INDUSTRY PANEL DISCUSSION
FAEGRE BAKER DANIELS
The Deal

M&A INSURANCE GOES MAINSTREAM

Lower premiums and policy changes increase use of RWI

EDITED BY CHARLES WALLACE

Representations and warranties insurance for mergers and acquisition deals, once very costly and time-consuming to obtain, has seen a dramatic reduction in price in recent years and can now be arranged in as little as one week, according to a panel of insurance experts. As a result, use of this insurance in M&A transactions is becoming increasingly common.

Recent developments in the market for representations and warranties insurance (RWI) were discussed at the M&A conference of international law firm **Faegre Baker Daniels** in Minneapolis on November 7.

Entitled "M&A Insurance: The Bigfoot of the Deal World or Another Tool in Your M&A Toolbox?" the panel included **Jay Rittberg**, **vice president of mergers and acquisitions insurance at insurer AIG; Craig Schioppo, managing director of Marsh USA's transactional risk group**; and **Melanie Wadsworth, a partner at Faegre Baker Daniels** who focuses on corporate finance, including M&A deals. The discussion was moderated by **Cathy Gryczan of Faegre Baker Daniels**.

When a buyer and seller agree on an M&A transaction, the seller is often required to provide escrow for a period of time and indemnities for a percentage of the sale price to protect against breaches of the representations and warranties made by the seller about the target company. These include such issues as the accuracy of financial statements, undisclosed liabilities, environmental matters and tax problems.

MELANIE WADSWORTH

JAY RITTBERG

In the past, buyers were reluctant to accept insurance to cover these issues but in today's sellers market, with several buyers frequently vying to purchase a company, RWI is becoming more accepted, especially in middle market deals of between $20 million and $1 billion.

Most insurance carriers have a maximum amount they will insure, usually between $20 million and $40 million, though AIG's maximum is $50 million. It's possible to layer carriers' coverage on a deal, so the insured can buy a total of about $300 million in coverage. That amount would be for a $2 billion deal.

Rittberg told the panel that the increase in the use of RWI has been dramatic, noting that his firm had written insurance on 15 deals in October alone, compared with 30 policies written in all of 2011. Schioppo added that he expected a total of 750 to 800 M&A deals to be insured this year.

Wadsworth said she believed the policies were becoming more popular because more insurers are entering the market, causing premiums to decline dramatically. Insurers also need much less time currently to get a policy written. "It used to be that it would take a

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couple of months to sort out a policy and make sure it really tied in with your share purchase agreement," Wadsworth said. "Now you can do that in a space of probably two or three weeks and therefore it's much less likely to have an adverse impact on the deal timetable."

In the U.S., Rittberg said it is now possible to get a policy written in a matter of days, although the average is about a week.

Schioppo said that as recently as 2004, premiums were at 5-6% of the amount insured. They have now declined to the 2-4% range, with the difference depending on how the deal is structured. "If you have an escrow and you are building on that, maybe it's at the low end of the range," he said. "But usually you see things at about three cents on the dollar. When you realize that most of these policies go out six or seven years, that's pretty cheap."

Wadsworth added that premiums in Europe tended to be less than in the United States, because the U.S. is more litigious than most European jurisdictions.

Rittberg said RWI has become more popular with the buy-side recently. "If a buyer is bidding on an attractive asset and wants to make their auction bid more attractive to the seller, they can purchase insurance and offer the sellers no indemnity exit or a very limited indemnity exit," he said.

On the sell-side, private equity sellers who want to liquidate their funds or get their money out immediately after the closing have been driving the process. "A lot of financial sellers are making buyers purchase the insurance or pushing them towards buying," says Schioppo. "So, while the buyer is the insured, it may not have been their idea at all."

CATHERINE GRYCZAN

CRAIG SCHIOPPO

Asked about how to get the right policy for a deal, Wadsworth said the key phrase was dovetail. "You really need to make sure that the disconnect between your share purchase agreement and the policy itself is as limited as possible," she said. "One of the biggest things we focus on is how loss is defined."

Rittberg said that insurers don't want to change the way buyers and sellers are approaching the due diligence process. "We want to keep the way that buyers look at businesses and inspect and make sure there aren't big problems," he said. 'We don't want to change that by what we're doing."

On the question of exclusions, Rittberg said his firm would not insure for a breach of a representation that was known about before the policy was issued. Schioppo said criminal fines are not included because that is illegal. Environmental representations are generally covered, he said, but not covered is a known issue such as a leaking oil tank or anything involving asbestos.

Asked about why RWI was more common in cross-border deals, Wadsworth said in such deals there was more nervousness on the part of buyers. "Often for buyers when they're operating in jurisdictions they understand less well, where there's perhaps less transparency, getting to grips with the disclosures is more difficult," Wadsworth said.

Schioppo credited the insurance industry with responding to earlier criticism of their RWI policies and making the necessary adjustments to make their policies more accessible to the M&A community. "When you see this now, it's only going up," he said. What we've done collectively, and I give the legal community a big hand for helping us and being champions of these policies. I think you are going to see this business keep growing and becoming more and more mainstream." ■