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M&A ACADEMY REPRESENTATIONS AND WARRANTIES INSURANCE

Presenter: Brian Keeler
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What is reps-and-warranties insurance?

- Insurance coverage that protects against losses from breaches of reps and warranties in an acquisition agreement
- May also cover breaches of tax indemnities
- First introduced in the US in 1998, but seldom used in M&A until recently
- In recent years, substantial increase in the use of reps-and-warranties insurance in M&A deals
- *E.g.*, in 2015, AIG alone closed 330+ insured deals
- More common in private company acquisitions than public deals

Why the increase in the use of reps-and-warranties insurance?

- Combination of “macro” M&A market factors and “micro” insurance policy factors
- Market Factors:
 - Hot sellers’ market
 - High seller leverage
 - Accelerated Processes
- Policy Factors:
 - Better pricing
 - Better process
 - Better terms

Who offers reps-and-warranties insurance?

- AIG
- AWAC
- Ambridge
- Beazley
- Chartis
- Chubb
- Concord
- Euclid (spinoff from AIG)
- Vale (f/k/a Maple Point)
- [etc.]

Types of reps-and-warranties insurance policies

- Buyer's policies: Buyer is insured; makes claims directly against the insurer
- Sellers' policies: Sellers are the insured; sellers pay buyer and are reimbursed by insurer
- Advantage of Buyer's policies:
 - Broader coverage, including for sellers' fraud
 - Extended terms
 - Higher liability caps
- Today, most policies issued are buyer's policies

Some metrics

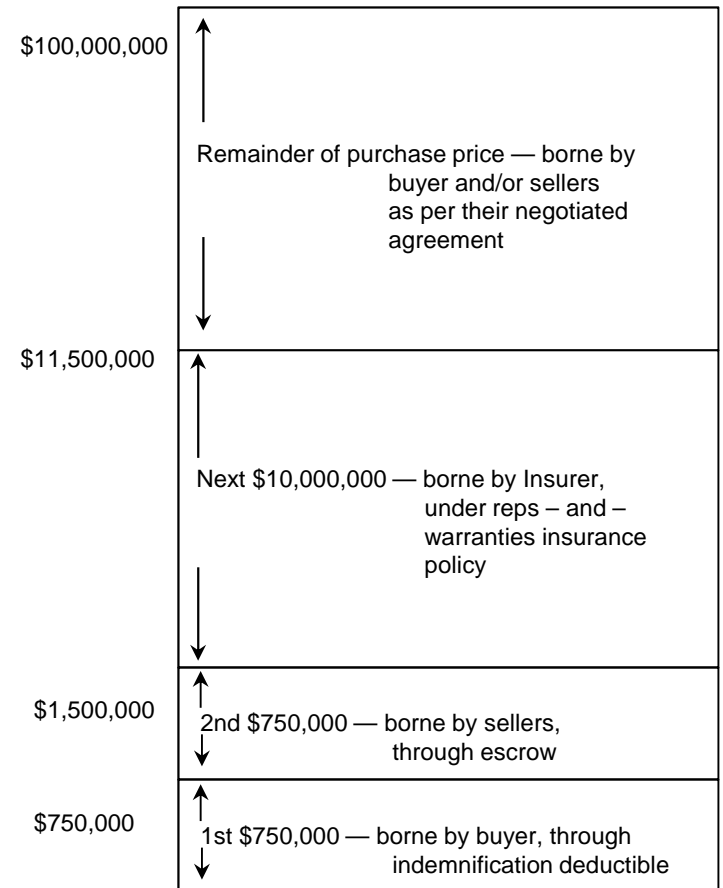
- Deal size: Target enterprise values from \$20 million to \$3 billion
- Policy limits: \$5 million to \$50 million per policy. Stacking of multiple policies is possible
- Pricing: ~3-4% of policy limit
- Retention: 1-2% of target enterprise value (with drop-down after 12 months)
 - Buyer and sellers can agree to share retention in various ways
- Policy period: Up to six years

Why use reps-and-warranties insurance?

- Sellers:
 - Limit (or eliminate) indemnity and escrow exposure; increase ROI
 - Expedite negotiations
 - Increase likelihood of getting to a signed agreement
- Buyers:
 - Increase protection against downside risks
 - Enhance competitive attractiveness of bid
 - Easier to collect
 - Expedite negotiations
 - Increase likelihood of getting to a signed agreement

Effect on deal terms

- *Hypothetical example – assume:*
 - \$100 million deal
 - \$10 million reps-and-warranties insurance
 - 1.5% retention
 - \$750,000 deductible
 - \$750,000 escrow (12 months)



The underwriting process

Underwriting process

- Engage broker, solicit non-binding indication letters (NBILs)
- Select insurer and pay diligence fee (\$25-50K)
- Insurer due diligence
- Negotiate policy terms
- Total time – 1-3 weeks start to finish

Underwriting considerations

Underwriting considerations

- Nature, size, history, and geography of target business
- Industry or geography specific risks
- Scope of reps and warranties
- Indemnification terms
- Quality of buyer's diligence
- Policy terms

Policy terms

- Policy Terms
- What is covered? All reps, fundamental and non-fundamental. Certain tax indemnities may also be covered.
- What is not covered?
 - Known problems
 - Losses covered by other insurance
 - Purchase price adjustments
 - Covenants (other than, possibly, certain tax covenants), estimates, projections and forward-looking information
 - Unfunded or underfunded benefit plans
 - Non-monetary relief
 - Asbestos and polychlorinated biphenyls
 - Deal-specific risks

Policy terms (continued)

- Policy terms (continued)
- Losses definitions
- Rollover equity
- Defense costs
- Subrogation
- Dispute resolution

Biography



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Brian Keeler focuses on negotiating and documenting complex corporate and commercial transactions, including mergers and acquisitions, private equity, and venture capital transactions.

Previously, Brian served as a law clerk to the Honorable Edward F. Hennessey, Chief Justice of the Supreme Judicial Court of Massachusetts. He is also a Certified Public Accountant. Before joining Morgan Lewis, Brian was a partner in the corporate practice group of another international law firm.

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