

## A key deal enabler: warranty and indemnity insurance in the Southeast Asian market



In the third edition of our 'Spotlight Series' Stephenson Harwood (Singapore) Alliance, KPMG, and Howden M&A look at how warranty and indemnity (W&I) insurance can act as a key deal enabler in the Southeast Asian market through examining some recent associated trends.

W&I insurance usually insures losses arising from the breach by the seller of warranties set out in the underlying acquisition agreement or a claim under a tax covenant. The provision and negotiation of W&I insurance will likely involve several different parties including insurers, lawyers, and tax advisors. This article has been jointly written by firms representing these three parties so as to give a well-rounded perspective and insight into the use of this product and how it has the potential to benefit both the seller and the purchaser in a Mergers and Acquisitions (M&A) transaction.

In particular, this article addresses some recent trends in how W&I insurance is being used in deals across the region including: (i) its increased use in minority investments; (ii) the use of synthetic warranties in the context of distressed deals; and (iii) tax-related policy enhancements such as affirmative cover and specific tax liability insurance.

Understanding how W&I insurance works and how it has the potential to act as a deal facilitator providing a degree of certainty to both the seller and the purchaser will assist deal advisors to better advise their clients should the parties decide to use W&I insurance.

**Previously a seldom-used weapon in the corporate arsenal, M&A insurance, in particular W&I insurance, has become an important part of corporate M&A transactions, both in mitigating sell-side liability and enabling deals.**

While the use of W&I insurance in the Asia-Pacific (APAC) region was generally previously confined to jurisdictions such as Australia and New Zealand, it has become more commonplace across the wider region. Particularly in Southeast Asia, businesses increasingly expect their advisors, including corporate finance experts and leading law firms, to be able to advise them in respect of W&I insurance policy.

This article will set out some key recent trends in W&I insurance in the region for both advisers and clients to be aware of:

- 1 An increase in W&I insurance** being used in the context of minority investments as opposed to 100% takeovers.
- 2 An increase in the use of synthetic warranties** (where the warranties are covered by the insurance company and not given by the seller under a sale and purchase agreement (SPA) or management warranty deed) particularly in the context of distressed deals.
- 3 Tax risk remaining a key deal consideration** and focus for W&I insurance coverage, reflecting the evolving global tax landscape and changes to tax regimes, including increased complexities and scrutiny by local tax authorities across the region.

## W&I insurance in M&A

"Having worked in M&A in Southeast Asia for several decades, the use of W&I insurance in M&A deals has never been as prevalent as it is now. It provides buyers with more certainty as to recourse and provides sellers more certainty as to price. Given its merits, I expect it will continue to become a staple of M&A transactions."

**Tom Platts**

Head of M&A, Southeast Asia, Stephenson Harwood (Singapore) Alliance



"While it may not be appropriate for every M&A deal, advisers and clients should be aware that underwriting a deal using W&I insurance is a tool available to them. The insurance can work around the type of deal (whether it is a 100% or partial acquisition) and can work to the advantage of both parties, generally smoothing the post-deal relationship."

**Chris Madden**

Associate, Corporate, Stephenson Harwood (Singapore) Alliance

"We have seen a sharp increase in the use of W&I insurance on recent deals we've advised on in the region. Over the last 6 months, we have observed buyers seeking W&I insurance on an average of 4 out of 10 transactions."

**Stephen Bates**

Head of Deal Advisory & Strategy, KPMG in Singapore



## W&I Insurance: protection for buy and sell-side

W&I insurance provides protection to the policyholder in the event of a loss resulting from a breach of warranty or a claim under a tax indemnity. Although the majority of W&I policies are held by the buyer, this benefits the seller as it allows it to make a 'clean exit' (especially if it caps its liability in the SPA) without the worry of a future claim from the buyer as a result of any mistaken warranty breach. It also benefits the buyer as it can claim directly against an "A-rated" insurance company without risking damaging the relationship with the seller, which may be particularly important if the seller has remained in the target group.

While W&I insurance can smooth the process for making a claim for breach of warranty, it is not a substitute for thorough due diligence and disclosure. Insurers are highly sophisticated in this area and usually work with their own legal team who will review the dataroom contents and due diligence reports to ensure that the warranties they are underwriting are supported by a proper due diligence and disclosure process.

As with any type of insurance, W&I insurance allows the risk, in part, to shift from the parties to the insurer. In this way, it is a key component in enabling deals to proceed by smoothing negotiations and overcoming hurdles that may prove unmanageable by the seller and/or the buyer without this third party intervention.



**"The W&I insurance market has responded to the increase in minority investments with a more commercial approach to seller retained stakes in the target business. Insurers' concerns of sellers inadvertently benefiting from their own breaches have been mitigated. W&I policy wordings allow minority investors full protection for their investment amount."**

**We recently provided advice to a distressed Asian infrastructure asset held by a government entity that was unable to give warranties of any kind. Insurers were able to offer synthetic warranties based on the buyer's diligence, allowing an avenue of recourse should unknown issues become apparent post investment."**

**James Kay**

Director, Howden M&A



**"As W&I insurance gains traction in the region, it is crucial for advisers to demystify its intricacies and highlight its benefits to clients. By providing clear and concise explanations, advisers can help bridge the knowledge gap and instill confidence in the use of W&I insurance – this will be instrumental in facilitating smoother transactions and ensuring that all parties involved can fully leverage the advantages this innovative solution offers."**

**Sheetal Sandhu**

Partner, Corporate, Stephenson Harwood (Singapore) Alliance

## Recent key trends in Southeast Asia

### 1 Increase in the use of W&I insurance in minority investments.

Many investors associate W&I insurance only with 100% acquisitions but deal teams are finding benefit in insuring minority stake transactions as well.

