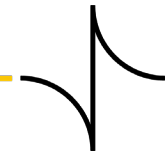


A low-angle, black and white photograph of several modern skyscrapers. The buildings are covered in glass windows and have a grid-like facade. One building in the center has a prominent cantilevered section that extends horizontally. The perspective makes the buildings appear to converge towards the top of the frame.

optio

Transactional Risk

Warranty & Indemnity (W&I) insurance



What is W&I

Warranty & indemnity (W&I) insurance is an insurance product designed to be used in M&A Transactions. Policies are claims-made and non-renewable, with a single premium being paid upon completion of the Transaction being insured (a Transaction). Each policy is structured as a single aggregate limit, and the retention and policy periods will match the warranty periods set out in the relevant Transaction documentation (i.e. SPA, tax deed, etc.).

W&I provides coverage for losses arising as a result of a breach of the warranty package and/or certain other indemnities set out in the Transaction acquisition agreement. Given the interaction with Transaction professionals (lawyers, brokers etc.) each Optio policy is bespoke and is tailored to each individual Transaction.

The Optio policy form is amended and negotiated on a Transaction-by-Transaction basis to ensure that the final policy is stylistically similar to, and reflects the negotiated position set out in, the underlying Transaction documentation.

Common Usage

W&I insurance can be used in many different situations and in many different ways.

Set out below are drivers for W&I insurance that Optio 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.



A W&I policy can be used to reduce or replace large escrow provision.



W&I insurance can be used as a risk management tool where a seller is exiting a non-core business division and wants to protect its balance sheet from any residual liability relating to the disposal of such business.



A buyer is entering new territories and product classes and W&I insurance can be used as a risk management tool.



In an auction process, a seller can use a W&I policy to strategically drive higher bids for the target on the basis it can offer a customary set of warranties and higher warranty cap from the outset.



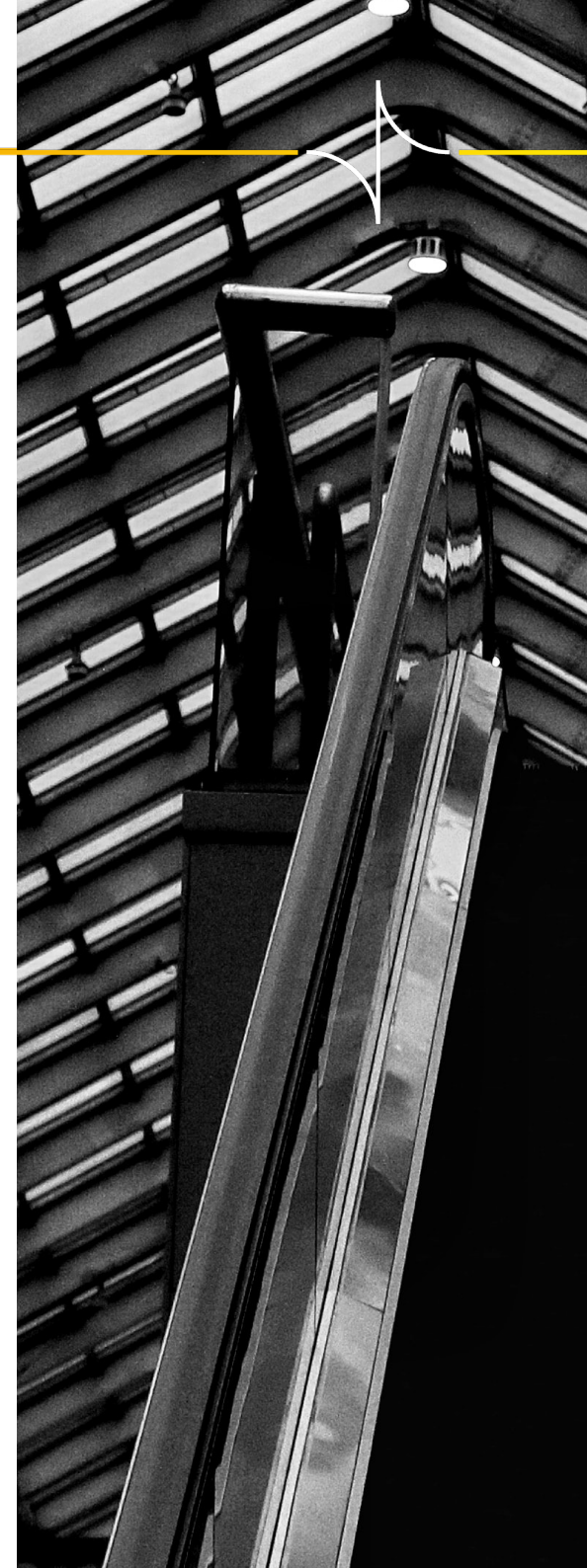
Similarly, a buyer can also strategically use W&I insurance to differentiate themselves from other bidders by accepting a lower warranty cap from the seller and thereby offering the seller a 'cleaner' exit.



