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2019 M&A Trend Alert | Utilization of Representation and Warranty Insurance

February 8, 2019 | Over the past several years, the M&A insurance space has changed significantly, particularly as it relates to representation and warranty (R&W) insurance.

Historically, R&W insurance – in the context of M&A transactions – has been an underutilized and virtually obscure product. Today, however, more entities recognize the myriad benefits it provides for both buyers and sellers. R&W insurance may enable buyers to offer more competitive bids, while sellers oftentimes receive a higher percentage of the sale proceeds compared to uninsured transactions.

Consider this: It is estimated that R&W insurance was utilized in less than five percent of all M&A five years ago. In 2018, estimates suggest R&W was at play in between 20 and 25 percent of all transactions. This trend isn't likely to change course, and here's why.

Without R&W insurance, a buyer will typically require a significant portion of the purchase price to be placed in escrow for up to 36 months, serving as an account from which indemnification obligations may be paid. Conversely, with R&W insurance, sellers receive a larger percentage of the sale price at closing. This is attractive to many constituencies, but particularly to private equity investors who want to return capital to their investors quickly.

As competition from insurers increases, buyers and sellers are seeing more favorable market terms. Current estimates are as follows:

- Coverage amount varies but is seldom more than 10 percent of the purchase price
- Premiums typically represent 2-4 percent of the coverage amount. It is usually the buyer who obtains the policy, with the buyer and seller negotiating who pays the premium
- Basket (or deductible) tends to be between 1-2 percent of the coverage amount, which is allocated between buyer and seller on a negotiated basis. Occasionally, the basket will decrease over time
- Term of the policies usually varies between three and six years, which oftentimes outlasts the survival period for non-insured indemnifications
- Generally, coverage is for only unknown breaches, so any matters contained in disclosure schedules to the Purchase Agreement are excluded

R&W insurance represents an important tool for both buyers and sellers. Participants in the M&A space should become familiar with the trends and current market terms of these products in order to maximize their position when negotiating deals.

For questions or more information, please contact Fairchild Morgan Law.

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