INTRODUCTION TO TRANSACTIONAL INSURANCE SOLUTIONS

Since 2010, the team at Aon Financial Solutions (AFS) has placed in excess of US$1.4 billion in transactional insurance products (frequently called M&A insurance). Over the past few years, these products have become a mainstay in the arsenal of tools used by buyers or sellers to structure/close M&A transactions, with many leads coming directly from attorneys.

Aon Financial Solutions (AFS) works with private equity, corporate clients and their legal, accounting and financial advisors to analyze exposures and transfer risk in M&A situations or financing transactions. References will attest to our ability and the market to work on “deal time” to solve problems and provide solutions.

Transactional insurance products have been utilized to help buyers win auctions and sellers to obtain higher prices by transferring risk using insurance as “capital”. Buyers often obtain equivalent or better protection than traditional indemnities while sellers can insure contingent liabilities or indemnity obligations cost effectively. In fact, longer survival and increased caps are often available through insurance than from many sellers.

Since each policy is customized and fact specific, policies are extremely straightforward and contain very few exclusions. All policies are negotiated and approved by insureds and counsel prior to binding. **Products include:**

1. **Representations & Warranties / Warranty & Indemnity Insurance**
   - For Sellers or Buyers
   - Transfer indemnity obligations to third party insurer
   - Replace / reduce / enhance escrow requirements
   - Extend survival or add to amount of seller indemnity
   - Provide creditworthy protection in distressed situations
   - Financial statement protection for buyers and lenders, i.e., fraudulent breach of the financial statements representation
   - Facilitate a clean exit

2. **Litigation Buyout Insurance**
   - Provide a “box” or “ring fence” around an existing claim to protect against catastrophic outcome; analogous to “bad judge” insurance
   - Existing claim / related claims capped at a maximum liability
   - Values a contingent liability, enhances certainty
   - Examples: Securities, Employment Practices, Construction, Patent and Tax litigation

3. **Tax Indemnity Insurance**
   - Transfer risk arising from IRS / other taxing authority challenge (i.e., global tax exposures)
   - Examples: NOLs, 355(e), Excess Loss Account, Cross-Border issues, Tax Credits, Transfer Pricing
   - Alternative to a PLR
   - Protect buyer or seller from low probability of a significant loss
   - Support a company’s FIN 48 and Schedule UTP analysis
   - Tax shelters and listed/reportable transactions are not insurable

4. **Environmental Insurance**
   - Onsite cleanup and third-party liability for pollution
   - Stop loss or cost cap coverage to quantify and transfer exposure

5. **Nontraditional Risk Transfer Solutions**
   - Known and unknown liabilities are transferred for a fixed premium
   - One-off situations not fitting within traditional product definitions
   - Examples: Intellectual Property, Successor Liability/ Fraudulent Conveyances, etc.
CLE Course:

Insurance Products for M&A Transactions – Tools to Help Close the Deal

Together, Aon Professional Services and AFS have designed a CLE course on transactional insurance products using actual examples as the basis for discussion. We have been sponsored by a number of major U.S. law firms to teach this course to its attorneys and even clients who may attend. In our experience, lawyers are critical problem solvers and many of our introductions come from lawyers. After receiving many last minute phone calls – where Aon could have helped with a little more time – we are making a significant effort to educate the legal community.

- The course is often taught as a “lunch and learn.” It typically can be structured for 1 or 1-1/2 hour of credit at a firm’s preference.

- The course is generally heavily attended by corporate, M&A and private equity lawyers with some attendance by tax, real estate, bankruptcy and litigation lawyers.

- The presentation is very informational and includes many actual examples of closed transactions. It is not an Aon commercial.

- There is often very lively Q&A during the course with many lawyers remaining afterwards to discuss transactions they are working on.

- The course is also available in non-CLE states for informational purposes only.

- In addition, we are pleased to teach subsets of the course, such as presentations on tax insurance to a tax department.

- Credits have been obtained under the sponsorship of firms which are “approved CLE providers.” The course has not been approved by any state.

References are available upon request.
Transactional Insurance Solutions: Case Studies

Case Study 1: Reps & Warranties Insurance

The Issues

- The Seller, a private retail business with over 100 non-owned locations, did not want to fund a substantial escrow or provide long-term indemnification to breaches of Reps and Warranties.
- The Buyer’s main goal was to structure the transaction to provide for substantial indemnification without causing the Seller to walk away and sell to another party with lesser requirements.

The Solution

- A Buyer-side R&W Policy allowed the Buyer to claim against an insurance company for breach of representations and allowed the Buyer to release the Seller from any indemnification requirement.
- The Seller agreed to a purchase price adjustment to reflect more favorable terms of the contract.
- The Policy had a limit of $10,000,000 above a retention which the Buyer made the decision to bear. The estimated cost at 2011 rates is US$250,000 to US$350,000 or 2.5% to 3.5% of the limit purchased.

Case Study 2: Tax Insurance

The Issues

- A foreign company sought to purchase the shares of a U.S. manufacturing corporation from a private equity seller.
- The Buyer’s due diligence revealed that a prior restructuring transaction might be taxable under complex consolidated return regulations. This was unexpected because the Seller had received a legal opinion that it should be a tax-free transaction. The opinion, however, was based on different facts than ultimately occurred.
- The Seller refused to provide the Buyer with full tax indemnity.
- The Buyer had 10 days remaining in its exclusive period (including the Christmas holiday) and the Seller was unwilling to extend the time period.

The Solution

- A Tax Insurance Policy was placed to insure the tax liability risk as a result of the restructuring not being treated as a tax-free transaction. Buyer was the insured.
- The Tax Insurance Policy has a $50 million limit, $6 million retention (equal to a Seller provided escrow), 5% coinsurance, and 7-year policy period. The one time premium was US$4 million.

The Outcome

- The Tax Insurance Policy was bound within the 10 days remaining on the exclusive period and the SPA was executed. The deal closed several weeks later.
**Case Study 3: Stapled Insurance Package – No Indemnity**

**The Issues**
- A U.S. private equity firm was preparing to sell a US$400 million manufacturing company through an auction process.
- The target was the last of 15 divestitures of a holding company which also was the last investment of a fund.
- The target/holding company had numerous hanging indemnities from past sales and tax (NOLs) and environmental issues.
- Seller desired to effect the sale on an “as is” basis and have no surviving indemnities post closing.

**The Solution**
- Before the auction began, Aon structured and obtained quotes for a package of reps and warranties, tax and environmental insurance in favor of Buyer. Bidders were told to work with Aon and Seller made it known that it would provide no indemnities.
- The R&W Policy covered hanging liabilities from prior transactions and reps related to the current transaction.
- The SPA had no survival and provided a credit to purchase price for the insurance cost (less than 1% of transaction value).
- The added benefit was that insurers vetting of these risks made the buyer more comfortable on due diligence.

For more information on our Transactional Insurance Solutions, please contact:

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