Transactional Insurance

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Representations and Warranties Insurance

R&W Insurance is a deal facilitator

In traditional (non-insurance) deals, improving terms for buyer or seller comes at a cost to the other party.

By transferring risk from the seller to an insurer, R&W insurance potentially improves terms for both parties and simplifies negotiation over reps, warranties and indemnities subject to certain exceptions.

Buyer advantages

- Broader reps and warranties
- Certain improved indemnification terms (e.g., broad loss definition and, subject to negotiated exclusions, fewer limitations)
- Longer indemnity period (extends survival)
- May distinguish bid in auction or other competitive process
- Avoids post-closing adversarial proceedings/litigation with sellers (including management sellers)
- Reputational considerations for insurers should result in an easier claims process
- Provides security where there is concern over the ability to collect indemnification (including distressed seller context)

Seller advantages

- Much lower post-closing indemnification exposure
  - Generally not more than 0.5% of EV cap for non-fundamental reps
  - No seller indemnity (public style) deals more common
- Avoid funds trapped in escrow at interest rate well below seller's hurdle rate
- Capability to build insurance into seller offering to achieve cleaner exit (pre-position lower escrows and indemnity caps)
- Provides option for reimbursement for indemnification obligation (seller-side coverage)

Benefits and Uses of R&W Insurance

- All parties benefit through transferring risk to an insurer

R&W Insurance Basics

Protects against financial losses from breaches of representations and warranties given by sellers and/or target company.

Most policies (over 99%) are Buy-side policies – they provide buyer with indemnification protection while allowing sellers to exit with minimal escrow/indemnity obligations.

Underwriting based on review of buyer's due diligence process.

Buyer policies cover seller fraud – insurers waive subrogation rights against sellers except in case of fraud.

Covers breaches of Representations & Warranties for up to six (6) years post-closing.

Premium: One-time payment, typically in the range of 2.75 to 4.0% of limits insured (e.g., $275,000-$400,000 for a $10 million limit) in the U.S. market (lower pricing in European market).

Retention: Minimum 0.5% to 0.7% of purchase price/enterprise value subject to carrier 'minimum requirements'

Retention funded either by a combination of the buyer deductible and seller indemnity (in acquisition agreement) or is entirely buyer funded. Typically reduces to match buyer deductible amount 12-18 months after closing (0.5% to 1% of enterprise value).

Public company-style/no-seller indemnity structures are very common.