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

Episode 86:
What RWI Buyers Should be Prepared for as Deal Flow Resumes

By Eric Jesse

MARCH 2024

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Eric Jesse: Welcome to Don't Take No for an Answer. I'm your host Eric Jesse from Lowenstein Sandler's Insurance Recovery Group, and today I'm pleased to be joined by Jeff Rubocki who is Senior Managing Director of the private equity practice at Risk Strategies. So, thank you for being here, Jeff.

Jeff Rubocki: Thank you. Appreciate the invite and glad to be here.

Eric Jesse: Of course. No, we're happy to have you. Jeff is a reps and warranties insurance broker, and we frequently work together on behalf of our mutual clients to place those Reps and Warranty policies. That's what we're here to talk about today. Deal flow has been slow for some time, and the R&W insurance market has been very competitive and buyer-friendly as a result. Since Jeff is on the front lines of the R&W insurance market, we wanted to have him here today to share his views on where the R&W market is headed in 2024 as deal flow hopefully will resume. Let's jump in. Jeff, do us a favor and look into your crystal ball and let us know, what does the rest of 2024 look like from just a RWI perspective?

Jeff Rubocki: Even if deal flow remains the same, and stagnant, and doesn't pick up, we think the pricing for the rest of the year will stabilize along with retentions. And the reason that we say that is because the pricing and the retentions have come down so significantly over the last couple of years, and we don't know if there's much more room for decreases. And the other factor, even in the absence of additional deal flow, is the pressure that we're seeing from claim activity. So over the last couple of years, especially with the explosion in '21 and '22 of deal activity, we're seeing a lot more claims on the books, and that's going to put pressure on the underwriters to either stabilize pricing or even try to maybe get some increases. Now, if the M&A activity does pick up, and we are hoping it certainly does, then we do think that pricing ... You'll see that start to creep up, as underwriters, to be more selective in their risk.

Eric Jesse: No, that's a good point and perspective. What's interesting, to your point, that maybe we've reached the bottom in terms of ... As the carriers have gone as low as they can so far. But Jeff, tell our audience, what are you seeing in the current market in terms of pre-standards, initial self-insured retentions, and typical premiums these days?

Jeff Rubocki: The retentions have come down. So we've seen retentions come down to 0.5% of the enterprise value. For simplicity, for a $100 million transaction that's going to be a $500,000 retention which you can imagine ... It's pretty low from what we saw just two years ago. But a lot of carriers are coming in at either 0.5 or we've seen a lot of 0.6, 0.65% of rate online, and 0.75%. But Eric, as you know, historically the starting retention was at 1%. And we're even seeing those lower retentions on the smaller deals which we never would expect. So even on the $30 million transactions, we're seeing starting retentions of 0.65 or 0.5, whereas you would never see that two years ago.

Eric Jesse: No, exactly. Ever the optimist that I am and hopefully, you are, hopefully deal flow does resume. I'm wondering, what are some pro-tips for M&A buyers, private equity buyers in the upcoming insurance market? What should buyers be doing to best position themselves to build maximize the value of their R&W policy?

Jeff Rubocki: Well, our philosophy is to start the process early so at the IOI stage or the LOI stage. So even if there's months before you think you'll sign the deal, we would say get into the marketplace. And that's good because you get your indications back, you get a sense and idea of what you're going to get from the markets. It may signal to you that hey, maybe we should focus on this particular area that we didn't think about. So it gives you a lot of insight as you're going through that process. And you never want to be caught off guard when you move into phase two.

And then Eric, the other key about getting the submission in early, if the market does pick up and all of a sudden that the carriers have 100 submissions sitting on their desk, but you already have your indication, you've locked into that. Especially as we approach third or fourth quarter. As we know historically, M&A picks up in the fourth quarter and carriers are going to be a lot more selective. If you already have your quote on the table, you're in a much better position than if you wait and say, "Hey, we want to sign in a week," and that might be tougher to get an option.

