MERGERS AND ACQUISITIONS

Willis

WILLIS LIMITED IS A LEADING GLOBAL INSURANCE BROKER, DEVELOPING AND DELIVERING PROFESSIONAL INSURANCE, REINSURANCE, RISK MANAGEMENT, FINANCIAL AND HUMAN RESOURCE CONSULTING AND ACTUARIAL SERVICES TO CORPORATIONS, PUBLIC ENTITIES AND INSTITUTIONS AROUND THE WORLD.

WITH OVER 300 OFFICES IN MORE THAN 100 COUNTRIES, ITS GLOBAL TEAM OF APPROXIMATELY 16,000 ASSOCIATES SERVES CLIENTS IN SOME 180 COUNTRIES. OUR M&A PRACTICE COMPRISES OVER 80 DEDICATED PROFESSIONALS SUPPORTED BY THE WIDER WILLIS NETWORK. ADDITIONAL INFORMATION ON WILLIS CAN BE FOUND ON WWW.WILLIS.COM

MERGERS AND ACQUISTIONS

The Mergers & Acquisitions Practice is an experienced, dedicated team concentrating on assessing and insuring the risks and exposures arising from mergers, acquisitions and other corporate transactions. Combining the due diligence, transaction solutions and environmental functions within one practice increases efficiency and communication during a transaction.

There are permanent Practice members in London, USA, France, Germany, Sweden, The Netherlands, Spain, Portugal, Italy, India, Hong Kong, Japan and Australia.

M&A CONSULTANCY / DUE DILIGENCE

Specialist consultants are available to conduct a risk and insurance due diligence exercise on a target company to supplement a client's own investigations. By identifying potential areas of exposure, we can assist both vendors and purchasers to plan for future contingencies.

Key areas reviewed include:

- The financial impact of the cost of insurance risk
- Statutory compliance
- Identification and quantification of contingent liabilities
- Accrual evaluation
- Sale & purchase / successor liability issues
- Appropriateness of post closing programme

BESPOKE TRANSACTION SOLUTIONS

The Practice continues to develop the traditional Warranty & Indemnity cover as well as seeking new and innovative ways to mitigate risks arising out of corporate transactions. We provide tailor-made policies to incorporate any aspects of the following:

- Warranty & Indemnity (W&I)
- Successor Liability
- Loss Mitigation / Loss Capping
- Prospectus Liability
- Opinion-based Contingent Risk
- Corporate Tax Indemnity

PORTFOLIO PROGRAMMES

A specialist programme of insurances allowing a fund to leverage the collective buying power of their portfolio companies. Typical benefits can be:

- Reduced costs
- Coverage optimisation
- Consistency of service
- Increase in management information

ENVIRONMENTAL

Environmental problems can and do threaten the viability of transactions. If they slip through the net and the transaction proceeds without the environmental risks being correctly evaluated or addressed, they can significantly reduce the profitability of the acquisition. Potential covers may include:

- Uncertainty of remediation cost estimates
- Unknown environmental risks
- Liability buy-outs
- Contingency risks

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RISK & INSURANCE DUE DILIGENCE

Our consultancy team specialises in Risk and Insurance due diligence and provides a suite of services to private equity, corporate clients and lender groups.

The undertaking of a thorough due diligence review of a target's insurance and risk management programme is an integral aspect of the overall due diligence process; the drivers for such services are dependent on the audience.

The core appointment should include an analysis of the target's business operations and its existing insurance arrangements to establish how accurately the insurance coverage reflects the true risks of the target's business environment. It should also assess whether there are any risk exposures that are not appropriately insured or financed which may represent a real risk to the business, post-completion.

This work will be undertaken in accordance with the Purpose and Methodology outlined as follows:

AIM

The ultimate purpose of our review is to identify any potential insurance related deal-breakers including significant cost implications for the transaction. In turn, this should assist the purchaser to:

- Consider premium forecasting and accruals / reserves + capital expenditure = total cost of risk
- Identify any hidden or underinsured liabilities or exposures which should or could be addressed by insurance
- Minimise the parties' reliance on contractual warranties
- Provide reliance to the finance providers
- Provide future balance sheet protection through appropriate insurance arrangements
- Identify potential pre-emptive risk management measures that could ease future negotiations and preserve deal value.

METHODOLOGY

No two due diligence projects will be the same and each client's expectation requires a unique team profile. A typical due diligence project will include an analysis of, inter alia: general identification of:

- Activities and operations (including historical)
- Territorial exposures
- Natural catastrophe exposures
- Regulatory insurance requirements in applicable territories.

ASSETS

An analysis of how adequately and effectively the business critical assets of the company are protected through insurance and risk management procedures in terms of:

- Physical, human, financial or intellectual assets.

