

# Representations & Warranties Insurance

Sourcing a deal is challenging. Completing the transaction is even more so as increasing complications, requirements, and post-close liability (i.e., trailing risk) require careful attention and often extended negotiation in respect of Representations and Warranties (“Reps & Warranties”).

Reps & Warranties are the contractual means by which buyers and sellers allocate risk and indemnity obligations related to a transaction. Allocating risk and indemnity is one thing, enforcing the arrangement is something else, presenting risks and potential delay. To mitigate the risks, expedite the closing and secure the financial interests of both parties, buyers and sellers are increasingly turning to Transaction Liability Coverage (a.k.a. Reps & Warranties Insurance). Simply put, Reps & Warranties insurance shifts potential liability for unintentional and unknown breaches of representations and warranties to an insurer, for a fixed cost.

## Reps & Warranties Clarified

A representation and warranty is a statement of fact. It can relate to the past, present or future. It can be made by the buyer or seller; if it turns out to be false, it entitles the other party to a remedy (i.e., indemnity). An indemnity is a promise to pay an amount to the other party if a representation proves to be false and results in a loss. Often, a great deal of time (and money) is spent negotiating the allocation of risk and related provisions for indemnity related to representations and warranties. Generally, the seller’s representations and warranties are considerably more extensive than the buyer’s.

Sellers try to limit the risk of a breach by narrowing the scope of the representations and warranties, as well as arguing for qualifiers regarding materiality and knowledge. Conversely, buyers seek broad representations and warranties that cover many aspects of the business, regardless of materiality or knowledge of the sellers. The scope of the representations and warranties becomes significant when viewed with respect to indemnification for breaches.

A buyer wants to ensure it receives the benefit of the bargain and is not burdened with unforeseen liabilities or damages following a closing. If unforeseen liabilities or damages arise post-closing, a buyer will argue that the seller breached its representations and warranties, and must therefore indemnify

the buyer for these liabilities and damages. Even though a buyer may be entitled to indemnification, it also needs to consider its ability to collect from the seller. Buyers frequently request a hold back of the purchase price, a third-party escrow, or a post-closing earnout to ensure that the funds will be available for indemnification.

The seller wants to realize as much of the purchase price as possible, up front, and eliminate/reduce the possibility that funds will be returned or forfeited through indemnity. To create greater certainty, sellers seek to negotiate limitations on indemnification, such as baskets, caps and survival periods.

## Buying and Selling Simplified

Reps & Warranties insurance can serve the interests of both buyers and sellers by eliminating complications, mitigating risk and reducing stressful negotiations. The cost of a Reps & Warranties insurance policy is typically 2% to 3.75% of the limits insured under the policy. The policy period may be the same and is often longer than survival period for indemnification in the underlying transaction agreement.

From a seller’s point of view, if the indemnification is limited to the policy, the time period is less important other than with respect to the payment of the retention (a.k.a. deductible), which is often funded by the seller. When a claim is made under a Reps & Warranties insurance policy, the payments from the insurance company are adjusted by the retention, typically in the range of 1% to 3% of the transaction value, the agreed upon purchase price.

Reps & Warranties insurance can cover most of the representations and warranties contained in a purchase agreement, including those relating to taxes and possibly environmental conditions. Items typically excluded are forward-looking statements and projections, covenants, known or disclosed items, asbestos, some environmental issues such as PCBs and pension underfunding liability. Additional deal specific exclusions may also be added.

Depending on the policy purpose, premiums may be borne by seller (more often) or buyer and the responsibility for the retention will be subject to negotiation.

## Benefits of Reps & Warranties Insurance

Both buyers and sellers are using Reps & Warranties insurance policies more frequently in a competitive marketplace. Buyers often present Reps & Warranties insurance as part of their bid as a way to distinguish the offer and provide greater certainty to the seller. Sellers will use a Reps & Warranties policy to expedite the due diligence process, provide greater certainty to seller thus enhancing deal value and facilitate a clean exit from the business with limited recourse.

Buyers and sellers will frequently agree to use Reps & Warranties insurance as a bridge to close gaps over escrows, deductibles and caps. In addition, lenders are increasingly looking for Reps & Warranties as a means to reduce risk. It is advisable to engage insurers early to get maximum value out of Reps & Warranties insurance. Underwriters will review available information and issue non-binding indication letters. This informs buyers and/or sellers and forms a foundation that focuses discussions and expedites both diligence and negotiations. As the transaction process continues, and if Reps & Warranties coverage is desired, additional information will be provided to the selected insurer. Insurers usually charge \$15,000 to \$40,000 to perform the due diligence necessary to approve coverage. A policy or policies in form and amounts specified by the parties can then be agreed to, with coverage bound at closing.



*Let us be your guide forward*



**Kyle P. Frigon**  
Director

kfrigon@cherrybekaertbenefits.com

[cherrybekaertbenefits.com](http://cherrybekaertbenefits.com)

12.26.18

## Reps & Warranties Coverage for Buyers:

Expands and often increases protection against breaches of reps and warranties.

Extend the duration and backstop the indemnity package.

Reduces or eliminates risk related to buyer's ability to collect from seller.

Indemnification against losses attributable to inaccuracies or breaches of various representations and warranties made by the seller.

Eliminates risk associated with seller resistance or inability to honor indemnity commitments.

Bid enhancement.

## For Sellers:

Reduces or eliminates escrow of proceeds and/or deferred payments.

Expedites sale and potentially increases purchase price.

Eliminates or reduces seller's indemnity liability.

Protects against unknown or unforeseen breach of representation and warranties.

## For Both Parties:

With fewer issues to negotiate and insurance to cover certain risks, the transaction moves along more quickly, financing requirements are more easily satisfied and total costs are often less.

May provide the certainty that gets the deal done.

May increase deal value.

Buyer gets the company sooner and the seller gets the proceeds sooner.

### ADDITIONAL INFORMATION

Cherry Bekaert Benefits Consulting provides comprehensive consulting and administrative services with respect to all forms of employee benefits, property/casualty insurance, risk management, compensation, human resources consulting, private client and executive life insurance, and qualified and non-qualified retirement plans. For additional information about our services, please contact Kyle Frigon at 404.731.0608 or via e-mail: [kfrigon@cherrybekaertbenefits.com](mailto:kfrigon@cherrybekaertbenefits.com)