Infrastructure – Risk Perspectives

Episode 4

Infrastructure M&A: Navigating known risks part one

Martin Bennett: Hello I'm Martin Bennett and I lead Marsh's work across the energy and infrastructure sector, advising clients in M&A situations as well as assisting them in delivering Marsh services through the investment lifecycle.

Really pleased to be joined today by colleagues Stefan Farahani and Tom Burrell. We're going to have a discussion on the theme of de-risking M&A transactions across the energy and infrastructure sectors, through adoption of specific risk insurance coverage. Tom.

Tom Burrell: Thanks Martin and great to be here to talk about this interesting and developing topic. So Stefan, I wanted to just kick off with an obvious starting question but what is specific risk insurance exactly and how does it work?

Stefan Farahani: It's a really good question and specific risk insurance is, in many respects, fairly self-explanatory. In that it's about insuring risks you've identified so specific issues that you know might be a problem. And hopefully when you've done the review, you think - well these risks that have come up we think they are reasonably unlikely to go wrong but if they do it could have really bad outcomes – so that's kind of a highlight as to what it is.

Martin Bennett: And Stefan, just with thinking about there are a myriad of risks – legal, financial, commercial – that essentially attach themselves to any M&A transaction across this sector. What actually makes a risk insurable in the context of M&A and wanting to de-risk the situation for seller and for buyer?

Stefan Farahani: So for a risk to be insurable, fairly obviously, it needs to be reasonably unlikely to go wrong. If you identify a problem and looks pretty much dead certain it's going to go wrong, it's not likely to be insurable. So first and foremost, it needs to look unlikely to go wrong and that might be because the data points that way or it might be because expert advisers, lawyers, accountants, technical experts, think that it's a good risk but they can't remove the possibility that it's challenged. And then the only other real requirement is that we need something that supports that proposition that it is unlikely to go wrong. So as I say it might be data, it could be a legal opinion. It could sometimes just be insurers see logic that demonstrates why something is unlikely to go wrong but there's no real magic to it. It's a very broad world of risks that are potentially insurable, we just need a credible basis to explain to insurers why they are what I would describe as good risks.

Tom Burrell: Yeah, that's really interesting Stefan. I think one of the things we are seeing and encouraging clients and others to reach out on is it's always worth asking the question and taking a look. It's worth exploring. It's very much here I suppose the art of the possible as opposed to an established product suite that people might be familiar with I suppose.

Stefan Farahani: That really is right and it is intellectually an unusual thing to be insuring. When we think of insurance we think of very very hypothetical disaster outcomes, like your house might burn down or your ship might sink, but normally you insure your house before you see your neighbour's house burning in a forest fire or a ship starting to sink. This is different because it is about insuring risks where you know there might well be a problem, so you know your tax adviser has flagged a risk in due diligence or it may be that someone has already commenced litigation against you. So to some extent it is about insuring a risk once the house has not quite started burning down, but certainly there might be some smoke starting to emerge.

Martin Bennett: So Stefan thinking about the parameters for insurability here, a fact that a risk that can be insured is the risk that is unlikely to mature. I suppose a question for our listeners today is very much, if there is a reasonable confidence that the risk is unlikely to actually mature – why would you be encouraged to insure it?

Stefan Farahani: Well whether insurance makes sense for a given investor, is to some extent going to depend on their risk appetite and their appetite for volatility. So if somebody had unlimited balance sheet and was quite happy to take the risk of submitting a downside, low probability event then it may well be that they don't need insurance. Most investors value stable cashflows and protecting their IRR so there is real value in paying a fairly modest premium to avoid potentially critical value destruction against investments or unexpected cash outflows from, for example a tax assessment being visited upon them or damages being awarded. So it's certainly not a solution for every single scenario but certainly most professional investors, there is real value in reducing volatility to protect investments and reduce capital costs.

Martin Bennett: Okay, Tom, Stefan, that's been a great introduction and a great conversation and I think we've certainly learnt some useful headline points there. This is, very much, the first of a number of conversations that we are going to have on the subject getting into more detail on particular aspects of specific risks, specific risks insurance and again, how they can alter the profile of an acquisition or a divestment to provide more favourable outcomes for sellers and for purchasers. Look forward to continuing the conversation in the next episode we record.