

TRANSACTIONAL AND LEGAL RISK INSURANCE SOLUTIONS FOR FUNDS

July 2023

Atlantic's specialist secondaries team was at the forefront of the initial development of RWI for secondaries transactions in the mid-to-late 2010s. Since then, Atlantic's secondaries team has supported more than 35 secondaries transactions and continues to innovate and generate significant developments in the scope and nature of cover available from the insurance market. Such recent market shaping developments include:

1. flat cover for specific portco-level representations and warranties without the need for additional diligence;
2. synthetic excluded obligations ("EO") cover;
3. RWI policies for LP portfolio transfers ("LP Transfers");
4. fully stapled RWI policies on fund continuation transactions; and
5. bespoke insurance policies that insure identified fund-level litigation/tax assets and liabilities.

This note summarizes each of these innovations, provides illustrative case studies for how Atlantic leveraged these RWI innovations for transactions it supported this year, and provides additional case studies where insuring identified fund-level litigation/tax assets or liabilities unlocked deals.

Hybrid Rep and Warranty Suites: Securing Flat Cover for Key Portco Reps

While the majority of portco reps on continuation fund transactions remain knowledge qualified, insurance for "hybrid" structures, whereby certain portco reps are given "flat," is often available, with either no or limited additional diligence requirements. Atlantic secured such hybrid cover on more than half of the continuation fund transactions we have supported since the beginning of 2022, without the need for additional diligence or disclosure requirements to those initially contemplated by the parties.

To secure such cover, Atlantic analyses the data room and CIM. We use our extensive experience from supporting more than 35 continuation fund transactions to prepare a rep structuring memo setting out:

1. portco reps that could be covered flat, without the need for additional disclosure/diligence;

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2. portco reps that could be covered flat with narrowly scoped additional diligence based on current data room disclosures;
3. additional information to support narrowly scoped diligence to secure cover for key portco reps; and
4. the remaining portco reps that would be knowledge qualified.

Conducting such an analysis at the outset of the process (critically, prior to selecting a preferred insurer) allows Atlantic to leverage the competitive tension between insurers to secure as many flat portco reps as possible. This analysis gives sponsors, lead investors, and their advisors the greatest optionality and flexibility in their transaction processes. **See the appended case studies for a more detailed description.**

Securing (Synthetic) Cover for the Excluded Obligations Indemnity

RWI insurers' appetites to cover EO indemnities has improved significantly in the last few years. Initially uninsurable, market leading secondaries insurers now cover it habitually for continuation fund transactions and have begun to take a similar approach for LP Transfers. That said, differences in EO cover and diligence expectations exist between insurers and few insurers will provide synthetic cover. The following considerations are particularly important to understand prior to engaging an insurer to maximize cover:

1. Whether the agreement contains an EO indemnity, or if synthetic cover is required;
2. the breadth of the desired EO indemnity (e.g., breaches of fund documents, obligations to portcos, taxes, clawbacks, excluded assets and historic assets);
3. whether the transaction takes the form of a stock sale or distribution and contribution;
4. partnership waterfall structure and whether carry is American or European style;
5. historic claims and/or clawbacks;
6. the age and activity of the selling fund(s); and
7. for an LP Transfer, whether the buyer (and insurer through the buyer) has any access to the general partner.

Atlantic pre-negotiates the relevant points above with insurers at the outset of the RWI insurance process to optimize both process and cover. **See the appended case studies for a more detailed description.**

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Fully Stapled RWI Policies

A fully stapled RWI policy is one where all underwriting is conducted on the sponsor-side with no lead investor underwriting call nor questions. Atlantic's secondaries deal team first placed a fully stapled RWI policy on a continuation vehicle transaction in 2020, given the need for the underwriting to be finalized in two days. While a fully stapled policy may not be available for all continuation vehicle transactions, Atlantic has implemented such a structure on two GP-leds this year. **See the appended case studies for a more detailed description.**

Insuring LP Portfolio Transfers

Atlantic's secondaries team first designed a policy and secured cover for an LP Transfer five years ago. Even so, purchasing insurance on LP Transfers has historically been exceedingly rare due to either (i) sellers being comfortable standing behind an indemnity and/or (ii) buyers being comfortable with the risk, even absent a market-standard indemnity package. However, LP Transfer insurance cover is now far broader than it was five years ago – e.g., full cover for customary representations and potentially full cover for the EO indemnity. Indeed, one insurer now offers specialized LP Transfers policies. Although EO indemnity claims are exceptionally rare, they are generally more of a risk on LP Transfers than continuation fund transactions (given the assets are not being transferred into a newly established fund with no existing liabilities or obligations) and accordingly the considerations listed above require particular scrutiny early on in the process.

