Risk, Wrapped & Insured: M&A's Safety Blanket

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1.Introduction

The global M&A market's restoration to pre-pandemic levels has led to a synchronised growth in the demand for investor protection mechanisms. Investors' attitude is shifting towards more robust investor protection tools which can guarantee them extensive coverage on a wide array of risks and a clean exit post-closing to the sellers. This has led to more purchasers seeking fortification of their investments through various insurance policies, such as warranty & indemnity ("**W&I**") insurance, Press Note No. 3 (2020 Series)[1] ("**PN3**") risk insurance, contingent risk insurance, litigation insurance, tax liability insurance, cyber liability insurance, intellectual property insurance, etc.

In this article, we focus on one of these insurance categories, i.e.W&I insurance. As mentioned above, investors are seeking policies that can give them extensive coverage while having minimum reliance on seller's ability to pay in case of default. Traditionally, this was achieved by sellers heavily relying on an indemnity construct, and incorporating a combination of escrows, holdbacks, and price adjustments in the Transaction Documents ("**TD**"). However, there was a lack of specialised and customisable tools available that could protect both the seller and buyer/ investor simultaneously while shifting the liability to a third party. W&I insurance seeks to precisely accomplish that by protecting the interests of both parties involved while shifting liability to a third-party, i.e., the insurer.

2.Warranty & Indemnity Insurance

I.Introduction to W&I Insurance

W&I insurance is a specialized insurance product used in M&A to provide protection against breaches of representations and warranties outlined in the TDs, whether in a share purchase or a share subscription deal. Representations and warranties are statements or assertions pertaining to a period prior to the closing date of the transaction, made by the seller/company about the condition, operations, or affairs of the company or assets being sold, covering areas such as financial health, legal compliance (including tax), and operational matters, to provide comfort to the buyer. A protection mechanism for breach of these statements are provided in the TD, where the buyer can directly claim indemnity from the seller/company for loss caused due such breach. For certain known issues which arise pursuant to a due diligence conducted on the target, certain specific indemnities are built in, which are generally uncapped in nature (both in liability and time period for which a claim is raised). Indemnity claims initiated by the buyers against the sellers/company were often prolonged and highly contested. W&I insurance addresses this issue by allowing buyers to make claims for undisclosed liabilities arising after the transaction directly against the insurer, a third party with a higher likelihood of payment, thereby reducing the buyer's risk. Simultaneously, it benefits sellers by limiting their liability post-closing and enabling a clean exit from the transaction.

W&I insurance is rapidly emerging as one of the more popular transaction risk products in India. Unlike other insurance policies that target specific risk areas (such as cyber, title, tax or environmental risks), W&I insurance provides comprehensive coverage for the entire M&A transaction through negotiated warranties in the transaction documents. While W&I insurance was not widely utilized a few years ago, there is an increasing trend of it being adopted more frequently and being supplemented by certain specific risk policies if required. Its reputational value and the repeated usage by satisfied parties in their other transactions, are contributing to its rising adoption and deeper market penetration in India.

II.Types of Policies

W&I insurance policies are structured in a way to provide the maximum possible coverage to the beneficiary of the policy, irrespective of the purchaser of the insurance policy. Most commonly, there are four types of insurance policies prevalent in the market:

a.Buy-Side Insurance Policies

Buy-side W&I insurance is increasingly favored in M&A transactions, as it allows buyers to recover losses directly from the insurer instead of pursuing a claim against the seller. This approach is particularly appealing in competitive auctions, where it provides sellers with a clean exit. Globally, buy-side policies dominate the W&I market with a shift in the winds from 2023, where buy-side policies accounted for over 90% of the policies purchased in the Asia-Pacific region, 2024 witnessed a continuing but slightly declining dominance for these policies, falling to a little over 70% of policy placements in the Asia-Pacific region (as of 2024), largely driven by private equity deals and cross-border transactions[2].