W&I insurance can be used to provide additional coverage to a buyer to satisfy lending banks or internal approval committees / mandates.



W&I insurance can be used where there are concerns over the ability of a seller to effectively service any post-completion claims that may arise.





Key Elements of any Merger, Acquisition or Corporate Transaction

The Sales & Purchase Agreement (SPA)

The SPA encapsulates the terms upon which the seller sells the target company or group (or collective assets) to the buyer. The SPA is likely to be heavily negotiated between the parties and contains the key commercial and legal parameters of the Transaction.

The Warranties

A key aspect of any SPA is the warranty package: warranties are factual statements about the target business and will address all material information and risks that could impact on the target business. Typically, warranties will cover the following aspects of the target business:

Title and capacity



Capitalisation and company structure



Financial information



Assets



Current trading and material contracts



Insurance



Employment and pensions



Litigation



Real estate



Environmental compliance



Intellectual property and IT systems



Tax



Warranties (cont'd)

When negotiating the warranty package, the seller will also undergo an exercise known as the 'disclosure process'. The purpose of the disclosure process is for the seller to make disclosures against those negotiated warranties so as to inform the buyer of all aspects and information material to the target business. Market practice for the disclosure process can vary between jurisdictions but typically takes the form of either a disclosure letter or disclosure schedules. Both formats will have a combination of general and specific disclosures:

- **General disclosures** are typically reference documents (for example the contents of specific reports or materials placed in a data room) or the results of searches of certain public registers (such as court registers and intellectual property registers).
- **Specific disclosures** are discursive disclosures made against specific warranties that talk to particular issues impacting the target business.

In a commercial context, the purpose of providing a warranty package (and making disclosures against it):

1. It allows the buyer to fully assess all the material information relevant to the target business so that it is able to properly value and understand the business it is acquiring.
2. Secondly, it operates as a risk allocation mechanism; in the Transaction documentation the buyer and seller agree a base purchase price together with any necessary adjustment mechanisms.

In the event a material issue (which was not previously disclosed) arises following completion of the Transaction, such non-disclosure may (depending on the facts and circumstances) qualify as a warranty breach, enabling the buyer to seek additional monetary compensation from the seller.

Ultimately, the negotiation of the warranty package, together with the review of the disclosure materials, is intended to highlight all material issues that will impact the buyer's valuation and decision to acquire the target business.

Tax Deed

The indemnities covered under a W&I policy typically relate to the customary tax covenants given in the Transaction. A standard form tax covenant provides that the seller will indemnify the buyer for certain tax liabilities relating to the period of ownership of the target prior to the buy acquiring the target. To the extent such tax liabilities have not been paid by the target or allocated in the accounts of the target then typically, the seller will agree to indemnify the buyer for such costs.

The commercial rationale for providing a tax covenant is that the buyer should not be liable for historic tax liabilities of the target that pre-date their acquisition of it.



Coverage

W&I insurance can be purchased by either the seller (via a seller-side policy) or the buyer (via a buyer-side policy) in the Transaction.

Seller-side policy

- The seller is protected 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.
- The buyer 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.

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.
- The buyer will claim indemnification directly against the W&I policy.
- In certain circumstances the buyer may still also bring a claim for indemnification against the seller pursuant to the terms of the SPA (for example where the buyer is seeking to recover the policy retention directly from the seller pursuant to the terms of the SPA).

Coverage

Depending on the specific Transaction, it is common to find the following coverages included within a W&I policy:

Buyer side	Seller side
Coverage for breach of the warranty package set out in the SPA	Coverage for breach of the warranty package set out in the SPA
Coverage for breach of the tax covenant set out in the SPA	Coverage for breach of the tax covenant set out in the SPA (or separate tax deed)
Coverage to match the liability time periods for bringing claims set out the in the SPA (up to a maximum period of 7 years)	Coverage to match the liability time periods for bringing claims set out the in the SPA (up to a maximum period of 7 years)
Ability to extend policy periods beyond those negotiated in the SPA: for example, it may be possible to extend the general warranty period from 1 year to 2 years	No need to offer extended policy periods as the policy only needs to match the contractual time periods set out in the SPA
Coverage for defence costs in respects of claims made by third parties against the target company that give rise to a loss under the policy	Coverage for certain aspects of defence costs in respect of claims covered by the policy
Coverage in respect of any fraudulent acts committed by the seller that give rise to a loss under the policy	



Policy Periods and Exclusions

Exclusions

A W&I policy will typically exclude the following from coverage:

- known matters that are either within the actual knowledge of the insured or have been disclosed within the Transaction documentation (for example matters set out in the disclosure letter);
- forward-looking warranties (such as warranties that guarantee the future collection of outstanding debts owed to a target business);
- fraud of the insured;
- matters dealt with through purchase price adjustment mechanisms;
- certain pension underfunding liabilities; and
- exclusions in respect of any loss arising in connection with certain fines and penalties that are prohibited from being insured.

