Special Situations M&A Insurance

Given the uncertainty generated by COVID-19, the global M&A market is experiencing turbulence the likes of which has arguably never been seen before.

As we will undoubtedly see an increase in disposals of distressed assets, restructurings, disposal of non-core assets and intragroup reorganisations, either to rationalise struggling arms or in advance of a disposal, there is an opportunity for M&A insurance to continue to assist with driving value and mitigating risk. The M&A and Tax insurance market remains well placed to provide solutions to wrap around a significant variation of deal dynamics, beyond the traditional disposal process. This note sets out further information on how M&A solutions may assist you and your clients in these unsettling times.

Acquiring assets from an insolvency practitioner and synthetic warranties

Insolvency practitioners are not able to provide contractual recourse to a buyer when disposing of distressed assets on the basis they will know very little about the underlying business compared to a typical seller who has owned and operated it for a number of years and they do not wish to incur any personal liability.

To bridge this gap in protection, insurers can offer buyers a 'synthetic warranty' policy which gives the buyer effective recourse to an insurance policy in the event there is a breach of warranty.

Rather than the seller providing warranties in the share or asset purchase agreement, the warranties are 'synthetically' inserted into a W&I policy.

Given the dynamics of the transaction, primarily the lack of any disclosure exercise, insurers will generally offer a more limited range of warranties than they might expect to receive from a seller.

Insurers will also expect to see detailed diligence carried out by the buyer. In addition to the synthetic warranties, it is also possible for the buyer to benefit from a synthetic tax indemnity. The policy would be subject to a sensible policy retention.

In the event the buyer's diligence uncovers an identified risk, be it related to tax, potential litigation, IP or other contingent risks, other M&A insurance policies can be used to ring fence these risks and shield the buyer from potential future costs.

Sale by distressed sellers

Where sellers are in a precarious financial position, buyers may consider that they provide limited covenant strength, even if a fulsome warranty package is provided.

The use of an insurance policy in these circumstances, whether a W&I or contingent policy, provide a buyer with the comfort that they have recourse against an insurer with a strong credit rating and/or Lloyds capacity.

Sale of an indebted asset

Where a seller is selling a heavily indebted target business, the transaction may be structured so that the majority of the consideration provided by the buyer is injected directly into the target to allow that debt to be repaid in an efficient manner.

A W&I policy can be structured so that the total amount paid by the buyer is covered by the policy, however the language needs to be tailored so that 'Loss' is not limited to the consideration paid for the shares which may be a fraction of the total paid.

Investing in a business

Given that many businesses will be struggling for cash flow, they may seek capital investment from new investors rather than just taking on additional debt. Again, if structured correctly, W&I policies provide the investor with recourse in the event of a breach of warranties given by the existing owners.

The key benefits of this are (i) the investors do not need to bring a claim against their co-investors which could potentially sour their working relationship and (ii) if there is a breach of warranty and the target business has failed, the investors do not need to pursue the warrantors for their personal assets.

Restructuring financing arrangements

There can be tax risks associated with restructuring financing arrangements, whether it be writing off debt or undertaking debt-for-equity swaps, that can potentially lead to a material tax charge.

Tax liability insurance can be utilised to ring fence these issues and can also cover off any associated interest, penalties and defence costs incurred in defending a challenge by a tax authority.

Intra-group reorganisations

Organisations may look to conduct intra-group reorganisations in order to streamline supply chains, ring fence struggling businesses, liquidate certain operations or in preparation of a disposal.

The more complex an organisation's structure and the more jurisdictions involved, the greater the chance a reorganisation creates risk. Whether it be a tax risk due to transferring assets out of a group, IP risks due to moving assets around a group or litigation risks as a result of winding up a subsidiary, contingent insurance policies are an efficient tool to ring fence these risks, providing financial certainty as to costs of the reorganisation.

Preparing for sale

Regardless of whether the sale is destressed or not, we work closely with sellers' and corporate finance houses that assist them in integrating M&A insurance at the beginning of the disposal process.

Whether it's inserting the terms available for a tax liability insurance policy into the data room so that bidders have comfort that there is a solution to a known tax risk, or inserting the terms available for a W&I policy in the data room which the bidders can price into their offers, initiating the M&A process early means that there is transparency between the parties and allows for an efficiently managed transaction timeline.

COVID-19 will continue to present a whole host of challenges to both M&A and global markets. We are ready to work closely with you and your advisers to find the right solution for your situation.

M&A Insurance Toolkit

Product	Description	Pricing Range*
W&I Insurance	Cover for financial loss incurred in relation to valid breaches of a warranty or representation pursuant to an acquisition agreement or a claim under a tax covenant or tax indemnity.	0.8% - 2.5%
Tax Liability Insurance	Cover for identified tax risks emanating from current, pending or historical transactions or reorganisations. Tax Liability Insurance can shift the responsibility for tax issues from the insured to the insurer, thereby minimising financial risks, uncertainty and associated exposures.	2% - 6%
Intellectual Property Insurance	Cover for financial losses suffered in connection with infringement lawsuits and IP invalidation proceedings, as well as to address indemnification claims related to a company's IP or its products or services under contracts with several parties (including licensees, licensors, customers and manufacturers).	1% - 5%+
Title Insurance	Cover for a number of real estate and asset related risks. These include challenges to legal title, boundary issues, incapacity of prior owners, restrictive covenants, chancel repair liability, rights to light and missing searches.	0.1% - 1%
Liquidation Insurance	Cover to help to unlock capital held in reserves for legacy and contingent liabilities where investment funds are reaching the end of their fund lifespan or where corporate groups are looking to be rationalised.	1% - 4%
Litigation Buy Out Insurance	Cover for a threatened, anticipated or current litigation, arbitration or dispute by ring-fencing the issue or providing cover in excess of the likely outcome.	3% - 10%+
Contingent Risk Insurance	Cover to offset the risks associated with identified contingent liabilities that are capable of legal and/or accounting analysis.	3% - 10%+

*Rate as a % of policy limit sought. Subject to minimum premiums. Fees and taxes in addition

About the BMS Private Equity, M&A and Tax Division

Every transaction is different and we pride ourselves on being able to structure bespoke M&A insurance solutions with the broadest coverage in a clear and concise manner.

We have access to insurance capacity across the world and have developed strong relationships with M&A and Tax insurance markets in London, Europe, North America and Asia.

Our team is a group of multi-disciplined professionals with backgrounds in M&A, Insurance, Law, Tax, Finance & Accounting, and Litigation. With our global reach and experience, we have extensive expertise of cross-border and domestic M&A transactions.

We partner with our clients and their advisers to help them navigate efficiently through the course of a transaction. This entails an in depth understanding of the transaction dynamic, our client's commercial goals and identifying potential obstacles as early as possible. This process allows us to provide innovative insurance solutions which facilitate transactions regardless of the complexity, size and sector, all within your transaction timetable.

30 years
combined M&A experience

250
transactions worked on in the last 5 years

40
jurisdictions where we have worked on deals

$6.7bn
largest transaction we have worked on

About BMS

BMS is an independent, specialist Lloyd's broker built around teams of experts in the fields of reinsurance, wholesale and direct insurance. We have been established since 1980.

We are the largest employee-owned insurance business in the London market. Headquartered in London, we have more than 400 employees and a global presence, with offices located across the US, Canada, Latin America, Australia and Europe.

In recent times, the company has diversified into other specialty Insurance lines, attracting market-leading talent, particularly in the areas of marine, property, cyber, construction, casualty, financial lines, energy and now M&A.

$2.4bn
Premium

400+
Staff worldwide

35
Product lines

18
Offices globally

Contacts

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