LIABILITIES

A review of the risks and responding insurance coverage, whether historical or current, arising from:

- Employer's Liability / Workers Compensation
- Public / Products Liability
- Professional Liability
- Outstanding Litigation
- Environmental Issues.

CONTINUITY OF THE BUSINESS

An assessment of the insurance protection and risk management measures in place in the event of a major business interruption including:

- Key revenue streams
- Key suppliers / subcontractors
- Location
- Major customer(s)
- Reputation.

LOSS PROFILING

A review of historical losses incurred by the business including:

- Major outstanding losses
- Trends within the loss experience
- Assessment of any potentially uninsured losses in the future as a result of insurer insolvency for historical periods of insurance.

RISK MANAGEMENT STRATEGY

An overview of the target's risk management philosophy, strategy and practice to include consideration of:

- Management structure and resources
- Health and Safety
- Business Continuity / Disaster Recovery Plans
- Corporate Governance
- Appetite for risk retention / transfer.

SUMMARY

Our experience means we recognise any benefits or short-falls in risk transfer programmes that may impact the ability of that programme to financially protect the company you are buying. Our resources enable us to efficiently review historic information, assimilate and interpret it to understand the financial and operational impacts of insurance issues.

For more information contact your local Willis associate, or call the London M&A Practice on: +44 (0) 20 3124 6000.

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ENVIRONMENTAL INSURANCE

Environmental insurance is a specialist form of insurance providing cover against losses that could be incurred as a result of third party and regulatory action arising from pollution or contamination. It is increasingly used as an effective mechanism to transfer environmental liabilities associated with corporate and property transactions as well as ongoing operations.

WHAT DO POLICIES COVER?

Environmental insurance policies cover statutory cleanup requirements, third party claims for bodily injury and property damage, and associated legal expenses, resulting from pollution or contamination events, whether such events are "sudden and accidental" or "gradual" in nature. Related costs such as business interruption losses (e.g. loss of profit, loss of rental income) can also be covered.

WHAT ARE THE MAIN POLICIES?

The principal environmental insurance coverages, which can be tailored to meet the specific risk, are:

- **Historical Pollution Cover:**
  Arranged for liabilities associated with pre-existing contamination (e.g. due to previous industrial operations) or for contingent liability exposures associated with previous divestments.
- **Operational Pollution Cover:**
  Cover for ongoing pollution risks, for example from unanticipated discharges, leakages or spillages.

- **Contractor's Pollution Cover:**
  Coverage for pollution liabilities associated with contractor's operations, whether from the new incidents or the mobilisation of existing contamination.
- **Remediation Cost Cap:**
  "Stop loss" programs designed to protect against cost overruns on contamination clean-up projects.
- **Combined Programmes and Liability Buy-outs**
  A blend of the principal coverages with a funded element to cover known remediation costs. Such programs can be structured to provide buyers and / or sellers with a long-term buy-out of environmental liabilities.

WHAT IS THE MAXIMUM PERIOD OF INSURANCE?

For a one-off premium payment, it is currently possible to obtain policy periods of up to ten years for historical contamination cover, and up to five years for "new" pollution cover. Combined programs and liability buyout programs offer the potential for longer policy periods.

DO OTHER POLICIES PROVIDE THIS COVER?

No. Traditional insurance products provide limited, if any, cover for pollution. At best, public liability policies may offer cover for third party claims (although not necessarily statutory clean-up costs) arising from "sudden and accidental" pollution events. Property insurance may provide limited clean-up cover, but only if losses occur as a result of an "insured peril". Such policies are clearly inappropriate for the majority of environmental risks, particularly those associated with historic contamination which is often the key concern during transactions.

Consultant's professional indemnity (PI) insurance solely provides cover for losses arising from the consultant's negligence, and is not therefore a substitute for environmental insurance. Environmental insurance can also be used to underpin or replace warranties and indemnities, or ring-fence liabilities incurred via such agreements.

HOW MUCH DOES IT COST?

Premium levels will depend on factors such as the limit of cover required, policy deductible (or **excess**), policy period and, of course, the nature of the risk. The environmental insurance market is currently very competitive, with premium levels starting at £1,000 for an annual policy. For longer term policies, premiums can vary from less than 1 percent to approximately 4 percent of the policy limit.

HOW LONG DOES IT TAKE TO OBTAIN COVER?

If necessary, environmental insurance can be procured within a matter of days. Even complex risks, requiring the review of substantial quantities of technical information, are routinely placed by Willis within transaction timescales.

WHAT INFORMATION IS NEEDED TO OBTAIN ENVIRONMENTAL INSURANCE?

