

M&A Insurance in 2022

An update for strategic buyers on the market for representation and warranty insurance | January 26, 2022

R&W INSURANCE

A REFRESHER ON THE
PRODUCT AND ITS ROLE

Representations and Warranties Insurance

From Novelty to Typical in Just a Few Years

R&W insurance (RWI) is used in mergers and acquisitions to protect against covered losses arising due to the seller's breach of certain of its representations and warranties in the acquisition agreement.

This is risk that would ordinarily be allocated to the Seller, subject to negotiated limitations

Structure (including Seller indemnity and Buyer deductible) depends on objectives of parties

Policies can be designed to supplement Seller indemnification obligations or function as Buyer's sole source of recovery (the latter becoming more common)

More commonly associated with mid-market M&A transactions but possible to put in place coverage value in excess of \$1B

- **Representations and Warranties Insurance
Enhanced Indemnity**

A buyer-side RWI policy may enhance a buyer's potential for recovery rather than simply replace the typical seller's indemnity.

**Survival
Period**

**Materiality
Scrape**

**Definition of
Loss**

**Policy
Limits**

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Representations and Warranties Insurance

Coverage Highlights

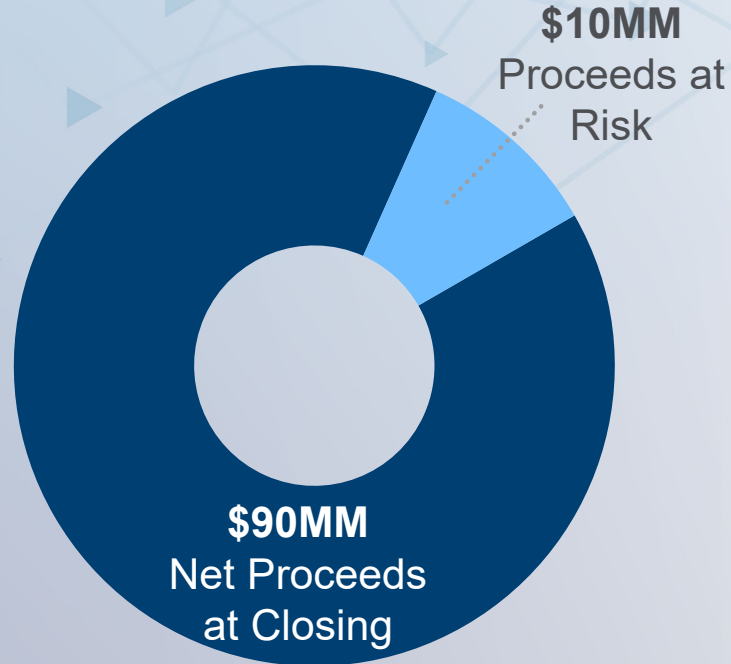
Duration of Policy	Three years for general reps; Six years for fundamental and tax reps
Coverage Limits	Typically 10% of enterprise value / purchase price (up to 100% potentially available)
Retention/ Deductible	Typically 1% of enterprise value, dropping down to 0.5% at 12 months
Definition of Loss	Policy silent with respect to consequential damages (additional losses incurred as a consequence of a direct loss) and multiplied damages (losses based on an EBITDA multiple)
Standard Exclusions	Matters known to the Insured or that were not given any/enough due diligence, interim breaches, forward looking statements, working capital adjustments, asbestos, PCBs and CFCs, pension underfunding or withdrawal liability, transfer pricing and the carry-forward value of NOLs and other deferred tax assets.



