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W&I INSURANCE TRENDS IN AFRICAN M&A TRANSACTIONS

— THOUGHT LEADERSHIP

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Warranty and indemnity (W&I) insurance is becoming more commonplace in African M&A deals due to brokers and insurers becoming more familiar with African markets along with increased appetite to insure standalone transactional risks, such as tax and contingent liabilities. In this briefing we explore the trends which are driving the market and the opportunities for the use of W&I insurance in order to enable transactions to complete successfully.

W&I has become a favoured tool for sellers to limit their liability, allowing for a "clean exit", and buyers to obtain further recourse without the need to bring claims against a seller directly. In 2023, the Clifford Chance Emerging Markets PE Practice worked on M&A transactions worth over US$ 1.7 billion in Africa, some of which involved W&I insurance. Likewise, market leading insurance broker, Aon, has advised on over US$ 4 billion of transactions across the continent in the past year. Notably, insurance capital offered by six to eight of the leading insurers to underwrite deals in the region has increased from about US$ 100 million to about US$ 350 million in the last three years and coverage continues to increase year on year.

Here are five trends for deal makers around W&I insurance in the context of African M&A transactions.

Corporates are using W&I insurance with increasing levels of sophistication

As in other jurisdictions, FI Sellers introduced W&I insurance to African M&A transactions but in recent years corporates, recognising its benefits are also using the product.[1] The key benefits include:

- Removing the need for sellers to account for contingent liabilities either at a fund level or on corporate balance sheets (including in some cases known litigation, tax or title risks).
- Providing buyers with a more straightforward claims process by being able to claim directly from the insurers.
- Making it more likely for buyers to receive a broader catalogue of warranties which should in turn drive effective disclosure from sellers.
- Being more cost effective than other types of risk allocation mechanisms, for example, escrow, deferred consideration or hold back mechanisms (which is particularly relevant in the current interest rate environment).

For larger Pan-African deals, the jurisdictional spread of the business may affect cover.

The jurisdictional spread of the target business may affect the level of coverage available although, we are seeing larger Pan-African deals being covered by W&I insurance. In our experience, it is important to consider the scope of due diligence at an early stage to ensure that material jurisdictions are included and the best coverage obtained. Early conversations with the brokers and the insurance market will also identify jurisdictions where the extent of coverage is affected by insurer appetite or track record for the product (although such instances are reducing). Practical considerations in some jurisdictions such as availability of legal counsel to act for the insurer may also affect underwriting time frames.

1 Aon's 2024 'Transaction Solutions Global Claims Study' highlights that in EMEA there are now more corporate insured policies (54%) in the marketplace compared to noncorporate insureds (46%).

Nil recourse remains the most popular structure however novel hybrid structures are also being considered

In developed markets it is the norm for W&I insurance to be provided on a nil recourse basis (where the seller's liability is capped at $1). Nil recourse remains the preferred starting point for sellers on African M&A deals, but we have seen hybrid structures being considered where the policy assumes a particular volume of risk (up to a specified amount) and the seller takes liability for an amount (to be agreed with the buyer in the SPA or equal to the policy deductible level) over and above the insurance coverage. As more corporates explore W&I Insurance, such structures might become a preferred option for a corporate as the corporate can provide some recourse as they would have the balance sheet to support the transaction. This offers flexibility and can provide comfort in circumstances where the amount of insurance coverage on offer is not to the satisfaction of the buyer, or where a hybrid structure is more cost effective.

Synthetic tax covenant as a policy enhancement

Tax issues are commonly raised on African M&A transactions due to the length of time tax audits can take to be finally settled. Historically, sellers have needed to provide tax covenants on African M&A deals, but the availability of synthetic tax covenants has been a helpful development especially for FIs. A synthetic tax covenant is structured as an indemnity within a buy-side W&I policy rather than being given by the seller in the SPA, yet will operate in the same manner as a conventional tax covenant. It is important to note that the inclusion of a synthetic tax covenant will typically attract a higher premium (up to 10%) and insurers will require comprehensive tax due diligence to be done by reputable tax advisors to provide coverage. The market is beginning to provide cover for identified tax risks, such as the availability of tax losses, via the tax covenant (whether given by the seller or purchased synthetically) for an additional premium.

Tax warranty breaches are the most common

Traditionally, breaches of financial statements and accounts warranties have been the area in which most claims have been brought. However recent data shows that the most common type of breach in EMEA is breach of tax warranties (27% of claims), followed by financial statements and accounts warranties (18% of claims).[2] It is important to note however, that while tax warranty claims are the most frequent type of breach occurring in EMEA, only 5% of total paid loss in EMEA arises out of such claims.[3] By contrast, financial statements and accounts warranty breaches typically result in a greater quantum of loss and larger pay-outs, representing 31% of all recovery in 2024.[4] Other warranties which are usually the subject of claims include material contract and compliance with laws, with the African market also following this trend.

2 Aon (2024). *Transaction Solutions Global Claims Study*
3 Aon (2024). *Transaction Solutions Global Claims Study*
4 Aon (2024). *Transaction Solutions Global Claims Study*

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