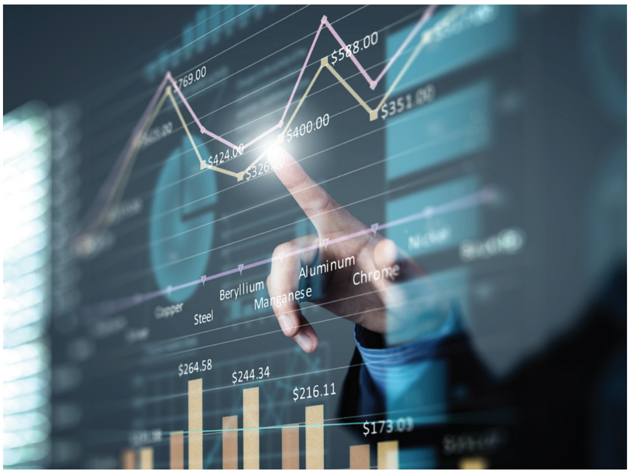
MARSH

INSIGHTS | MAY 2020

Warranty and Indemnity Insurance in Distressed Sales

Warranty and Indemnity (W&I) insurance is one of a suite of insurance solutions secured by Marsh's Private Equity and M&A Practice to assist our private equity and corporate clients to manage their transactional risks and can be particularly useful in transactions involving a financially-distressed seller.

Where dealing with a seller undergoing financial distress, the buyer may have concerns regarding its ability to obtain sufficient recourse against the distressed seller for a breach of a warranty or an indemnity claim under the acquisition agreement (Agreement).



Under such circumstances, W&I insurance can serve as an alternative avenue of recourse and thereby provide the buyer with greater comfort and security.

From a distressed seller's perspective, W&I insurance can facilitate the transaction and enable the seller to optimize value from the sale, as the buyer will have reassurance that it might not otherwise have with regard to the strength and reliability of its contractual protections under the Agreement.

Distressed Sales Scenarios

	SCENARIO	COMMENTS
1	**Seller is able to give warranties even though it is in financial distress**	**The insurer will undertake a normal underwriting process, with increased underwriting focus on certain areas and potential exclusions for matters relating to solvency / liquidity of the seller including clawbacks for voidable transactions.**
2	**Seller is unable to give warranties, but management of the target is able to do so by way of a warranty deed**	**The insurer will undertake a normal underwriting process with similar focus areas and exclusions as above, but warrantor fraud will be excluded in this case.**
3	**No party is able to give warranties**	**In an administrator / liquidator-led sale where there is no other alternative warrantor to the seller, W&I coverage on the basis of synthetic warranties may be available. Please see below for further comments on synthetic warranties.**

Considerations for Sellers

The seller will be expected to:

- Arrange a comprehensive and well-organized data room.
- Provide the insurer with access to the data room.
- Provide thorough disclosures against all warranties given under the Agreement.
- Be engaged with the buyer and its advisers throughout the buyer's due diligence process.

The seller should also be prepared to explain the following:

- The nature of the seller's financial distress.
- Whether there are any ongoing or threatened proceedings (either voluntary or involuntary) in relation thereto.
- How the seller's financial distress may impact the transaction, such as whether there is a possibility of the transaction being challenged by creditors after closing.

Considerations for Buyers

Although a distressed sale tends to proceed on an expedited timeline, the buyer will still be expected to retain appropriate third party professionals to conduct comprehensive due diligence in respect of the subject matter of all warranties which the buyer would require the W&I policy to cover.

In addition to due diligence, buyers should also take note of the points below:

Coverage:

There will be a general exclusion regarding any losses which relate to the potential insolvency or illiquidity of the seller including any clawbacks on the transaction itself.

Underwriting focus areas:

The key focus areas for insurers during underwriting would include the financial performance, liquidity and overall solvency of the target company as well as related party transactions.

Synthetic warranties:

A very limited number of insurers may be able to provide “synthetic” cover by providing and insuring a suite of synthetic warranties (i.e. warranties that are not actually given by the seller or other warrantor) in a buy-side W&I policy. Synthetic warranties can be negotiated with the insurer after being drawn up by the insured’s counsel or based on the insurer’s standard suite of warranties as a starting point.

Synthetic cover is currently offered by some insurers on a case-by-case basis in Asia, and only in situations where an administrator / liquidator is implementing the sale. This feature is still in the early stages of being developed in the W&I market globally but insurers are now seriously considering offering this feature in light of the current economic climate.

The availability of synthetic cover will depend on sector and jurisdiction. In terms of sector, insurers will generally apply their normal sector appetite that they would on a conventional insured deal, while in terms of jurisdiction, insurers will tend to have a preference for countries with a more mature W&I market (e.g. Singapore and Hong Kong). That said, there are insurers with a broader jurisdiction appetite for synthetic cover.

Pricing wise, insurers tend to charge relatively high premiums for synthetic warranties as compared to conventional policies.

For more information about managing risks in distressed sales and other solutions from Marsh, visit www.marsh.com, or contact a Marsh Private Equity and M&A Practice representative.

CHEOW AI LING
+65 6922 8019
ailing.cheow@marsh.com

LEE XIAN WEI
+65 6922 8110
xianwei.lee@marsh.com

ADRIAN CHAI
+65 6922 8038
adrian.chai@marsh.com

HAOREN FU
+65 6922 8270
haoren.fu@marsh.com

JENNIFER SADELI
+65 6922 8020
jennifer.sadeli@marsh.com

PH20-0728