



## MERGERS AND ACQUISITIONS

---

Representations and  
Warranty Insurance  
Policies

**Geoffrey Cowling**  
Managing Partner

Local Touch. National Strength.™



The ability to insure risks associated with the acquisition or divestiture of an entity, or its assets, is an evolving area in the risk and insurance field.

During a merger or acquisition situation, as with any transaction, there is the potential for malfeasance, misrepresentation, innocent error, or risks deemed too great to accept for either the buyer or the seller. In the past, a buyer or a seller had to rely solely on their own due diligence process and accepted risks associated with a transaction as the price of doing business.

Typically, the seller (or shareholders), agree to indemnify the buyer subject to caps, exclusions, and time limits for breaches of the seller's representations and warranties. Often, the indemnity has been backed by an escrow of a portion of the proceeds otherwise payable at closing, often 10% to 15% for one or two years. The use of Representation and Warranties insurance is modifying or eliminating this traditional structure.

The use of Representations and Warranties insurance is modifying or eliminating this traditional structure. Representations and Warranties insurance products are available to mitigate these risks, with their primary goal being to facilitate the closing of a transaction between parties by offsetting the risks that one party or the other may deem too onerous.

Policies are available for either the buyer or the seller and can be purchased by either party. Sellers' and buyers' policies are designed to cover the general representations and warranties as well as any tax covenants or representations.

## **When would insurance be used?**

- To enable a transaction to proceed.
- To provide adequate level of warranty recourse to the buyer.
- To enable the seller(s) to utilize sale proceeds immediately (allow investment funds to make distributions to investors).
- Where there is a mismatch in the expectations of the parties on risk allocation.
- To allow the parties to 'get comfortable' with their negotiated position.
- To remove risks associated with cross-border acquisitions.



## Seller Side Policies:

Cover is written to respond directly to action for breach of warranty or tax covenant in the Sale and Purchase Agreement (SPA) by sellers/warrantors:

- Defence costs cover included within policy.
- Interests aligned with Insured – (i.e. to defend a claim vs. buyer).
- Flexibility/discretion on claims management.
- There must be a liability which is being insured.

## Buyer Side Policies:

Cover is written as an addition to or, at times, alongside the liability of the seller/warrantor under the SPA. A Buyer side policy will:

- Protect the buyer against risk of fraud by the seller.
  - Policy gives the buyer the benefit of simply claiming against the Insurer, a single entity with a S&P A+ rating.
- Increase financial recourse available or extend time periods under the SPA, or both.
- Mirror many of the SPA provisions but not seller's cap and time limitations.
- Offer a policy retention typically set at seller/warrantor cap.
- Be structured to achieve a seller clean exit (i.e. little or no post-close liability for seller) – subject to adequate disclosure and the buyer retaining some first loss liability.
- Entice the seller to give more extensive representations and warranties in the acquisition agreement, this improves the buyer's likelihood of prevailing on a claim under the policy.



## What is not covered by a Representations and Warranties Policy:

- Liabilities beyond the scope of the representations and warranties contained in the SPA.
- There are “standard” exclusions to coverage that the insurance does not cover such as covenant breaches by the seller or purchase price adjustments, and there may be specifically tailored exclusions based on the results of the insurance company’s underwriting.
- Actual knowledge of the insured (insured being the recipient of claim proceeds under the policy).
- A Representations and Warranties policy is not a substitute for:
  - Proper disclosure by seller.
  - Proper due diligence by buyer.
  - Proper negotiation.

## The Process

As with any insurance product the more information and time available, the better. The process for obtaining a policy usually starts with the buyer or seller approaching Iridium Risk Services to solicit quotes from insurance companies.

Insurers will sometimes charge a due diligence fee which can be credited against premium when a policy is purchased. They will require access to the data room and will participate in non-disclosure and confidentiality agreements on the same basis as any transactional advisory firm.

As the cover will closely mirror the SPA, regular updates and any changes to the SPA will be required to be notified prior to binding cover.

---

*If you have questions specific to your business, or would like additional information, please reach out to your Iridium Risk Advisor.*

---

**LET US HELP YOU MANAGE YOUR RISK**

Suite 1100, Bow Valley Square 3  
225 - 5th Avenue SW  
Calgary AB T2P 3G6

403.263.9654  
[www.irsnvacord.com](http://www.irsnvacord.com)  
[info@irsnvacord.com](mailto:info@irsnvacord.com)

Local Touch. National Strength.™