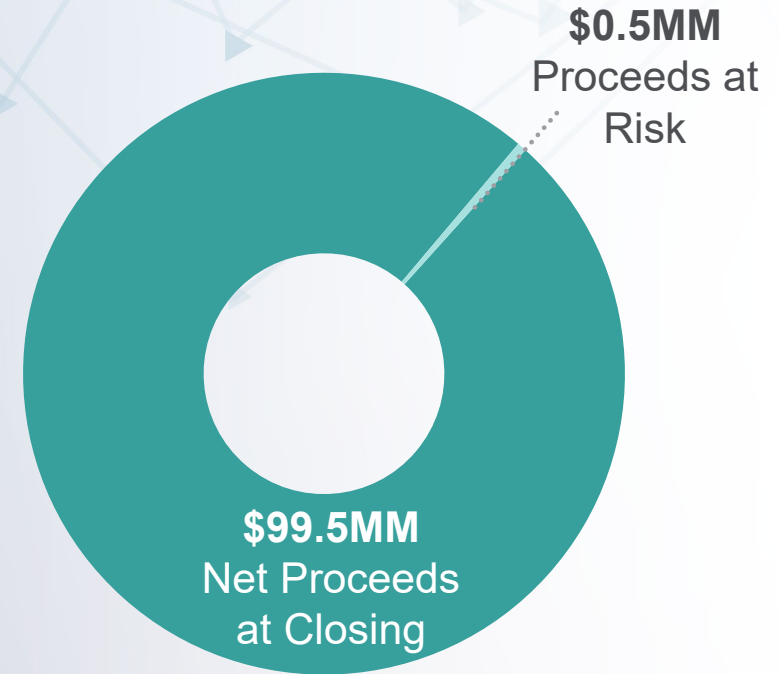
Representations and Warranties Insurance

RWI allows sellers to close a deal with limited or no indemnity and can make a buyer's bid more attractive.

Traditional Deal Structure



Representations & Warranties Policy



*Seller may cover a share of policy premium

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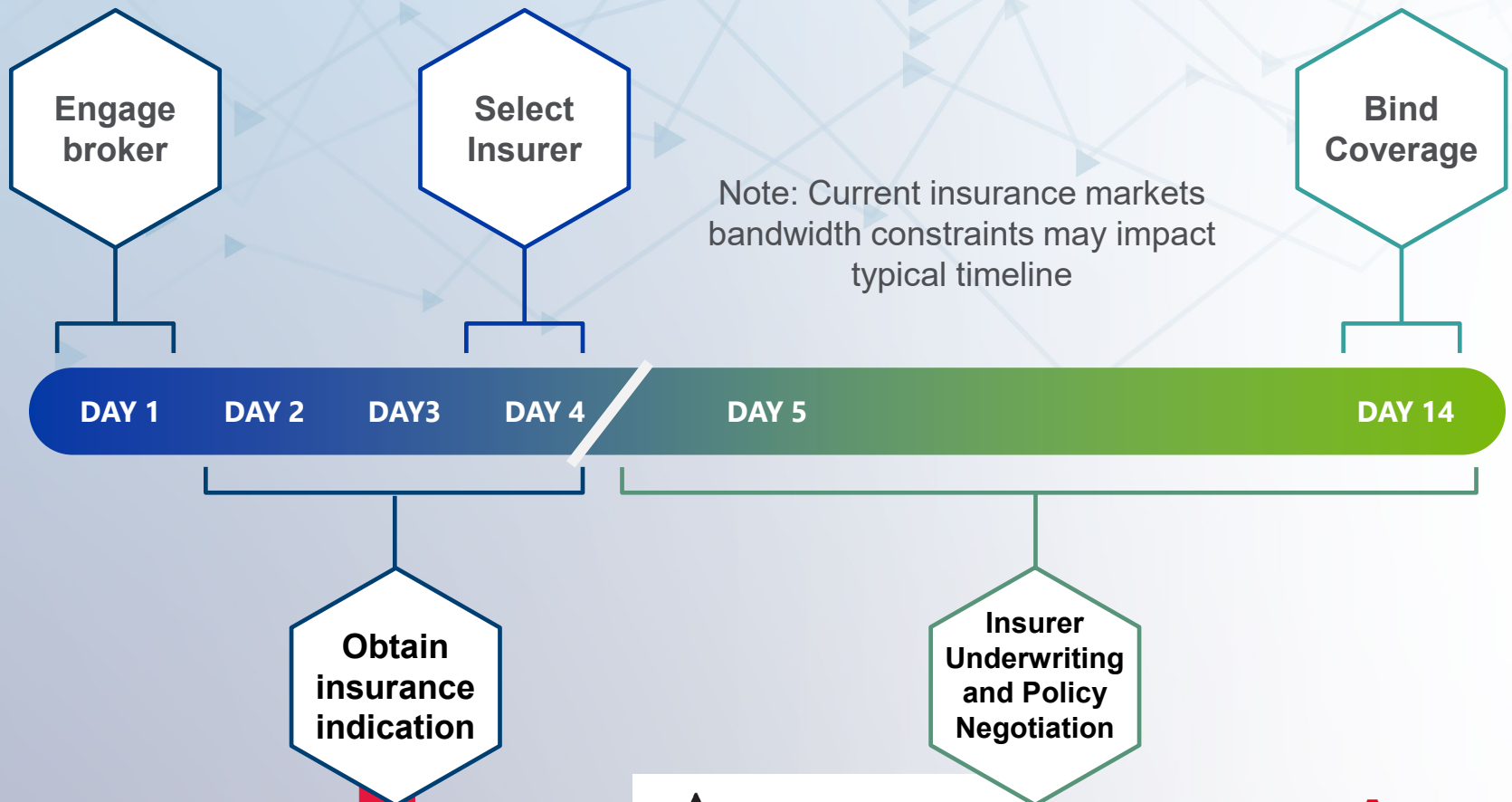
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Representations and Warranties Insurance

