



Matheson

Update:
W&I Insurance in the
Irish M&A market

Dublin Cork London New York Palo Alto San Francisco

Matheson LLP

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Warranty and indemnity (“**W&I**”) insurance has, over the years, become a popular means used by parties in M&A transactions to bridge the gap between the desired level of warranty coverage from a buyer perspective, and the level of exposure a seller is willing to assume in respect of potential warranty claims on the sale of a company or business.

As the W&I market has developed, a European/US hybrid approach to W&I policies has emerged, whereby insurers in Europe are willing to apply enhancements to their European style W&I policies to adopt certain of the more typical US styles and approaches. In this article we explore some of those enhancements and ‘hybrid’ approaches, provide an update as to how W&I insurance is being used in M&A transactions and we look at some recent market trends.

Why use W&I insurance?

Every M&A transaction involves a certain level of risk for both buyer and seller. Buyers typically focus great efforts on the completion of due diligence on a target business, by which they will seek to identify potential risks and to negotiate solutions to such risks with the seller prior to signing the transaction documents. As part of this process, the parties will agree a set of warranties (i.e. contractual statements about the state of the business) as well as terms setting out how any claim against the seller for breach of the warranties should be dealt with.

The purpose of W&I insurance is to bridge the gap between the desired level of warranty coverage sought from the buyer, which they will typically desire to be as extensive as possible, and the scope of protection that the seller is willing to provide, which is likely to be much more limited in nature, to reduce the likelihood of being subject to warranty claims in future.

W&I insurance is a mechanism by which liability for any breach of warranty or indemnity under the transaction documents can be invoked against a W&I insurer, who steps into the shoes of the seller by providing cover for loss incurred on a breach of a seller warranty or indemnity. Use of W&I insurance therefore allows a seller to have a “clean break” from the target business, whilst providing deal protection to a buyer in respect of any unexpected liabilities that arise post-closing of the transaction.

Coverage under W&I insurance policies

The default position is that insurance cover will extend to all warranties under the transaction documents, aiming to provide ‘back-to-back’ cover with the protections set out in the sale and purchase agreement. Policies can, however, be tailored to address transaction specific requirements. Coverage will usually extend only to unknown issues in areas that have been the subject of due diligence by the buyer, giving comfort to the insurer that the buyer has investigated the state of the business prior to putting W&I insurance in place.

Exclusions from coverage

A W&I insurance policy will include a number of exclusions from coverage. Whilst the extent of such exclusions may differ from transaction to transaction and will be impacted by matters such as the level of diligence carried out by a buyer and the outcome of that diligence process, market standard exclusions across industry sectors include:

- i. known risks identified during the due diligence process;
- ii. fraud or misrepresentation of the insured;
- iii. pre-completion re-organisations;
- iv. forward-looking warranties;
- v. secondary tax liability and transfer pricing;
- vi. purchase price adjustments and/or leakage;
- vii. condition and title to real estate assets;
- viii. environmental matters;
- ix. cyber risks;
- x. consequential losses; and
- xi. other seller obligations such as non-compete obligations.

Whilst additional coverage for some of the above matters can be sought from the insurer, such enhancements to a W&I policy are likely to be provided for an increased premium.

Many insurers also offer separate specific insurance policies to cover matters such as environmental or tax liabilities which are excluded from a W&I insurance policy.

Pricing of W&I insurance policies

A W&I insurance policy will stipulate a maximum level of cover that the insurer will provide in the event of a breach of warranty or indemnity, the premium charged by the insurer for the insurance (typically calculated as a percentage of the maximum level of cover provided) and a ‘retention’ or ‘excess’ amount for which the insured party will be liable before the insurance cover can be invoked.

Pricing will depend on the key features of the deal including the industry or sector that the target operates in, the jurisdiction of the target and the enterprise value of the target business. Choice of policy limit (which will dictate the premium amount to be paid) will also depend on the amount of risk that the parties are willing to take.

Whilst the majority of W&I insurance policies in the market are taken out by buyers, the responsibility for payment of the policy premium is typically a matter for commercial negotiation between the parties.

