

PREPARING FOR THE 'WRAPPER' OR 'END OF LIFE' INSURANCE POLICY

With winners' funds, continuation vehicle and secondaries funds becoming more common than ever in the Indian scenario, general partners (**GPs**) (and re-investing limited partners (**LPs**) alike) are becoming more prudent about potential liabilities from earlier / exiting funds. While these liabilities may arise from various sources, the most common form of such obligations emanate from indemnities provided at the time of exit from portfolio companies.

To cover for these, a 'fund wrapper' insurance has been common globally, but is now gaining currency in the Indian funds' ecosystem as well. The demand for the product has been fuelled by global LPs of domestic funds, who find such policies common in other jurisdictions, coupled with GPs trying to limit their liability since most of the carried interest / promote is re-invested in the subsequent funds. The growing demand has seen insurers looking to devise bespoke products to cater to the Indian fund space, drawing from global precedents / experience.

From an insurance perspective, the insurer's key thrust is the robustness of the process followed by the fund when the portfolios were divested, and the reasonableness of the warranties provided. If any of the exits have existing W&I insurance availed, carving out the particular portfolio or the wrapper policy sitting in excess of the existing W&I may be considered by the fund. The wrapper policy is also important, even if one or more indemnity periods (such as business warranties) have expired, while others have not.

We explore some key considerations that funds should bear in mind while exiting portfolio companies towards establishing a robust process having been undertaken by the Seller.

- Diligence: Unless undertaking a bid / competitive process, it is not common for sellers to conduct diligence on portfolio companies. In such cases, it is more likely that the buyer would conduct its independent diligence. If an exit is a part of a primary and secondary transaction, it is possible that the portfolio may also run a vendor diligence. In such cases, it would be prudent for the seller fund to obtain access to these diligence reports, whether from the portfolio or from the buyer, if possible. Having these reports (even on a non-reliance basis) would go a long way in providing comfort to the underwriters. While confirmations from the fund may act as a substitute, it does not add the same weightage since the insurance may not cover any incorrect confirmations.
- External confirmations: Another option that should be considered by sellers (whether in addition to the diligence reports or as an alternative) would be to have the management / promoter of the portfolio companies review the warranties proposed to be offered by the seller fund and seek confirmations on the veracity of the same, even if this is to the best of their knowledge. The intent of the confirmation is not to hold the management / promoter liable later, but to merely demonstrate a robust mechanism followed when providing the warranties.

These confirmations become more important when business warranties are being provided by the seller fund, say, in sales by control funds, or a strategic sale of the entire company.

BOMBAY LAW CHAMBERS

- Internal confirmations: In addition to external confirmations, it is important for the seller fund to have a confirmation from its own employees running the transaction to document the veracity of the warranties, to the extent information is known to them. While this may seem unnecessary, it is possible that the employees running the sale are not employed with the fund at the time of the winding down / dissolution. This confirmation seeks to provide additional comfort to the insurer about the processes undertaken and the level of involvement of the deal team members in offering the warranties. While insurers are amenable to seek this confirmation from a designation (say CFO or partner or general counsel) instead of individuals, from a fund perspective, it may be prudent to get this from the individuals concerned.
- Robust information rights: Robust information rights, including compliance checklists (confirming aspects like filing of tax returns and TDS, not triggering of PFIC, etc.) should be included in the transaction documents and obtained regularly to ensure adequate back-ups of warranties, if required to be provided at the time of exit.
- Additional steps: Some additional steps that the Seller may consider are as follows:
 - Fundamental warranties: The Seller should ensure that all documents in relation to its investment, i.e. the acquisition of the shares originally whether by way of a primary investment or a secondary investment are proper and adequate and appropriate documentation for the same is retained.
 - Tax warranties: All back-ups for tax related warranties, including computation of capital gains, applicability of treaty benefits, tax withholding and TDS / TCS and evidence of payments should be retained. In cases of indirect transfers, appropriate opinions/ documents in relation to any indirect transfer taxes should also be retained.
 - Fund level liabilities: For fund level liabilities, insurers would need confirmation that all actions taken by the fund were compliant with fund documents (including side letters) and all fiduciary obligations have been complied with as well. Regular reporting and approval for any conflicted transactions, coupled with minutes of meetings / approvals of investment committee/ LP advisory committee should be retained, even though these may not have to be shared with the insurer.
 - Sanctions/ AML / ABC: Liabilities arising due to issues around sanctions, anti-money laundering and anti-bribery and corruption (whether at a fund level or at a portfolio warranty level) are tricky and ensuring appropriate and adequate procedures being adopted by both the fund, as well as the portfolio companies in advance are important.
- Assignment: Considering that the fund may be wound down/ dissolved, it may be pertinent to figure out the entity which would be the beneficiary of the policy since this may need to be notified to the insurer upfront. GP entities / manager entities are the usual suspects for these benefits to be assigned, similar to the liabilities of the underlying fund.
- IPO exit: For a large number of funds, exits have been by way of an offer for sale in a public listing of the portfolio company. In such cases, the warranties are offered to the managers of

the IPO, and liability for misstatement to the public is also attached. Adequate comfort in such cases can be provided by way of the diligence undertaken by the company as well as the managers to the IPO. In addition, the selling shareholder certificate and consent letters, in addition to the legal counsel opinions provided to the underwriters should be retained to provide comfort to the insurers.

It would be important for fund managers to bear these steps in mind, and comply with these to the extent possible, even if a wrapper insurance is not contemplated at the time. If a wrapper insurance is availed, it helps to have these in place. If not, these do not hurt the fund overall and may help streamline the diligence by future LPs for subsequent funds. While not having these steps do not necessarily preclude the fund from obtaining a wrapper insurance, it may be subject to additional carve-outs/ exclusions, not being ideal for the fund.