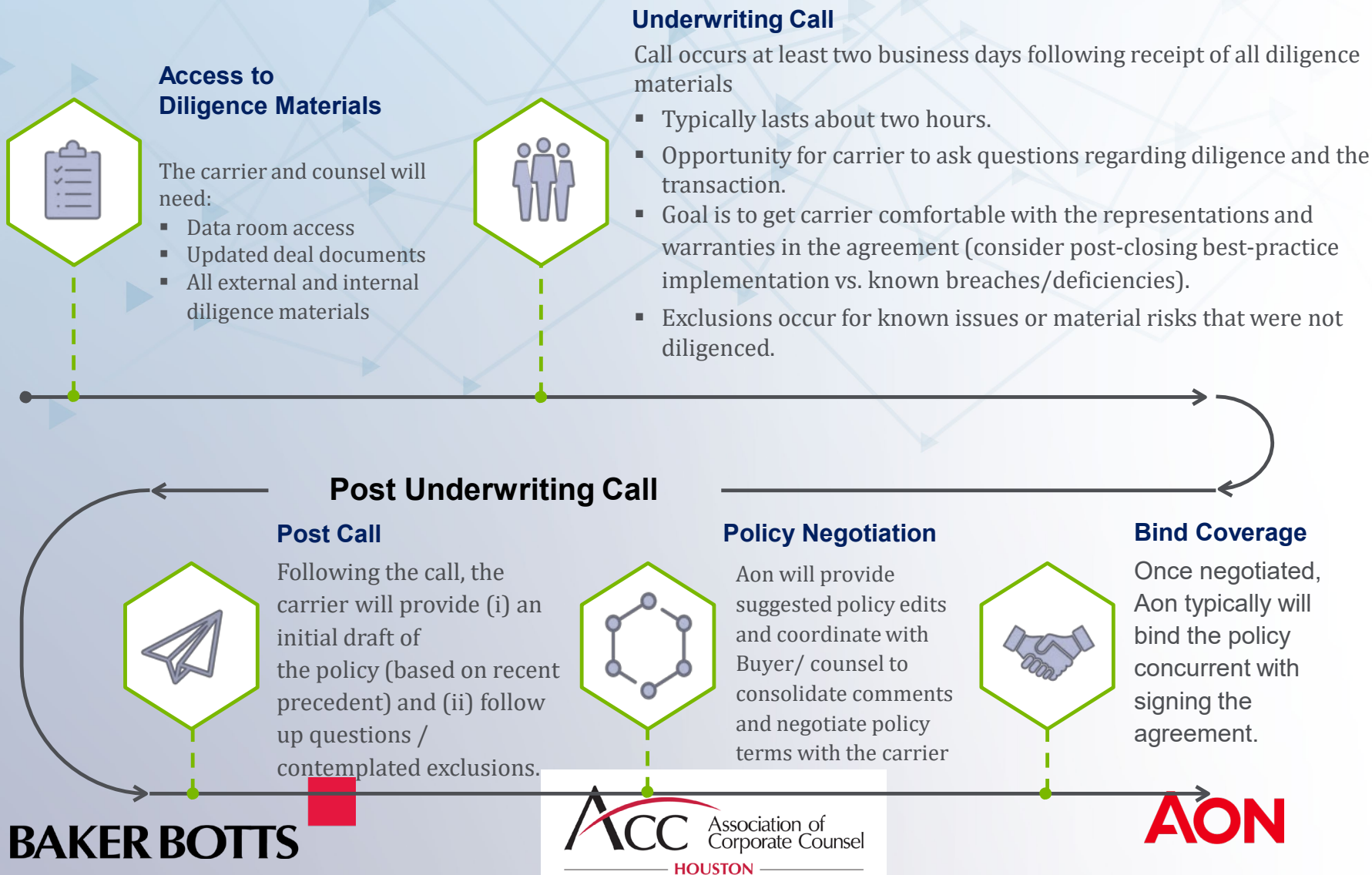
Process and Timing

Partnering with your deal counsel and an RWI broker that is fluent in the product is critical to a smooth deal process.



