



Innovative Insurance Solutions for Today's Mergers & Acquisitions

Cliff Rudolph, Principal, Vice President // **Parker, Smith & Feek**

The year 2015 set a record for mergers and acquisitions (M&A) activity with more than \$2.1 trillion in deals reported in the United States. Melissa Crowe of the *Puget Sound Business Journal* reported that Washington's 50 largest deals of 2015 accounted for more than \$17 billion. While the first quarter of 2016 has slowed, a recent survey by Deloitte reported 87% of respondents expected deal activity to sustain or increase over last year.

If record valuations and low interest rates were fuel to 2015's M&A activity, transactional insurance may have been the match. To facilitate a deal, buyers offered to procure representations and warranties insurance (RWI), which reduced the necessary amount of purchasing price held in escrow for indemnification of breaches in the representations and warranties. RWI provides protection against financial loss for certain unintentional and unknown breaches of the seller's representation and warranties made in an acquisition or merger agreement. Benefits include:

- Protection of the buyer beyond the negotiated indemnity cap and survival limitations in a purchase agreement
- Provides the seller with a clean exit by reducing or eliminating the need to establish escrows or purchase price holdbacks, thereby enabling the seller to quickly distribute greater portions of the purchase price to its investor(s) or owner(s)
- Enhances the seller's return on capital in the current low interest rate environment
- Protects the buyer against the collectability or solvency risk of an unsecured indemnity by a seller
- Enhances a buyer's bid in a competitive auction process by requiring a seller to provide short survival periods, modest liability caps, and reduced escrow amounts for breaches of representations and warranties in a bidder's draft purchase agreement
- Preserves key relationships by mitigating the need for a buyer to pursue claims against management sellers working for the buyer

While RWI has been around since the 90's, broader coverage and a significant drop in premium have resulted in four times the number of deals insured since 2012. Recently, real estate transactions in which the entity holding the real estate is the target of the

M&A have also been considered by a handful of insurers. As for cost, a properly structured RWI policy will cost the buyer between 2-3.5% of the coverage limit. For example, a \$10 million dollar policy will cost about \$250,000-\$300,000. Typically, this will include a deductible of 1-3% of the total transaction value, and underwriting fees of \$25,000-\$50,000 (although insurers can provide an indication of what the premium would be at no cost).

Most importantly, claims are being paid. In a recent study of United States Insureds published by AIG, 15% of deals valued at less than \$100 million resulted in a RWI claim. Furthermore, properly written policies will consider coverage for multiple based damages, such as when damages are expressed as a multiple of a negotiated EBITA.

While this article has highlighted the value of RWI, it is highly recommended you consult with your insurance broker on the following as part of your M&A due diligence:

- RWI
- Tax liability insurance
- Contingent liability insurance
- Run off and tail for existing D&O and E&O policies
- Employee benefit review including compliance, plan funding mechanisms, and future needs assessment
- Pro forma insurance budget for future merged organization

In today's M&A market, regardless of whether you are a buyer or seller, you should consider transactional insurance. Specifically, RWI helps protect both buyers and sellers involved in these transactions from financial loss in the event inaccuracies in representations and warranties are made. If you are a buyer, including RWI may give your offer the competitive advantage in today's hot M&A marketplace that you need to get the deal. If you are selling, request that bidders include RWI in their offers, which enables you to maximize your liquidity and lower your indemnity obligations. In the end, both parties can close the deal with confidence.

RWI helps protect both buyers and sellers

Parker, Smith & Feek is a full service brokerage firm providing commercial insurance, risk management, surety, benefits, and personal insurance solutions. Cliff Rudolph is a Principal at Parker, Smith, & Feek and leads the firm's Manufacturing Practice Group with a focus on middle market privately owned businesses. He is also a significant contributor to the firm's Private Equity Practice. You can reach him at (425)-709-3705, or cerudolph@psfinc.com

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