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## Guide to Insuring SPACs in 2021





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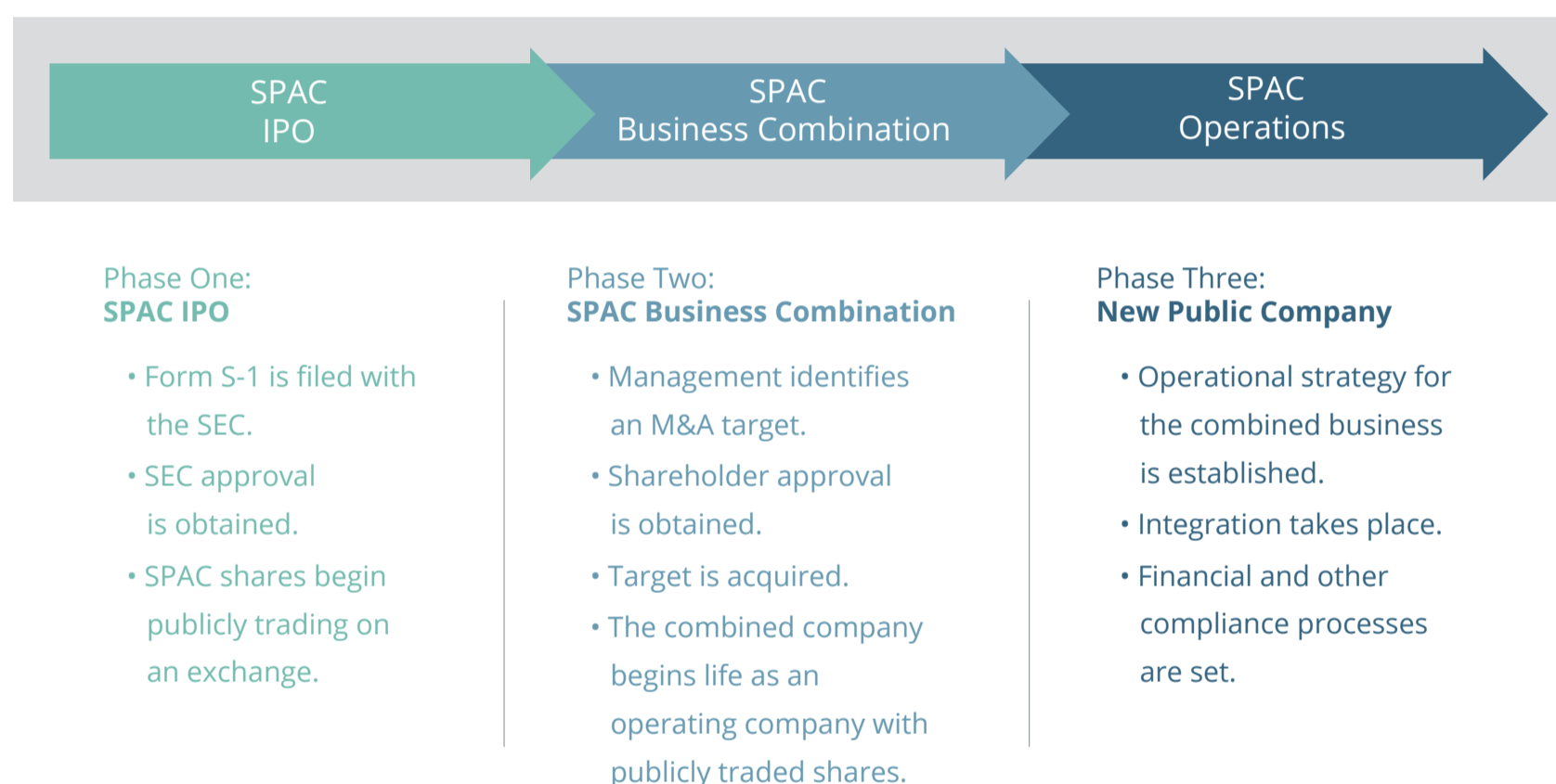
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SPACs (special purpose acquisition companies) had a banner year in 2020, raising more funds in the public market and doing more business combinations than ever before. As they go through their IPO and the subsequent M&A process, SPACs face many regulatory, legal, and business hurdles, including obtaining the appropriate amount and type of insurance for each stage of their life cycle. But with some smart preparation and the expertise of the right advisors, insurance can go from being a necessary hurdle to a strategic asset.