Typical requirements include desk study information (e.g. environmental database reports, **Phase 1** reports, or even perhaps just property survey reports), where necessary supplemented by **Phase 2** intrusive investigations (e.g. at industrial sites with a long industrial history). Additional information, such as environmental management plans, and correspondence with environmental regulators may also be relevant.

WHAT HAPPENS IF ENVIRONMENTAL LEGISLATION CHANGES?

One of the key benefits of environmental insurance, particularly long term policies, is that they are designed to respond to changing legislation and enforcement practice, both of which are becoming increasingly stringent in many countries.

CAN ENVIRONMENTAL INSURANCE POLICIES PROVIDE COVER FOR THE EUROPEAN UNION ENVIRONMENTAL LIABILITY DIRECTIVE?

Yes. Cover is available for pollution liabilities faced under the Directive, which can be broade than those previously imposed under legislation in many countries.

DOES IT PROVIDE COVER FOR THE E.U.?

Yes. Even if a third party claim fails, the cost of defending such a claim can be substantial. This is covered as standard under environmental insurance policies.

WHAT HAPPENS IF THE INSURED PROPERTY OR COMPANY IS SOLD?

Environmental insurers are typically willing to assign policies or include additional insureds upon transfer of the relevant assets or business to a new owner.

WHY WILLIS?

There is simply no such thing as an **off the shelf** environmental insurance policy, as they require careful scrutiny, evaluation and negotiation with insurers to ensure that the policy terms and conditions meet the client's requirements. As a market leading broker in this specialist field, Willis is ideally placed to deliver innovative, robust and cost effective environmental insurance solutions, often working in conjunction with environmental consultants and legal advisers.

DO CLAIMS SUCCEED?

Yes. The environmental insurance market is relatively young; nonetheless we are seeing a maturing claims experience in many countries as a result of ever more stringent environmental legislation and increasing third party litigation.

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PRIVATE EQUITY PORTFOLIO SERVICES

The objective of the M&A Portfolio team is to initiate and coordinate the delivery of Willis' servicing, broking and risk management capabilities to portfolio companies of Private Equity Funds, on a single entity or group basis.

Our due diligence team will occasionally unearth coverage discrepancies, or simply that Newco's insurance programme has not been tested in the insurance market, competitively or otherwise. Often introduced to Newco's management post closing, the Willis portfolio team will work toward putting right outstanding discrepancies and/or introduce competitive tension to deliver premium savings.

The objective of a private equity fund's portfolio team is to prepare the investment for a profitable exit in years to come. Reducing operational costs is an obvious part of this process, of which insurance can be a significant component. Adopting a portfolio approach, i.e. creating economies of scale by leveraging the portfolio's collective buying power, on a virtual basis, can deliver the following:

- Increased premium reductions
- Enhanced policy terms and conditions
- Sustainable premiums and policy terms
- Consistency in:
  - broker service
  - policy coverage

The important factors to consider in exploring the feasibility of a portfolio approach are the portfolio companies' ability to maintain their autonomy and sustain the positive impact derived from the facility post exit.

The structure of a portfolio approach can be varied according to the make up of the portfolio, current and future. Considerations include, for example:

- Specific Sector versus All Portfolio
- Specific Class versus Cross Class
- Single Territory versus Multi Territory
- Wholesale versus Retail
- Sponsored broker appointment versus mandated broker appointment

One of the challenges to portfolio insurance initiatives is the disruption of relationships between the operating company management and their incumbent insurance broker. Depending upon various influencing factors, it is possible to structure a portfolio programme, which respects these often strong relationships, on a wholesale basis, where the incumbent broker is able to access a Willis-arranged facility.

The choice of insurer is commonly based upon pricing, security rating, flexibility and geographical reach. However, insurers often act as investors in LP's and therefore our aim is always to bring this to each party's attention and where appropriate form part of the consideration in choice of market. Also, where appropriate, we will actively seek to introduce potential investors to LP's during their fund raising activities.

Traditional portfolio initiatives are centred on positively impacting the bottom line, by reducing insurance costs. However, there are circumstances where insurance solutions can impact the top line and deliver revenue growth opportunities. For example, affinity insurance schemes (household, motor, personal accident, travel and term) are popular sources of additional revenue to the retail sector and those who deal extensively with the general public. Affinity schemes can also be attractive propositions for the provision of additional or more appropriate benefits to employees and/or contractors.

PORTFOLIO CASE STUDY

As a result of a recent portfolio tender process undertaken by a leading private equity fund, Willis has been appointed as the preferred insurance broker to the portfolio. The tender process was structured and involved the management of the sponsoring fund and each portfolio company, ensuring the buy-in from all parties at the outset. Willis' proposal comprised a winning combination of innovation, partnership with pre-identified insurers, and knowledge of the business and personnel involved. The coordinated approach through the Willis Client Advocacy Model engendered consistency in services levels. By taking a portfolio approach to the procurement of insurance, Willis delivered premium savings in excess of 25 percent.

