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Insuring Deals Around the World: Variations of Representations & Warranties Insurance Across the United States, Europe and Asia

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Introduction¹

Representations & Warranties Insurance² (“Transactional Insurance”) has become a popular tool in effecting private equity and mergers and acquisitions transactions around the world.³ Transactional Insurance generally shifts responsibility for most seller representations and warranties to one or more third-party insurance underwriters, resulting in a seller generally receiving the benefit of a “clean exit” in a sale. While fundamentally the same product worldwide, this article highlights key differences in Transactional Insurance⁴ among the U.S., European and Asian markets.⁵

Observations

Cost of Insurance and Policy Limits

Transactional Insurance policies are typically least expensive in Europe, followed by Asia and then the United States. European policies typically cost approximately 1.0% to 1.5% of policy limits, Asian

policies typically cost 1.0% to 2.5% and U.S. policies typically cost 3.0% to 4.0% of policy limits.⁶ Insurers will typically cover up to 50% of enterprise value (and may cover up to 100% of enterprise value, particularly in the U.S., with respect to “fundamental” representations), although generally, the insured purchases limits of 10% to 20% of enterprise value. As much as \$700 million in total limits (through multiple carriers) may be obtained in certain circumstances. While the upper limit of coverage has increased from historic levels, coverage at the lower range of limits has also become more available. For example, there are now carriers willing to provide U.S.-based limits as low as approximately \$2 million, while in Asia and Europe the minimum policy limits still tend to hover around \$5 million.

Retention Structures

The retention (deductible) applicable under European and Asian policies is typically lower than under U.S. policies. European policies feature retentions of 0.5% to 1.0% of enterprise value. Asian policies feature retentions of around 1.0%. U.S. policies typically require retentions of 1.0% to 2.0% of enterprise value, but alternative retention options often exist. For example, instances of lower retentions (for significantly higher premiums) have been seen, with insurers often offering a lower “drop-down” retention (often 50% of the initial retention) upon the 12- or 18-month anniversary of closing, and other bespoke or multi-tiered “drop-down” features may be available.

Availability in Absence of Seller Indemnity

To varying degrees, insurers across the jurisdictions offer coverage in both the “low-indemnity” context (i.e., where seller remains liable for breaches of reps, post-closing, to some degree, even absent fraud) and the “no-indemnity” context (in which seller is liable for breaches of reps only in the event of fraud). However, insurers tend to prefer underwriting

in the low-indemnity context, and only more recently have European underwriters become increasingly willing to underwrite in the no-indemnity context. In the U.S., carriers often command higher premiums and retentions in the no-indemnity context, and may not offer a materiality scrape for closing date reps absent certain insurer-protective provisions in the acquisition agreement.

Summary of Key Provisions Across Jurisdictions

The chart below summarizes key provisions of Transactional Insurance across jurisdictions.

	Asia	Europe	U.S.
General Terms & Provisions			
Costs: typical premium (% of policy limit, assuming no excess layers)	1% – 2.5% ⁷	1% – 1.5%	3% – 4%
Policy limit	Generally able to match liability cap under acquisition agreement (up to liability cap on sell-side policies and can top up beyond liability cap on buy-side policies); typically policies range from 10% to 30% of transaction value and limits of liability available from US\$5 million up to US\$700-800 million	Generally 0% – 50% of enterprise value (but can be up to 100%)	While generally 0% – 50% of enterprise value is insurable (some carriers will even insure up to 100% of enterprise value, particularly with respect to coverage of “fundamental” reps), typically 10%-20% of enterprise value is insured; up to approximately \$700 million in total limits available
Retention/ deductible (% of enterprise value)	Typically 1%, but can be lower	0.5% – 1%	Typically 1% – 2%; insured may negotiate for a “drop-down” retention after 12 or 18 months
Tipping retention	Available but less common (and more expensive)	Common	Not available
Policy period	Generally able to mirror survival periods in acquisition agreement, with ability to extend to meet buyer requirement; 2 – 3 years for general warranties; up to 7 years for tax and fundamental warranties	Matches that of the purchase agreement but can be extended up to 10 years	Typically 3 years for general reps and 6 years for fundamental and tax reps (although 6 years for all reps may be available for extra premium)
Losses covered	Able to match acquisition agreement definition, including potentially consequential damages if applicable (determined on a case-by-case basis)	Bespoke to each deal but intended to be “back-to-back” with the acquisition agreement	(i) “Back-to-back” with acquisition agreement in “low-indemnity” deal, including vis-à-vis materiality scrape, or (ii) broad, synthetic definition included in policy in “no-indemnity” deal
Claim <i>de minimis</i>	Typically 0.1% of enterprise value, but can be lower ⁸	10% of deductible	Very atypical