Woodruff Sawyer is the market leader for placing Directors and Officers (D&O) insurance for IPO companies. Woodruff Sawyer is also a nationally recognized leader when it comes to Representations and Warranties insurance (RWI), a critical element of the SPAC M&A process.

## SPAC Life Cycle

When thinking about insurance for a SPAC, it is helpful to think in terms of the SPAC's life cycle. From an insurance perspective, there are three main phases:



The insurance needs of the SPAC are different at each of these phases, as illustrated and further discussed below.

### Phase One: IPO

As it goes through the IPO process, the main assets of a SPAC are its management team, the management team's investment strategy, and the SEC's approval of the SPAC Form S-1 registration statement.

The SPAC's sponsor selects the SPAC's directors before the IPO, and other directors are appointed soon after. The fact that the common stock of the SPAC is publicly traded after the IPO makes the management team and the SPAC's directors vulnerable to lawsuits from public investors.

Operating companies that go through an IPO process are sued frequently and for a variety of reasons. Lawsuits are brought by stockholders against a company's management and directors and usually allege material misstatements and omissions in the IPO registration statement. Given that SPACs are not operating companies, however, SPAC IPOs are not traditional targets of litigation—but lawsuits are still a possibility.

## 5 Forms of Private Litigation Against SPACs

Potential SPAC-related private litigation has five forms:

1. Plaintiffs can allege liability for damages for material misrepresentations or omissions of facts in the SPAC's S-1 registration statement.
2. Plaintiffs can bring a suit challenging the completeness of the proxy statement filed in connection with the SPAC's acquisition of an operating company during its de-SPAC transaction. The suit filed in the United States District Court of Delaware against [Greenland Acquisition Corporation](#) is typical.
3. Plaintiffs can sue after the merger transaction because they are unhappy with the resulting company. A critical element of these suits is the allegation that SPAC shareholders learned of the true nature of the target company only after the merger was completed. One example is the [Heckman](#) case (aka the "China Water" case), which settled in 2014 for [\\$27 million](#).
4. Plaintiffs can bring a securities class action suit against the newly public operating company after the SPAC combination. An example is the April 2020 case against [Akazoo](#), which became a publicly traded company after merging with Modern Media Acquisition Corp., a SPAC. Plaintiffs in this federal case allege that Akazoo made false and misleading statements about its revenue, profits, and operations, among other things, and that, consequently, SPAC shareholders purchased securities at artificially inflated prices.
5. Directors of a SPAC that purchases a target company which subsequently becomes bankrupt may be sued by the bankrupt company's creditors. The situation faced by the board of Paramount Acquisition Corp. in a [bankruptcy court proceeding](#) is a cautionary tale.

In addition, it is worth remembering that the Securities and Exchange Commission may also take an interest in the activities of directors and officers of SPACs, as they did in the case of [Cambridge Capital Acquisition Corp.](#)

The vulnerability associated with being a public company creates a need for directors and officers liability insurance coverage for the SPAC's management team and its board. Moreover, a majority of a SPAC's board must consist of independent board members to satisfy stock exchange listing rules. Professionals who serve as independent board members typically do not accept a board appointment without good D&O insurance already in place.

## D&O Costs for SPAC IPOs Are Increasing

The general litigation environment has deteriorated recently, including as a consequence of a 2018 Supreme Court decision, [Cyan v. Beaver County Employees Retirement Fund](#). Lawsuits are now brought in multiple jurisdictions, including federal and state courts. Plaintiff law firms have been quick to capitalize on the Supreme Court's ruling, which in turn has driven up the cost of D&O insurance dramatically for new IPO companies compared to the cost for mature public companies. The increases in non-SPAC IPO D&O insurance premiums coupled with the recent surge of SPAC IPOs and the scarcity of insurers who are willing to write D&O coverage for SPACs have significantly pushed up SPAC IPO D&O premiums in the last quarter of 2020. Premium pricing will remain higher than pre-2020 levels going into 2021.



