

# 8 Things You Need to Know About Representations and Warranty Insurance

Patrick Stroth

The typical M&A deal can be a long, drawn out process – and painful, too. Negotiations on the Purchase and Sale Agreement can stretch out for months – or longer – as lawyers haggle over terms and contract language. And Sellers are often dismayed by how much money is held in escrow at closing to cover indemnity.

There's a way to make those problems go away: Representations and Warranty (R&W) insurance. This specialized type of insurance transfers risk in case of breach to a third party – the insurance company. That means less money in escrow (which makes Sellers and their investors happy) and a quick remedy if a problem pops up post-closing, because the Buyer simply files a claim with the insurance company. No legal action is needed.

## 1. What does it cost?

R&W insurance has never been more affordable. There are a few elements at play here:

### Premiums

Premiums are currently running 2% to 4% of the Policy Limit.

### Underwriting Fee

It's essential to note when discussing cost, to be sure and add in the Underwriting fee (\$25K - \$50K depending on the complexity of the deal).

### Policy Taxes

The policy taxes (3% to 7% of the premium) which are determined by the Buyer's state of domicile.

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## **\*Side Note on Attorney's Fees**

It's worth mentioning that when R&W coverage is in place, deals are smoother and faster, with less negotiation needed between the Buyer's and Seller's legal team. A good rule of thumb is you can save 10% on attorney's fees.

## **2. How much time does it take to secure a policy?**

Securing a R&W policy is hassle-free and quick as long as you have your ducks in a row. As with any insurance, Underwriters don't want to take on unnecessary risk.

Provided there is a draft Purchase and Sale Agreement (PSA) and audited or reviewed financials for them to review, Underwriters can issue a non-binding indication in a day or two.

If the client wants to move forward, following payment of the Underwriting fee, it routinely takes about two weeks to review and complete a formal R&W policy placement.

## **3. What is the process for securing a R&W policy?**

1. Underwriters review the draft PSA, financials and CIM (if available) and provide a non-binding indication within 48-72 hours.

2. Following payment of an underwriting fee, Underwriters will access the data room and also reach out to Buyer's deal team.

3. A conference call is scheduled with the Buyer's deal team within a week of commencement of the Underwriting process. Insurers will generally provide a list of questions that will be asked. Generally, they'll want to speak with the CEO and CFO, as well as the CIO or CTO - if the company has those positions.

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4. Formal proposal for R&W coverage is issued within two or three days of conference call. If there are any outstanding supporting documents needed, those are listed as conditions of the policy taking effect.

5. R&W policy is ready for issuance upon signing/closing.

It's essential that at every point in this process, the policyholder is responsive to any requests from the Underwriters in order to not cause any delays.

## 4. Who pays for R&W insurance?

We've seen the Seller pay the costs. We've seen Buyers cover the costs. As with many business deals, who covers the costs depends on which party has the most leverage in the deal. But, most often the costs are split evenly between the two.

In many cases, Sellers are happy to pay for a Buyer Side policy because much less of their money is held in escrow and their liability is reduced.

## 5. What size deals qualify for R&W insurance?

It wasn't too long ago that only deals valued at \$50M to \$1.5B were considered eligible for R&W insurance. But that benchmark has dropped steadily in recent years.

In general, today we see transactions in the \$40M - \$800M range as the best "fit" for R&W policies.

## 6. What type of broker should you look for (based on deal size and other factors)?

R&W is completely different from commercial insurance, so this is not the scenario where a company reaches out to their business insurance representative.

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M&A parties and their advisers should seek insurance brokers that not only specialize in R&W, but have done so for an extended period to have developed the relationships necessary with multiple R&W underwriters. The significance of the transaction to be insured should not be left to a “beginner.”

## 7. Do claims get paid?

R&W is unlike any other insurance product, covering a very specific set of exposures (Seller Reps and Warranties outlined in the Purchase and Sale Agreement), all of which have been subject to diligence.

Given this scenario, there are very few claims that end up triggering the R&W policy, making R&W wildly profitable for insurers. This is actually a benefit to policyholders.

## 8. When should you first discuss including R&W insurance with your deal?

Ideally, R&W should be discussed at the Letter of Intent stage. Preliminary coverage terms can be prepared at no cost at this stage. And, if R&W isn't a fit, it can be removed without interrupting the process, so there's really nothing to lose.

## Find Out How R&W Can Fit Into Your Next Deal

It's clear that R&W insurance offers many advantages to both Buyers and Sellers in M&A. Costs are minimal. And the process is painless to secure a policy. To explore to see if Representations and Warranty insurance is right for your upcoming deal – and to get answers to your specific and detailed questions, contact me, Patrick Stroth of Rubicon Insurance Services. We're located in the heart of Silicon Valley. You can reach me here: [pstroth@rubiconins.com](mailto:pstroth@rubiconins.com) or 415.806.2356