Policy Periods

As noted above a W&I policy is a claims made policy and the policy period will generally match the warranty periods set out in the underlying SPA. This typically means that in an SPA there will be a general warranty period of 1 to 2 years from completion of the Transaction together with a tax warranty and tax covenant period of up to 7 years from completion of the Transaction.

The commercial rationale for such time periods is as follows;

The general warranty period should be long enough to allow the target company to go through at least one audit following completion of the Transaction and the tax period should be long enough so that the local tax authority enquiry window for the tax years prior to the Transaction have come to a close.

A W&I policy will generally match the general warranty period and tax periods set out in the SPA under the terms of the policy itself so as to provide back to back cover with the time periods set out in the SPA.



Policy Structure

A W&I insurance policy is not necessarily required for each and every private M&A Transaction.

The need for the insurance arises where there is a disconnect between the level and quality of financial recourse required by a buyer and the level or quality of financial recourse that the seller is either able or willing to offer.

Optio has proven expertise at devising bespoke W&I policies that bridge this gap and help facilitate the Transaction.

Pricing

Each Transaction is assessed by our underwriters on its own merits. Optio will only insure risks where the parties to the Transaction can demonstrate a robust deal structure, a proportionate level of risk allocation, and good commercial drivers for requiring the insurance.

Key factors that will influence the pricing for a particular W&I policy include:

Target industry



Scope of the insured warranties and tax covenant



Identity and role of the principals in Transaction



Quality and adequacy of the disclosure and due diligence process



Geographical footprint



Extent of liability of seller in the SPA



Identity and role of professional advisers acting in connection with the Transaction



Jurisdiction & Governing law of the Transaction





Underwriting appetite

Optio's Transactional Risk team will focus on the provision of W&I insurance for SME transactions. Our underwriting team has a proven track record for both innovation and first-class service levels. Our products will offer insurance in the following areas:

Security	100% by certain Underwriters at Lloyd's of London lead by Syndicate ASC1414 (as at 01/05/20)
Transaction Values	up to GBP 120m (or currency equivalent)
Sectors	broad sectoral appetite including financial services
Insureds	both sell-side and buy-side policies available
Jurisdictions	European focus, including UK (particular interest in UK Regional M&A) Nordics, DACH, Benelux and Iberia
Limit of Liability	up to GBP 27.5m (or local equivalent)
Policy Period	maximum of 7 years
Retention	nil excess possible for non-operational transactions i.e. Real Estate, Wind Farms etc
Seller Liability	coverage available where limited seller liability
Synthetic Coverage	available on a case-by-case basis for an additional premium
Knowledge Scrape	available on a case-by-case basis for an additional premium



Team

Our dynamic underwriting team is experienced in underwriting and advising on SME M&A in the UK and across EEA territories

Alex Smith
Head of Transactional Liability

Alex began his career at Kinmont, a corporate finance advisory, where he participated on private equity backed MBO's and private M&A. He then became as Associate M&A for AIG in 2014.

Prior to joining Optio in 2019, Alex was Underwriting Director of Capital Risks MGA Limited, specialising in the provision of W&I insurance for the SME market.

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Richard Moir
Senior Underwriter, Transactional Liability

Richard began his career at CMS UK where he worked as a Corporate Associate, working on M&A transactions across broad spectrum of sizes and industry sectors. Richard joined Optio in May 2020 as Senior Underwriter to continue the development of the product line with Alex.

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Paul Tominey
Senior Underwriter, Transactional Liability

Before joining the Transactional Liability team at Optio, Paul served as senior associate at global law firm DLA Piper, where he advised primarily on buy-side strategic acquisitions and PE-backed investments across a range of sectors in the UK, US, Middle East and Nordic regions.

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Lewis Phillips
Underwriter, Transactional Liability

Lewis is an ICAEW Chartered Accountant, with eight years' experience in Financial Services, predominantly in Insurance. Lewis' focus was FS Assurance/Audit in the early stages of his career at EY, then QBE, and more recently Lockton Companies. Lewis then transitioned internally to Lockton Transactional Risks (M&A) in November 2021 as a Client Executive/Broker. Lewis joined Optio in March 2023 as an Underwriter in the Transactional Liability team.