There may be some relief on the horizon due to some positive litigation outcomes in the Delaware Supreme Court case, [Sciabaccuchi](#), as well as in a critical California state court case, [Restoration Robotics](#). D&O insurance carriers have so far not lowered prices on the basis of these two decisions. If they do, it will only be for companies that have [federal choice of forum provisions](#) in their charter documents. Be sure to discuss this with your securities counsel.

### Get a Sense of Pricing—from a SPAC Insurance Expert

For now, the pricing for D&O insurance for SPAC IPOs remains volatile. In the course of 2020, the cost of a good-size D&O insurance program for a typical SPAC more than doubled. Given how dynamic the current D&O insurance market is, you will want to be sure to talk to your insurance broker to get an indication of current pricing sooner than later. It has to be said: if you are asking this question of someone who does not place a lot of D&O insurance for SPACs, you are at risk for having asked for pricing information from someone who does not realize that they do not know the answer to your question.

### Risk Factors Examined by Underwriters

When deciding premium and retention structure for a SPAC IPO D&O policy, insurers typically examine the following factors, among others:

1. Whether the SPAC sponsor team has successfully executed previous SPAC IPOs and has experience in the industry of the target company it plans to acquire. Premiums are higher for more inexperienced sponsor teams that lack substantial track record or experience in raising SPACs and for teams that are seeking targets outside of their area of expertise.
2. Jurisdiction of the SPAC entity and the potential target. If the SPAC is based outside of the United States or aims to acquire targets in riskier markets, the premium pricing can go up considerably.
3. Size of IPO raise. The larger the SPAC IPO, the riskier it is from an insurer's perspective, thereby resulting in higher D&O premiums.

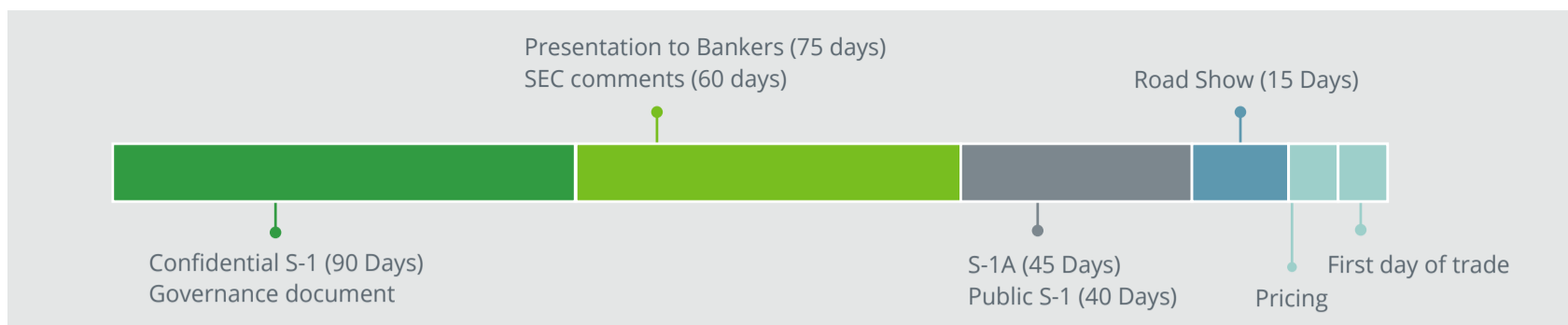
For more information about factors insurance underwriters consider when pricing D&O insurance for SPACs, see [D&O Insurance for SPAC IPOs: Costs and Underwriting Factors](#).