b.Sell-Side Insurance Policies

Sell-side W&I insurance, though less common, is used by sellers to protect against potential claims arising from warranty breaches post-transaction. It is particularly useful in scenarios involving multiple sellers, such as joint ventures or distressed sales, where the sellers are not in a financial position to provide the requisite indemnities. Trends indicate a decline in sell-side policies, as buyers increasingly demand buy-side coverage to enhance deal security and streamline the claims process. As a result of this surge in demand for buy-side policies, only about 26% of policies purchased in the Asia-Pacific region (as of 2024) are sell-side insurance policies,[3].

c.Sell-Buy Flip Insurance Policies

Initially, the seller engages a broker and negotiates the sell-side W&I insurance. Once a preferred bidder is selected, the policy is transitioned over to the buyer, who becomes the insured party post-closing. Typically, the seller pays the premium during the sell-side phase. However, the cost-sharing arrangement can vary and may involve negotiations between the buyer and seller during the finalization of the share purchase agreement. This strategy effective in deals requiring transitional risk management and offers flexibility and tailored policy terms to both parties, thereby leading to an increase in its popularity.

III.Broad Policy Framework

W&I policies inculcate within their framework, the concepts of *'de-minimis'* ("**de-minimis**"), *'retention'* ("**retention**"), enterprise value ("**EV**"), as well as general exclusions and specific exclusions.

1. Enterprise Value (EV): EV is a measure of a company's total value, considering both its equity and debt. In the context of a W&I policy, EV is relevant because W&I insurance coverage is often structured as a percentage of EV (e.g., 10% of EV) to align with the transaction's overall risk exposure. Insurers use EV to gauge the financial scale and risk profile of the transaction, helping determine premium pricing and coverage terms.
2. De-minimis: De Minimis under a W&I policy is the minimum claim threshold that must be exceeded for a loss to be recoverable under the policy. It ensures that the insurer is not burdened with minor or trivial claims. If an individual claim falls below the de minimis threshold, it is disregarded entirely and does not count toward any basket or retention. This mechanism helps filter out small claims, allowing the policy to focus on more significant risks.
3. Retention: Retention under a W&I policy refers to the portion of a loss that the insured (typically the buyer) must bear before the insurer starts covering claims. It functions like a deductible in traditional insurance and is usually set as a percentage of the transaction value. Retention amounts can decrease over time, particularly as the survival period for certain warranties expires. In many cases, W&I insurers align the policy retention with the indemnity basket in the transaction, ensuring that smaller claims remain with the insured while the policy covers larger, more material losses.

W&I policies do not cover any "known" risks, including issues identified during due diligence, specific indemnities, conditions precedent, and documents uploaded to the data room. Recently, there has been a growing trend of requests for insurers to exclude the virtual data room—and in some cases, even the due diligence report—from the scope of "disclosed" items. Insurers assess such requests based on the adequacy of the diligence process and reports, often requiring a no-claims declaration from the counsel conducting the diligence.

Additionally, changes in laws (including tax rates), accounting methods, forward-looking information, and publicly available information are also excluded from coverage. Apart from this, the policies also include certain general and transaction specific exclusions, as outlined below:

1. General Exclusions: These exclusions vary based on jurisdiction, as risks differ across regions. In India, common general exclusions include pollution, punitive damages, bribery and corruption, pension underfunding, and deferred tax assets. Other frequently excluded matters include purchase price adjustments, fraud, war, terrorism, sanctions, anti-money laundering provisions, and transfer pricing.
2. Specific Exclusions: Insurers may also introduce exclusions tailored to sector or industry-specific risks associated with the target company. For instance, in infrastructure projects, exclusions may cover property and asset conditions, maintenance issues, construction defects, and development or construction costs. In the case of under-construction projects, exclusions may extend to development cost overruns and delays. In manufacturing and service industries, product liability and professional negligence risks are increasingly being excluded from coverage. Another example is in software and IT companies, where cybersecurity and data privacy are now being viewed as operational risks, with certain insurers showing limited appetite for covering them under W&I policies.
3. Time Limitations: The policy also specially sets out time limits for claims which can be raised under the policy, which varies according to the category of the warranty. Typically, the policy period for fundamental warranties (title and capacity) is seven years from the completion date, for tax warranties the period is seven years from the end of the financial year in which completion occurs, and the general warranties are covered for a period of three years from the completion date.

