

Increasing Importance of Representations & Warranties Insurance in M&A Marketplace



In recent years, Representations & Warranties Insurance (RWI), also known internationally as Warranty & Indemnity Insurance, has expanded from being a tool utilized mostly by parties in large M&A transactions to being almost universally accepted as an important part of middle and lower-middle market transactions. The marketplace of active insurers in this space has expanded as well and has yielded robust available capacity for deals as low as \$25,000,000 total enterprise value (TEV).

RWI has become widely popular because it can ease and quicken negotiations of an indemnification package, enables a buyer to have a party to pursue other than the management team behind which it just invested if a breach occurs, and it allows sellers an immediate and clean exit by replacing proceeds that would otherwise have been tied up in escrow for years post-closing.

Some important facts to bear in mind about the product and process involved:

- RWI policies can be placed by the buyer or seller but 90%+ of policies are buy-side for a variety of reasons, not the least of which is that buy-side policies provides fraud coverage.
- The process of obtaining RWI requires a broker facile with this unusual process and specialty marketplace. In a two phase process, a broker can typically obtain non-binding indication letters (NBILs) from a variety of competing insurers in Phase 1 at no cost, then the buyer must choose what they believe to be the indication that best suits them, pay the required underwriting fee (typically in the range of \$25-35,000) and move into Phase 2. This involves detailed review of the deal documents, data room contents, other expert reports, etc.–often referred to as “diligence on the diligence.”
- Policy limits can be chosen on any number of factors, but the most common outcome is to insure to 10% of TEV. Policy periods are usually 6 years from closing, and in transactions where signing and closing do not take place simultaneously, coverage can usually be bound at closing. Retentions (which can be borne by either party or shared) are typically in the range of 1% of TEV and reduce by half after 12 months from inception. Premiums commonly fall in the range of 2.5% - 3.5% or so of the limit purchased (i.e. a \$10M limit would mean a \$250-\$350k one-time payment for a six-year policy).
- In today’s marketplace, coverage is often available for unknown breaches of all the seller’s reps and warranties, but this can vary by industry and especially by the level of diligence performed by the buyer in high-profile areas such as environmental, employment issues such as pension funding, wage and hour, FCPA, etc. The detailed language of the RWI policy itself is typically negotiated on a deal by deal basis between the insurer and the team of the buyer’s counsel and RWI broker, as each policy needs to be customized based on the terms of coverage and the dynamics of the underlying transaction.

Simkiss & Block is prepared to help with your transactional insurance needs, including representations & warranties insurance, to facilitate getting your deal to closing. [Contact us](#) today to get started.