## Process for Securing D&O Costs for your SPAC IPO

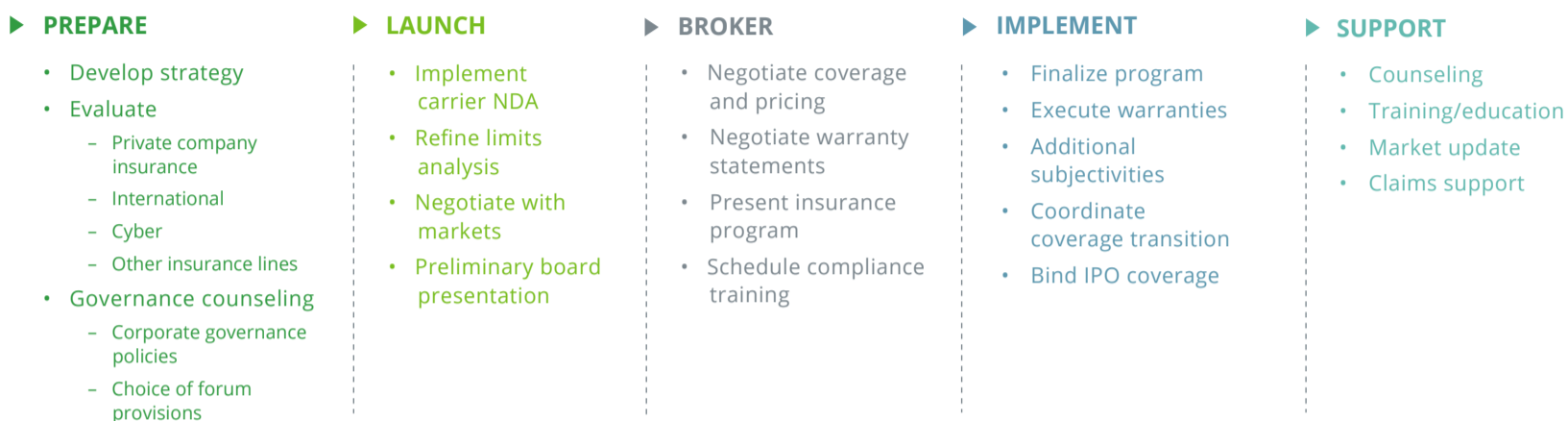
The process for securing D&O Insurance for your SPAC begins with choosing the right D&O Insurance broker. (See [Choosing the Right Insurance Broker: Questions to Ask](#)). Ideally in advance of the first filing of your confidential Form S-1 registration statement, your broker will launch the process by sending non-disclosure agreements to the relevant insurance carriers. Your S-1 registration statement will be sent out next and will serve as the insurance underwriters' primary underwriting document. Your broker will then negotiate with the insurance carriers on your behalf while keeping you informed and updated.

You will need to decide on the limit of insurance that is appropriate for your SPAC. This is an area where a good broker can provide useful guidance with good data and analytics. A rookie mistake is to buy too much D&O insurance. A good broker can help you avoid this mistake.

Once your broker has presented you with your options and you have made your choices, the broker will wait to hear from you that you have priced your deal. If your deal might be delayed, be sure to tell your broker in case there is a need to refresh your insurance carriers' quotes. Above all, remember to call your broker on the day of pricing, confirm the price, and instruct your broker to bind your policy so that it is active before your first trade the next day.



## D&O Insurance Process



Source: Woodruff Sawyer

For a more detailed look at this process, check out our [Guide to D&O Insurance for IPOs and Direct Listings](#).

Remember, it is critical that your insurance broker considers and guides the SPAC management team through the milestones of the SPAC’s life cycle. For example, a knowledgeable broker will be able to pre-negotiate the cost of the SPAC’s D&O insurance coverage for the 18 to 24 months of its pre-business combination lifespan. A good insurance broker will also be able to ensure cost efficiencies if the SPAC is able to complete its acquisition significantly ahead of its deadline.

## Phase Two: SPAC Business Combination

After the IPO, the SPAC has the funds to purchase or merge with another company. The SPAC’s management team must find an attractive target company and complete the merger or acquisition (sometimes known as the “de-SPAC” transaction), typically within 18 to 24 months after the IPO. When the management team approaches potential acquisition targets, which are typically private companies, M&A representations and warranties insurance (RWI) comes into play. However, the management team must also consider and plan for D&O insurance coverage of the post-business combination entity. Let’s take these one at a time.

