Insure to ensure the deal

AIG

Asia Insurance Review

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Long a popular product in Australia, the use of Warranty and Indemnity insurance (W&I) products is on the rise in the Asia Pacific region. As global Mergers and Acquisition (M&A) activity begins to tick upwards, W&I is being recognised as a valuable tool by both buyers and sellers to reduce uncertainty, accelerate agreement, and increase trust, says **Mr Darren Savage** of **AIG**. Once seen as an esoteric piece of financial engineering, it is now recognised as a core part of any broker's client-servicing toolkit.

W&I is a tailored insurance product designed to cover breaches in representations and warranties given in the sale of a business. Warranties are statements of fact that a certain set of circumstances exist, and they are habitually given by sellers in relation to all areas of the business being sold, whether that is accounts, tax, employment, real estate or otherwise.

Absent insurance, in the event that one of these statements of fact is incorrect, a buyer's only option (other than to do nothing) is to seek compensation from the seller who gave the warranties. This is often an area of significant negotiation on an M&A deal.

Faster, higher, stronger

A W&I policy can offer a neat way of overcoming some of the barriers to agreeing a deal. Either buyer or seller – but not both – can take out a W&I policy. A seller-side policy covers the seller for its own innocent misrepresentations; a buyer-side policy covers the buyer against the seller's misrepresentations, innocent or otherwise.

Buyers are increasingly willing to use W&I as a tool to win bids in auctions and to get deals done. Assets are being more hotly contested than ever before, meaning that if a buyer wants to be successful, they may have to accept a seller having less post-transaction liability than in the past.

By incorporating W&I insurance into the deal, sophisticated buyers can limit their own future liabilities. This potentially fulfils the buyer's risk planning and corporate governance requirements and can even accelerate the pace at which a deal is completed.

Global M&A activity has increased in recent years as companies look for growth opportunities while private equity or other private shareholders look for exit strategies for their portfolio of companies.

In 2013, Private Equity M&A activity was up 22% and represented 16% of all M&A activity. As of March 2014, it was reported that global "dry powder" for all PE funds stands at a record $1.16 trillion, surpassing the previous high of $1.06 trillion set in 2008.

Buyer Benefits

- Supplement protection for breaches of warranties both in terms of value and certainty of payment
- Extend the duration of warranties, affording buyers additional time to detect and report problems that may exist with the acquired business
- Differentiate a bid in a competitive auction by negotiating more limited recourse from the sellers by supplementing the contractual recourse with insurance
- Protect relationships with sellers who may become the buyers' key employees or commercial business partners after the transaction

Seller Upside

- Reducing the risk of contingent liabilities arising from future claims, allowing sellers to exit a business cleanly
- Distributing all or most of the sale proceeds to investors or use proceeds to pay down existing debt; there is no need for an escrow account
- Protecting passive sellers who have not controlled or been actively involved in the management of the target business from unintentional non-disclosure or breaches of the transaction documents
- Expediting a sale and potentially increase the purchase price by eliminating obstacles to closing, such as indemnity negotiations

It is likely that this will continue to drive W&I insurance policy issuances as PE funds deploy their unused capital. Further, large corporations are holding historically high levels of cash on their balance sheets, which is likely to be channelled in part into large-scale acquisition activity.

As the M&A market begins to expand, companies and their advisors are using their deeper understanding of W&I insurance to facilitate transactions and transfer significant risk.

During the past few years, AIG has provided W&I cover in an ever broader range of sectors and deal types, including PE firms divesting or acquiring portfolio companies, bidders in auction situations, financially distressed companies selling assets, divisions or subsidiaries, strategic buyers seeking to expand their presence in a given industry and individuals and families selling closely held companies.

Growing demand

We expect the M&A market to continue to grow into 2015 as macroeconomic volatility and uncertainty, especially in Europe, stabilises. This should mean a continued rise in demand for W&I across the Asia-Pacific region as sophisticated buyers and sellers take advantage of the product's advantages to protect the value their M&A activities generate.

The expected upturn in the economy should see fewer forced disposals by financially distressed companies, and the deals that are done are likely to be accompanied by an increased focus on risk, and therefore due diligence. AIG is expecting an increased submission flow from brokers supporting deals being carried out in the region, as well as for Asian buyers pursuing investments overseas.

Streamlined sophistication

The leading law firms increasingly advise their clients to structure deals using W&I. This demonstrates the level to which W&I has become an acceptable tool for facilitating M&A deals, and reflects the confidence that sophisticated advisers have in W&I cover.