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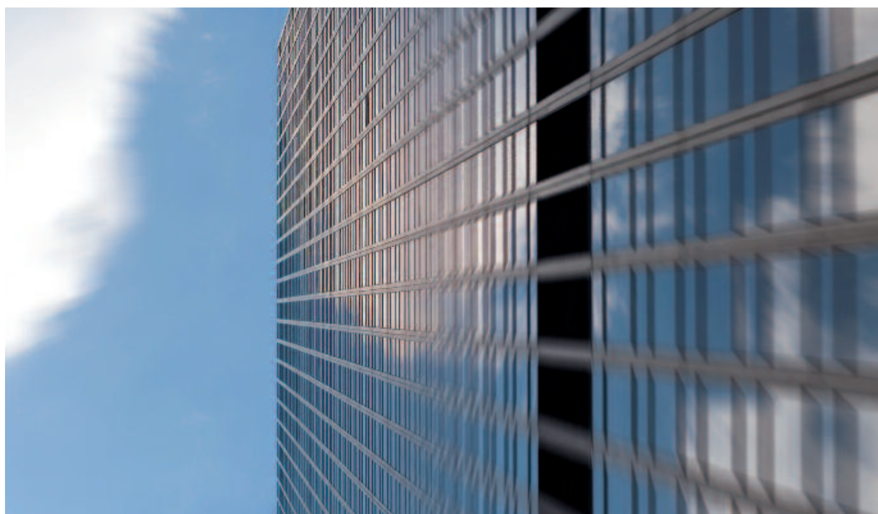
PRIVATE EQUITY MANAGEMENT & PROFESSIONAL LIABILITY

Willis has worked in partnership with selected underwriters to design an exclusive product which addresses the key management liabilities which arise from the operation of a private equity or venture capital fund, from the initial structuring of the fund to its last exit and subsequent final distribution.

The partnership approach has delivered a highly effective product designed to address the client's requirement on a platform that works for all parties. The combination of our knowledge, experience and pioneering mentality has resulted in a bespoke cutting-edge product for a unique industry.

Private Equity and Venture Capital (PE/VC) funds face a unique exposure in the area of management liability. These risks appeared to be minimised in an era of ever-increasing returns and outperforming funds. However, the changing economic landscape, combined with an increased focus on corporate governance, may serve to accelerate the rate of claims against funds (and the individuals therein) from a variety of sources, irrespective of the reputational nature of the industry.



The area of management liability within the structure of a fund is highly specialised. Standard Directors' & Officers' (D&O) policies have been shown to have gaps in coverage leaving individuals with unnecessary levels of exposure, especially when compared with the protection available in the market today.

Claims brought will still require a legal defence. The Private Equity Management & Professional Liability (PEL) policy will respond in respect of recovering legal expenses for both valid and invalid claims within the parameters of the policy. Willis believes that the sector is misunderstood by the insurance market and is therefore not fully represented during discussions with underwriters in delivering additional breadth of wordings.

POTENTIAL EXPOSURES

- claims by Limited Partners (LPs) alleging misleading offering documents or mismanagement of the fund
- poor due diligence
- Corporate Governance issues in both the PE/VC companies and their portfolio companies
- insolvency of a portfolio company
- alleged negligence by the PE/VC companies to the management team of a portfolio company
- employment-related issues in the management of portfolio companies
- minority shareholders of portfolio companies, especially at exit stage
- indemnification provisions in portfolio companies
- exits from investments, especially Professional.

Professional Indemnity (PI) exposure associated with advice on investment banking issues:

- internal crime/fraud
- administrative errors in distribution of proceeds including "in-kind" distribution.

BESPOKE COVERAGE

Willis has been successful in negotiating broad insurance cover which goes beyond standard policy coverage typically available in the market:

- blanket cover for all PE/VC representatives on portfolio company boards
- no restriction in terms of industry sector
- coverage for claims brought by the portfolio company where acting wholly independently of the PE/VC company
- no requirement for positive net worth of portfolio company
- no requirement for portfolio company to purchase D&O
- no "non-aggregation of limits" clause
- no "Financial Institutions" exclusion
- no recourse to Fund for indemnity
- automatic inclusion of new funds below a threshold of 150% of the value of last fund
- no exclusion for claims brought by insured person(s) or the company against other insured person/s.

"BLENDED POLICIES"

Willis predominantly recommends a "blended policy" to fulfil the needs of PE/VC funds.

Advantages of this approach:

- in a General Partnership structure the D&O and PI exposures are more difficult to separate. In the Willis policy insurers provide coverage across both these areas
- cost effectiveness through the purchasing of reduced overall capacity
- separate policies tend to produce a disproportionate premium allocation to the PI policy.

