



Lowenstein Sandler's Real Estate Podcast: Terra Firma

Episode 7 Insuring Real Estate Transactions: When RWI Pays Off

By [Eric Jesse](#), [Stacey Tyler](#), [Steven Tanico](#)

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- Kevin Iredell:** Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Now let's take a listen.
- Stacey Tyler:** Welcome to Terra Firma: Conversations on Commercial Real Estate. I'm Stacey Tyler.
- Stephen Tanico:** And I'm Stephen Tanico. Stacey and I are real estate attorneys at Lowenstein Sandler. On today's episode, we'll be talking about rep and warranty insurance, R&W insurance. Joining us in this discussion is Eric Jesse, a partner in Lowenstein's Insurance Recovery Group, an absolute wizard when it comes to everything insurance, and very much a conductor when it comes to an R&W insurance call. And the guy you don't want to hear from after that call that you messed up everything. Thanks for joining us today, Eric.
- Eric Jesse:** Pleasure to be here. You're way too nice.
- Stephen Tanico:** I think at just the most basic level, we'd like our listeners to get a better understanding of what is R&W insurance.
- Eric Jesse:** Yeah, sure. So reps and warranty insurance been around for a while. It's been very popular in Europe for a long time, and really in the past 10 years or so has gained popularity in the US in M&A transactions. And what R&W insurance is in an M&A transaction, the seller is making reps and warranties about the company. We're in compliance with laws. We're telling you the things we're doing right about the company and we're promising that those are accurate. And so traditionally, the seller would stand behind those representations and warranties that they make, and they would provide an indemnification in the purchase agreement. And so what reps and warranty insurance is designed to do is really take the role of the seller's indemnification obligation. It can sometimes be entirely. There can be a walkaway deals where the seller has no indemnification obligation and so rep and warranty insurance is going to be the only recourse, or the seller might just have a little bit of skin in the game, and after their little bit of liability is exhausted, you're going to the R&W policy. But that's what it is.
- Stephen Tanico:** And similarly, you have rep and warranties in a purchase transaction in real estate. And it's fascinating because it's really a new element in real estate versus these typical M&A transactions. So I think we could kind of go with both the idea of why it

applies in M&A transactions and then see how that would apply in a real estate transaction. Typically, why do you see clients decide to get R&W insurance or not to get R&W insurance? Is there kind of one reason, or?

Eric Jesse:

Yeah, in the past few years, I think, when deal activity was very high, when it was active, I think the sellers had a lot of leverage. And sellers obviously like R&W insurance because it takes them off the hook. So sellers were often pushing for it. And so buyers, you would agree with them getting a policy because they wanted to stand out to the seller. Early on, it was probably a way for buyers to distinguish their bid in an auction process, for example. More recently, it's like a baseline requirement to even be competitive. So that's one of the reasons, but there are other reasons as well. So these R&W policies have policy periods of traditionally six years for fundamental reps and three years for general reps. So in many cases, the reps in a traditional M&A deal, our purchase agreement could be one year for general reps or 18 months. So you have a longer period of time to bring claims.

And just another benefit that immediately comes to mind is, listen, when a buyer has a claim against the seller, that might be an uncomfortable conversation to have, particularly when the seller is remaining with the company post-closing. And as part of management the buyer is really depending on the seller to be incentivized to continue to grow the business. And so R&W insurance smoothed that process over because instead of going to the person in the office next to you and saying, "You owe me all this money, you lied in your purchase agreement in your representations and warranties," you can go to the insurance company and no one has an issue making an insurance claim or going after them.

Stacey Tyler:

And how does that business conversation go? Who's paying for the insurance and how does the insurer enter the negotiation as far as survival periods, like you mentioned?

Eric Jesse:

Yeah, so I've seen it multiple ways. I think one very common way is the buyer and the seller will just share the premium 50/50, but sometimes the buyer will agree to pay all of it. Sometimes we've seen the seller be willing to pay all of it, especially if it's going to be a walkaway deal and R&W insurance is going to be the buyer's only recourse.

Stephen Tanico:

Is there a formula for determining what that premium is? How is that determined?

Eric Jesse:

Yeah, that's a very good point. So the pricing has fluctuated over the years. At the end of, I think if I have my calendar right, it was the second half, really the fourth quarter of 2021, when deal activity was going absolutely crazy. So there are only so many underwriters and underwriting hours in the day, and so pricing was very, very high. And the way the pricing is, it's really a percentage of the limit of liability that you're purchasing. So at that time, in 2021, it might've been five or six or sometimes even maybe 7% of the limit of liability. Now as deal activity is much slower, that percentage has really dropped like a rock, and it's probably, call it two and a half percent to 0.7% of the limit of liability. So it's a very good opportunity for buyers to come in and buy R&W insurance at a low price or to maybe increase the limits of liability because you can get it at that low price.

Stephen Tanico:

Fascinating. I mean, interesting to me that sellers typically drive this. I did not know that. Why, though, if you were thinking from the buyer's side, would you want R&W insurance?