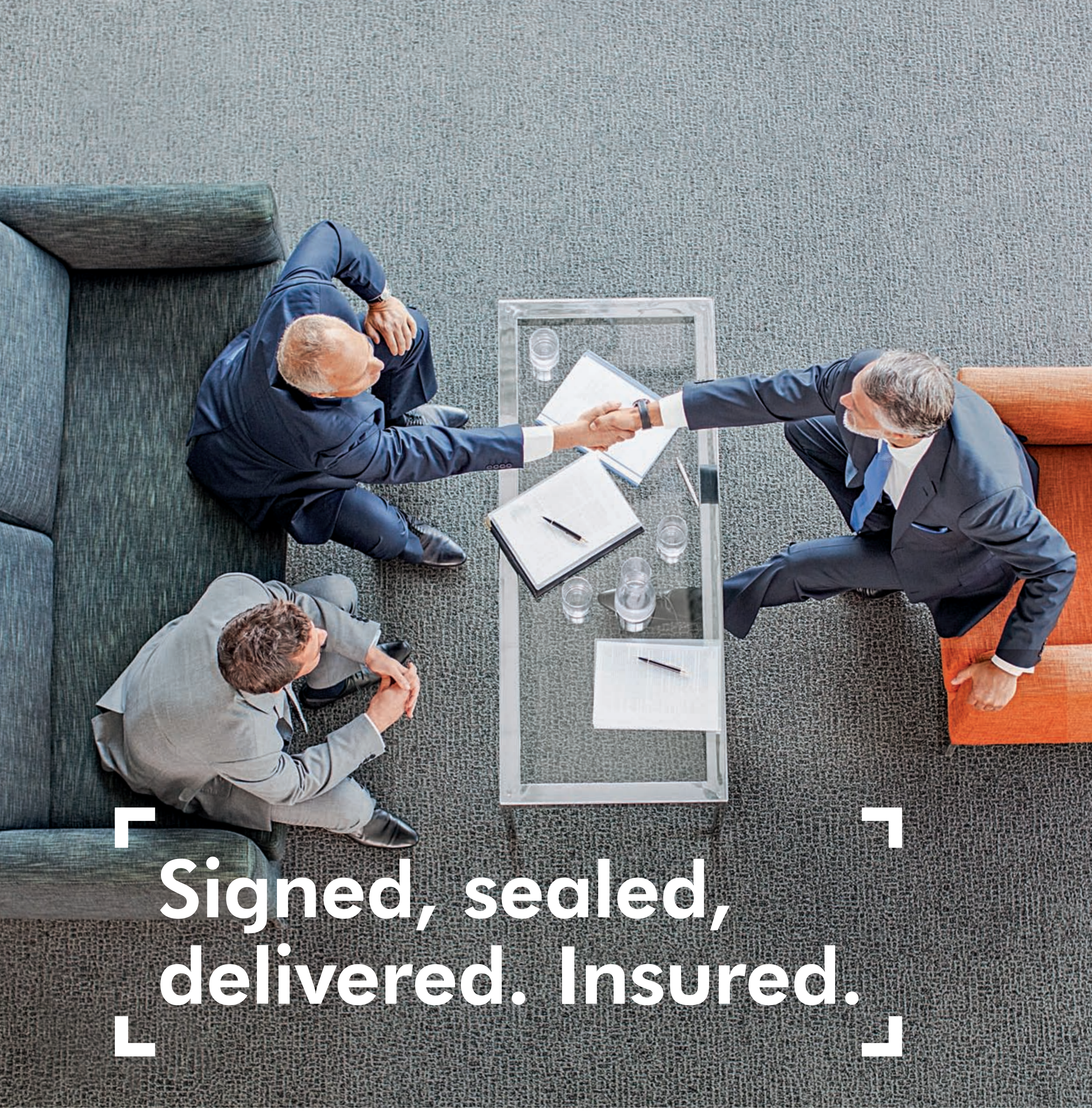
The product itself has evolved significantly over recent years, with coverage becoming more comprehensive, policy language being simplified and processes becoming more streamlined.

The more sophisticated brokers and underwriters themselves employ experienced M&A professionals who are used to the demands of M&A deal processes and their compressed timetables, with most policies being placed five to seven business days from initial enquiry.

At AIG, we have one of the largest teams in the global W&I market, with a strong team of underwriters based here in Asia-Pacific. Where once the majority of our work was based in Australia, in recent years AIG has insured transactions in Singapore, Hong Kong, Japan, China, Korea, Philippines, Malaysia, Vietnam and Taiwan. This deep local experience, blended with global expertise, enables us to confidently say, "Bring on tomorrow".

Mr Darren Savage is a leader in AIG's Regional M&A team based in Hong Kong.

For more information on AIG and its products and services, visit www.aig.com.



AIG's Warranty and Indemnity Insurance can help you close the deal.

In any M&A transaction, the seller wants to walk away with the full purchase price and the buyer wants protection from liabilities down the road. AIG's customised warranty and indemnity insurance can help a buyer distinguish a bid in a competitive landscape by reducing the seller's indemnity obligation, while giving the buyer extended reassurance post-completion. Learn more at www.AIG.com/warrantyandindemnity

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