

ENHANCING LENDER PROTECTION

By: **Matthew G. Heinz, Assistant Vice President**
Jennifer Richards, Senior Vice President

When financing mergers and acquisitions (M&A), lenders must concern themselves with the adequacy and quality of the collateral that will support their loans. Lenders have numerous weapons in their arsenal to counteract perceived borrower risk when financing an M&A transaction, including interest rate adjustments, collateral requirements, covenant protections and extensive due diligence reviews. Another weapon that lenders can employ when underwriting M&A-related loans is the suite of Transactional Insurance products offered by Chartis' Mergers & Acquisitions Insurance Group (the "M&A Group").

Representations & Warranties Insurance (RWI)

RWI protects buyers against financial losses arising from breaches of representations and warranties made by the seller to the buyer and adds a layer of protection with respect to the nature and quality of the assets and liabilities being purchased. Given that the assets being purchased ultimately collateralize the loan, these policies help to preserve the purported value of the underlying assets and further ensure that the buyer, and in turn the lender, get the benefit of their bargain.

Tax Liability Insurance (TLI)

TLI is designed to protect a buyer against certain potential tax issues where there is uncertainty in the application of the tax code to a particular transaction or issue. TLI protects the buyer, and indirectly the lender, from potential tax liabilities that could impact the target's financial performance and accordingly its ability to service the loan.

Litigation Buyout Insurance (LBI)

LBI enables a buyer to manage its exposure to a specific known lawsuit or portfolio of claims, thereby providing a level of protection for both buyers and lenders against the unpredictability of litigation and a damages award that may affect the target business in the future.

Contingent Liability Insurance (CLI)

Chartis can provide insurance for a wide variety of contingent liabilities that arise in an M&A transaction, ranging from successor liability issues to contractual consent issues. CLI can be used to essentially take the related liabilities off the table, providing further comfort to buyers and their lenders that the potential liabilities have been fenced in.

Transactional Insurance products can also be used by lenders who are selling a business/assets over which they have assumed control/ ownership after a borrower default in order to minimize their post-closing indemnity obligations and cleanly exit from the sale.

Engaging the M&A Group in connection with a leveraged transaction has other benefits for lenders, as well:

- Transactional Insurance can ease a lender's collection concerns. The buyer insured can name its lender as a loss payee under a Transactional Insurance policy, essentially allowing a lender to exercise its rights under its loan agreement against any available proceeds from the policy.
- As part of its underwriting, the M&A Insurance Group performs a due diligence review of the target. The results of this review can serve as a supplement to the lender's own due diligence efforts and can bring to light new issues that may have eluded lender's counsel.

Below are some real-world examples of the ways in which lenders have utilized Chartis' Transactional Insurance products to either obtain better deal terms or to buttress their contractual protections.

- A group of lenders, having recently acquired a marketing company through a reorganization, put the company up for auction and sought to maximize its proceeds while providing a de minimis indemnity. Counsel to the lenders contacted Chartis to understand the parameters of a buyer-side RWI policy that could be offered to the winning bidder in lieu of a more extensive indemnity. The M&A Insurance Group provided lenders with a letter, to be included in the final bid package, that set forth the basic pricing and coverage terms of a buyer-side RWI policy to be purchased by the winning bidder. The lenders successfully used RWI to maximize proceeds and minimize indemnification.
- A borrower acquired a distressed business for over \$15 million and purchased a buyer-side RWI policy. The target company's condition deteriorated and the lenders assumed day-to-day management of the company. The borrower and lender group submitted a claim against the seller and the buyer-side RWI policy for alleged breaches of representations. While the borrower and seller were still engaged in arbitration, Chartis and the lenders agreed upon a settlement with respect to several of the disputed items and Chartis paid in excess of \$1.5 million in settlement and expenses directly to the lenders, as assignees of the policy's proceeds.

The suite of Transactional Insurance products offered by the Chartis can provide a powerful tool for lenders who finance M&A transactions, both in terms of protecting the value of their collateral, and also in terms of improving their contractual protections. Lenders in the M&A marketplace should consider the potential benefits of making Transactional Insurance an essential part of the bundle of insurance products to be purchased by borrowers on every transaction prior to funding.

To learn more about transactional insurance products, please visit our website, www.chartisinsurance.com, send us an e-mail at MAInsurance@chartisinsurance.com, or contact your insurance broker.



Chartis is the marketing name for the worldwide property-casualty and general insurance operations of Chartis Inc. For additional information, please visit our website at www.chartisinsurance.com. All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to underwriting review and approval. Some coverages may be underwritten by a surplus lines insurer. Risks placed with a surplus lines insurer must be placed in accordance with surplus lines laws and other applicable laws. Surplus lines insurers do not generally participate in state guaranty funds and insureds are not protected by such funds. The information contained herein is for general information only and does not constitute an offer to sell or a solicitation. The description herein is a summary only. It does not include all terms, conditions and exclusions of the policies described. Please refer to the actual policies for complete details of coverage and exclusions.