

Howden M&A

Sell-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.



Whilst W&I policies are typically held by the buyer, they can be held by the seller. Sell-side W&I policies indemnify the seller following a breach of warranty under the acquisition agreement or a claim under the general tax indemnity that requires the seller to make a payment to the buyer.

By design, such policies require the seller to retain liability under the transaction documents with respect to warranty breaches and the general tax indemnity.

Key parameters

Policy Limit

Policy limits are typically equal to the seller's liability for a breach of warranty or claim under the general tax indemnity, but can be increased to cover gross-up exposure.

Deductible

A deductible will apply to claims under a W&I policy which will usually mirror the basket under the transaction documents, subject to minimum thresholds 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 usually apply a deductible of 0.10% - 0.25% of the enterprise value;
- 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 usually match the de minimis under the transaction documents.

Policy periods

W&I policy periods will match the survival periods in the underlying transaction documents, up to a maximum of:

- 3 years following completion for general 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 including:

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

Key parameters

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: 0.50% - 1% 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 sell-side W&I policy typically takes 3 weeks, but can be expedited and placed in as little as 5 days following provision of advanced form transaction documents and due diligence reports. The below shows the timeline of a typical process:

1

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.

2

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.

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