Eric Jesse:

Yeah, so I'll do a plug for a reps and warranty claims survey that Lowenstein did. And we published it, I think it was back in April of this year. And it was actually a refresher of one that we had done back in 2020. And one of the reasons I think R&W insurance is an attractive option, seemingly, is because R&W insurance is born out of the M&A

world where people want to make a deal, people have business mindset, commercial mindset, and so R&W insurers are taking that approach to claims. And so R&W insurers were behaving commercially and they were paying claims. So in our 2020 survey, this was a survey of market participants, so insurers, buyers, brokers, investment banks, and the survey results were buyers were able to negotiate and get payment on 87% of the claims that exceeded the retention. So that was a great result.

Now, more disappointing was that actually dropped a little bit in 2023 down to, I think it was 60 or 61%. So carriers are still paying claims, but the takeaway was that the carriers were being more difficult, the claim process was taking a little longer. Our clients don't understand how they can do a multimillion or a billion-dollar deal in a matter of months, and then it takes the insurance company years to pay a claim that's a subset of the company. So one of the things we said in our most recent survey was R&W insurers, you better be on guard because one of the attractive things about this product is how commercial it has been in the past. So don't kill the goose that laid the golden egg by treating this like a commoditized insurance product, like D&O or E&O or general liability. Carriers can become entrenched to continue to be commercial so that buyers can have the benefit of a smooth claims process because it's veering in the other direction.

Stephen Tanico: And is there any correlation? This is interesting, right? When the pricing was higher, they were paying out more, and now the pricing is lower and they're paying out less.

Eric Jesse: That's really, I think, driven by market forces more than anything. I mean, I think the carriers have made so much money because especially when this was really coming of age in the first five years, maybe call it 2013 forward, there really weren't a lot of claims. The claims activity has really picked up more recently. So I think that's market force driven.

Stephen Tanico: No, that's fascinating. I think we like to try and inform our listeners in a way that if you're not a lawyer, something that your lawyer wishes you thought about before picking up the phone and calling them. Is there anything with R&W insurance that you wish your clients thought about on the front end so that it's not really a large issue on the back end or a smaller issue?

Eric Jesse: We try and make sure that it's a very smooth process on the placement side. So when we're getting involved in a deal, we are reaching out to our client. A lot of our clients already have good experience with R&W insurance and understand that process. I think what's helpful is when that claim comes in after the closing, after our clients have been in the company, it's really being proactive in making sure that claim is reported. Because one of the things our surveys have told us is there can be a delay between the discovery of the breach and the reporting of the claim as that investigation is going on. So when our clients are able to speed up that process and get in touch with us sooner that we think there's an issue, we think there's a claim, that can help just speed up the process a little bit more.

Stacey Tyler: So we have seen R&W insurance intersect with our real estate world when we have a merger and acquisition that has a real estate component where all of a sudden we as real estate attorneys are used to really driving the bus on the diligence process, doing the title and survey review for the benefit of our client. And now we're in a different framework where the R&W insurers in the middle, and they're kind of assessing all of those risks for themselves rather than us doing it for the client. Can you talk a little bit about how that kind of changes the way that clients should be thinking about the diligence process generally?

Eric Jesse: When we're doing the diligence or the client has their advisors, legal advisors or environmental consultants or whatever, the R&W insurer's really going to be looking to the buyer and their advisors to do that frontline diligence, and they'll want to see the buyer's legal diligence reports, environmental reports, the real estate reports you've got, and then you've been on these underwriting calls and they ask you questions sometimes. So I think just making sure that you're going to do that traditional diligence. Now, if it's not an issue, it's not an issue, and we can tell that to the carrier and explain why diligence wasn't done here. But I think making sure that traditional diligence is being done is important.

And the other thing we see in this process though, because the carriers will poke and prod, and so we might get follow-up questions. So our clients should expect follow-up questions from the carrier that says, "Hold on, what about this issue? Or tell me about that." So sometimes we're going back to the sellers. And what the R&W insurers would tell you as another added benefit to the policy is, "Listen, we're an extra set of eyes for you, buyer, right? You're doing your diligence, but we're giving you feedback, giving you input. We're making you dig a little bit more, and that's good for everyone." And I might answer your earlier question, Stephen, that there's another added benefit, at least what the R&W insurers would tell you. I don't know if our clients are always pleased with those follow-up questions, but.

Stacey Tyler: One more person breathing down our necks, yay.

Eric Jesse: Exactly. Yeah.

Stacey Tyler: All right. Well, thank you so much, Eric. This has been super informative. Thank you for helping us get a little bit smarter about representation and warranty insurance.

Eric Jesse: Yep. Happy to be here.

Stephen Tanico: And thank you, listeners, for tuning in today. Be sure to like, subscribe and follow Terra Firma wherever you're listening to this episode. Stacey and I would love to hear from you. So feel free to reach out to us at terrafirma@lowenstein.com, or if you want to see the survey Eric kept referencing, definitely be sure to reach out to us. Until next time.

Stacey Tyler: Ciao.

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