

International mergers and acquisitions will continue to grow.

By no coincidence, so will the risk.

Mergers & Acquisitions Insurance



IRONSHORE **INTERNATIONAL**

Depth in Leadership. Trusted Partnership. Your Safe Harbour.™



LLOYD'S

Underwriters

For the last 15 years, Lloyd's of London has been a lead market and innovator in the area of Mergers & Acquisitions (M&A) Insurance. Lloyd's has been trading since the 17th century and has an enviable reputation for underwriting expertise, innovation, claims handling and excellent financial ratings.

Pembroke Syndicate 4000 at Lloyd's is an established lead underwriter in this field. Pembroke Syndicate's M&A underwriting is managed by Robert Brown, who has 10+ years' experience as a lead underwriter in M&A insurance. Our experience covers hundreds of M&A transactions in a variety of jurisdictions.

Pembroke

MANAGING AGENCY



Mergers & Acquisitions Insurance

M&A Insurance can be a valuable tool to facilitate M&A transactions. This specialist area of insurance includes products and solutions such as Warranty & Indemnity Insurance (for buyers or sellers), Tax Opinion Insurance, Prospectus Liability Insurance and one-off, unique policies created for individual risks.

The most frequently used product is Warranty & Indemnity (W&I) Insurance utilised for private transactions. W&I Insurance policies are structured to address specific conditions of Sale & Purchase Agreements, including post-sale contingent liabilities, which often last for seven years. Policies are non-cancellable to ensure coverage remains in place for the duration of potential liabilities. Policies are customized to insure against damages identified in Sale & Purchase Agreements, with the following types of coverage being the most common:

- Policies offering liability protection (defence costs and settlement) to sellers. We protect each innocent warrantor even if other warrantors are found to be dishonest.
- Policies offering first-party protection to buyers for losses resulting from a breach of warranty (or call on an indemnity or covenant) given in the Sale & Purchase Agreement and Tax Deed. Policies can sit on top of the warrantors' cap ("top-up cover"), alongside the warrantors' cap, or straddle the cap. We protect the buyer even if the seller has been fraudulent.
- Both buyer and seller policies can match the liability time limits in the transaction documents (e.g. up to 7 years for tax liabilities).

Warranty & Indemnity Insurance: Can you afford to ignore it?

The prevalence of Private Equity has helped fuel large numbers of acquisitions and disposals over recent years, and this activity appears set to continue as we emerge from the recent financial crisis. As a result, many clients are being acquired. **Would you automatically suggest Warranty & Indemnity Insurance to your clients buying or selling a business? Perhaps you should....**

During this tough economic climate, parties in transactions have become much more risk averse. Buyers often insist on greater warranty caps and placement of consideration in escrow. Buyers are also concerned about the financial covenants of some sellers. Many sellers wish to utilise sale proceeds to repay loans but find it difficult when they have significant warranty & indemnity obligations.

Virtually all private sales of businesses require the sellers to provide warranties and indemnities to purchasers. Often these warranties and indemnities are a seven-year obligation. But what if you wanted to spend the proceeds of your sale, but risked a claim from the purchaser during the next seven years? What if you were to sell-up, retire and were later faced with litigation from an aggressive purchaser of your business?

Insurance can provide a comprehensive solution. For a one-off premium, clients can purchase Warranty & Indemnity Insurance policies with significant benefits, including a policy period of up to seven years, defence costs cover and settlement protection and protection for all warrantors. If clients are faced with a warranty claim, defence costs and settlement protection could be exactly what your client needs. W&I Insurance can remove a large amount of risk and uncertainty from a transaction.

W&I Insurance can be used in many situations:

- to enable parties to release or utilise their sale proceeds
- to break a deal deadlock
- to equalize a mismatch in expectations between the parties on risk allocation
- to allow the parties to "get comfortable" with their negotiated position
- to satisfy lenders

On the buyer side of the transaction, there may be different concerns. What if the warrantors default on payments? Could the purchaser make a successful recovery? What if the warrantors only give a low value of warranties compared to the amount which the purchaser paid for the business? (This is common where a private equity investor is selling and refuses to give warranties.) Or what if the seller is undergoing financial restructuring?

W&I is frequently suggested to their clients by M&A lawyers. We have broad warranty and indemnity experience, having provided coverage to hundreds of clients over the years in a variety of businesses.



