RSG
EUROPE
TRANSACTIONAL RISKS

Warranty & Indemnity

Warranty & Indemnity (W&I) insurance is an insurance product that can be used in M&A transactions. A W&I policy is a non-renewable, single premium product which protects an insured against loss flowing from warranties being breached in underlying transaction documentation. Each policy is structured as a single aggregate limit with no reinstatements.

Reasons for W&I

RSG TRE facilitates hundreds of transactions per year with bespoke W&I insurance solutions. W&I insurance can be used in many different situations and in many different ways. Set out below are some key drivers for W&I insurance that RSG TRE frequently sees:

- A seller is often able but unwilling to give warranties beyond capacity and title. For example, a W&I policy will allow a private equity firm to exit a portfolio company without any contingent liabilities.
- W&I can be used to reduce or replace a large escrow provision allowing distribution of otherwise locked up proceeds to investors.
- A buyer can also strategically use W&I to differentiate itself from other bidders by requiring a lower warranty cap from the seller thereby offering the seller a ‘cleaner’ exit.
- W&I can be used to provide additional coverage to a buyer to satisfy lenders or internal approval committees/mandates.
- W&I can be used where there are concerns over the ability of a seller to effectively service any post-completion claims that may arise.
- W&I can be used as a risk management tool where a seller is exiting a non-core business division and the seller wants to protect its balance sheet from any residual liability relating to the disposal of the non-core business.
- A seller can use W&I to strategically drive higher bids for the target company as it can offer a customary set of warranties plus a higher warranty cap from the beginning.

Coverage

RSG TRE’s policy provides comprehensive coverage for losses arising from breaches of warranties, indemnities and tax covenants contained in the sale and purchase agreement (SPA) in the form of both buyer-side policies and seller-side policies.

A buyer-side policy sits in place of the buyer’s normal contractual recourse against the seller offering the buyer direct recourse against the W&I policy for a breach of warranty or an insured indemnity. In a buyer-side policy the buyer will claim indemnification directly against the W&I policy. A RSG TRE buyer-side policy ensures that warranties given under a SPA are of financial value to a Buyer allowing financial recourse if a seller is incapable of paying a buyer as a result of a breach of a warranty.

A seller-side W&I policy protects the seller from certain losses in the event that the buyer brings a claim against the seller under the transaction documentation for a breach of warranty or an insured indemnity. In a seller-side policy the buyer still brings a claim against the seller pursuant to the terms of the SPA and the seller then looks to the W&I policy for indemnification in respect of such claim.

Duration

W&I policies are claims–made policies and the policy period and coverage under policies usually extends to 2 years for coverage of general warranties and 7 years for fundamental warranties and tax warranties, although these periods can change.

RSG TRE policies can provide the purchaser of the insurance policy with an extension to the recourse period provided under the underlying transaction documentation, allowing buyers additional opportunity to claim for breaches of warranties.

Should you wish to reach the RSG TRE team, please email us at **info@rsgtre.com** or contact our office at the information found below:

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Retention

The policy retention will generally be set at below 0.5% or 1% of the overall transaction value and nil retentions can be offered for static asset deals. The final value of the retention depends on how comfortable the purchaser of the policy is with assuming that financial loss. The policy retention will often match the claims threshold set out in the SPA itself. It may be that the claims threshold in the SPA is a "tipping" threshold meaning that once the threshold is exceeded, the seller will be liable to the buyer from the ground up and not merely for amounts above the threshold.

Exclusions

Each W&I policy is bespoke and is tailored to fit around the specific transaction and risk being insured. That said, there are exclusions that are included within almost all policies, such as:

- Known matters
- Fraud of the insured
- Matters dealt with through purchase price adjustment mechanics ; and
- Pension underfunding liabilities
- Losses in connection with fines and penalties that cannot be insured at law

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