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TOP TIPS FOR LANDING THE BEST R&W POLICY

Akin Gump's David D'Urso, David Antheil and Kevin Tsai outline the steps dealmakers should follow to secure the best possible representation and warranty insurance, or RWI, in M&A transactions. Sponsored

The following article was written by partners David D'Urso and David Antheil and counsel Kevin Tsai of the law firm Akin Gump Strauss Hauer & Feld LLP.

Now that the use of representation and warranty insurance, or RWI, has become ubiquitous in M&A transactions, the question dealmakers should be asking is not whether they should be using RWI but what steps they can take to secure the best possible policies in the market.

M&A investors who invest time in building an understanding of the RWI market will be the best-placed to know what to ask for and how to negotiate R&W coverage on the most attractive terms and pricing.

This article outlines key issues RWI users should consider when reviewing bids from carriers, what criteria to think about when selecting an RWI carrier, the coverage options and enhancements available in the market and how to effectively harness the market knowledge of brokers to deliver the best results.

Akin Gump's David D'Urso, David Antheil and Kevin Tsai

Reviewing Bids at Term Sheet Stage

M&A investors should always review the scope of coverage outlined in the nonbinding indication letter, or NBIL, from insurers. This should include an evaluation of the purchase agreement representations, ancillary agreement representations, other certifications and the appropriateness of any deal-specific and standard exclusions.

M&A investors also should look at the scope of heightened risks in the target's core operations, the scope of diligence underway and any matters that may have already been noted in diligence.

Reviewing the scope of coverage and scope of heightened risks has become especially important following Covid-19, as exclusions have been included because of the pandemic. Given the competitiveness of the market, however, a thoughtful approach can see insurers reconsider some exclusions to secure the business of an M&A investor.

Other substantive coverage terms that should also be included in any RWI review at the NBIL stage include excess coverage positions, loss definitions, the amount of insurance recourse in the event of a material rollover/co-investment or minority investment, and materiality scrapes.

A review of these items is important for ensuring consistency with the acquisition agreement. Previously, coverage of consequential and multiple damages was explicitly excluded from policy coverage, but more recently the door has been left ajar for buyers to seek these damages if the purchase agreement doesn't mention them.

Options and Enhancements

Following a scope of coverage review, dealmakers are in a better position to assess what coverage options and enhancements could be available to them.

Insurers, for example, are now customarily providing indemnity for the pre-closing taxes of the target and its subsidiaries for up to six years after closing, although this still excludes transfer taxes and taxes accurately accrued. It is worth noting that insurers are willing to cover existing pre-closing tax indemnity or to incorporate an acceptable version of a pre-closing tax indemnity into the policy, even if absent from the acquisition agreement.

Dealmakers will also find insurers open to providing special coverage for items such as cybersecurity and intellectual property, and there are options to lock in longer periods of representation survival beyond the usual six years, subject to paying a premium for coverage.

Selecting the Right RWI Carrier

Underwriter selection is a crucial part of securing R&W cover that is best suited to an M&A investor's specific requirements for a deal. Choosing a carrier should be based on a variety of considerations.

The strength of terms indicated during the nonbinding quote stage, based upon review of preliminary deal information, will give dealmakers a good indication of whether a carrier is a good fit. The number of providers servicing the market has grown strongly during the past five years, supporting the development of broader, buyer-friendly coverage. Make sure the offer on the table reflects this trend.

The claims experience and reputation of the underwriter should also be factored into the selection criteria, as should any commercial experience with the underwriter. Larger, established carriers have built up an increasing track record of positive claims payments, but newer entrants still present an unproven option when trying to anticipate the degree of coordination and claims process functionality.

Dealmakers also can leverage their existing relationship with insurers, as well as the relationships of their brokers, to strengthen their position in underwriting and claims scenarios.

Building a picture of an underwriter's team size and bandwidth, experience of the target company industry and ability to execute within the deal timing parameters is also essential. As the market has become more competitive, the underwriting process has become more efficient. M&A investors must ensure their carrier can keep pace with deal processes to avoid delays and get deals over the line.

Leverage Broker Knowledge

The role of third-party advisers and brokers in finding the best available policies should not be underestimated either.

It is important that a buyer's broker is in the insurance market every day to take advantage of the trends and maximize the value of coverage for their client. Brokers will see a significantly higher volume of R&W policies and will be able to share how the terms, processes and risk thresholds of various providers compare to each other and advise on which underwriters are the best fit for a particular deal. Without the support of a broker with a finger on the pulse of the market, differentiating providers bidding for a deal becomes difficult.

Given the speed at which the M&A deal process moves and the expectations of clients and counsel for the RWI underwriting process to match up to the overall deal process, brokers must also be highly attuned to the purpose of and process for using transactional insurance.

The more aligned a client's broker and advisers are with respect to how to optimize the underwriting process, the better results will be for the client's coverage and the deal overall.

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