### M&A RWI Coverage: Advantages for Buyers and Sellers

More and more SPACs are folding RWI into their acquisition strategies. For a relatively low premium, RWI provides an insurance backstop to the buyer if the seller’s representations and warranties turn out to be flawed. Buyers also typically prefer not to sue the management team members of the target company that may have produced the flawed representations if that management team now works for the combined company. Looking to the RWI for compensation and leaving management out of a lawsuit goes a long way towards maintaining a productive employee environment.

RWI is a very attractive option for the seller because it allows the seller to reduce the amount of the purchase price that would otherwise be held in escrow. For the SPAC, a RWI policy can offer protection against seller

fraud and can be an important differentiator for a SPAC that is courting a reluctant private company or a private company with multiple suitors. RWI is now used in over 75% of transactions done by private equity firms and is considered a market standard in the PE world. For a SPAC that is competing against private equity firms or other SPACs for the same target, not offering the benefits of a RWI policy may mean a failed acquisition attempt and costly time delays.

Indeed, a well-designed RWI policy allows a SPAC to offer the same purchase price to a target company, but with



*For SPACs competing against PE firms, not having an RWI policy may result in a failed acquisition attempt and costly time delays.*

minimal or no seller indemnity and with minimal or no escrow. Because RWI is now almost a market standard in auction processes, it is likely to be offered and used by the rest of the competition. Excluding RWI from its offer effectively puts a buyer at a serious disadvantage.

Moreover, for SPACs that are under extra pressure to close their acquisition transactions before their post-IPO 18- or 24-month deadline runs out, spending management time and efforts on failed auction processes can be fatal.

### RWI Market Trends

The insurance market is now a lot more familiar with the M&A RWI product and has changed and adjusted to consumer demand and competition. Whereas there were just a handful of carriers offering the product in 2016, there are now over 20 insurers competing for the same business in 2020 and going into 2021.

### Policy Premiums Have Dropped

Competition and familiarity have significantly driven down policy premiums for representations and warranties insurance. What would once have cost 4%–4.5% of the policy limit has now dropped down to 2.5%–3.5%, dipping even lower for larger deals. The self-insured retention, or deductible, built into the policy has been pushed to 1% or 0.75% of the enterprise value of the transaction, making the policies even more attractive.

### Minimum Limits Have Come Down

RWI policies are also no longer limited to large deals. The minimum limits for these policies have come down from \$5 million to, in some cases, \$2.5 million. Minimum premiums now range between \$150,000 to \$200,000. RWI being placed for transactions having an enterprise value as low as \$20 million is no longer unheard of. Many insurers are willing to work specifically with SPAC-driven acquisitions and with minority interest deals.