Market trends

Whilst initially most frequently used in private equity transactions, W&I insurance has now become prevalent across the entire M&A market. Having experienced a period of sustained growth over a number of years, the rate of that growth appears to have slowed over the course of the last 12 months. This downturn is more likely reflective of a period of reduced deal flow, rather than being indicative of attitudes towards W&I insurance itself.

One area in which we have seen increased activity in the W&I insurance market, is the use of W&I products to bridge the gap between the market approach to transactions in Ireland and the US.

The standard approach to policy coverage in Europe and the US has tended to differ in the following key areas:

Disclosure

- **European approach:** the transaction data room, as well as any due diligence reports are deemed to be disclosed against the warranties given for the purposes of the W&I policy, effectively putting the purchaser on notice of all the matters contained therein and excluding the ability to claim for such matters under the W&I insurance.
- **US approach:** neither the data room nor due diligence reports are deemed to be disclosed (though the No Claims Declaration used in a US transaction will refer to such reports and confirm that they have been read).

Materiality / Knowledge

- **European approach:** provisions of the transaction documents relating to materiality and/or knowledge of the seller are taken into account and are considered relevant for the purposes of coverage under the W&I policy.
- **US approach:** materiality and/or knowledge provisions may be disregarded by way of a 'materiality scrape'/'knowledge scrape' in the W&I policy, effectively meaning that the warranties are deemed to be given without any materiality and/or knowledge references.

Basis of Damages

- **European approach:** damages are typically calculated by reference to how the breach of warranty has affected the value of the target company's shares.
- **US approach:** an indemnity basis of calculating damage is common, allowing recovery for loss incurred on a dollar for dollar basis.

Warranties

- **European approach:** all warranties in the relevant transaction documents are reviewed by the insurer and specific exclusions/amendments to that suite of warranties are negotiated, which may lead to certain warranties being covered only partially or excluded entirely from the W&I cover.
- **US approach:** individual warranties are not typically reviewed and negotiated.

De Minimis

- **European approach:** the de minimis amount specified in the purchase agreement will typically apply equally to the W&I policy.
- **US approach:** the policy does not typically apply any de minimis amount.

Underwriting Process

- **European approach:** an extensive diligence exercise is undertaken with the insurer including providing written responses to specific underwriting questions.
- **US approach:** a much more limited process is followed, which is typically managed solely by the buyer.

As the market has developed, a European/US hybrid approach to W&I policies has emerged, whereby insurers in Europe are willing to apply enhancements to their European style W&I policies to adopt certain of the more typically US styles and approaches. Such enhancements will often (though not always) result in a higher policy premium and are typically presented to clients as a menu of options from which certain desirable enhancements to a European style policy can be chosen. This is considered particularly attractive to US buyers of European entities, who want their W&I policies to be in a form which reflects the style more familiar to them in the US market and which typically provide greater protection for a purchaser.

For further information on W&I insurance, see our previous publication [here](#).



George Brady

Partner | Corporate and Commercial

E: george.brady@matheson.com

T: +353 1 232 2027



Sandra Lord

Partner | Corporate and Commercial

E: sandra.lord@matheson.com

T: +353 1 232 2676

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DUBLIN

70 Sir John Rogerson’s Quay,
Dublin 2
Ireland

T: +353 1 232 2000
E: dublin@matheson.com

CORK

Penrose One,
Renrose Dock,
Cork, T23KW81

T: +353 21 465 8200
E: cork@matheson.com

LONDON

Octagon Point,
5 Cheapside,
London EC2V 6AA

T: +44 20 7614 5670
E: london@matheson.com

NEW YORK

200 Park Avenue
New York, NY 10166
United States

T: +1 646 354 6582
E: newyork@matheson.com

PALO ALTO

530 Lytton Avenue
Palo Alto, CA 94301
United States

T: +1 650 617 3351
E: paloalto@matheson.com

SAN FRANCISCO

156 2nd Street
San Francisco CA 94105
United States

T: +1 650 617 3351
E: sf@matheson.com