	Asia	Europe	U.S.
Full coverage of seller liability	Yes, able to match policy coverage with scope of seller's claims/indemnity liability under acquisition agreement – no "skin in the game" requirement on seller (although some insurers may have preference for some "skin in the game")	Yes, increasingly insurers are less concerned about "skin in the game"	U.S. insurers will cover "no-indemnity" deals (with no seller "skin in the game", except in the case of fraud), but typically the premium and retention will be higher than in a "low-indemnity" context. Buyer will still need solution to cover insurance retention for fundamental reps (e.g., limited seller liability)
Disclosure	Contents of the data room and due diligence reports typically deemed disclosed against reps and warranties, and therefore not covered by the policy	Anything deemed disclosed under purchase agreement arrangement (i.e., data room and general disclosure letter)	Contents of data room and publicly-filed documents are not deemed disclosed; however, insurer may seek to raise such information in an "actual knowledge" defense (but burden is on insurer to prove actual knowledge of information and that it constitutes a breach)
Tax indemnity (for pre-closing tax liabilities)	Generally able to include in coverage, subject to retention/deductible; may increase premium	Generally able to include in coverage, subject to retention/deductible; may increase premium	Generally able to include in coverage, subject to retention/deductible and carve-outs for accrued/reserved and disclosed taxes; generally does not materially increase premium
Exclusions and Partial/Qualified Coverage of Representations and Warranties⁹			
Known breaches	Breaches actually known (by buyer in buy-side policy and seller in sell-side policy) at time of policy commencement (including matters disclosed in transaction documents, disclosure letter and diligence reports)	Matters of which the insured has actual knowledge and would give rise to a claim under the warranties at signing and completion	Breaches of which any "deal team member" (limited group of people) has actual knowledge prior to inception (typically signing) and closing
Covenants	Breaches of covenants typically excluded	Exclusion for breaches of covenants	Exclusion for breaches of covenants (though losses from such breaches may erode retention in some policies)
Post-closing adjustments	Any post-closing adjustments to purchase price are excluded from coverage	Any post-closing adjustments to purchase price are excluded from coverage	Any post-closing adjustments to purchase price are excluded from coverage
Prohibited coverage	Civil/criminal fines or penalties prohibited by law to be insured	Fines and penalties where insurance is contrary to public policy; tax "avoidance"	Punitive or exemplary damages and criminal or civil fines or penalties, with certain exceptions; related defense costs <i>not</i> excluded
Multiplied damages	Multiplied portion of multiplied damages award excluded	Normally excluded	Excluded in low-indemnity deal unless acquisition agreement is silent as to availability of such damages
Secondary tax liabilities	Tax liabilities that are primarily liabilities of parties that are not members of target group or that are not referable to income/profits of target group; taxes on indirect transfers (e.g., Circular 698/Bulletin 7 in the PRC) also excluded	Secondary tax liabilities excluded	Typically covered, unless a specific issue has been identified (e.g., prior membership in another consolidated group)
Transfer pricing	Application of transfer pricing legislation, or inability of target group to substantiate transfer pricing policy to tax authority	Application of transfer pricing legislation, or inability of target group to substantiate transfer pricing policy to tax authority	Transfer pricing matters typically excluded in transactions in which target company has material international operations

