



**Lowenstein Sandler's Insurance Recovery Podcast:
Don't Take No For An Answer**

**Episode 73:
Myths and Misconceptions About Reps & Warranties
Insurance**

By [Lynda Bennett](#), [Eric Jesse](#)

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Lynda Bennett: Welcome to Don't Take No for An Answer. I'm your host, Lynda Bennett, chair of the Lowenstein Sandler Insurance Recovery Group, and today I'm joined by my partner and co-host, Mr. Eric Jesse. How are you doing today, Eric?

Eric Jesse: I'm good. How are you, Lynda?

Lynda Bennett: All right. Well, I'm actually very excited because today we're going to be talking about something that's near and dear to our hearts. And yes, even though we're lawyers, we do have them, and that is we're going to talk about reps and warranties insurance. It's common knowledge that in the merger and acquisition community, reps and warranty insurance is and remains a widely used risk transfer solution in deals.

But despite the popularity of reps and warranties insurance for the better part of a decade, there are still many common myths and misconceptions. But today, Eric and I are going to break down some of those myths and dispel them as we always do. Eric, let's dive in. While there are many myths that we could talk about, what are the ones that you tend to encounter the most often?

Eric Jesse: I think one of the most common myths we see is that R&W insurance is not going to be the right fit for a deal. I think that's because there's a perception that R&W insurance might not be for a specific type of deal, or the deal isn't the right size or it's not the right industry. The reality is that R&W insurance is very versatile.

Working with underwriters and brokers, I find that they are committed to finding ways to make R&W insurance fit a specific type of deal or a unique or non-typical deal. I'd say that's even more true in the current market environment where deal flow is not as heavy as it was in the past. R&W insurers are a bit more hungry and looking for ways to make it work.

Lynda Bennett: Right, and these brokers and the insurers are just like the transaction lawyers that we get to deal with. They're all adrenaline junkies and they love to get problems and solve them, right? What about pricing, Eric? Is there a perception that the premiums are still too high? When these products first came out, I think that was a big barrier. What's the state of play on that?

Eric Jesse: Look, we have certainly seen high premiums, like what you said, or really what comes to mind immediately for me is in Q3 and Q4 of 2021 when the M&A market was on fire, only so many underwriting hours in a day and pricing really, really shot up at that time. But pricing today has more than stabilized, it's extremely competitive, and pricing is as low or lower than it's ever been. I think the more common myth we see when it comes to pricing is that the premium should drive the selection of the R&W insurer.

Lynda Bennett: It definitely shouldn't.

Eric Jesse: I definitely agree. I like the saying, don't be penny wise and pound foolish. As we know, whether it's R&W insurance or other lines of insurance, not all insurers are created equal. One of the nice things about R&W insurance is you can negotiate that policy form and have that give and take with the carrier. But you can have the strongest policy form, but it's not going to mean a whole lot if you're with a difficult or non-commercial carrier that you're going to have to litigate against to get coverage.

I think the reality is here on paper, when you see the insurance quotes, they're all going to look similar. You have to figure out what the distinguishing factors are. Look, from my perspective when evaluating quotes, I'm focused on the carrier's commerciality and underwriting and actually placing the policy, keeping up with the pace of the deal, and of course, commerciality on claims. Pricing is going to be important, but it can't be the only factor.

Lynda Bennett: I still chuckle when we get these proposals from the brokers and the quotes are... It almost rises to the level of antitrust as the pricing is so similar, eerily similar. You're right. What really matters is, is the insurer going to be a good partner on the underwriting side and on the claims side, which is a great segue. For our most loyal listeners of Don't Take No for An Answer, you know that Eric and I have put out a white paper recently on what is the state of play in the claims market. Eric, why don't you break down some of the myths that surround claims handling after a transaction has closed?

