Transactional Insurance

UT Law CLE's 20th Annual Mergers and Acquisitions Institute

October 11, 2024

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.

Title search: Transactional Insurance

Also available as part of the eCourse
2024 Mergers and Acquisitions eConference

First appeared as part of the conference materials for the
20th Annual Mergers and Acquisitions Institute session
"RWI Update and Negotiating an RWI Policy for Your Deal"