## Coverage Can Be Obtained Promptly

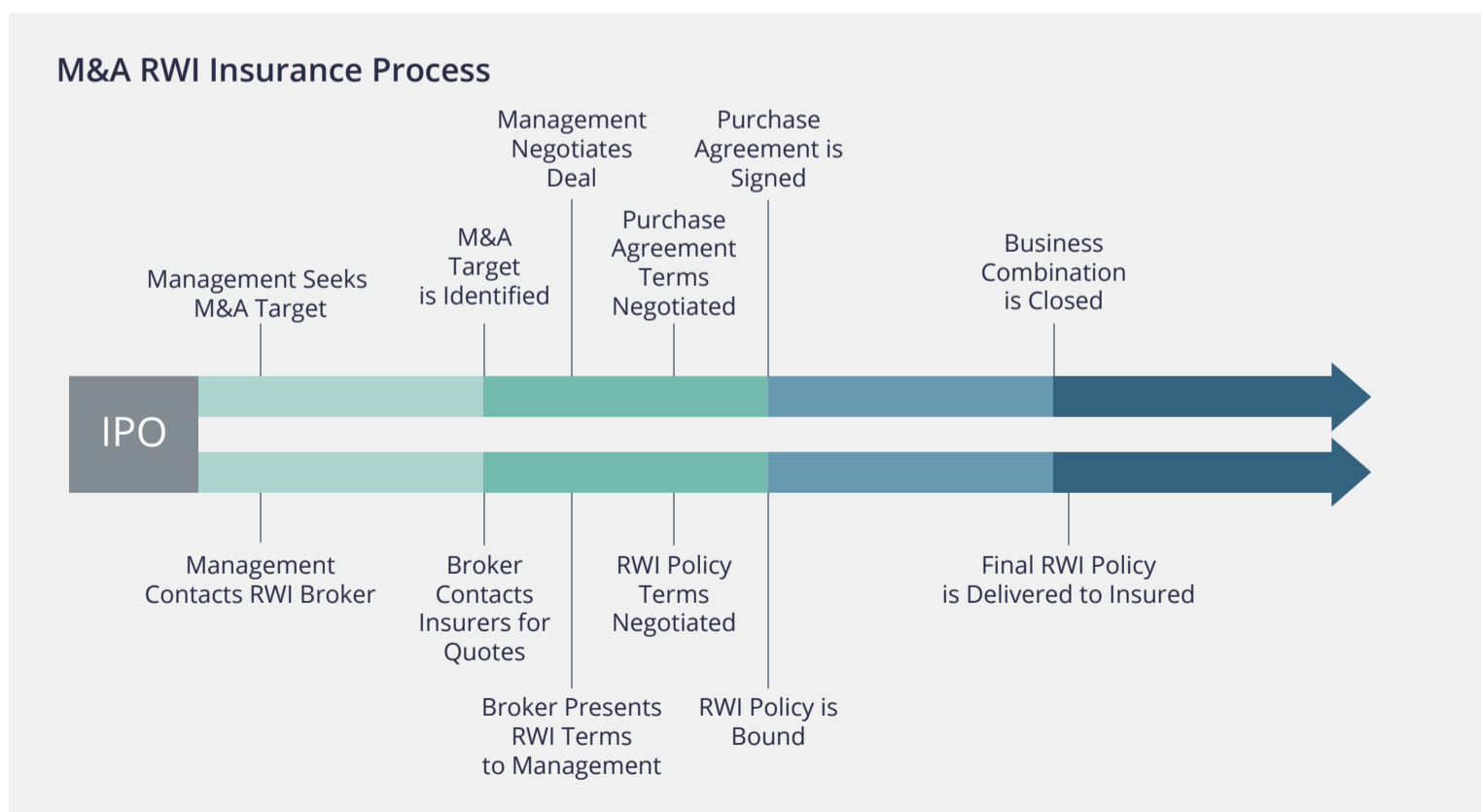
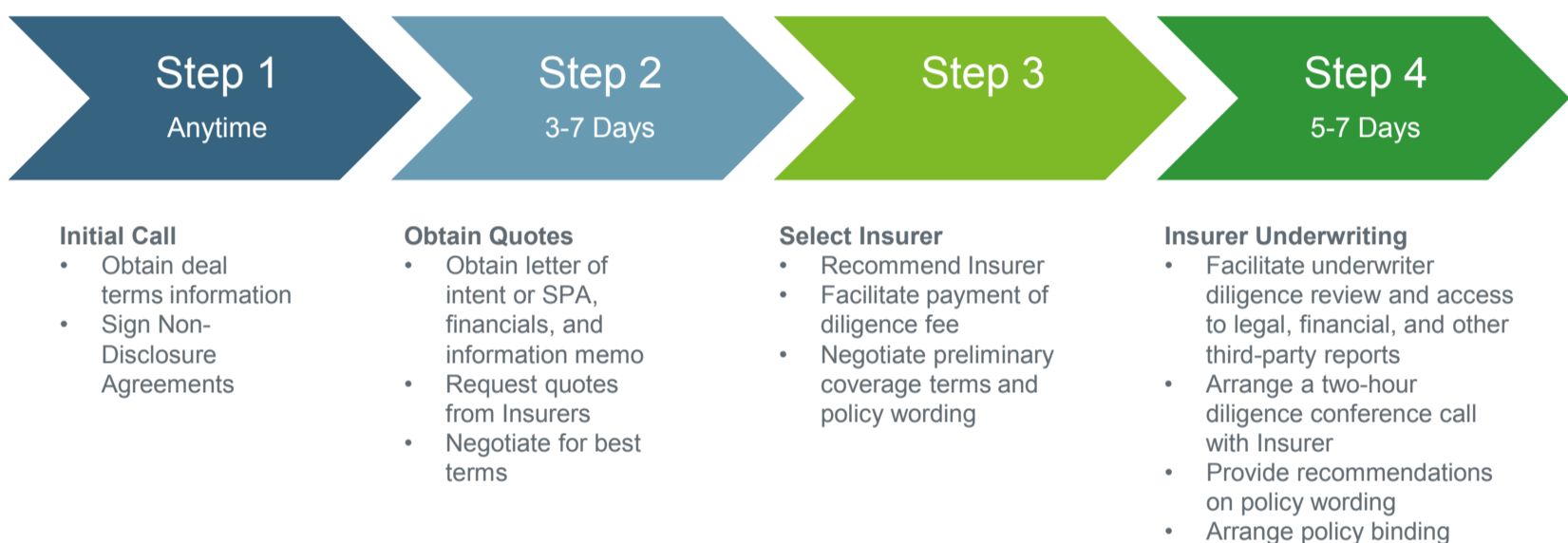
By preparing in advance, the insurance placement process can run along the acquisition timeline so as to avoid holding up the acquisition schedule.