Eric Jesse: That's a very good point, and one where there might sometimes be a misunderstanding or a surprise at what is needed to actually ... For you to go out to the R&W insurance market, which is not a whole lot, you can still get a quote basically with background about the target sim or award presentation and audited financials, and you can get an initial quote basically with that type of information. And there's no downside to getting those quotes early either.

Jeff Rubocki: No, you bring up a great point because phase one of the process there is no downside, it doesn't cost the client anything. As you mentioned, with a couple pieces of information, the LOI, IOI, a similar overview to the target, and the financials you can get initial indications.

Eric Jesse: And it's also a good opportunity to get out in front and communicate with the carrier about what your due diligence process is going to look like. For a strategic buyer, they might be doing some of the diligence so you can preview that with the carrier and make sure everyone's on board so yes.

Jeff Rubocki: Eric, that point you cannot emphasize enough. When you can run into issues on R&W it's as you approach phase two and the carrier expects diligence, a read report in a certain area, maybe expecting it from a third party advisor, and it's going to come internally, you want to let the carrier know that upfront so there's no surprises and that they could sign off on a scope of work or not, but either way you know.

Eric Jesse: You were talking about just what a buyer-policyholder-friendly market it's been for the past year or so. Looking into your crystal ball, if deal flow picks up, we might see increased retentions or increased premiums, but any policyholder benefits from the current market that are here to stay going forward.

Jeff Rubocki: My experience between soft market and hard markets has been ... The carrier generally doesn't pull back on coverage. What they may do is say, "Hey, if you want this provision, we're now going to charge an additional premium for it." So rather than have everything upfront, you might see a sea of options for certain coverages. The one thing, Eric, I predict that will change significantly ... And again, we go back to when the market was extremely hard and it was tough to get a quote, are the comments on the purchase agreement. I remember a time when we were getting well over a dozen comments on the agreement because the carriers just wouldn't accept if they felt the ref were too broad. That has narrowed. And that's one of the things that I think our clients have benefited from is the less comments on the agreement. I believe carriers will probably look at the agreement, and take their pen to it more, and we'll see more comments on the agreement in terms of ... For the purposes of the policy, XYZ will be deemed deleted, or they'll add a certain phrase.

Eric Jesse: Yes, the hidden exclusions as I call them, yeah. Let's go even back in time before we've had the lulling M&A activity because you've had a day for the R&W insurance market back in 2021 and really Q4 2021. Why don't you remind our audience what the market looked like back then?

Jeff Rubocki: Well, I'm still catching up on my sleep from that, and it was incredible. It was a perfect storm for a hard market. And what I mean by that is that the submission flow, the M&A activity was at recorders. However, at that time we didn't have as many carriers in the market, nor did we have the amount of underwriters that we have today. With all those factors, what it led to was a substantial increase in pricing. We went from 3.5% of rate online, or 35,000 per mill upwards to 70,000 people reeled in of rate online. It was extreme.

Also, at that time you were lucky to get one quote for your risk, so it was tough. And you really had to manage that process to get through it and get your client a quote. And hopefully we won't go back to those days. I mean, hopefully, we'll see an increase in record-breaking M&A activity. But now with the amount of capacity, the number of underwriters, and the number of carriers, we'll never have that perfect storm where the carriers are taking the rate from 3.5% to 7%, or we're only getting one quote. And that we're always being able to provide our client options.

Eric Jesse: What I've heard, and certainly what your take is that after that heyday in 2021, the R&W insurers they reacted, and they staffed up on the underwriting side so there are more ... And the deal flow didn't really come but the carriers are hopefully staffed up so that, right, you can have an M&A boom. To your point, it doesn't have to send the market sideways in terms of pricing and the ability to get quotes.

And so here's a question. This is something I've seen for the past year or so which is there's a lot of just smaller deals that we've seen, and it's possible it's relatively easy to get R&W insurance for those small deals. And I'm talking about it could be a $30 million deal or even a 20 or $15 million deal. While I say that R&W insurance is certainly adaptable to a number of deals, a $15 million deal two or three years ago by R&W insurance might not make sense. It certainly has in the past year or so. And I'm wondering if you think that's something that's here to stay where there will be market capacity for these smaller deals as you have more insurers and increased underwriting capacity?