Representations and Warranties Insurance

Underwriting & Diligence Process and Timing



Representations and Warranties Insurance

Coverage Exclusions

Standard Exclusions

- Actual Knowledge of Breach
- Purchase Price/Working Capital Adjustment
- NOLs
- Pension Underfunding / Withdrawal Liability
- Forward looking statements
- Asbestos, PCBs and CFCs
- Interim Breaches*
- Transfer Pricing*
- COVID

Deal Specific Exclusions

- Material known issues discovered in diligence likely to result in a breach
 - Language tailored to specific identified issue (no catchall)
 - Materiality viewed as respects policy retention

Representations and Warranties Insurance

Coverage Exclusions (Cont'd)



Sample Deal Specific Exclusions

- Arises out of or results from any failure of the Target to pay sales or use taxes or file sales or use tax returns in Arkansas, Arizona, Minnesota or South Carolina
- Arises out of or results from any failure of the Target to pay income and/or franchise taxes or file income and/or franchise tax returns in Virginia
- Arising from or related to the failure to pay, remit or otherwise satisfy any non-US Tax liability or obligation, including any interests or penalties thereon
- Arising out of or resulting from the Target Group's failure to obtain prior express written consent from patients for automated text messaging
- Arising out of or resulting from the misclassification of Nick XXX as an exempt employee and of Sharon XXX, Jack XXX, Michele XXX, and individuals retained pursuant to the Target Group's agreement with XXX as independent contractors

RWI TRENDS 02

Expanding Range of Deal Structures

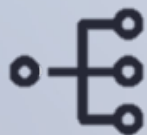
Standard
M&A



Public
company



Secondaries



Spinoffs



SPACs



M&A Insurance

Demonstrable Impact

Aon estimates

48%

of North American private deals used representations & warranties

More than **75%** of private equity/financial sponsor deals utilized R&W insurance

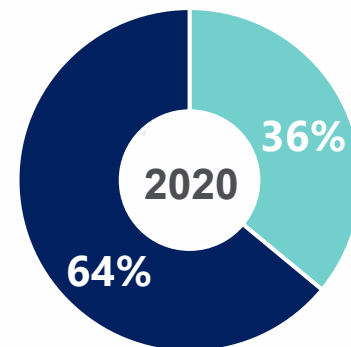
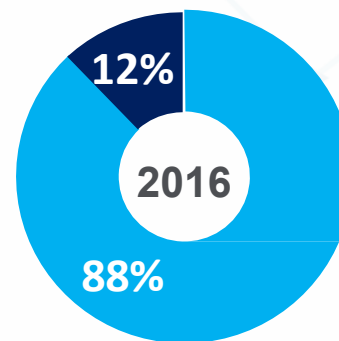
Approximately three out of four policies bound across all lines in 2021 were in North America

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Reflecting industry trends, Aon observed “no seller indemnity” policies increased

