

Howden M&A

# Buy-side Warranty & Indemnity Insurance

**HOWDEN**

A W&I policy is designed to cover the full suite of warranties given under an acquisition agreement and the general tax indemnity, subject to the policy exclusions.



W&I policies are usually held by a buyer but can be taken out by the seller if required. When held by a buyer, a W&I policy facilitates sellers/management to exit the transaction with a nominal liability of \$/€/£1.00.

This is clearly advantageous for sellers, but is also helpful for buyers, in particular by providing A-rated insurer capacity as counterparty to the risk of a warranty breach or claim under the general tax indemnity, and helping preserve commercial relationships with management going forward.

# Key parameters

## Policy Limit

Policy limits typically range from 10% - 30% of the target's enterprise value, although a policy limit of up to 100% of the enterprise value can be acquired. It is possible to obtain capacity of €1bn+ per deal, meaning even the very largest transactions are insurable.

## Deductible

The type of deductible applied to claims under W&I policies varies depending on the nature of the deal:

- For operational transactions, insurers usually apply a deductible of 0.25% - 1% of the enterprise value;
- For semi-operational real estate transactions (e.g. hotels), insurers will usually apply a deductible of 0.10% - 0.25% of the enterprise value, although it is often possible for this to 'tip' to nil;
- For pure real estate transactions, the deductible will usually be nil.

Higher risk jurisdictions or industry sectors may require higher deductibles.

## De minimis

Each insurer will apply a de minimis to losses under W&I policies which will match, or can be lower than, the amount set out in the transaction documents, thus enhancing the buyer's position. Insurers nevertheless expect the de minimis to be the same or higher than the financial materiality thresholds applied to the due diligence reports.

## Policy periods

A W&I policy will typically survive for:

- 2 years following completion for general warranties, but this can be extended to 3 years for most warranties and, in certain jurisdictions, 5 years for employment and environmental warranties;
- 7 years following completion for title and capacity warranties, tax warranties and claims under the tax indemnity.

## Exclusions

There are market-standard exclusions which apply to all W&I policies, including:

- Any fact, matter or circumstances of which the buyer's deal team members have 'Actual Knowledge';
- Matters which are 'Fairly Disclosed' in the transaction documents, data room and due diligence reports;
- Purchase price adjustments (other than those arising from warranty/indemnity claims) and leakage;
- The physical condition/design of properties;
- Secondary tax liabilities, transfer pricing and the non-availability of carried forward tax-reliefs, although these matters can be brought back into cover subject to robust due diligence.

Where known issues (e.g. a potential tax liability) have been identified in due diligence, it may be possible to obtain specialist insurance products to cover these risks.

# Premium

## Premium

The premium is a one-off cost determined by the amount of insurance required, the nature of the transaction, and the governing law of the acquisition agreement. Typical premiums are as follows:

- Real estate transactions: 0.45% - 0.80% of the policy limit;
- Operational transactions: 0.70% - 1.50% of the policy limit.

Certain jurisdictions and industry sectors command higher pricing, with premium rates increasing to as much as 3% - 4% of the policy limit for higher risk transactions.

## Legal fee

Each insurer will require a legal fee expense agreement to be entered into before commencing formal underwriting. This is to cover the cost of instructing external counsel.

Legal fees typically range from € / £10,000 – € / £30,000, although can be higher depending on the nature and complexity of a transaction.

For most insurers, the legal fee is charged in addition to the premium and is payable at completion, but some insurers waive their legal fee upon the policy incepting.



# Process

The process of securing a buy-side W&I policy typically takes 3 weeks, but can be expedited and placed in as little as 3 days following provision of advanced form transaction documents and due diligence reports. The below shows the timeline of a typical process:

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## Securing terms week 1

Initial discussion between client and Howden M&A regarding the proposed transaction.

Howden reviews the underlying transaction documents and due diligence reports, provides commentary on drafting and scope from an insurance perspective, and approaches the insurance market to secure terms.

Howden produces a report for the client with a comparative study of terms offered by insurers. The report will also include a recommended insurer.

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## Underwriting week 2

The client selects an insurer and enters into their legal fee expense agreement.

The insurer performs the underwriting process, reviewing the transaction documents, due diligence reports and documents contained within the data room. Based upon this review, the insurer prepares a list of underwriting questions.

The client and advisors provide written responses to the underwriting questions. Howden hosts an underwriting call (1 - 2 hours) with the client, their advisors and the insurer to discuss the responses in more detail.

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## Binding week 3

Howden negotiates the W&I policy wording and coverage position with the insurer. The policy incepts simultaneously with the SPA signing.

# Your Howden contacts

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