Seven Signs a Transaction Liability Broker Isn't a Good Fit

Risk Managers Should Screen Brokers for Industry Experience, M&A Knowledge, and a Responsive Service Model

by Gary Blitz and Allyson Coyne

Risk managers have frequently overlooked transaction liability insurance as a way to mitigate risk inherent in corporate mergers and acquisitions (M&A). But representations and warranties (R&W), tax, and litigation insurance policies have become a regular presence among M&A deals and tax credit financings, as well as non-transactional services such as those that might involve restructuring to maintain solvency or covering a risk that erodes balance sheet health.

That means brokers should be expected to meet the same standards as other advisors. In the same way corporate development teams expect law firms, investment banks, and accounting firms to meet high professional standards, risk managers should expect brokers to have the experience and industry knowledge to grasp the legal and financial complexities of the deal community.

So how can risk managers weed out the brokers ill-equipped to keep pace with the transaction liability environment? They can start by scrutinizing a broker's experience, skills, and service model for a few red flags.

How can risk managers weed out the brokers ill-equipped to keep pace with the M&A and transactional environment?

1 Broker lacks M&A, tax, and finance industry experience

Evaluating a transaction liability broker calls for a different set of criteria than other brokers. Transaction liability brokers should have an acute understanding of underlying M&A, tax, or financial risks and the subject matter knowledge to advise the larger deal team.

A representations and warranties policy, the most common type of M&A insurance, essentially replaces the indemnification provisions of a transaction agreement, often the most contested aspect of the M&A legal negotiation.

Brokers should have an M&A legal background, as they need to interact with the legal team and articulate M&A concepts to R&W insurance underwriters, typically former practicing M&A lawyers. Similarly, a broker placing a tax insurance policy needs to interact with a carrier's tax underwriters, outside diligence counsel, and tax professionals at the company.

2 Broker has placed few policies

Risk managers should know the number of transactional insurance policies a broker has placed. The most experienced transaction liability practices manage hundreds of transactions each year and are best positioned to ensure deals move quickly with smooth coordination with the deal team.

Industry-leading brokers maintain strong insurance carrier relationships that allow them to negotiate competitive pricing and terms and conditions. This skill is critical because carriers do not offer consistent terms across brokers and transactions. Carriers generally respond to what they are asked to do and charge more for additional work.

An overlooked material exclusion in a policy can be broadened with impunity and pricing can fluctuate wildly based on the preferences of the carrier. An experienced broker can detect problem areas in policies before it's too late and negotiate lower prices.

A risk manager should also know how many claims brokers have negotiated and how much loss they have helped clients collect.

3 Broker seeks few quotes from market

Competition among insurance carriers is critical in a specialty business where the underwriting appetite is still maturing, carriers have different industry-specific preferences, and new carriers continue to emerge.

Risk managers should ensure their broker makes the effort to fully test the market and has proper internal support to analyze that market check, including a deeply staffed team that can manage multiple indications on "deal time."

4 Broker fails to review draft policies

Risk managers should establish whether the broker provides comments on insurers' draft policies. Brokers should routinely review these draft policies in the same way M&A and tax attorneys do. Because this is still a relatively new area and experience with M&A and tax insurance lawyers can vary widely, risk managers should vet their broker's technical offering.

The reality is an experienced broker in this space may have managed more transactions than any one law firm. That knowledge can help identify critical "market" terms, and how and when an insurer should be pushed to depart from the standard model to solve a client's problem. A thorough review of the draft policy ahead of the legal review should also lead to savings in legal fees.

5 Broker has poor track record working on M&A timeline

M&A transactions don't happen at convenient times. Calls frequently interrupt weekends, evenings, and family events. Deals are often signed and policies often bound in the middle of the night.

Brokers should be staffed with an experienced team to provide 24/7 support for each deal.

6 Broker has no dedicated transaction liability insurance claims department

The claims experience needed for transaction liability claims is very different from that of property and professional liability claims. It requires a team fluent in this specialized space to manage issues such as financial statement breaches and impact, and other first-party exposures.

These transaction-related claims are new to many insurance carriers, as well as to many risk managers and insurance claims professionals at the client level. Brokers should offer dedicated transaction liability claims knowledge and have experience assessing and negotiating M&A indemnity concepts.

7 Broker isn't transparent about compensation

Risk managers should expect a broker to disclose its compensation arrangements. They should be aware of any incentives or disincentives to ensure company and broker interests are aligned. Often, there is a focus on broker compensation without consideration of how broker compensation can affect total cost — the more important metric to the enterprise and deal teams — and whether the compensation structure actually incentivizes and aligns the broker to actively negotiate on the client's behalf for the broadest coverage at the lowest cost.

When a deal happens, it happens quickly. Proficiently managing the pace, understanding the legal and financial ramifications, and coordinating the deal team's bankers, lawyers, and accountants can mean the difference between a successful outcome and an erosion of profits. And it all starts with a risk manager's ability to spot the most promising broker candidates.

For additional information about the solutions described, please contact the following practice leaders or your Aon broker.

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