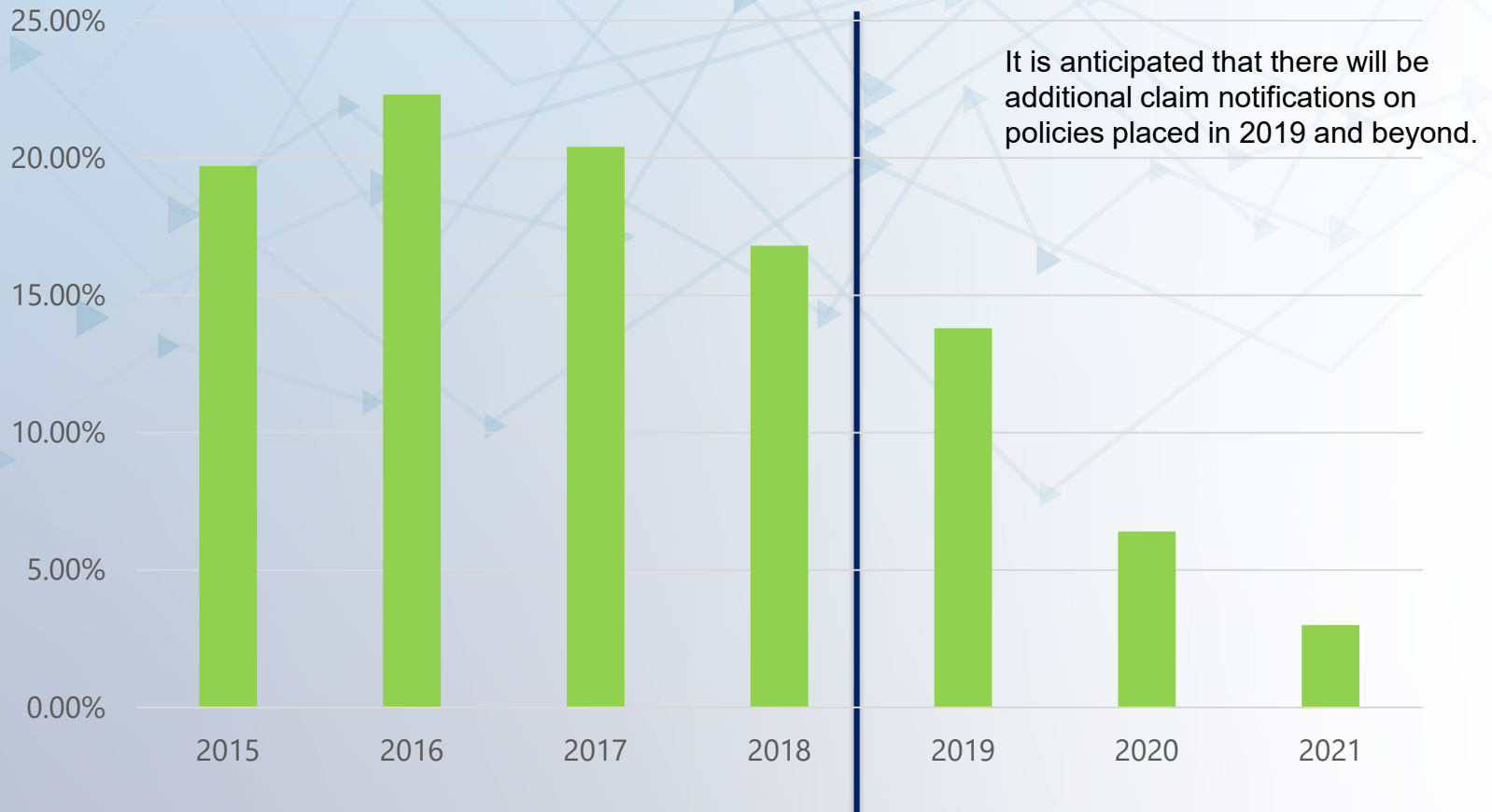
● No Seller Indemnity ● Limited Seller Indemnity



RWI CLAIMS 03

TRENDS AND PROCESS CONSIDERATIONS

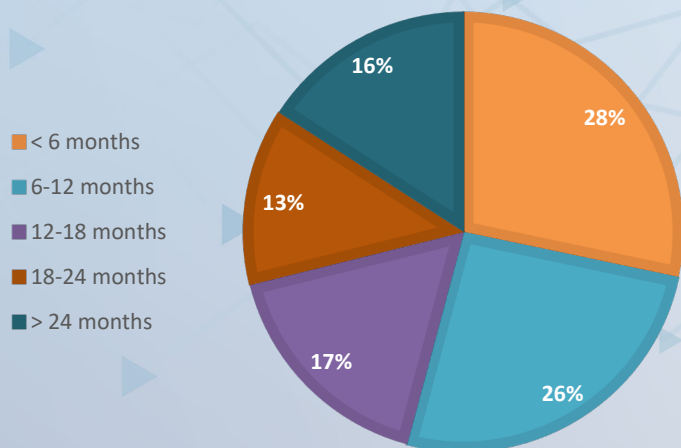
R&W Claim Frequency 2015-2021



This chart illustrates the frequency with which R&W insurance policies are notified of a claim each year when taking into account situations in which multiple claims are made on one policy.

