

Transactional Risk Insurance for distressed M&A and special situations



Insurance | Risk Management | Consulting

As the Covid-19 crisis evolves, the Transactional Risk Insurance market continues to innovate. With distressed transactions becoming a major theme in 2020, buyers and sellers are relying even more on Warranty & Indemnity (W&I) Insurance, Tax Insurance and Contingent Risk Insurance (CRI) to get deals done.

Though distressed deals have been relatively common over the past few years, when there is a 'falling market' they become even more prevalent. Given the current economic downturn, insolvency, restructuring and distressed acquisitions will form a key part of M&A activity.

Despite offering some appealing opportunities, distressed deals do come with their own complications and uncertainties. As a result, distressed M&A funds, banks, insolvency and restructuring specialists are turning to Transactional Risk Insurance as the best way to create value and unblock deals in distressed situations.

Warranty and Indemnity Insurance

Warranty and Indemnity (W&I) Insurance has long provided a useful and valuable tool for transactions, particularly where there is low seller covenant strength, or none at all.

If a distressed seller is able to provide warranties, traditional W&I Insurance may be available; the buyer can rely on the W&I policy, allowing the seller to limit their liability and make a clean exit. In this scenario, insurers will expect to see a thorough disclosure and due diligence process.

On the other hand, a distressed seller (such as an administrator) may be disinclined or unable to give warranties. W&I Insurance would normally be unavailable as the policies are traditionally designed to sit 'back to back' with the warranties given by a seller. However, as a result of increased competition, insurers are starting to offer synthetic warranty insurance.

Synthetic warranties are artificially negotiated between the insured and the insurer and can be an attractive solution in distressed situations where seller warranties are not available. They provide the buyer much needed protection and allow transactions to move forward.

Whilst synthetic warranties are an appealing and feasible solution, the availability and scope of the insurance policy depends on a number of factors including the size of the deal, operations of the target (including jurisdictional spread), the availability of a comprehensive data room and the standard of due diligence provided.

It should be noted that synthetic W&I might not be available for distressed deals where there is an absence of information or counterparty disclosure. However, Tax and Contingent Risk Insurance (for known and unknown exposures) for key risks such as intellectual property (IP), litigation, material contracts and tax, may instead provide the necessary protection.

Tax Insurance

The Tax Insurance market has evolved rapidly over the last few years. Previously 'uninsurable' tax risks can now be covered, owing to increased underwriting experience and appetite. The tax market is even going beyond traditional M&A into the likes of corporate restructurings and fund wind-ups.

When it comes to distressed M&A, Tax Insurance can not only be used to release funds, protect a liquidator and provide alternative recourse but, it can also be utilised to remove tax liabilities from a target's balance sheet; freeing up capital and unlocking value. Beyond this, Tax Insurance has also helped find valuable solutions in several distressed and special situations:

- **Pre/post-sale/liquidation restructuring** – in the course of a restructuring process, various tax complications may arise such as debt release, capital gains tax, corporation tax and stamp duty land tax. Tax Insurance can be a useful tool to de-risk pre and post-sale corporate restructurings, help with debt tidy-ups and avoid the seller having to give an indemnity or escrow.
- **Judgment/settlement protection** – if a tax authority has reached a judgment or settlement but has not closed out the issue, it could prevent escrow distribution or winding up. A Tax Insurance policy can stand behind the judgment or settlement, allowing the release of funds and helping the deal move forward.

More so than ever, these complex tax risks which would normally be dealt with by way of escrow or price-chip are being transferred to an insurer, providing a valued and commercial solution in distressed situations.

Contingent Risk Insurance

Contingent Risk Insurance (CRI) offers cover for known legal risks that could have a negative impact on a company or asset's value. Through CRI, we can ring-fence these known legal exposures that may not have been insurable through traditional W&I and Tax Insurance or may have even completely derailed or prevented a transaction from moving forward.

CRI offers a major tool to de-risk distressed M&A and can be tailored to cover a variety of risks including:

- **Distressed acquisitions** – insurance for seller indemnities, title to assets, sale at an undervalue and known or unknown third party claims.
- **Voluntary winding up** (to reduce administrative costs and distribute proceeds) – insurance for third party claims.
- **Insolvency winding up** – insurance for the sale of assets, closing out the company's financial position and resolving claims made against the company, administrators, trustees and insolvency practitioners.

In a distressed transaction, the target is often sold on an 'as seen' basis only. Known legal risks become magnified and are frequent deal breakers. CRI offers the protection needed by a buyer whilst also allowing the seller to exit with limited liability.

As we start to see a downturn in traditional M&A, the availability and need for CRI is increasing. In an effort to explore these legal contingent style risks, insurers are expanding their appetite and underwriting authority, which means that the Transactional Risk Insurance market is fast becoming the home of these 'weird and wonderful' insurance risks.

About Gallagher

Gallagher's M&A team specialises in providing transactional insurance solutions in the most challenging times. We understand the problem areas which may arise during a transaction and can quickly work with transaction parties to identify and present a valuable solution. If you would like to learn more about Transactional Risk Insurance and distressed M&A, please do not hesitate to contact us for a confidential discussion.

Would you like to talk?

Hollie Markham

Transactional Risks Broker

T: +44 (0)20 7204 6239

M: +44 (0)7849 613 771

E: Hollie_Markham@ajg.com

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Registered Office: The Walbrook Building, 25 Walbrook, London EC4N 8AW.
Registered in England and Wales. Company Number: 1193013. FP512-2020 Exp. 01.05.2021.

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