New minority investors may be reluctant to claim for a mistaken breach of warranty from fellow shareholders. The business relationship is unlikely to result in a successful investment if one shareholder is suing another. W&I insurance can be used to bridge this risk gap.

The minority investor can claim against the insurer for breaches of warranty by the selling shareholders without the risk of derailing the very investment that they made. Insurers are increasingly comfortable with significant seller stakes in the new entity. Previously there was an insurer concern of "sellers benefiting from their own warranty breach", however, W&I policy drafting has now mitigated this concern.

### 2 Increase in the use of synthetic warranties in the context of distressed deals.

A distressed M&A transaction will usually be run on an accelerated timeframe, with less opportunity for extensive due diligence than would typically be the case in a non-distressed context. Furthermore, a prospective buyer's access to documentation is more likely to be limited where insolvency practitioners have already been appointed.

The seller (or the administrators) will typically provide only a limited scope of warranties or may only provide fundamental warranties relating to title and capacity. This increases the level of risk for prospective buyers and so may result in fewer potential offers with lower sale prices.

One way of resolving the situation where sellers are unwilling or unable (e.g. if the company is in administration) to stand behind warranties is via the use of synthetic W&I insurance. The insurer gives the warranties directly to the buyer, rather than insuring the warranties provided in the underlying SPA. The warranties are negotiated directly between the buyer and insurer and are contained separately in the W&I policy. In this situation, buyers should expect that the warranties that an insurer would be willing to provide will likely be more limited than in a normal deal context. The warranties will relate primarily to factual statements based on the due diligence that the buyer has performed. An insurer will also take comfort from the seller team who will, where possible, give a cursory look through the warranty suite and agree that they look sensible for the target business.

With continuing economic headwinds in certain sectors, clients should note that synthetic W&I insurance is a potential deal facilitator when evaluating a distressed asset with a shareholder base unable or unwilling to provide warranties.

### 3 Tax considerations: Tax risk coverage through W&I insurance remains a key deal consideration.

Whilst now trending in line with global averages, claims related to tax warranties across APAC remain high (approximately 25% of all breach types for FY22).

Generally, tax indemnities and warranties will be excluded from W&I insurance policy coverage unless sufficient tax due diligence has been performed, or otherwise be subject to coverage exceptions.

While W&I insurance typically covers unknown or undisclosed tax breaches, there is an increasing trend in certain policy enhancements for tax such as Affirmative Cover, which can be obtained for tax risks identified as "low" in the tax due diligence, and which an insurer will state as not "disclosed" for the purpose of the W&I policy. There are other examples of enhanced coverage trends that our clients have found of benefit in negotiations, including extending time limitations for claims and removing general knowledge or materiality qualifiers for warranties.



**"Despite economic headwinds globally, as Singapore and Southeast Asia continue to perform well economically, we expect deal volume and consequently the use of W&I insurance as a product to increase. Consequently, there has never been a better time for corporate advisors to garner a sound understanding of the merits of W&I insurance."**

#### Tom Platts

Head of M&A, Southeast Asia,  
Stephenson Harwood (Singapore) Alliance

Specific tax liability insurance, which has been popular in other parts of the globe, is also a growing trend in APAC. Specific tax liability insurance is a different product to standard W&I insurance that, for an additional premium, covers the potential crystallisation of identified tax risks raised during due diligence - where supported by a tax opinion on risk and likelihood from an accepted tax advisor. This can be beneficial to both buyer and seller, particularly in unlocking cash via removing the need for other deal protections (e.g. price adjustments, escrows etc.).



**"Scoping the tax due diligence requires careful consideration and there can be challenges in respect of targets with operations across multiple jurisdictions. However, with a good understanding of the target's industry and operating structure, a focused risk-based approach to tax due diligence can be adopted."**

#### Adam Rees

Partner, M&A Tax, KPMG in Singapore

Specific tax liability insurance is trending as a particularly useful tool in insuring structural tax risks, again supported by appropriate tax advisor opinions, or pre-transaction vendor reorganisation. This also enables vendors to exit cleanly and buyers to obtain fuller transaction risk protection.

## Conclusion

In the complex world of M&A transactions in Southeast Asia, the ability of deal advisers to effectively explain how W&I insurance works is becoming increasingly valuable. Whether the deal at hand is a minority investment or 100% acquisition, a distressed deal, or one that requires tax risk coverage, the key benefits of W&I insurance are the same. It allows risk to shift from the parties to the insurer, gives price certainty to the seller and recourse certainty to the buyer, and helps to preserve the post-deal relationship between the buyer and seller. Therefore, it is highly likely that the use of W&I insurance in corporate transactions will only continue to increase.



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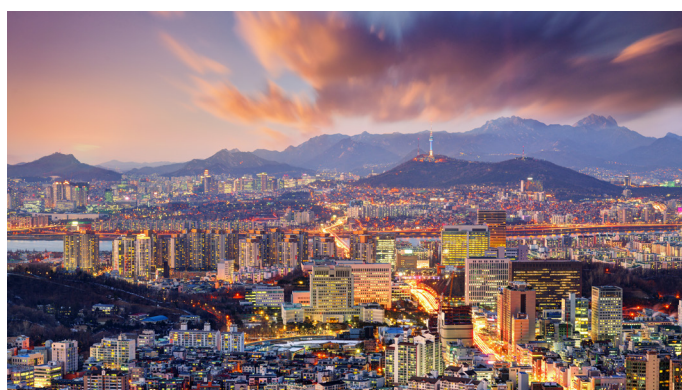
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“The firm’s M&A team in Southeast Asia provides the quality we would normally associate with the larger ‘Magic Circle’ firms, but at much more reasonable prices.”

The Legal 500 Asia Pacific, 2023

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