CLAIMS SCENARIO (I)

A Private Equity fund planned their exit strategy via the Initial Public Offering (IPO) route. At that time, the fund owned a large proportion of the issued share capital with a number of smaller investors owning the remaining shares. During the IPO, an action was brought against the fund by a minor shareholder. The minor shareholder claimed that the IPO structure was designed specifically to maximise value for the fund and left the smaller investors disadvantaged.

CLAIMS SCENARIO (II)

The Private Equity fund breached the investment parameters defined within the Private Placement Memorandum (PPM) after an investment within a certain geographical region. Subsequently, the target company underperformed significantly leaving the investors looking for recourse. When it was discovered that the fund were in breach of the PPM, LP's wasted no time in bringing an action against the private equity fund.

Other claims in this sector include:

- non-completion of deals
- Vendor disputes
- lack of additional funding
- claims surrounding management change
- refinancing creating conflicts of interest
- portfolio company purchaser claim
- creditor claims for insolvent exits.

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PROSPECTUS LIABILITY INSURANCE

When a company seeks to raise capital through the offer of securities to the public, or seeks an admission to trade securities, a prospectus or listing particulars will be issued, detailing in-depth financial information about the company and its future objectives and strategies.

If capital is being raised in the UK, the issuing directors must be satisfied they have complied with the requirements laid down by the Financial Services Markets Act (2000), the listing rules and the London Stock Exchange's admission and disclosure standards.

The capital raising may be through simultaneous offerings on one or more stock exchanges, in which case care must be taken to comply with the relevant laws and regulations of the territory in which each of the stock exchanges is domiciled. In all jurisdictions signatories to the prospectus have a personal responsibility for the accuracy of the contents.

Liabilities may be incurred if the prospectus contains errors or omissions which are relied upon by investors in making their decision to purchase the company's securities. These liabilities, which potentially represent the greatest risk exposure that the directors (and the company) may incur in the corporate life of the company, can be insured through the purchase of a Prospectus Liability policy [variously known as Initial Public Offering insurance (IPO) or Public Offering of Securities Insurance (POSI)].

Prospectus Liability Insurance is transaction-specific and addresses the following risks:

- shareholder actions alleging misstatements in the prospectus upon which investment decisions were made
- shareholder actions alleging failure to disclose material information in the prospectus
- legal expenses in respect of regulatory investigations
- shareholder derivative actions
- crisis management expenses
- long-term contractual liabilities arising from the offer or listing.
- claims for misrepresentation in the lead up to the offering (roadshow activity)
- breach of warranty in the placing agreement / underwriting agreement
- secondary offerings made on similar terms to an initial public offering

WHO IS COVERED BY PROSPECTUS LIABILITY INSURANCE?

The company, its directors (including non-executive directors) and officers and employees for a securities claim.

Additional interested parties to the prospectus may also be covered:

- the issuing underwriter
- selling shareholders
- controlling shareholders
- advisors to the transaction

USE OF PROSPECTUS LIABILITY INSURANCE

Cover has been available for some time in the insurance market, and has been substantially utilised by companies undertaking initial and secondary offerings of shares, rights issues, bond offerings or private placements. Cover will also be of interest to companies involved in other forms of transactions where a prospectus may be issued, such as a debt-for-equity swap.

Prospectus Liability Insurance is viewed as an attractive product by company directors and especially by the non-executives, who face increasing responsibilities in respect of corporate governance along with the risk of personal liabilities which can result from failure to ensure the accuracy of corporate statements and publications. Many are now unwilling to assume such long-term liability exposures without the benefit of insurance.

ADVANTAGES OF PROSPECTUS LIABILITY OVER DIRECTORS' & OFFICERS' LIABILITY INSURANCE

- A Prospectus Liability policy ensures that a ring-fenced limit of cover is in place for specific prospectus exposures (which can be higher than annual Directors' & Officers' Liability policy limits).
- Policy covers the strict liability exposures relating to the prospectus.
- The one-off premium can be attributed as a transaction cost of the listing.
- Cover is provided for claims arising from issue of the prospectus and the policy period covers the statute of liability for those claims (six years in the UK, three years in the US).
- Directors' & Officers' Liability cover does not provide cover for prospectus liabilities as standard.
- The purchaser does not face a renewal risk of insurance premiums shifting upwards or market capacity not being available in future years.
- The insured does not have to buy extended levels of Directors' & Officers' Liability cover in relation to prospectus risks.
- Any claims made against the Prospectus Liability policy will not erode aggregate cover limits purchased under the company's Directors' & Officers' Liability cover.
- The Prospectus Liability policy remains in place in the event the company is taken over or merges with another.
- The policy may help attract directors who are joining the board for the offering.