Trends in Claims

Months Between Closing and Claim Notice



Median: 11.75 months
Mean: 13 months
Range: 3 days - 61 months
Claims before closing: 18

Type of Breaches Most Commonly Cited



Examples of "Other"

- Healthcare: 6
- Property Related: 4
- Subsequent (Non) Events: 3

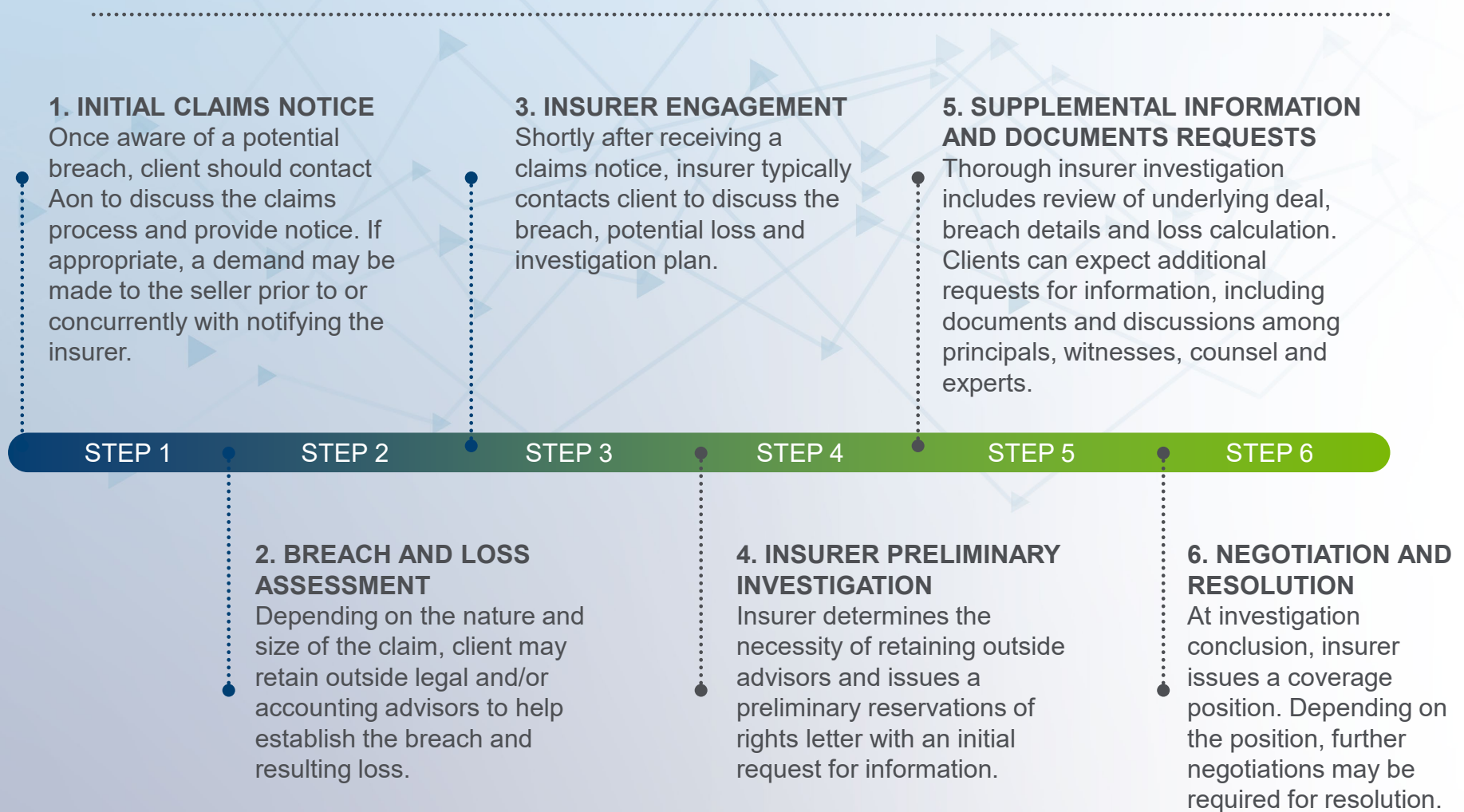
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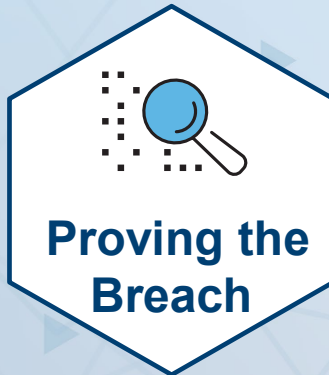
Timeline of a Claim

Buyer-Side Policy



Claims Takeaways

What are Insurers Evaluating?