	Asia	Europe	U.S.
Net operating losses	Availability of NOLs typically excluded	Amount, availability or existence of NOLs or other tax attributes typically excluded, depending on facts	Amount, availability or existence of NOLs or other tax attributes typically excluded, depending on facts
Pension/social security underfunding	Funding deficits and other liabilities imposed by regulators excluded	Funding deficits and other liabilities imposed by pension regulators excluded	Monetary amount by which any unfunded or underfunded benefit plans are unfunded/underfunded typically excluded
Financial forecasts	Estimates, projections, forward looking statements or financial forecasts excluded	Forward looking statements excluded	Forward looking statements excluded
Specified environmental matters	Specifically identified environmental matters excluded	All environmental claims excluded	Asbestos or Polychlorinated Biphenyls excluded; other environmental matters only excluded on case-by-case basis
FCPA, anti-bribery and other similar laws and related investigations and proceedings	Typically excluded	Knowledge qualifier required, otherwise warranty excluded	Typically excluded, depending on context (e.g., FCPA and similar laws for target companies with international operations in high-risk jurisdictions)
Seller fraud	Excluded in sell-side policies (i.e., losses relating to seller's own fraud not covered), but insured in buy-side policy may recover from insurer if a breach involving seller fraud, and insurer may subrogate against seller after making payment to insured	Excluded in sell-side policies, but insured in buy-side policy may recover from insurer if a breach involving seller fraud, and insurer may subrogate against seller after making payment to insured	Excluded in sell-side policies, but insured in buy-side policy may recover from insurer if a breach involving seller fraud, and insurer may subrogate against seller after making payment to insured
Product liability matters	Risks that would usually be covered by a product liability insurance policy typically excluded	Market specific, but error and omission type claims typically excluded	Product liability, warranty and recall, as well as personal injury may be excluded (clean claims history and reserve for product liability on balance sheet may allow for coverage from certain carriers)
Partial/qualified coverage of "10b-5" and other reps	Representations and warranties of this type may be an issue for certain insurers, but coverage is available	N/A	Insurers will typically not cover a 10b-5 rep as they may view it as an overbroad catch-all; insurers generally will not cover solvency reps or reps regarding the collectability of accounts receivable
Other Matters			
Subrogation (buy-side policy)	Yes, but limited to claims of fraud and willful concealment made against seller	Insurers forgo right to subrogate against sellers under buy-side policies, except in the case of fraud	Insurers forgo right to subrogate against sellers under buy-side policies except in case of fraud and insured may negotiate to limit insurer from subrogating against insureds or their affiliates and counsel, or (to some extent) customers, clients or suppliers of such parties

	Asia	Europe	U.S.
Tax treatment of insurance proceeds (in particular, tax treatment with respect to buyer)	Varies by jurisdiction	Varies by jurisdiction	Likely taxable in case of a buy-side policy, as not treated as purchase price adjustment (unlike indemnity payment); if insured is the entity suffering the loss or is part of a consolidated group with such entity, tax treatment may be mitigated by offsetting deduction arising from underlying loss (although no deduction for U.S. federal income tax losses), and some insurers may offer a tax gross-up for additional premium
Separate insurance coverage for known matters (e.g., litigation, tax, environmental and other)	Coverage for new known breaches may be available, depending on facts; separate coverage for other known matters may also be available, again depending on facts	Known breaches excluded under policy; separate coverage available, depending on facts	Known breaches (and often, known issues, even if not breaches) excluded under policy; separate coverage may be available, depending on facts

1. This article is for informational purposes only and is not intended to constitute a solicitation of insurance. Any decision as to whether to purchase insurance or as to the terms of such insurance should be made in consultation with a qualified insurance producer.
2. Known as “Warranty & Indemnity Insurance” outside the U.S.
3. One global insurance broker with whom we work placed nearly \$6 billion in Transactional Insurance in North America alone in a recent year, including over \$1 billion of coverage for strategic buyers. Another such broker placed nearly \$8 billion in Transactional Insurance worldwide, with approximately 39% of its policies placed for strategic buyers.
4. Given its prevalence, this article focuses specifically on buy-side, rather than sell-side, coverage.
5. At the time of this writing, there are approximately 15 insurance carriers and groups offering Transactional Insurance in the U.S. market and about 16 thereof in Europe. Transactional Insurance is offered in Asia by an increasing number of insurers and is available in many markets. To date, Transactional Insurance has not generally been utilized in certain other markets, including South America, the Middle East, India and Africa.
6. The U.S. market pricing differential may be due in part to perceived greater chances of claims and litigation, as well as policy coverage typically more comprehensive than that offered in the other markets.
7. Pricing varies depending on jurisdiction and sector of the target business, governing law of the acquisition agreement and other factors. For example, in Australia, where the use of these insurance products has been widespread for many years, pricing will generally be on the lower end of this range as compared to the PRC, where such products are still relatively new and the number and amount of policies that can be written are limited. Within Asia (ex-Australia), pricing will also be closer to the lower end of this range for certain jurisdictions such as Hong Kong and Singapore.
8. The level at which the *de minimis* is set is not as significant a factor in pricing as the retention.
9. Partial or qualified coverage of warranties (and the exclusion of many warranties from coverage entirely) is the norm in Asia and Europe and policies in such jurisdictions typically include schedules listing out each warranty and identifying whether it is partially or fully covered or excluded. Partial/qualified coverage of reps is less a formalized part of the process (e.g., no schedule of reps) and more often successfully resisted by insureds in the U.S. market, although carriers regularly pare back “above-market” buyer-favorable reps on a case-by-case basis. The items covered in this section of the table are not exhaustive.

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