Furthermore, various media outlets have reported that LPs may increasingly become forced sellers due to the denominator effect or an inability to recycle cash in time to meet capital calls. Given this dynamic, coupled with the insurance market offering improved cover, we have seen more transaction participants turn to the insurance market for cover this year than all previous years combined.

Fund Level Litigation and Tax Risks

When a fund itself becomes exposed to a legal liability of uncertain quantum or timing via one of its investments (e.g., commercial litigation, wage and hour cases, or uncertain tax positions), the presence of that contingent liability can be a disproportionate economic barrier to selling the investment within the fund's lifecycle or transferring it to a continuation fund. In such cases, it may be necessary to hold back value from investors to cover unexpected but possible worst-case outcomes (impacting fund IRRs), or it may impact valuations of continuation funds. Similar valuation questions may arise when a fund holds a contingent legal asset (e.g., trial court judgment that may be reversed on appeal, or tax assets). In each of these cases, insurance can give financial certainty by either (i) capping the amount of liability or (ii) guaranteeing the value of the asset, thus removing the barriers that would otherwise apply. **See the appended case studies for further detail.**

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Atlantic's Specialist Deal Teams

Atlantic's specialist secondaries team members lead all secondaries transactions we assist. In practice, this entails the Atlantic deal team being led by at least one of Ben Prebble, Alvin Reynolds, or Richard French with support from subject matter experts (e.g., real estate, infrastructure, healthcare, life sciences, financial services, tax, litigation, etc.). Staffing transactions in such a way ensures our clients receive the best terms from the insurance market and market-leading execution.



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Ben leads Atlantic's West Coast practice and co-leads our secondaries practice. He was previously a corporate attorney in New Zealand and most recently a transactional insurance broker with Howden M&A.



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Alvin is the head of Atlantic's Boston, Mid-Atlantic and financial services practices in addition to co-leading our secondaries practice. Previously, Alvin was an attorney with Ropes & Gray LLP.



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David oversees a number of business areas at Atlantic and is responsible for management of deal execution teams. Prior to Atlantic, David oversaw U.S. transactions for Howden M&A.



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Chris leads Atlantic's structured solutions practice where he designs insurance products to cover litigation and other complex legal risks. He was most recently with the US and UK tax structuring team at Barclays.



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Jerry leads Atlantic's tax practice advising on transactional and operational tax risks. He was most recently with Credit Suisse where he led their Global Strategic Transactions Group and was the Americas Head of Tax.

RWI Case Studies

Case Study 1: Flat Cover Without Additional Diligence

Background

- Atlantic was approached by the sponsor's counsel in Q4 2022 who was advising on a REIT continuation vehicle transaction for a portfolio of property assets. Atlantic's secondaries team looped in Atlantic's real estate and tax experts to review the CIM and data room (the draft agreement was not yet available).

Process

- The Atlantic deal team **discovered** that the data room contained historic environmental reports and property condition reports covering ~50% of the properties in the portfolio.
- Using the historic reports, Atlantic **negotiated to secure flat cover** for environmental and asset condition reps with no additional DD.
- In addition, Atlantic's tax team **structured a diligence scope to obtain flat cover** for REIT qualification matters.

Outcome

- The sponsor and advisors then had a roadmap, designed by Atlantic in its rep structuring memo and endorsed by the shortlisted insurers at the quote stage, to **achieve their desired level of cover**. The mix of flat versus knowledge qualified company reps added valuable optionality and certainty to their process.

Case Study 2: Synthetic Excluded Obligations and Flat Financial Statements Cover

Background

- Atlantic was approached by an intermediary in Q4 2022 who was advising on a financial services continuation vehicle transaction.

