



# Mergers and Acquisitions Warranty and Indemnity Insurance in Southeast Asia

Warranty & Indemnity (“W&I”) Insurance is a tailored insurance product from AIG’s Mergers & Acquisitions Insurance team to cover breaches in representations and warranties given in the sale of a business. Sellers can cover themselves to prevent sale proceeds being tied up in escrow accounts. Buyers can ensure the warranties have real value even if the seller is unable to pay a warranty claim which arises some time in the future.

## Cover

The policy, whether seller-side or buyer-side, will indemnify the insured for loss resulting from a breach of warranty or tax deed/covenant in a Sale and Purchase Agreement (SPA).

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). The buyer claims directly against the insurance policy and does not have to seek recourse against the seller.

## Policy Form

The policy will be tailored in each case to offer broad coverage that matches the representations and warranties in the SPA as closely as possible. Consequently there will be little difference between what could be claimed against the seller pursuant to the SPA and what the seller (or the buyer as the case may be) can claim against the W&I policy.

- **Policy Period** - The policy term will generally run from signing of the deal for the full survival periods of the warranties and indemnities in the SPA. The period for a buyer-side policy can extend the limitations prescribed in the SPA to meet the buyer’s needs.
- **Retention** - The insurer and insured will agree on the “retention” or excess, which is the uninsured amount of the loss to be borne by the insured. This is generally set at 1% of the value of the transaction, but may be higher depending on the deal or to reduce premium costs.
- **Exclusions** - Although cover is tailored in each case to match the warranties specific to the transaction, some issues will be excluded on all policies. These will include matters set out in the disclosure letter or due diligence, pension under-funding and, on a seller-side policy, fraud by the seller.

## Underwriting Considerations

AIG will consider offering insurance in respect of most mergers and acquisitions (M&A). The limit of liability under the policy will be agreed by the insurer and insured and will be driven by the transaction value. The premium will take into account such factors as the complexity of the transaction, the industry sector and geographical spread of the business as well as the quality of the transaction process and advisers involved. The timescale for obtaining W&I insurance will depend on the stage reached in the transaction, but will usually be available within two weeks from first enquiry.

## Local presence and experience

AIG has a dedicated local underwriting and claims teams across the globe, including in Southeast Asia, Australia and London. This makes AIG uniquely based to underwrite transactions quickly and efficiently and removes logistical risks in placing the insurance.

## Limit

USD5m to USD50m aggregate.

## Premium

Typically 1.5% to 3.5% of the cover purchased.

## Strategic Benefits

### W&I Insurance enables buyers to:

- 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
- Distinguish 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

### W&I Insurance enables sellers to:

- Reduce the risk of contingent liabilities arising from future claims, allowing sellers to exit a business cleanly
- Distribute 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
- Protect 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 SPA
- Expedite a sale and potentially increase the purchase price by eliminating obstacles to closing, such as indemnity negotiations

## Case Studies:

**Singapore** - A European parent was selling 100% of the issued share capital of a Singaporean manufacturing company to an Asian investor, for which the consideration was approximately USD100 million.

The target entity had subsidiaries and operations in each of the People's Republic of China (PRC), Singapore, Malaysia and Indonesia. The parent company took out a seller-side W&I policy with a limit of liability of USD25 million that provided cover for breaches of general, environmental and tax warranties.

A unique aspect of the cover was that the policy also provided cover for certain, specific indemnities, including potential tax liabilities arising out of the liquidation of dormant subsidiary companies of the target or a failure on the part of the seller to have made the necessary filings with the relevant government authorities.

**Thailand** - An off-shore based private equity firm wanted to exit its investment in an agribusiness company operating in Thailand with the sale of 100% of its share holding in the target to an unrelated fund for consideration of approximately USD75 million.

The buyer required substantive warranties, beyond the fund's title and capacity, which the private equity owner was unwilling to give as it could not take on long-tailed financial liabilities during the divestment phase of its fund's life-cycle. Placing part of the purchase funds into escrow to cover potential warranty claims would prevent a clean exit for the private equity firm and they were not prepared to consider a reduction in the consideration.

Accordingly, the management of the target company gave the more extensive warranties the buyer required and the seller took out an insurance policy with a limit of USD27 million, which allayed the concerns of the buyer regarding the ability of the management team to meet any claim for a breach and enabled the fund to distribute returns to investors.

**Hong Kong** - Foreign institutional and individual sellers had sold their communications network across the Asia Pacific region to an off-shore private equity fund. The transaction was subject to Hong Kong law and the enterprise deal value was approximately USD200 million.

As some of the individual shareholders were remaining as management and staff following the change of ownership, the buyer did not want to have to claim directly against those individuals and risk losing their goodwill. Accordingly, the insured procured a buyer-side W&I insurance program of USD75 million, of which AIG provided the primary and first excess layers with a total limit of liability of USD40 million.

### London

Tel: +44 20 7954 7000

### Singapore

Tel: +49 69 97113 0

### Melbourne

Tel: +61 3 9522 4000

### Sydney

Tel: +61 2 9240 1711

### New York

Tel: +1 212 770 7000

## Claims Example:

A private equity fund that backed a management buyout of a manufacturing company is alleging several breaches of warranty against the seller (and current minority shareholder). The alleged breaches relate to the manufacturing capabilities of a key piece of machinery, doctored invoices and expenses, and operating key software without the appropriate licenses. The buyer is also alleging that the seller has breached a warranty in relation to the value of contracts that were in existence at the time of the transaction. The claim is being brought on a buyer-side policy and the damages claimed by the buyer total USD13.5 million.

These scenarios show the potential applications and possible scope of W&I Insurance. Note that they are illustrative only and not to be relied on to justify coverage in any particular situation.

For more information please contact:

#### Michael Turnbull

Mergers & Acquisitions  
AIG Asia-Pacific  
+852 3555 0063 Telephone  
+852 6088 6210 Mobile  
michael.turnbull@aig.com

#### Ben Brindle

Regional M&A Manager  
AIG Asia-Pacific  
+ 61 2 9240 8297 Telephone  
+61 4156 3849 Mobile  
ben.brindle@aig.com

#### Cameron McLisky

Vice President – Financial Lines  
AIG Asia-Pacific  
+65 63 19 77 72 Telephone  
+65 91 13 94 42 Mobile  
cameron.mclisky@aig.com



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