WHAT LIMITS ARE PURCHASED?

Limits purchased will vary depending on the risk appetite of individual companies, the circumstances and size of each individual offering and in which jurisdictions the offering takes place. There is enough insurance market capacity to provide substantial limits for policies covering the full period of the statute of limitations.

COST OF INSURANCE

The premium is usually calculated as a percentage of the overall limit of cover. Key factors which will affect pricing are whether the share listing is being undertaken on a main or specialist exchange and whether it is multijurisdictional, the number of interested parties being covered and the amount being raised.

There are a number of carriers offering bespoke policies in a competitive insurance marketplace which helps keep premiums at an attractive level for the buyer.

INFORMATION REQUIRED TO OBTAIN A QUOTATION

In order to underwrite prospectus exposures insurers will require the following:

- copy prospectus / listing particulars
- percentage of securities to be offered pursuant to US laws and regulations
- value of securities being offered
- copy of placing / underwriting agreement
- proposal form

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TAX INSURANCE

WHY WOULD TAX INSURANCE INTEREST US?

Tax and Tax Law in many jurisdictions is complex. Corporate entities and their advisers can spend enormous amounts of money obtaining tax advice, particularly during the due diligence processes involved in a transaction. Often, tax exposures arise following a transfer of shares or assets as a result of a corporate reorganisation, restructure, disposal or acquisition. However, due to the nature and breadth of the possible tax liabilities and governing laws, potential exposures can arise from other circumstances . What happens if, despite the best advice from qualified experts, the tax authorities challenge the planning? Such a challenge can be expensive and time consuming.

Tax Insurance has been developed in order to provide cover for the potential tax liability and the costs involved in the event it is necessary to defend a challenge by the tax authorities. In the context of a transaction, policies of this nature have unblocked deal deadlocks and enabled the successful completion, as illustrated in the case examples overleaf.

WHAT DOES IT OFFER PROTECTION AGAINST?

In most cases, the nature of the tax exposure has been identified by advisers either during their tax planning advice or in due diligence. Typically, the risk is contingent and based on the provisions of the prevailing tax law. Insurers are therefore able to offer an insurance policy to either the principal tax payer (typically a corporate entity or target), a seller by virtue of indemnities given under an acquisition agreement, or the buyer, where comfort from the seller is not available or any other party whom may have an insurable interest.

The key provisions of the policy contract indemnify the insured against:

- A claim for tax due from the relevant tax authority;
- Interest payments, fines and/or penalties; and
- Costs and expenses incurred in defending such claims.

For cover to be offered insurers will need to reach an understanding of the tax structure to the extent that they fully believe it will be successful following a rigorous challenge. As a consequence, schemes or transactions that are solely based on the tax benefit and have no other commercial purpose are unlikely to be considered. The insurance market has grown in sophistication over the last five years and has therefore gained significant experience and appreciation of tax issues that arise. Based on the above principle they and are keen to consider these risks and adapt their capabilities to provide a solution.

WHEN SHOULD YOU INVOLVE WILLIS? HOW LONG DOES IT TAKE TO ARRANGE A POLICY?

When insurers first started to offer this type of insurance, they were cautious and required detailed and reasonably robust opinions from qualified tax advisers regarding the likelihood of the tax risk being challenged. As underwriters have gained experience and understanding of tax treatments this position has changed and insurers are sometimes able to get comfortable without such opinions. They will however require full access to information and guidance from the clients and their advisers on the underlying tax treatment and the potential contingency risk. This is vital and will heavily influence the timescales required for insurers to offer a policy. We would suggest the following steps in order to place a policy:

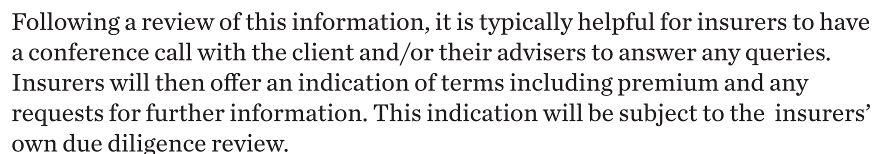
INITIAL CONSULTATION

The client will enter into discussions with Willis and explain the nature of the risk. Willis will then contact appropriate insurers whom have experience in underwriting tax risks. From these consultations, Willis will gauge the viability of insurers in offering insurance, subject to further details.

SUBMISSION AND INDICATION

If the initial consultations are positive, a submission to insurers will be required this includes:

- An overview of the tax issue and description of steps or transactions proposed;
- Copies of any advice (legal or accounting) provided by the clients' advisers regarding the exposure;
- Copies of any documentation which support the steps proposed / transaction e.g. minutes of meetings, sale or transfer agreements &/or any proposed indemnity to be given in relation to the tax liability



Following a review of this information, it is typically helpful for insurers to have a conference call with the client and/or their advisers to answer any queries. Insurers will then offer an indication of terms including premium and any requests for further information. This indication will be subject to the insurers' own due diligence review.