The underwriting focus of an insurance policy often determines the critical factors that can influence an acquisition. For example, when acquiring companies in the renewable energy sector, key considerations in the underwriting process include environmental risks, regulatory and permit-related issues, technology failures, CUF-capping issues (minimum capacity utilization factor), force majeure events that could disrupt technology, asset conditions, and title deed validity. For an acquisition of a company in the technology sector, focus would be on factors such as the data infrastructure, compliance with data and privacy laws, service agreements, etc. These factors are typically outlined in the non-binding indication, with heightened scrutiny given to the adequacy of due diligence on these aspects.

3.Global Trends in W&I across M&A Transactions

Global trends in W&I insurance across M&A transactions reflect an evolving risk landscape, with insurers adapting to shifting market dynamics, regulatory developments, and sector-specific considerations. The demand for W&I insurance remains strong, particularly in competitive deal environments where sellers seek clean exits and buyers aim to mitigate post-closing risks. In mature markets like the US and Europe, insurers have broadened coverage and reduced exclusions, driven by improved underwriting confidence. Conversely, emerging markets, including India, parts of Asia and Latin America, still see tighter policy terms due to regulatory complexities and heightened risk perceptions. Pricing has largely stabilized following recent volatility, although high-value and distressed transactions continue to attract higher premiums.

A sector-specific approach to underwriting is gaining prominence, particularly in industries such as healthcare, energy, and infrastructure, where regulatory risks and contingent liabilities are significant. Another emerging trend is the heightened focus on information technology and cybersecurity risks. Insurers are placing increased scrutiny on companies' data security measures, regulatory compliance with privacy laws, and exposure to cyber threats—given that breaches can result in exponential damages.

4.Trends in W&I across M&A Transactions in India

The increasing complexity of M&A transactions in India, coupled with a strong focus on risk mitigation, has driven the rapid adoption of W&I insurance. This product helps sellers minimize post-closing liabilities, accelerates deal closures, and is no longer restricted to high-value transactions—insurers now offer tailored policies for smaller deals with lower enterprise value. Initially favoured by private equity firms, W&I insurance is now widely used by corporate buyers, reflecting its growing acceptance across deal sizes and structures.

While traditionally concentrated in sectors like manufacturing, automotive, and infrastructure, W&I insurance has expanded into high-growth areas such as renewable energy, healthcare, education, media, and technology. Leading insurers across the globe are becoming increasingly comfortable with the Indian regulatory landscape, leading to more competitive pricing and broader coverage. Policy costs have declined, with retention values dropping as low as 0.5% of enterprise value. Additionally, insurers are reassessing traditional exclusions—land title, stamp duty and Section 280 certificates, once standard carve-outs, are now covered in certain cases based on due diligence adequacy. While anti-money laundering (AML) warranties are increasingly insurable, anti-bribery and corruption (ABC) exclusions largely remain although there are corner case exceptions even for this.

Market competition has also driven insurers to enhance policy flexibility, with increasing requests for restricted actual knowledge exclusions, coverage of investigation costs, synthetic indemnities, and nil de minimis for fundamental warranties. As W&I insurance continues to evolve in India, it is expected to become even more buyer-friendly, offering tailored solutions that align with market demands.

Beyond W&I insurance, deal participants are also exploring specialized transactional risk policies to ring-fence known risks, such as tax liabilities, ongoing litigation, and title issues, ensuring comprehensive risk protection in complex transactions.