Eric Jesse: I don't know if this is a myth or an expectation, but what comes to mind is that our M&A clients, if there is a claim, they expect a smooth process, a quick process, and a commercial claim resolution process. What our claim report showed is that's not always the case. We did that claim report. We surveyed R&W insurance market participants, and what we saw was a difficult prolonged claim process.

There's just that disconnect because our clients, they take weeks and months to vet an entire target company and to engage in an acquisition in the tens of millions, hundreds of millions, sometimes billions of dollars. They do it quickly, and then you have a claim process that can take years.

Lynda Bennett:

I think one of the key takeaways from our report was that the claims activity is very much on the rise. The carriers are starting to treat these claims more like a D&O claim or the traditional claims that have been handled under other types of policies. As I mentioned a few minutes ago, when you're dealing with transaction lawyers and you're dealing with private equity and M&A guys, they are adrenaline junkies.

They need to get that return on investment and move on to the next deal. Disconnect is exactly the right word. There's a misalignment of expectations on both sides here. Maybe some of the great tips that we provided in that report will be picked up on by the carrier so we can have a smoother ride. Is rep and warranty insurance viewed as more catastrophic loss coverage, do you think?

Eric Jesse:

I have heard that. I think some buyers will see it that way, and then other buyers will just view it as responding to major, but not necessarily catastrophic losses, and that's because of where the retention was. They really sometimes will question if R&W insurance can be meaningful. But I think the new reality is that R&W insurance is more accessible than ever. And by that, I mean you can have quicker access to the policy limits because retentions are dropping.

10 years ago, retentions were as high as two or two and a half percent of the purchase price, and then that dropped down to around 1%. I think that was the standard retention for a long period of time. Actually, that was the case when we did our first survey claim report back in 2020 where we reported that I think it was 71% of claims were within that retention. We highlighted that disconnect. What we saw following that is that retentions are now much lower.

Sometimes it's 0.9%, 0.75%, even as low as 0.65 or even 0.5% of the retention. That's great for our clients. It means that if there is a claim, you'll be able to access those limits much quicker.

Lynda Bennett:

Again, our prediction in our 2020 rep and warranty report came true, so now maybe hopefully some of our predictions in the 2023 report will also be picked up and acted upon. One of the things in our 2023 report that stood out and I think really is driving some more of this claims activity is the M&A market, and you referenced it a couple of times already, was absolutely on fire. Deals were closing in weeks, not months, and there was virtually no diligence being undertaken by the buyer of the company and by the insurers.

I think what we're now seeing through the increase in claims activity is maybe everybody needs to slow down for a minute and take a little bit of a closer look. The catastrophic losses are coming because... What did our report show? Financial statement breach claims are the number one by a very wide margin, the number one claim that's out there. Even if you think about your rep and warranty insurance's catastrophic loss coverage, unfortunately, many buyers of companies in the last couple of years have experienced those types of catastrophic losses.

Eric Jesse: I was going to say numerous carriers were reporting that they're getting claims on about 20% of the policies that they issue. That 20% I think is meaningful and it shows that R&W insurance is needed for these claims.

Lynda Bennett: Another myth, we often hear that rep and warranty insurers will require the sellers to have skin in the game that they have to provide some level of indemnification for rep breaches. Eric, is that true or false?

Eric Jesse: That is false. R&W insurance, it's designed to take the place of the seller's indemnification obligation. In many deals, that reduces significantly the indemnification obligation, but it can also eliminate it. Many years ago, I think when R&W Insurance was really just at its genesis in the US at least, you could have a pretty significant difference in pricing where an R&W policy is placed in a deal where the seller has some skin in the game versus a walkaway deal.

The insurer's theory at that time was that, well, they just expected more claims where the seller isn't providing any indemnification whatsoever. And that history or that claim differential never really panned out. I think our 2020 report confirmed that as well. What you're seeing today is that the pricing between policies for those two types of deals really is minimally different. But yes, you can absolutely get a policy in a walkaway deal.