INSURERS UNDERWRITING DILIGENCE

Insurers will appoint their own advisers to conduct an underwriting diligence review in order to assess the risk. If the tax exposure is simple and straightforward and they have experience of underwriting the risk before, this step may be limited. More complex transactions and exposures may need detailed underwriting diligence to enable the insurers to fully assess the risk. Following such due diligence, a bindable offer of insurance / quotation may be made along with a policy wording.

POLICY NEGOTIATION

As each tax risk is individual in nature, the policy wording for each project is specifically adapted, often resulting in some negotiation of its terms, in order to provide the required cover. This will also include a review of the representations the client will be required to give regarding information pertinent to the risk which needs to be provided to insurers, prior to binding cover. Willis' knowledge, expertise and experience in such negotiations is central during such discussion.

COMPLETION

Once the policy wording negotiations are settled, then the client can accept the offer from insurers. Cover will be incepted subject to insurers being in receipt of the premium.

HOW MUCH DOES IT COST?

It is extremely difficult to provide accurate guidance on premium levels without knowing the tax risk concerned. In our experience, if the risk is insurable the rate (which is applied to the aggregate policy limit) varies from a minimum of 1.5% upwards and is more typically between 3-7%. For a more accurate assessment of the current market position, please contact us.

CASE STUDIES

The benefits of tax insurance are more easily illustrated through case examples where such bespoke insurance has been critical to clients.

PROPERTY DEAL

A portfolio of commercial properties was being sold for £90 million. The properties had been owned through five 5 special purpose vehicles SPV's based in Guernsey for over four years. These SPV companies had purely owned the properties and had no employees and all management of the properties was conducted through a property management company. The properties were being sold through the sale and purchase of the shares in the SPV's. During due diligence the proposed buyer was advised of the contingent risk that the tax authorities may challenge the off-shore domicile of the SPV's resulting in exposure to corporation tax and capital gains arising if such a challenge was successful. The buyer was a large property trust fund and was unwilling to accept such exposure, although there was no evidence to suggest that the tax authorities could challenge the status of the SPV's. The ultimate sellers of the SPVs' were high net worth individuals and trust funds that would not provide an indemnity. Willis was engaged to advise and arrange tax contingent insurance for the risk on behalf of the buyer.

HIVE-OUT

A private equity firm appointed an adviser to consider the exit options in relation to its investee company. The findings suggested that better value could be obtained by splitting the company's operations in two and disposing of certain trademarks and separating business units from others. The operations of the business were re-organised with the result that the shareholders held shares in each of the two holding companies. It was identified that a potential exposure to capital gains for the value of the assets could arise if the necessary steps had not been followed and / or the tax authorities made a successful challenge to the provisions on which the steps to split the operations had taken place. The proposed buyer had appointed their own tax advisers to review the planning and recommended that the buyer seek an indemnity from the sellers for this issue. The private equity shareholders were unable to give an indemnity for the length of the required period. Tax Insurance was arranged for the benefit the targets from any challenge from the tax authorities regarding such steps, thus enabling the transaction to complete successfully and the private equity firm to realise its yield.

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Willis

WARRANTY INSURANCE FOR MERGERS AND ACQUISITIONS

(Representations and Warranty Insurance (R&W Insurance) / Warranty and Indemnity Insurance (W&I Insurance)

WHY WOULD WARRANTY INSURANCE ADD VALUE TO OUR DEAL / INTEREST US?

Warranty insurance provides protection for losses which would fall within the scope of warranties in a share / asset purchase agreement (an Agreement). Coverage can be arranged for a seller or buyer;-

Seller-side Policy: Designed to provide cover to a seller and responds to claims made by a buyer. The Policy including defence and investigation costs;

Buyer-side Policy: Structured to provide coverage for a buyer where they require an enhanced level of protection through insurance, typically because the recourse against the sellers may be limited.

WARRANTY INSURANCE CAN ADD VALUE

- Individual sellers / warrantors giving warranties under the Agreement
- Corporate warrantors who seek a clean exit from the sale of a subsidiary
- Private Equity / Institutional Investors seeking to maximise the yield from the sale of their investment without exposure to their funds
- Buyers looking to secure direct access to insurance proceeds when the sellers want to (i) 'walk away' from the transaction (with limited warranty exposure) &/or (ii) where there are a diverse range of sellers and recovery would be difficult and expensive;
- Buyers seeking to enhance their security for a breach of warranty claim where the long-term financial strength of the seller is questionable
- Investors, Banks or Financiers looking to protect their investment where recourse against the warrantors would be limited e.g. in a management buy out
- Buyers looking to gain a strategic advantage in an auction situation by offering the sellers' a bid with low warranties and taking buyers warranty insurance to top-up their protection
- Sellers preparing a target for auction and proposing very limited warranty protection and proposing buyers insurance to increase the buyers warranty cover

WHAT DOES INSURANCE OFFER PROTECTION AGAINST?

