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M&A: The need for speed matched with evolving insurance product

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Mar 16, 2018

Mergers and acquisitions are heating up – and competition is fierce. With the uptick in activity, private equity firms are increasingly seeking out Representations and Warranties Insurance. In the past five years, the world of transactional insurance has seen a record high demand for this popular coverage. Why? Because with increased competition comes increased speed to closing.

Think of it like the real estate market: with competition high, buyers need to act quickly. When acting quickly, important details can be forgotten or overlooked. The intent of this innovative product is to protect a buyer from financial loss suffered due to inaccurate and/or unknown statements made by the seller.

The product has merit. Today's buyers need to respond to deals where sellers "walk away" from indemnifications at closing, or shortly after, thereby eliminating or reducing escrow funds and buyer access to seller for indemnification. Primarily sold on a buy-side basis to private equity sponsors while the purchase agreement is being negotiated, the coverage is highly customizable to fit the needs of the transaction at hand. In addition to the need for speed and flexibility, its popularity is being driven by decreasing premiums and access to decision makers.

The product has flexible terms and conditions: policy limit, policy period, retention, and coverage extensions such as consequential and multiplied damages are negotiable. Typical coverage today includes a limit that is 10 percent of purchase price, 1-2 percent retentions (with healthcare reps requiring higher retentions), and policy terms of two to six years. Premiums average 3 percent of limits purchased. Heightened focus areas include foreign operations, regulatory issues, tax, employment matters, cyber, and product warranty/recall exposures.

It should be noted there are exclusions with this coverage, such as covenants, actual knowledge, unfunded pension obligations, NOLs, forward looking statements, working capital adjustments, asbestos and other environmental exposures and specific deal issues that arise – but it provides the seller with a clean exit, and the buyer with protection against fraud. Everybody wins.

As noted in AIG's 2017 M&A Claims Report, the majority of representations and warranties claims stem from the following areas: financial statements, compliance with laws, material contracts, and tax. On a positive note, the claims are being paid out. From 2011 to 2015, we've seen average payouts of $3.5 million for claims between $1 million to $10 million and $300,000 for claims between $100,000 to $1 million.

Back in the day, buyers typically had two months to conduct due diligence, including proper fact-checking and insurance research. Today, they're lucky to have a full two weeks. When working under such stringent time constraints, it can be tempting to rush the process – making it vital for both parties to be adequately protected against mistakes or falsehoods. When seeking brokers, find the right fit. Make sure they work as an extension of your team, and are adept at operating within small windows and unique parameters.

Looking to buy? Make sure you have our number on speed-dial. It's 617-330-5706.

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