Example 1 Ironshore International provides W&I to facilitate a M&A transaction:

Sector: Food manufacturing

M&A Transaction Value: Approximately £60M

M&A Transaction Needs: This M&A transaction involved the sale, by a family trust, of its last remaining trading company. The family wanted certainty as to the cash proceeds from the sale of the company. The family also wanted to wind up the remaining holding company, which acted as the seller in this transaction. This manufacturing business operated in several countries and its structure included several joint venture companies. The overseas trade buyer insisted upon £5M of general and tax warranties and a tax indemnity from the seller.

M&A Insurance Solution: **Insuring the Seller**
We provided the seller with a bespoke Warranty and Indemnity Insurance Policy. This policy protected the seller for defence costs and settlements with a £5M policy limit. The policy was also structured to protect any future liquidator in the event that the holding company was wound up.

Key Benefits of Insurance:

- The seller (the family trust) was immediately able to realise all of the sale proceeds, without having to keep funds aside to meet any future claims.
- The buyer received the warranties and indemnities it required from the seller.
- A carefully structured insurance policy protected the liquidator in the event that the seller was wound up.



Example 2 Ironshore International providing W&I to facilitate a M&A transaction:

Sector:

Real Estate Investment Fund

M&A Transaction Value:

£19M

M&A Transaction Needs:

An investment manager wished to sell a U.K. commercial property investment held through a Jersey-registered company to an international financial institution and distribute the sale proceeds to investors.

The buyer required the sellers to give warranties capped at 25% of the total consideration. They also required a significant amount of the consideration to be retained in escrow for a period of two years from completion of the sale. The buyer was concerned that although it may receive warranties, recovery under those warranties could be limited if the seller had little or no assets at the time of the claim. Such a situation could arise if bank debts were paid off and the remaining proceeds of the sale were distributed to shareholders.

Since this escrow would be a substantial portion of the seller's equity and would prevent a full distribution to investors for a period of two years, the sellers reorganised the capital structure of the business so that individual investors did not have to act as the sellers and warrantors. A holding company was inserted to sell the operating company and to give warranties to the buyer.

Purchasing the target company made economic sense, but the buyer needed to be confident that it would not inherit any tax or other liabilities from the reorganisation or the previous operation of the target company. If the buyer purchased the property from the target company it would have had to pay 4% Stamp Duty Land Tax (SDLT) on the purchase price. Purchasing shares in the Jersey-based target company meant that SDLT was not payable.

M&A Insurance Solution:

The seller's lawyer suggested Warranty & Indemnity Insurance (W&I) to the buyer and the parties approached Pembroke Syndicate at Lloyd's. Within days, Pembroke provided the buyer with a W&I policy. By using W&I, the seller managed to sell the property and immediately distribute the proceeds to its investors and lenders. W&I facilitated the transaction and also avoided tying valuable funds up in an escrow. W&I gave the buyer the comfort to purchase the target company rather than just the property, thus saving the buyer the cost of SDLT and providing the buyer with a tax-efficient vehicle to hold the property.

Key Benefits of Insurance:

- The Pembroke Buyer's W&I policy attached at a low level and avoided the need for an escrow. The benefit being that the full proceeds from the sale could be distributed to investors and lenders immediately after completion.
- The Buyer obtained peace of mind protection from the "reorganisation" which occurred prior to the sale.
- The Buyer was insured for all the warranties (general and tax) contained in the Share Purchase Agreement, plus the tax covenant in the Tax Deed. This gave the Buyer the protection they needed to purchase an off-shore company.
- By purchasing shares of the Jersey company (rather than purchasing the property from the Jersey company) the buyer did not have to pay SDLT, which at a rate of 4% of the property value, would have been payable on a direct property purchase. Pembroke's W&I policy cost a very small percentage of the SDLT saving and facilitated the share purchase.

Do not confuse D&O policies with W&I policies:

Some clients assume that their D&O policy covers them for the contractual (i.e.; warranties and indemnities given in a Sale & Purchase Agreement) risks of selling their business. Usually shareholders sell shares as shareholders, not as directors. A D&O policy generally will not apply in this case because the sale is not done in an insured capacity. A W&I policy is specific to the risks of selling your business and the policy is designed to protect you for the whole period of your obligations (typically 7 years).

Contact us:

If you would like to learn more about Pembroke and our M&A Solutions, please contact your Lloyd's broker or:

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