

COVERED

The rise of W&I insurance

We talked to three W&I insurance experts in North America, EMEA and Asia Pacific to find out what's happening in their markets.

From its origins in the 1980s as a sell-side product used in only a handful of private equity transactions, Warranty & Indemnity insurance has grown to become a fundamental deal-risk management product used by both private equity and corporate buyers and sellers. Providing a buyer with recourse if the seller breaches its warranties, W&I insurance can eliminate the need for escrows and purchase price hold-back mechanisms, allow sellers to limit their liability for warranty claims (sometimes as low as €1/£1/\$1,) and even provide a buyer with additional protections to those negotiated with the seller in the sale documents, such as longer claims periods and higher caps for warranty claims.

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Yem Mai

Senior VP, Marsh Transactional Risk Practice
Focus: North America



What are the current trends in the North American W&I market?

W&I policies almost doubled between 2013 and 2014, an increase we attribute to greater acceptance of W&I insurance by corporates and private equity houses in the US and Canadian markets. This has been driven by sellers and buyers recognizing that W&I insurance can mean the difference between a successful and unsuccessful auction process. For sellers, W&I insurance can make the sales package more attractive to bidders, as many sellers are offering to fund all or part of the buyer-side policy as an inducement to proceed with the transaction whilst also limiting their post-closing liability. Buyers, especially corporate buyers, are realizing the product is necessary to compete with private equity bidders because the product will allow them to accept a seller's proposed limitations on liability. As a result, demand has continued to rise in 2015, especially in US\$1 billion-plus transactions. Our expectation is that this trend will continue as the buoyant M&A market drives policy uptake.



Who is purchasing W&I insurance for their M&A transactions?

We almost exclusively broker policies to buyers. In fact, we only brokered six sell-side policies last year out of 186. A few years ago, private equity sponsors thought if they offered to buy W&I insurance, it gave them a competitive advantage over other buyers. Those days seemed to be numbered. More and more corporate and private equity buyers are coming to the table at the beginning of an auction willing to use W&I. Sellers are also giving buyers preliminary buyer-side quotes at the start of the process.

How has the pricing of W&I policies changed?

Pricing for W&I insurance in North America remains stable, with rates at 3% to 4% of the limit of liability. While pricing in the US and Canada is the highest among Western economies, policy holders get broader coverage. Underwriters in the US and Canada are more willing to remove their consequential damages and multiplied damages exclusions and provide cover for representations and warranties on a broader basis than is set out in the sale documents.

What do you think will happen in the W&I market over the next year?

We believe more corporates will continue to use the product as sellers to attract private equity bidders, and as buyers to compete with them. We also expect to see more insurers willing to provide transactional risk insurance but pricing will remain steady.



More buyers are coming to the table at the beginning of an auction willing to use W&I.

Brian Hendry

Head of M&A Insurance Group, Paragon International
Focus: EMEA



What trends are you seeing in the EMEA W&I market?

As the result of increased demand for W&I insurance, the number of underwriters providing cover has more than doubled in the past two years. As the W&I insurance market continues to expand, we expect to see specialization by industry sector, geography or type of risk. To a degree this has started where certain W&I insurers have already developed expertise in the real estate sector and can offer a comprehensive policy to encompass general warranty risks, tax exposures and title risks. As the European W&I market matures further it will be interesting to see how each insurer differentiates its product from the next.

What are the biggest challenges W&I insurers face in the EMEA market?

Macro-economic issues apart, with more insurers available and bigger underwriting teams within these insurers, the EMEA W&I insurance market is approaching a stage where underwriting resources are able to match deal opportunity. This means insurers will need to compete more aggressively for new business and demonstrate why their offering is more attractive. It has been many years since insurers had to compete on this basis and it should result in a positive outcome for insurance buyers as the increased competition drives product evolution.

As sellers continue to run aggressive auction processes in which the warrantors take a minimal cap of liability in the SPA combined with a “stapled” buy-side W&I policy (i.e. a policy in the name of the buyer which the seller negotiates on the buyer’s behalf), insurers will have to focus more on the disclosure and due diligence processes and accompanying warranty language negotiations. The experience of the underwriters in assessing the key W&I insurance exposures and positively addressing these within the W&I insurance process will become increasingly important.



Michael Turnbull

Asia Pacific M&A Manager, AIG

How would you characterize the Asian W&I market?

The Asia Pacific region is diverse, made up of many countries with different ways of doing business. The W&I market is comprised of three categories. First, the highly sophisticated markets of Australasia, where the use of W&I is widespread, particularly in the private equity space. Second, the mature markets of Hong Kong, Singapore, Japan and South Korea, where the use of W&I has grown significantly in recent years. And third, markets such as China and other South-East Asian countries, where corporates and private equity bidders are starting to see the use of W&I as a viable alternative to other risk management options such as monetary escrows.

What trends are you seeing in the Asia Pacific W&I market?

In 2015 we sold more policies in the region than in any prior year, writing 82 policies that insured deals with a total value of US\$20 billion. Buy-side policies were the most popular, accounting for 89% of our Asia Pacific policies.

What is driving increased use of W&I policies in Asia Pacific?

The recent increase of Asian outbound investment has led to more Asian corporates buying the product because sellers in EMEA and the US are making W&I insurance a prerequisite for doing the deal. We're also seeing money going the other way, with US and European investors buying the policies when making acquisitions in Asia Pacific because they view the deals as higher risk.

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Which W&I markets were the most active?

Last year Australasia continued to be the busiest in Asia Pacific but we also wrote our first W&I policies in the Philippines and Malaysia. The rise in W&I use is expected to continue in 2016 as advisers and private equity firms become increasingly comfortable with the concept. The Australia market is becoming a global leader in both the sophistication of advisers looking to improve coverage and competition amongst insurers as more W&I providers enter the market and look for ways to differentiate their offerings, such as new breach cover for matters that arise between signing and completions and tipping retentions for lower risk deals.

