Mergers and Acquisitions

Warranty and Indemnity Insurance in Southeast Asia

Warranty & Indemnity ("W&I") Insurance is a tailored insurance product from AIG's Mergers & Acquisitions Insurance team to cover breaches in representations and warranties given in the sale of a business. Sellers can cover themselves to prevent sale proceeds being tied up in escrow accounts. Buyers can ensure the warranties have real value even if the seller is unable to pay a warranty claim which arises some time in the future.

Cover

The policy, whether seller-side or buyer-side, will indemnify the insured for loss resulting from a breach of warranty or tax deed/covenant in a Sale and Purchase Agreement (SPA).

A seller-side policy covers the seller for its own innocent misrepresentations; a buyer-side policy covers the buyer against the seller's misrepresentations (innocent or otherwise). The buyer claims directly against the insurance policy and does not have to seek recourse against the seller.

Policy Form

The policy will be tailored in each case to offer broad coverage that matches the representations and warranties in the SPA as closely as possible. Consequently there will be little difference between what could be claimed against the seller pursuant to the SPA and what the seller (or the buyer as the case may be) can claim against the W&I policy.

- Policy Period - The policy term will generally run from signing of the deal for the full survival periods of the warranties and indemnities in the SPA. The period for a buyer-side policy can extend the limitations prescribed in the SPA to meet the buyer's needs.
- Retention - The insurer and insured will agree on the "retention" or excess, which is the uninsured amount of the loss to be borne by the insured. This is generally set at 1% of the value of the transaction, but may be higher depending on the deal or to reduce premium costs.
- Exclusions - Although cover is tailored in each case to match the warranties specific to the transaction, some issues will be excluded on all policies. These will include matters set out in the disclosure letter or due diligence, pension under-funding and, on a seller-side policy, fraud by the seller.

Underwriting Considerations

AIG will consider offering insurance in respect of most mergers and acquisitions (M&A). The limit of liability under the policy will be agreed by the insurer and insured and will be driven by the transaction value. The premium will take into account such factors as the complexity of the transaction, the industry sector and geographical spread of the business as well as the quality of the transaction process and advisers involved. The timescale for obtaining W&I insurance will depend on the stage reached in the transaction, but will usually be available within two weeks from first enquiry.

Local presence and experience

AIG has a dedicated local underwriting and claims teams across the globe, including in Southeast Asia, Australia and London. This makes AIG uniquely based to underwrite transactions quickly and efficiently and removes logistical risks in placing the insurance.

Limit

USD5m to USD50m aggregate.

Premium

Typically 1.5% to 3.5% of the cover purchased.

Strategic Benefits

W&I Insurance enables buyers to:

- Supplement protection for breaches of warranties both in terms of value and certainty of payment
- Extend the duration of warranties, affording buyers additional time to detect and report problems that may exist with the acquired business
- Distinguish a bid in a competitive auction by negotiating more limited recourse from the sellers by supplementing the contractual recourse with insurance
- Protect relationships with sellers who may become the buyers' key employees or commercial business partners after the transaction

W&I Insurance enables sellers to:

- Reduce the risk of contingent liabilities arising from future claims, allowing sellers to exit a business cleanly
- Distribute all or most of the sale proceeds to investors or use proceeds to pay down existing debt: there is no need for an escrow account
- Protect passive sellers who have not controlled or been actively involved in the management of the target business from unintentional non-disclosure or breaches of the SPA
- Expedite a sale and potentially increase the purchase price by eliminating obstacles to closing, such as indemnity negotiations

Case Studies:

Singapore - A European parent was selling its ownership stake of a Singaporean company to an Asian investor. The target entity had subsidiaries and operations across Asia. The parent company took out a seller-side W&I policy that provided cover for breaches of specific warranties given and for certain seller indemnities relating to subsidiary companies of the target and governmental filing requirements.

Thailand - A private equity firm wanted to exit its investment in a company operating in Thailand with the sale of its shareholding in the target to an unrelated fund. The buyer required substantive warranties, which the private equity owner was unwilling to give.

To resolve the issue, the management of the target company gave the warranties the buyer required and the seller took out a W&I insurance policy. Coverage in this scenario gives the buyer comfort regarding the ability of the management team to meet any claim for a breach and enables the fund to distribute returns to investors.

Hong Kong - Shareholders sold their business operations across the Asia Pacific region to a private equity fund. As certain shareholders were remaining as management and staff following the change of ownership, the buyer did not want to be in a position where it would be claiming directly against those individuals in the event of a warranty breach and risk losing their goodwill. Accordingly, the insured procured a buyer-side W&I insurance programme.

Claims Example:

A strategic buyer alleged that certain warranties given by the seller of the target business had been breached. The alleged breaches related to the incorrect treatment of an invoice discounting facility in the target's financial statements. The effect of this treatment was to overstate the target's assets and resulted in the buyer paying more for the business than would otherwise have been the case. The buyer had purchased a buy-side W&I policy at completion of the deal which included coverage for breach of accounts warranties. The buyer brought a claim under one of the covered financial statements warranties and AIG paid damages equivalent to approximately USD21 million.

These scenarios show the potential applications and possible scope of W&I Insurance. Note that they are illustrative only and not to be relied on to justify coverage in any particular situation.

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