering US style coverage (without the premium) – no disclosure of data room or exclusion for “facts and circumstances”

# M&A INSURANCE CLAIMS FREQUENCY



- AIG M&A Claims Study 2017 shows increase in claims
  - ▶ 14% of policies they wrote 2011-2014 had claims;
  - ▶ 18% of policies they wrote 2011-2015 had claims.
- Material difference in claims frequencies between small, medium and large deals
  - ▶ Deal size  $\leq 100\text{m}$ : 17% of policies had claims;
  - ▶ Deal size  $>100\text{m}-250\text{m}$ : 18% of policies had claims;
  - ▶  $>250\text{m}-500\text{m}$ : 18% of policies had claims;
  - ▶  $>500\text{m}-1\text{bn}$ : 18% of policies had claims;
  - ▶  $>1\text{bn}$ : 23% of policies had claims.
- The majority of claims related to accounts (20%) and tax (15%)

# EXAMPLES OF M&A CLAIMS



- Motor Services: Accounts **£12.5m**
- Drinks manufacturer: Accounts and fraudulent misrepresentation **\$180m**
- Flooring manufacturer: Raw materials supply **€3m**
- Property deal: Defective roof **€4m**
- Paper manufacture: Taxes, equipment and pallets **£2m**
- Property: **£170k** VAT
- Contingent French tax policy **€70m**
- Employee working time class action **\$5m**



## GET IN TOUCH



Nigel Brand

+44 (0) 1481 737414

[nigel.brand@neonsapphire.gg](mailto:nigel.brand@neonsapphire.gg)

[www.neonsapphire.gg](http://www.neonsapphire.gg)



**NEON  
SAPPHIRE**

*Neon Sapphire Underwriting Limited is licensed by the Guernsey Financial Services Commission.*

The content of this presentation is for information purposes only and is not intended to and does not constitute an invitation or inducement to enter into, to offer to enter into or to exercise any rights to acquire, dispose of, underwrite or convert an insurance or reinsurance contract or any other type of investment contract with any member of the Neon group.

Member of the  
**NEON**  
group of companies