

# REPRESENTATION and WARRANTY INSURANCE



**MERGERS &  
ACQUISITIONS**

Representation and Warranty (R&W) insurance – also known as Warranty and Indemnity insurance – provides coverage for losses arising from breach of representations and warranties within the context of an M&A transaction. Often, during M&A negotiations, a gap exists between the level of warranties that will be offered by a seller and the level of warranties that a buyer will accept. This can often lead to a deadlock between the parties and their advisors. An R&W insurance policy can bridge that gap by transferring certain risks to a third party.

Allied World's R&W policies are crafted specifically for each risk in order to give the best coverage available in today's market. Our aim is to maximize the coverage available to the insured by offering tailored policy terms and conditions.

## R&W INSURANCE OVERVIEW

The R&W policy helps eliminate negotiation obstacles. R&W insurance can be purchased by a buyer or a seller to protect against the loss or liability arising from an unknown or undisclosed matter and is normally put in place at the time of the transaction signing.

### “Seller Side” Policy:

A seller side R&W policy protects the warrantors for any losses suffered in the event that a buyer brings a claim for breach of a representation or warranty. The policy essentially ring-fences contingent liabilities associated with the sale of a business. Defense costs incurred are also covered under the policy. Circumstances prompting the need for R&W insurance include instances when a seller:

- offers a monetary cap on the warranty liability which is much lower than the minimum a buyer will accept
- is a private equity investor who will not give warranties as a matter of policy
- has concerns regarding its ability to meet its financial obligations under the warranties
- wishes to be relieved of future risk to facilitate a clean exit

### “Buyer Side” Policy:

A buyer side policy replaces the buyer's normal contractual recourse against a seller – protecting the buyer for any losses arising from a breach of a representation or warranty. In these cases, the R&W policy provides:

- the necessary level of recourse for the buyer when sellers are unable to offer sufficient protection – in cases where internal approval for an acquisition may be subject to a predetermined level of recourse, an R&W policy can be used to top-up this level
- policy proceeds to be assigned to a lending bank to form part of the bank's security package – an important enhancement for banks, especially for highly leveraged acquisitions
- the buyer with a direct claim against the insurer rather than pursuing sellers – saving time, money and helping to protect commercial relationships with sellers or incumbent management
- a strategic advantage in the context of an auction – the buyer can require a lower than usual indemnity from the sellers, thus distinguishing and enhancing the bid

## TARGET MARKETS

Allied World's Mergers & Acquisitions team is able to address all U.S. and Canadian domiciled risks.

## POLICY COVERAGE

Each policy can be tailored to each unique transaction. We can offer the following policy enhancements depending on the transaction dynamics:

- **Duration:** the policy period usually matches the period in the transaction document and, on a buyer side policy, can be extended beyond this period. For example, it may be possible to extend coverage for the general warranties under the policy to cover a second audit period. The policy period for tax claims will usually match the period in the transaction document (typically six or seven years).
- **Retention:** the insured must bear an element of the risk in the form of a retention before a claim can be made under the policy. This retention will typically be eroded by all contractual claims, not just those covered by the policy. This gives the insured certainty as to when policy funds will be available.

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- **Disclosure requirements:** warranties given in the transaction documents are typically qualified by a disclosure letter or schedule provided by the sellers. Our policy mirrors the disclosure standard set out in the transaction documents to eliminate coverage gaps.
- **No claims declaration:** our policy contains a 'no claims' declaration from the insured stating that they are not aware of any potential claims arising from a breach of the transaction agreement at the time of policy inception. The wording is very clear and focuses only on the insured's actual knowledge of a breach.
- **Environmental coverage:** our policy does not contain a standard environmental liability exclusion. We will consider providing coverage for contingent environmental risks on a risk-specific basis.

## EXCLUSIONS

Our R&W insurance policies contain certain exclusions, including defects that were within the knowledge of the insured or which were disclosed, forward-looking warranties, pension underfunding liabilities, insured fraud, and matters where the insured has recourse through a mechanism other than the warranties (for example, completion accounts adjustments).

## CAPACITY

Up to \$25M available

## PRICING FOR R&W INSURANCE

Each transaction is priced on its own merits and parameters. The premium charged is typically a percentage of the total limit of insurance purchased. Our goal is to offer commercial terms and pricing, while providing a responsive service. The following issues are considered:

- Target business and location
- Value of transaction
- Scope of the insured warranties
- Extent of liability under the SPA
- Gap between signing and closing
- Identity of the principals and their advisors
- Quality of the transaction process
- Market pressures

## THE UNDERWRITING PROCESS

Our dedicated team of M&A specialists have both the legal backgrounds and experience needed to offer tailored, transactional solutions. We offer access to real-time decision making, enabling an efficient process even when time frames are very tight. Upon receipt of relevant documentation, we can produce a non-binding quote – very quickly setting out the structure of the policy, its terms and conditions, and a range of pricing. Generally, our dedicated team follows a phased underwriting process, from submission of a risk to the binding of a policy:

- **Phase 1:** Internal legal review of all documents received to assess insurability of risk and provide a nonbinding indication, including limits, retention and proposed structure.
- **Phase 2:** If the Insured wishes to formally engage Allied World to fully underwrite the risk, we may execute an expense agreement whereby the insured agrees to be responsible for our fixed costs should they ultimately decide not to purchase the insurance.
- **Phase 3:** Provision of binding terms and finalization of the policy form. Where appropriate, we can ensure that a final policy is available simultaneously with the signing of the transaction documents.

## ADDITIONAL PRODUCT OFFERINGS

Additional Allied World M&A products include Tax Liability Insurance, and Special Situation/Contingent Risk Insurance including Litigation Buyout Insurance.

## CONTACT US

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