Jeff Rubocki: I think it is. And I think one of the benefits of this very soft market was the expansion of the underwriting appetite in terms of the risks that they would look at and take on as far as industry like healthcare and financial institutions. But one of the other big benefits of the soft market was the emergence of carriers writing these smaller deals. I don't think it's going away because a lot of carriers are making it a niche. And I think it's a very smart strategical move because you want to balance your book. You just don't want to have the larger deals you want some smaller deals to offset that as far as the risk goes and premium. Having the ability to place those smaller deals is significant because I think it opens the market up to a lot of our other clients that might not be doing those large 100 million, $250 million transactions.

But the other benefit was for add-ons, and that's what we're seeing today. So a lot of our clients aren't doing platform acquisitions they're doing a lot of add-ons, and these add-ons are below 20 million in enterprise value. And as we mentioned, two years ago it didn't make economic sense. Now you could ask for a two million or a $3 million limit. And carriers before had a minimum premium, but we're seeing premiums as low as $70,000 for a risk-

Eric Jesse: Oh, wow.

Jeff Rubocki: Which is very enticing to our client. Now I will say though, the one thing that you cannot get away from, the small transactions, is you still have to go through the diligence process. The carrier is going to expect that you're going to provide a quality of earnings report, that legal's going to look at things that legal should look at. Tax. If there's an environmental exposure, environmental. So you can't skirt the diligence but you can get very economical quotes. And the carriers are trying to be more efficient. Some carriers are coming up with their small units where they're saying, "Look, we'll give you the great coverage that we give you but we're trying to make this more efficient so therefore we're going to try to be more reasonable in terms of our ask."

Eric Jesse: And that goes back to the point at the top of the podcast which is a lot of it's just start early and communicate with the carrier. If you're upfront with the carrier about your scope of diligence you can find what makes sense and you're all on the same page as you move forward. You mentioned environmental. Sometimes a carrier will want a more recent phase one, but if you go to them and say, "Listen," right, "We have this phase one that a year or two old will you take that," right, and you can solve for that on the front end.

Jeff Rubocki: That's exactly right. And you want to do that negotiation before you move into phase two so that they ... Again, avoiding surprises is a good thing.

Eric Jesse: I think that there were some carriers that were successful in the sluggish market. What did you see? Or what distinguished those carriers or help them stand out and still be extra competitive and more popular than others?

Jeff Rubocki: I think it comes out to name recognition and credibility, experience. So if you've had experience with a specific carrier underwriter, and it was a good experience, you're going to tend to go back to those individuals and continue to work with them. Once you build that reputation ... And clients tend to gravitate back towards those that they had that good experience with. So if you were in the marketplace prior to the expansion and built up a good reputation, you're going to have an advantage just based off of name recognition. And also those carriers that have been in it for a longer period of time, you also know how they're going to approach the claim. So some carriers have bad marks but others have gotten good marks in terms of how they handle claims. So as brokers and as counsel, you have no problem recommending those even if their premium is higher than what others have quoted when you have four, five, six, a dozen options.

Eric Jesse: Absolutely. Yeah, two good points. I mean, one is yes, the advice we are sometimes giving clients is don't be penny wise and pound foolish because you can have the most beautiful, amazing policy form but if it's with a carrier that can be difficult on the claims side it might not be worth the paper it's printed on. We definitely tell clients to factor that in. And you also raise a good point about just the relationship, right? I think the R&W insurance market it is a closely knit market and relationships matter. I agree with you that when our clients work with one carrier, and have a good experience with them, and go back to them, right, that relationship develops. That certainly helps on the claim side as well. The deeper the relationship the easier the claim process can potentially be.

Jeff Rubocki: Absolutely.

Eric Jesse: When we're going to be selecting carriers or helping our advisor clients on which carriers to select in 2024, is there any one factor, or one or two factors that you'll be looking for that's going to stand out to you? Because a lot of times on paper these ... The quotes can look very similar.