- Is there a breach of a representation in the transaction agreement?
 - What is the specific language of the representation at issue?
 - Is there a knowledge qualifier?
- Are there applicable exclusions?
- Did the relevant deal team members have actual conscious knowledge of the breach prior to the close of the deal?
- Specific to a financial statements breach:
 - Is there a violation of GAAP (where required by the rep)?
 - Is the alleged breach based on accounting procedures that were in place pre-close?



- How is loss calculated?
 - How can the insurer validate the amount of loss?
- If a multiple is sought, can the policyholder demonstrate that the breach would have had an impact on the purchase price had it been known?
 - Was the transaction value determined using a multiple?
 - Were there changes to the financials during the negotiation process that resulted in a corresponding change to the purchase price?
- Can the loss be mitigated or is there an offset?
- Do the actions giving rise to the breach straddle a pre- and post-close period?

• Claim Resolution Highlights

- Aon has seen more than 600 claims made by clients on RWI policies placed in North America since 2013
- As of November 2021, RWI insurers have paid more than \$550M above the policy retention to Aon clients in North America since 2013, and more than \$825M in total loss has been recognized (when factoring in erosion of policy retentions)
- To date, 12% of claims have resulted in a payment, 20.5% of claims have settled below the retention, 3.5% have been denied, 50% remain active and 14% are inactive (have had no correspondence for more than a year)
- Approximately 25% of our clients' claims since 2013 have been resolved within six months of filing the claim notice and 58% have been resolved within 12 months of providing notice
- To date, ten claims have utilized mediation, five have begun arbitration (with two settled before the hearing and the other three active) and three have resulted in litigation being initiated by insureds



TAX AND SPECIALTY PRODUCTS 04

State of the Tax Risk Landscape

Uncertainty is inherent in transaction and business tax planning and tax equity investing. Tax insurance addresses a range of tax planning and investing issues to help bring certainty to improve outcomes.



Mergers & Acquisitions

- Complex deal tax planning
- Transfer pricing
- REITs



Tax Planning

- Cash flow and liquidity management
- Balance sheet risk
- Family office and estate planning
- Transfer pricing



Tax Equity Investing

- Section 45Q Carbon Sequestration
- Hybrid tax and representations and warranties

Litigation Risk Insurance

- Litigation Risk Insurance protects businesses from adverse judgments and preserves the benefits of favorable judgments to facilitate balance sheet optimization and successful M&A and other material transactions.

Adverse Judgment Insurance

The potential for significant damages from litigation can hinder business operations or complicate M&A and other material transactions that weigh on your stock price or force you to reserve funds that could be better used to grow your business.

Judgment Preservation Insurance

When a party has won a significant judgment in court or in arbitration, judgment preservation insurance protects against the risk that the judgment will be partially or completely reversed on appeal, or that the quantum of awarded damages will be reduced. Such appellate risk can impact business operations, M&A deals, and other material transactions.

Today's Presenters

Jim Marshall

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Jim Marshall represents public and private companies, primarily in the energy and telecommunications sectors, in a broad range of corporate and securities matters. Mr. Marshall advises companies in connection with business combinations involving public companies, private sales and acquisitions, joint ventures and strategic alliances, many of which involve seeking creative solutions to complex cross-border issues. He also represents issuers and investment banking firms in connection with equity and debt capital markets transactions and counsels companies general corporate governance matters and U.S. public company reporting requirements.

Matthew Wiener

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Matthew Wiener is the co-practice leaders for AON's Transaction Solutions team and the national leader for its energy practice. In this role, Mr. Wiener is responsible for the development and implementation of transactional-based risk solutions, including the deployment of insurance capital for M&A transactions through representations and warranties, litigation, tax and other contingent liabilities insurance. Prior to joining Aon, Matthew was an attorney at Vinson & Elkins LLP, where he specialized in corporate finance and securities law matters, including mergers and acquisitions, private equity, public and private securities offerings, divestitures, and general corporate representation, with a significant focus in the energy sector.



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