AIG

Financial Lines

Representations and Warranties Insurance

Inaccuracies in representations and warranties made by the seller or the target company in connection with a merger or acquisition can result in costly liabilities. Buyers can be left without the ability to recover losses and sellers can be forced to hand back a portion of the purchase price.

Representations and warranties insurance helps protect both buyers and sellers involved in these transactions from financial loss in the event inaccuracies in representations and warranties are made. By purchasing representation and warranties insurance, buyers can distinguish a bid, sellers can reduce indemnity obligations and both parties can close deals with ease and confidence.

Reducing Seller's Indemnity Obligations

A private equity firm was selling a portfolio company to a buyer for around $130 million. Initial drafts of the acquisition agreement considered that 10% of the purchase price would be placed in escrow for breaches of representations and warranties.

The seller contacted its insurance broker to explore the use of an insurance policy to reduce the escrow amount. After negotiations, AIG provided the buyer with a pre-negotiated buyer-side policy with an $11 million limit of liability above a $2 million deductible (to be borne by the seller in the form of a reduced escrow). By purchasing the representations and warranties coverage, the seller could dispose of its portfolio company with a significantly reduced escrow obligation and the buyer was able to obtain its desired level of protection.

Coverage Highlights

- Coverage is optimally suited for transactions involving companies valued between $25 million to $1 billion.
- Up to $100 million in coverage is available for any single transaction; larger programs can be structured on a case-by-case basis.
- Coverage is highly customized to individual transactions.
- Policy periods generally align with the survival period of the representations and warranties set forth in the acquisition agreement.
- Buyer-side cover can extend beyond the survival period of the representations and warranties that the buyer is receiving from the seller in the acquisition agreement.
- Typical premium is 2% to 4% of the amount of insurance purchased.
- Deductibles are typically 1% to 3% of the transaction value (based on variables such as the type of business being acquired, the nature and scope of the representations and warranties being insured, the due diligence, etc.).

Key Advantages for Sellers

- Reduces the risk of contingent liabilities arising from future representations and warranties claims, allowing sellers to lock in their return on investment and cleanly exit a business or industry.
- Distributes all or most of the sale proceeds to investors or uses proceeds to pay down existing debt.
- Protects passive sellers who have not controlled or been actively involved in the management of the target business from unintentional non-disclosure or breaches of representations and warranties.
- Expedites a sale and potentially increases the purchase price by eliminating obstacles to closing, such as indemnity negotiations.

Representations and Warranties Insurance

Distinguishing an Auction

An investment bank conducted an auction bid of an IT staffing company owned by a financial sponsor and company management. In order to distinguish its bid, a private equity firm bidder contacted its insurance broker. AIG provided a quote for a buyer-side representations and warranties policy with a $10 million limit of liability above the sellers' minimal indemnity (which served as the deductible). Confident it would have this coverage in place if it won the auction, the private equity firm submitted its bid with a lower than customary indemnification request and won. Following an underwriting review, the policy was bound at closing. The buyer won the auction without sacrificing its protection for breaches of representations and warranties.

Key Advantages for Buyers

- Enhances protection for breaches of representations and warranties, supplementing the indemnification provided by the sellers.
- Extends the duration of representations and warranties, affording buyers additional time to detect and report problems that may exist with the acquired business.
- Distinguishes a bid in a competitive auction by accepting a lower than customary indemnification from the sellers and supplementing this indemnification with representations and warranties insurance.
- Eases concerns about the ability to collect on the sellers' indemnification due to the sellers' poor financial condition or other practical considerations (e.g., sellers may be numerous, geographically dispersed or difficult to locate).
- Protects relationships with the sellers who may become the buyers' key employees or commercial business partners after the closing.

Expert Claim and Litigation Management

- In the event of a claim, AIG has a claims team dedicated to transactional insurance, including representations and warranties insurance. These seasoned professionals specialize in disputes surrounding complex transactions and in processing customer claims in a professional and expedient manner.
- Representations and warranties insurance is part of a suite of insurance products that AIG offers for the spectrum of exposures inherent in mergers, acquisitions, divestitures and other transactions. Other products in the suite include tax liability insurance and contingent liability insurance.

To learn more about representations and warranties insurance, please contact:

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