



TRANSACTIONAL RISK PRACTICE

# Reps and Warranties Insurance: A Critical Tool for Dealmakers

Acquiring a new asset or business entails risk, but private equity fund managers, corporate executives, risk managers, and other stakeholders can mitigate some of the uncertainty with the right kind of contractual protections in the underlying purchase agreement. Participants in mergers and acquisitions (M&A) are also increasingly using representations and warranties (R&W insurance or reps and warranties insurance).

Marsh’s team of experienced transactional risk professionals can help you build effective R&W insurance policies to protect against unintended contractual misrepresentations made during negotiations of corporate M&A transactions. We can help you build programs that enable you to shift a significant portion of your transactional risk to an insurer rather than retaining it on your balance sheet.

## Benefits for Buyers and Sellers

Once considered a specialty insurance product for which there was little demand, R&W insurance is now a commonplace feature in the global M&A landscape. Standard practice in most auction processes is for sellers to instruct buyers to obtain R&W insurance as part of the purchase agreement negotiations.

R&W insurance generally provides coverage for all representations and warranties of a target company or seller(s) contained in an M&A purchase agreement. The policy protects an insured against financial loss — including defense costs — resulting from breaches of such representations and warranties. This type of insurance can be used by public and private

organizations in both traditional change of control transactions and non-control, minority investments.

The vast majority of R&W insurance policies are issued to buyers. However, either party — but not both — can be insured and can benefit from coverage.

Benefits for Buyers	Benefits for Sellers
Provides added protection beyond the negotiated indemnity cap and survival periods in a purchase agreement and a provision of recourse when there is no seller indemnity available in the purchase agreement.	Replaces or backstops negotiated indemnity obligations (key for private equity or venture capital funds to maximize returns for investors and to efficiently wind up funds at the end of their life cycles).
Protects against collectability/solvency risk of an unsecured indemnity (for example, in financially distressed M&A processes or when there is a large group of sellers).	Protects minority/passive sellers concerned with joint and several liability.
Enhances ability to submit qualifying bids in competitive auctions where a seller is mandating the use of R&W insurance.	Provides additional comfort for individual or family sellers.
Preserves key relationships (for example, by eliminating the need to pursue claims against management sellers who continue to work for the buyer post-closing).	Offers a solution for situations where there is a lack of ownership history (for example, restructurings, “loan to own”).

R&W insurance policies are fully customizable and negotiated on a deal-specific basis. Certain standard exclusions, however, apply across the industry. These include:

- Asbestos/PCBs.
- Pension underfunding or withdrawal liability.
- Criminal fines and penalties.
- Post-closing purchase price adjustments.
- Net operating losses.
- Transfer pricing.
- An insured's actual knowledge of breaches at the time of binding coverage.

## Competitive Market and Pricing, Simple Process

### Limits

Although representations and warranties insurance is a specialized class of coverage, the marketplace includes a substantial number of well-established and specialist underwriters with global capabilities. Collectively, more than 20 insurers and managing general underwriters offer R&W insurance coverage in North America. Insurance capacity is robust, with policy limits in excess of \$1 billion available for a single transaction. The typical range of R&W policy limits has historically been between 10% and 15% of the enterprise value of the target company, with certain buyers purchasing greater or lower limits depending on their risk tolerance and other factors.

### Process

No-cost pricing indications for R&W insurance can typically be obtained from insurers within a few business days. To prepare a quote, an insurer will generally request to see a draft purchase agreement, offering memo, or other document that describes a target's business and a copy of the target's most recent financial statements. Existing due diligence reports, data room information, and conference calls with the insured's deal team and advisors will generally provide the basis for underwriting. Policy negotiation and underwriting generally take five to seven business days, although this timeline can be expedited to meet transaction-specific requirements.

### Costs

Pricing depends on a number of factors, but R&W insurance policies — including premium, taxes, underwriting fees, and broker compensation — typically amount to between 3% and 3.5% of the insured amount for most transactions; the rate can be lower for large programs. This amount is a one-time upfront cost (generally paid at the transaction closing) for the entire policy period, which is typically three years for general representations and warranties and six years for fundamental representations and warranties (including tax). Rates for deals in leading economies outside of the US and Canada are generally lower, but coverage may be different from what is typically provided by North American insurers.

### Deductibles

Like most forms of insurance, a R&W insurance policy will have a deductible that must be exhausted before the policy will pay out. The deductible is an aggregate amount for the duration of the policy and is usually set at 1% of the enterprise value for typical US and Canadian transactions, with a drop-down feature at the 12-month anniversary of closing. Higher or lower retentions may apply based on the specific risk insured and/or the size of the transaction. Certain carriers may offer a zero or "nil" retention policy for true fundamental representations given by sellers (for example, authority to conduct the transaction, ownership of shares, no brokers other than those listed on disclosure schedules).

## Why Marsh?

Members of Marsh's transactional risk insurance team in North America have years of experience working on complex M&A transactions at major corporate law firms, and our Private Equity and M&A Services (PEMA) team has worked on thousands of due diligence projects across several industries and regions. We bring unparalleled experience, relationships, service, and insight into the structuring and placement of transactional risk insurance to aid C-Suite executives, risk professionals, attorneys, bankers, and others involved in mergers, acquisitions, divestitures, distressed situations, and corporate restructuring. On behalf of our clients, we place billions in limits for transactional risk products with leading insurers each year and can offer proven solutions to unique deal problems.

For more information about Marsh's transactional risk services and other solutions, visit [marsh.com](http://marsh.com), contact your Marsh representative, or contact:

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