5. Other Transactional Risk Offerings

I.Contingency Risk Insurance

A Contingent Risk Insurance Policy protects against specific, identified risks that could lead to significant financial loss if they materialize. These are typically low-probability but high-severity risks that arise in M&A transactions, litigation, regulatory matters, or contractual obligations. Unlike traditional insurance, which covers broad categories of risk, contingent risk insurance is customized to address particular issues—such as an ongoing lawsuit, tax exposure, unresolved indemnities, or regulatory approval uncertainty—that may otherwise act as dealbreakers. These policies are particularly useful in corporate transactions where due diligence uncovers "red-flag" risks that neither party is willing to assume. By providing financial protection in case the risk event occurs, contingent risk insurance enhances deal certainty, facilitates smoother negotiations, and ensures transactions can proceed without prolonged disputes or unexpected financial burdens.

II.Tax Liability Insurance

Tax Liability Insurance protects businesses and investors against financial losses arising from uncertain or disputed tax positions. It is commonly used in M&A transactions, restructurings, and investments where there is a risk that tax authorities may challenge a particular tax treatment, potentially leading to additional taxes, interest, and penalties. This insurance provides coverage for specific tax risks, such as the availability of tax credits, the classification of a transaction, or the deductibility of certain expenses. By transferring the financial exposure to an insurer, tax liability insurance helps mitigate uncertainty, facilitates deal negotiations, and provides assurance to buyers, sellers, and investors. It is particularly valuable when there is no clear legal precedent or when a tax ruling is pending, ensuring financial protection in case of an adverse determination by tax authorities.

III.Litigation Risk Insurance

This category of insurance provides financial protection against potential losses arising from ongoing or future legal disputes. It is designed for businesses, investors, and individuals facing significant litigation exposure, covering adverse judgments, settlements, defense costs, or enforcement risks. This insurance is particularly useful in M&A transactions, commercial disputes, and class actions, where legal uncertainties can impact deal valuations and financial stability. Coverage can be tailored for plaintiffs seeking to monetize a favourable judgment or defendants looking to mitigate the financial risk of an unfavorable outcome. By transferring litigation risk to an insurer, this policy enhances deal certainty, supports financial planning, and allows businesses to proceed with transactions or operations without the fear of unpredictable legal costs.

IV.Press Note 3 Risks Insurance

Press Note 3 of 2020 ("PN3"), issued by the Indian government in April 2020, mandates prior approval for foreign direct investments (FDI) from countries sharing a land border with India, introducing regulatory hurdles in M&A transactions. To address these challenges, PN3 risk insurance has emerged as a specialized solution, protecting investors from financial losses due to approval delays, denials, or post-closing government interventions.

This insurance covers risks related to regulatory scrutiny, compliance failures, and disruptions caused by PN3 restrictions, ensuring smoother transactions for both buyers and sellers. By mitigating uncertainties tied to FDI approvals, it enhances deal certainty and facilitates cross-border investments in a complex regulatory landscape. These solutions reflect the evolving role of insurance in managing regulatory risks and enabling seamless business operations.

6.Conclusion

As global M&A transactions continue to scale unprecedented heights, the demand for robust investor protection mechanisms has become indispensable. In an environment characterized by intricate regulations, transnational complexities, and evolving market dynamics, innovative insurance products like W&I insurance, PN3 risks insurance, contingency risk insurance, tax liability insurance, and litigation risk insurance are redefining the landscape of risk management.

These policies mitigate uncertainties, streamline transactions, and address diverse stakeholder needs. W&I insurance covers breaches of representations and warranties, ensuring clean exits for sellers. PN3 risk insurance safeguards against regulatory hurdles, while contingent risk insurance provides tailored solutions for unique liabilities. Tax liability and litigation risk insurance further protect businesses from financial disruptions due to tax complexities and legal challenges. By enhancing deal certainty and financial security, these innovative tools empower investors to focus on growth, long-term strategy, and value creation in an increasingly interconnected M&A ecosystem.

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