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Optio Group is a leading specialty MGA focused on emerging insurance risks bringing together technology and market leading underwriting capabilities. Optio Group is one of the largest independently owned specialty MGAs.

We are here to drive innovation in insurance to manage risk more effectively. By harnessing expertise and embracing technology, we strive to evolve with the needs of our business partners.

Using a combination of technology and market specialists, we create new products, services and solutions that bring efficiency to the market. With an open culture and unified approach, our people aim to form strong, long-term relationships with business partners so we can exceed expectations every time.

Products available:

Political Violence & Terrorism	Transactional Liability
Accident & Health	Medical Billings
Marine	
Professional Indemnity	



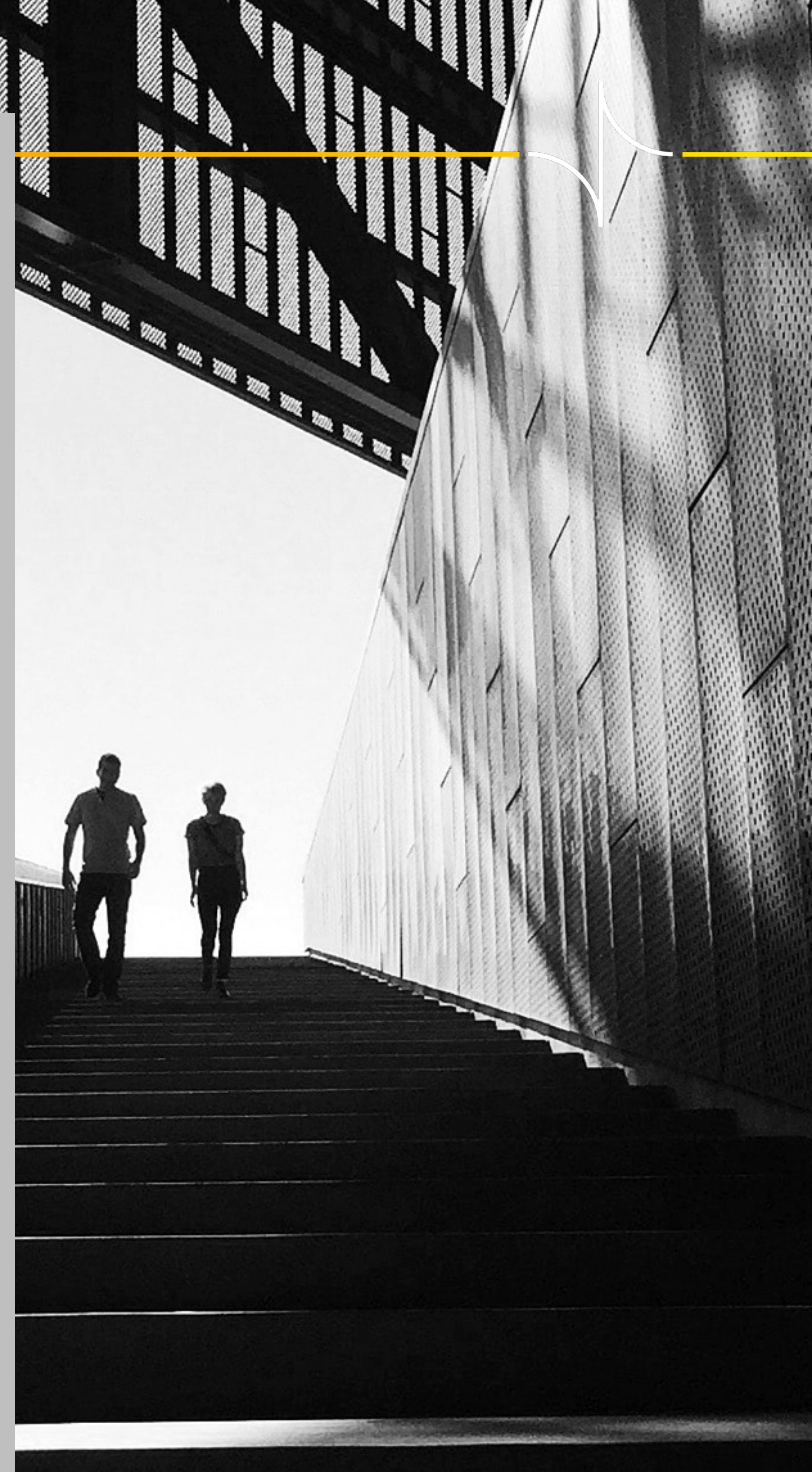
Products available:

Subcontractor Default Insurance



Products available:

Nuclear Property
Nuclear Liability





Future thinking

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www.optiogroup.com

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