WARRANTIES / REPRESENTATIONS:

A standard insurance policy covers the Insured for loss which would fall within the scope of the (representations and) warranties in the Agreement. It is intended to provide protection for matters which the Insured was not aware of at the time of signing the Agreement / entering into the policy. Despite thorough due diligence there may remain unknown risks which could seriously damage the value of the business. Warranty insurance provides financial protection from such risks. In certain jurisdictions such representations and warranties are given on an indemnity basis either in entirety or for areas such as tax.

LEGAL COSTS:

Coverage is usually provided for costs of investigating a loss and defending a claim. For sellers, these costs are incurred in defending the buyer's warranty claim. For buyers, these are incurred in defending a third party claim such as a tax authority. This is an important aspect of insurance protection as costs in this area can build up quickly and significantly.

POLICY PERIOD:

The policy period normally mirrors the period provided in the Agreement. Insurers can offer buyers an extended period of coverage beyond those negotiated in the Agreement, for example in situations where sellers may have restricted their period of risk to less than what is normally negotiated.

RETENTION / EXCESS / DEDUCTIBLE:

Most insurers require a policy retention / excess, whereby the policy coverage will not respond for the first amount of risk. The level of retention / excess is dependent on the deal size and claim limitations negotiated in the Agreement eg. baskets, thresholds or small claims and de minimis.

IS COVER FOR SPECIFIC INDEMNITIES OR MATTERS IDENTIFIED IN DUE DILIGENCE?

During due diligence, matters will be identified which will be managed through disclosure and would not therefore be covered by a standard warranty insurance policy. However, contingent risks are often identified which the buyer is not willing to accept and seeks specific protection through indemnities &/or escrows. If such risks are contingent, identifiable and assessable in quantum and likelihood, insurance cover may be available either within the warranty insurance policy or more typically separately as a bespoke product dependent on the nature of the risk.

As the insurance market has matured and insurers gained experience, they have become more sophisticated and there are now variations in the capabilities and products offered globally by insurers. Our global M&A Practice utilises years of experience, expertise and knowledge of the M&A market to guide you on policy coverage and the creation of bespoke solutions.

WHEN SHOULD WE INVOLVE THE WILLIS M&A PRACTICE?

We would be happy to assist and provide guidance at any stage in the M&A process.

CONCEPTUAL / FEASIBILITY STAGE:

During the early stages of the transaction, the scope of our engagement consists of providing estimates and broad feasibility assessments. These are based on our knowledge of the market and the current market trends. This can significantly assist the clients in early stage discussions and negotiations and the clients are able to realise the maximum benefit of the structure and scope of insurance available.

DOCUMENTATION STAGE:

As the transaction progresses and as and when the documentation becomes available we would guide you on approaching applicable insurers. It is a key part of our engagement that the presentation of the risk to insurers is conducted with a thorough knowledge of the transaction in order to obtain the best deal for our clients. If we felt that documentation was at an early stage, and it might prejudice clients position, we would guide the clients on how best to manage this.

HOW LONG DOES IT TAKE TO ARRANGE COVER?

Once insurers have been instructed, the insurer will conduct its' own diligence exercise. This is not intended to be intrusive and is not dissimilar to the type of diligence a bank would undertake as part of its credit application. As a result, timescales need to accommodate this process and we can guide the client on the minimum time requirements. We would continuously update the clients and their advisers of progress in order to achieve a successful completion within the timescales.

We work together with clients, their deal team and insurers to deliver the required products within the tight time schedules required and across international time zones.

HOW OFTEN ARE THERE CLAIMS UNDER THESE POLICIES? DOES THE INSURANCE PAY-OUT?

Warranty Insurance has been underwritten in the insurance market for over 25 years but it is really in the last 5-10 years that it has become an established product utilised globally. Therefore, claims data is relatively new particularly in certain territories and often shrouded in secrecy due to the sensitivities of such claims. However, members of the Willis M&A team have actively been involved in handling claims where payments from insurance policies have exceeded seven figures.

In our experience, most claims that have been made under insurance policies have stemmed from third party claims or actions which neither party anticipated. The knowledge and experience of members of our team in handling claims under Warranty Insurance policies is utilised to guide the client through the process with the aim of achieving a satisfactory resolution and payment.

For further information, please contact your local Willis associate or the London M&A Practice on +44(0)20 3124 6000.

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