Insurance carriers are also more efficient in their due diligence review process, which allows them to reduce the processing time of the policy to between one and two weeks. In addition, some of the policy exclusions that used to be standard a couple of years ago have been curtailed or even eliminated, although, not surprisingly, all insurers now incorporate a COVID-19 related exclusion into their policies.

These factors have created the environment in which SPAC management teams can now fully take advantage of the RWI market, with guidance from a knowledgeable insurance broker that specializes in SPAC representations and warranties policies. Woodruff Sawyer's RWI placement process is highlighted below.

## RWI Insurance Placement Process

Placement of an RWI policy can be accomplished in about two weeks.





## D&O Insurance Coverage for the Business Combination (de-SPAC) Transaction

The D&O and the RWI insurance policies need to be approached in concert. As soon as the parties close on the business combination, the D&O coverage of the SPAC and that of the target entity are no longer in effect. The new entity's directors and officers must be covered by a new D&O insurance policy.

Specifically, there are up to three different D&O policies that may need to be placed before the transaction closes: (1) a tail policy for the SPAC company's D&O policy, (2) a tail policy for the target company's D&O policy, and (3) the D&O insurance that needs to be put in place for the new combined entity (which is, of course, a new publicly traded company).

### Tail Policies Explained

The issue with the first two policies is ensuring that there is coverage when a claim arises after the merger transaction closes where the activities in question took place before the closing date. The SPAC's and the target's D&O policies typically need a "tail policy" added to them, which is to say that additional premiums have to be paid to the D&O insurance carriers so that the policies will continue to respond after the closing date of the transaction.

It is customary for the tail policies to have a six-year term. Carriers will charge a one-time premium to be paid at the closing of the business combination for each policy. Note that the cost of the D&O tail policy for the SPAC is typically negotiated when placing the initial D&O insurance policy for the SPAC IPO. Note further that there may be situations in which no tail policy will be placed on the private company's D&O insurance program. You will, of course, discuss this with your broker.

### Covering Claims That May Occur Post-Transaction

The D&O policy for the going-forward public company will cover the newly combined company for claims based on actions taking place after that transaction closes. This looks and feels like the D&O insurance policy of any new, publicly traded operating company. It is important to start this process well before the deal will close. The cost of the D&O insurance policy for the new public company may be less than that of a traditional IPO company, but these costs are trending upwards.