Process

- Atlantic's financial services experts reviewed the CIM and data room (no draft agreement was available) and **discovered** that a sell-side QofE had been prepared.
- **Before the draft agreement was available**, Atlantic advised that the EO indemnity could be obtained synthetically from the insurance market, as opposed to needing to be drafted and negotiated in the definitive documents.

Case Study 2: Synthetic Excluded Obligations and Flat Financial Statements Cover *continued*

Outcome

- Atlantic **negotiated, and ultimately secured, (i) flat cover** for the financials diligenced in the QofE and (ii) knowledge qualified cover for the most recent interim financials.
- Atlantic **secured synthetic excluded obligations cover** – i.e., the agreement did not need to contain an excluded obligations indemnity and instead the insurer offered to indemnify the continuation fund for such matters directly in the policy.

Case Study 3: Fully Stapled RWI Policy

Background

- Atlantic was approached by a sponsor in Q1 2023 who was rolling a single asset healthcare business into a continuation vehicle.

Process

- Atlantic's secondaries team looped in their healthcare experts to conduct the same review as above.

Outcome

- Due to the transaction's particular structure, the sponsor preferred not to involve the lead investor in the underwriting process. Accordingly, Atlantic **negotiated for the RWI policy to be fully underwritten on the sponsor-side** with no lead investor underwriting call.

Litigation and Tax Case Studies

Case Study 4: Judgment Preservation

Background

- Atlantic worked with private investment funds who were involved in a lengthy litigation and appeals process that caused **significant capital to be trapped**. The funds had received a favorable decision from the trial court, which the plaintiffs appealed.
- While the funds were confident in their legal position, there was a risk that the appellate court could rule against them and cause the capital to be lost. The timeline for resolution of the legal proceedings was also uncertain.
- The funds were **unable to access the trapped capital**. The uncertainty of the risk made lending against the trapped capital unattractive and investment planning and risk management difficult for the funds and their investors.

Outcome

- Atlantic created an insurance solution to **help the funds protect and realize the trapped capital** by indemnifying the funds for losses they suffered if the trial court decision was reversed on appeal.

Case Study 5: Replacing the Need for Specific Indemnities

Background

- Atlantic advised a sponsor that wanted to acquire a company for their late-stage fund. The company was **subject to the risk of losses** from potential (but not yet asserted) statutory damages claims related to its historic wage and hour practices.
- The risk of losses was related to the uncertainty of whether certain employees were manual workers who should be paid weekly rather than biweekly under state law. The sponsor was not itself concerned about the risk and, out of an abundance of caution, planned to change the company's wage and hour practices going forward, but intended to wind-down the fund within the next 18 months and endeavored to ensure that the company would be attractive to sell at that time.
- Given that the sponsor wanted to sell the acquired company and wind-down the fund shortly after the acquisition, a specific indemnity was not an option.

Outcome

- Atlantic structured an insurance policy that **capped the exposure of the company** – and thereby the sponsor or a future buyer – to damages if claims were ever brought, thus facilitating both present and future transactions.

Case Study 6: Insuring Potential Piercing of the Corporate Veil

Background

- Atlantic was approached by two private equity funds that had previously invested in a telecommunications company.
- The company had issued debt to various noteholders. Following a period of financial decline, the company was unable to pay its debt, so the noteholders proposed and effectuated a "strict foreclosure" pursuant to UCC Article 9 (securing more than 96% approval from the noteholders).
- Following the strict foreclosure, a small percentage of noteholders brought a breach of contract claim against the company and its guarantors that resulted in protracted litigation. The funds were **subject to potential liability** arising from corporate veil piercing so they sought to obtain an insurance policy that would enable them to distribute the residual monies left in the fund structure.

Outcome

- Following negotiations with insurers, **Atlantic structured an insurance solution that in essence "ring-fenced" the potential liability** arising from the litigation which allowed the private equity funds to efficiently release the residual monies.

Case Study 7: Potential LP Tax Liability

Background

- Atlantic was approached by a litigation finance fund.
- The fund's tax advisor believed that income derived from the fund's investments may trigger a U.S. income tax liability for the fund's non-US LPs (i.e., effectively connected income) so the fund was required to indemnify its LPs for any potential liability.

Outcome

- To support the fund's ability to indemnify its non-US investors for any effectively connected income, Atlantic designed a policy to **provide coverage for any losses** arising from the contractual effectively connected income indemnification.

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