Jeff Rubocki: You can get even more granular. Every carrier has a multitude of underwriters but underwriters that you've worked for that specific carrier in the past and what your experience was. How responsive are they? In the underwriting process are they going to be reasonable? What's important for us, are they able to rationalize what they put into a policy such as a deal-specific exclusion?

Eric Jesse: Agree.

Jeff Rubocki: So we want a carrier that's going to sit down with us and have a conversation of why they need that exclusion. Now, some are obvious, Eric. I mean, if there's an obvious tax liability exposure, a million dollars, we understand that that's going to be an exclusion. But then it comes down to the wording. What is that exclusion intended for? And it should be no more than what the exposure was identified in that diligence report. So an underwriter that's going to work with you so that both parties are in agreement, in terms of the attention of that exclusion, I think goes a long way. There are carriers and underwriters that do a much better job in that than others. And that's important to me as a broker because ultimately those underwriters that are going to work with you, you're going to end up with a better result for your client and a better experience. That's the ultimate goal.

Eric Jesse: I agree 100% with that. The other thing and it's related to what you say. I like to say, and put it this way which is, we're also looking for insurers on the underwriting side that don't sweat the small stuff. That have the experience and probably the confidence to know what to ask about and to ... What can go by the wayside. We do get the follow-up questions and information requests, and then you answer it, and then it's another question, another question. And sometimes the client, the attorneys are like "This really isn't an issue."

Jeff Rubocki: And to go off that point. I always ask the underwriter areas that are issues that you should focus on because you know ... You've had claim experience, you know that this is an area that you have to be very clear on. And then there are areas that maybe your outside counsel is saying, "Hey, ask this question." But one, it might not be relevant. Or if it is relevant, how often is there a claim or what's the exposure? And if it's minimal yeah drop it and focus on things that matter.

Eric Jesse: All right. Just a last question here, or it's going to be a compound question, but let's wrap it up just talking about claims. You mentioned earlier that there has been an increase in claims and so that's a pressure point here. How have you seen insurers in the claims-handling process over the past year or so? What can carriers do better and what can we as policyholders do better?

Jeff Rubocki: I think the biggest frustration with carriers in this space, with our clients with carriers, is the length of time to get a claim to the finish line, to settle. It seems like it's months and months and it could be over a year, sometimes a couple years. We are pushing and hoping carriers can cut back on that timeframe. And I think carriers are working on that to do that, to come to a conclusion much, much earlier in the process. Now with that being said, and as you mentioned, that is important that we as the broker and our client produces the information needed so the carrier can come to their conclusion. I think sometimes we delay the process, so we need to make sure that we're communicating the entire way.

And I think it's important to set up an agenda, and a timeline, and to have constant follow-ups and calls. And that's something that we've been doing with our clients and the carriers. We're doing frequent calls, getting everyone on a conference call just so that everyone can ask their questions and everyone remains on the same page in terms of where we are and what is needed. Because sometimes information that's needed does take some time. It's nobody's fault it's just a matter "Hey, we need this to make our final assessment, can you go out and get it?" "Yes, we will." And then just make sure that that's being worked on and it's not slipping through the cracks.

Eric Jesse: Yeah, I agree with that. The timeframe I think is one of the biggest challenges we see and hear from clients as well. I think it goes back to part of the theme of our discussion today, communication is key, and certainly reasonableness on both sides too. And if you can have that there is the strong likelihood of a more seamless or a much better outstanding process.

Jeff Rubocki: You're right. And we always like to say here, "It's a simple formula, communication."

Eric Jesse: Exactly. Great. Well, Jeff, I think this was a very valuable discussion. And thank you for sharing your insights and your predictions on the R&W insurance market with our audience. Like I said, ever the optimist, hopefully we see deal flow come back and we'll be working together on a lot of deals together this year.

Jeff Rubocki: Absolutely, Eric. And it will, it always does. It's cyclical, it's just a matter of time. And again, thank you for having me, much appreciated.

Eric Jesse: Absolutely. Thank you, take care.

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