## Phase Three: SPAC Operations/New Public Company

At this point the combined company is up and running—and carrying with it all of the attendant risks of an operating public company. As such, the company needs to be ready for public company scrutiny, which calls not only for ongoing compliance with all necessary regulations, but for a review and usually an upgrade of the company's overall insurance coverage. This can mean upgrading everything from the company's property insurance to the company's [cyber liability insurance](#).

### Ongoing D&O Coverage

The operating company must establish a process around its annual D&O insurance renewal. Starting the renewal process with an expert D&O insurance broker early saves time, averts potential frustration, and can save on costs. Companies are able to optimize the renewal process by being prepared and taking a focused approach to their D&O insurance renewal. Getting up to speed on the litigation environment and the current state of the insurance market is a key step. A great resource for this can be found in the Woodruff Sawyer 2021 [D&O Looking Ahead Guide](#). Having trusted advisors on your side ensures your success.

## Choosing the Right Insurance Broker: Questions to Ask

Given the rapidly changing nature of the D&O insurance market, the peculiarities of SPAC IPO companies, and the high cost of D&O insurance for public operating companies (which result from the de-SPAC transaction), your choice of insurance broker is consequential.

A quirk of the insurance market is that, to optimize your result, you must choose one insurance broker to approach all the viable insurance markets on your behalf. Sending multiple insurance brokers into the market will lead insurance carriers to conclude that you don't know what you are doing and that you are not a serious candidate for their insurance capacity. For this reason, if you are interviewing D&O insurance brokers, be sure to instruct them to refrain from sending your name into the market until you have actually informed them that you have chosen them to be your broker.

Not unlike bankers, lawyers and accountants, different insurance brokers bring with them varying levels of experience and resources. You want to be sure to work with a broker who places a significant amount of premium with the major insurance carriers.

To get the optimal D&O insurance coverage at the best possible price, here are some questions to ask potential D&O insurance brokers before you choose one.

### 1 What level of experience does the particular brokerage team you are talking to (not just the brokerage firm, but your particular team) have when it comes to placing D&O coverage for SPACs?

It is critical that your D&O insurance broker has extensive and current experience working with SPACs, IPO companies, mature public operating companies and RWI deals. The market for this type of insurance changes very rapidly. Unless your broker is in the market every day, you will miss out on the latest developments in the terms and conditions of your policy, which are critical elements of your negotiated, customized D&O insurance program.

### 2 Will the broker be using a wholesaler, or making a direct placement?

Many brokers only do a limited amount of SPAC/IPO/RWI/Public Company D&O business. These brokers may be excellent in other areas, but will inevitably have to use a "wholesale" broker to work on your business if they do not transact a large volume of this business routinely. That can be bad for you, especially if there is a claim, because the person you are talking to will have no relationship with the insurance carrier that will be deciding whether to pay or deny your claim.

### 3 Can your broker clearly articulate the business and legal risks you face?

There is little chance your D&O insurance broker will do a good job of ensuring you have insurance coverage for critical risks if your broker cannot clearly articulate them. If your broker is not an expert in understanding the risks you face, you are talking to the wrong person.

### 4 What experience does your broker have in terms of advocating for coverage payments with carriers on behalf of clients with complex claims?

Many brokers have an anemic claims function at best, and often the same claims person who handles client auto or workers' compensation claims is also being asked to handle your difficult D&O insurance or RWI claims. Given the complexity of D&O insurance and RWI claims, this is a mistake. Find out if your broker has specialists who can swing into action on your behalf.

It is in your best interest to choose a broker that has the experience and expertise to be able to recommend the most strategic insurance program placement options, as well as one with extensive experience managing claims for SPAC-related claims.

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## About Woodruff Sawyer

**As one of the largest insurance brokerage and consulting firms in the US,** Woodruff Sawyer protects the people and assets of more than 4,000 companies. We provide expert counsel and fierce advocacy to protect clients against their most critical risks in property & casualty, management liability, cyber liability, employee benefits, and personal wealth management. An active partner of Assurex Global and International Benefits Network, we provide expertise and customized solutions to insure innovation where clients need it, with headquarters in San Francisco, offices throughout the US, and global reach on six continents.

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