Lynda Bennett: Well, and isn't that also driven by just what the M&A market matured and became, which is sellers demanded walkaway deals, right? The rep and warranty insurance market had to adapt to that too because you and I remember we used to review and negotiate sell side rep and warranty policies and those have really gone the way of the dodo bird because the sellers are like, "I'm out. Go get your rep and warranty policy. I'm not giving an indemnification. I'm out of here."

I think that also has driven that, but let's talk about that idea of a walkaway deal and the seller having no skin in the game. Is there coverage for seller's fraud under these rep and warranty policies?

Eric Jesse: Yes, that's another misconception we sometimes see, that R&W insurance won't cover the fraud. And that's the misconception, because again, that's what this policy is designed for, to cover a breach of a rep. All the buyer needs to show in order to access the policy is that there's a breach that the rep is inaccurate. It's irrelevant in terms of accessing the policy whether the rep is inaccurate because the seller made an honest mistake or was blatantly lying.

In fact, the policies expressly expect that they're going to cover a fraudulent breach of a rep because that is the one claim where the insurer after it pays, they're going to potentially have the right to assert a subrogation claim against the seller only in the instance where the seller acted fraudulent.

Lynda Bennett: Right. In those rare deals where there is some limited indemnification provided by the seller, our listeners need to be very careful not to give a complete and broad release to that seller, because they've got to preserve that subrogation right under the policy. Well, since we're talking about

coverage limitations now too, when it comes to these policies, should M&A buyers expect a laundry list of exclusions on these policies?

Eric Jesse: No, they shouldn't. What we see on these policies is that there's standard exclusions, which are relatively few. Look, when it comes to the policy, the clients are most focused on the exclusions. I think they now have the perception that there isn't going to be a laundry list of exclusions. I think what actually happens is if the buyer does see 567 deal specific exclusions, that's where the surprise comes because they expect those exclusions to be far fewer.

Look, if you get exclusions 567, that's where you need to dig in, have a discussion with the insurer, make sure those exclusions are truly based on diligence, and make sure that they're as narrow as possible because I'd rather have three very targeted specific exclusions than one broad one.

Lynda Bennett: Well, and I have to give a shout-out to my partner, Eric Jesse, because he has been very successful in the past in getting initially proposed deal specific exclusions removed. Our clients need to understand that just because you get that laundry list, you can start sorting that laundry and taking some of those exclusions out of the policy, right?

Eric Jesse: Absolutely.

Lynda Bennett: Something you do very well. All right, well, so before we wrap up, I have one last question for you, Eric. What about deals where the target is a foreign entity? Are US buyers stuck with a European style policy when they're doing a foreign transaction?

Eric Jesse: Yeah. I think that there is an expectation or there is the myth that if a US buyer, they're acquiring a foreign target that they're going to have to live on a European style form, and the reality is you can get a US style form. And that's important, very important from my perspective, because US policies, they're just much better forms, much more commercial, and US underwriters are much more commercial than compared to their European counterparts.

The issue with the European style form is, number one, you do actually have that laundry list of exclusions sometimes from A to double Z I've seen. And then the other issue with the European style form is that the entire data room is going to be deemed disclosed. What that means is if you have an unknown claim that comes up and it's tied to a stray one-page document that's buried at the bottom of the data room that no one reviewed, you might be out of luck on your claim.

We always try and strive for a US form and try to find the US hook that can get us a US style form when the target is a foreign one and we've been successful in doing so.

Lynda Bennett: All right. Well, that's great, Eric, and thanks for that. I think our key takeaways on the discussion of myths for reps and warranty policies are, one, these policies are a staple now in M&A transactions. On the underwriting side, they are negotiable, and the pricing is coming down on them.

On the claims side, buckle up because the process of getting the claim actually paid is getting longer and more complicated, but you should hang in there because there is oftentimes recovery at the end of that long process. All right, thank you for joining today and educating us on the myths associated with reps warranty policies, and we'll catch you next time.

Eric Jesse: All right, sounds good. Thank you.

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