



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

### Episode 67:

**Part II: The Intersection of Emerging Trends in M&A/  
Private Equity and Reps & Warranty Insurance: The  
Road Remains Bumpy For Dealmakers**

By [Lynda Bennett](#), [Eric Jesse](#)  
JUNE 2023

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**Lynda Bennett:** Welcome to Don't Take No for an Answer. I'm your host, Lynda Bennett, Chair of the Insurance Recovery Practice at Lowenstein Sandler. Today, I'm very pleased to have with me my co-host and partner, Eric Jesse, also of the Insurance Recovery Group at Lowenstein Sandler. Good to see you again, Eric.

**Eric Jesse:** You too, Lynda. Glad to be here.

**Lynda Bennett:** We're picking up a discussion, actually, that we had last time when we were fortunate enough to visit with our partner, Marita Makinen, to discuss the current state of play in the M&A and private equity space and deal flow. At this point, it's been a few months since we released our report addressing whether buyers are still getting paid under the rep and warranty policies that are put in place at the conclusion of the deal process. I want to start off, Eric, because you recently attended a conference where stakeholders involved in this type of deal flow activity gathered. So, what was the buzz associated with the results of our survey?

**Eric Jesse:** I attended a conference where there were industry players in the reps and warranty insurance market. So it was insurers, brokers, insurers council, accounting experts were there. I was called, in a friendly way, a pot stirrer. We raised a concern in our report with data about insurers, so it was the people in the room, that R&W insurance may be forgetting its way or forgetting its roots in commerciality and speedy resolution of claims. So that was our report, and the call to action that we had.

The report was referenced at the very beginning of the panel discussion on claims handling, noting some of the report's findings, particularly that claim resolutions take years, according to our respondents. Other things we highlighted in our report made its way into panel discussions, like the timeframe to get a coverage position letter, the importance of knowing your

customer, in many cases, PE firms. So it seemed to be read and recognized, which was good to see.

**Lynda Bennett:** I'm very proud of the results of our report, and the thought leadership we've provided there. Just to level set for our listeners, Eric, why don't you just touch on some of the highlights of what the message of the report really was.

**Eric Jesse:** It really was a call to action that reps and warranty insurers should not get entrenched in difficult unclaims. They can't forget that reps and warranty insurance, when it really was becoming popular probably about 10 years ago, was born out of the M&A market, let's make a deal, commerciality. Reps and warranty insurance is, and was, at its best when that commerciality translated over to the claims side.

**Lynda Bennett:** I think it's interesting, in our report, that readers of that report are really focusing on two interrelated issues, and you mentioned it at the top. The first one is that promise that's in the policy, that you'll get a very swift coverage determination from the carrier. Sometimes these policies will specify as little or suggest that as in a little as 60 days you'll have a determination as to whether this claim is going to be covered or not. So, that's one issue. The other thing our report showed is the growing dissatisfaction of certain stakeholders in the market because that promise isn't being delivered upon. Let's talk a little bit about how we can rebalance the harmony among all of the stakeholders in this M&A and rep and warranty space.

**Eric Jesse:** One of the key themes of our report was knowing your customer. In many cases, it is a PE firm or corporate development representatives at a strategic buyer who moved quickly on deals. They're able to close deals in a matter of months, so they can't understand why an R&A claim takes years. What I did hear at that reps and warranty insurance conference was that message being conveyed by the panelists, the know your customer component. The other problem that you allude to with these expectations, that you're going to get a coverage position in 60 days.

The insurers are over-promising and under-delivering, both in terms of the words on the policy, and then the buyer's expectations and understanding about how R&W insurance is supposed to work. When we talk about rebalancing the expectations, in terms of the 60-day expectation, that policy language needs to be revised where the parties will communicate, collaborate, use their best efforts to set deadlines, so that the right deadline is set for a financial statement breach each claim that might take a year to investigate. There needs to be a timetable to get reasonable information requests to the insured.

**Lynda Bennett:** Let me interject there, because we do like to keep it real on Don't Take No for an Answer here. A true policy holder advocate, of course, loves to see that 60-day promise, and the buyers of this product like to see that 60-day promise on a coverage determination in their policy. I do have some reluctance in saying, "Just take it out," because the carriers do need to be kept on a timetable as well.

What we are really striving for is, be far more upfront about what that reasonable timetable is. You and I have worked on a number of these deals, and we have to guide our clients too, to make them realize there's no way. When you've got a multi-million dollar and sometimes, potentially, billion dollar claim that's being submitted, there's no way that a coverage determination can be made in 60 days.

So we have to strike that right balance somewhere in between having the policy remain silent, because you and I have seen that movie before, where the carriers then can't be kept on task to say, "Hey, keep this process moving along," versus putting out a patently unrealistic timetable of 60 days, because the level of information, damages, documentation and all of the diligence that was done leading up to this deal doesn't facilitate an answer in 60 days.

Last time, Marita gave us some really interesting insights on current deal flow, and she provided some predictions on where things are headed. So now, I want you to take some of those concepts and, through the insurance lens, what do you make of her predictions and observations? Particularly, let's start with the fact that Marita noted, "There is going to be more careful diligence going forward from where we were back over the last two, three years."

**Eric Jesse:**

I think that's certainly going to translate onto the underwriting of the reps and warranty policies, in part just because of the increase in claim frequency and severity that's being seen. So, as insurers start to see a lot of claims in a particular area, you're going to see them focus on diligence areas. One of the things R&W insurers like to say is that they help to better the due diligence process because of their underwriting. So we can expect them to be expecting that heightened underwriting or due diligence as well.

**Lynda Bennett:**

Again, I'm going to go back to my concept of rebalancing expectations because, on the one hand, our clients, the stakeholders who are acquiring these businesses, speed, time kills all deals. We've heard that one before many times, but I think our report certainly shows there is a consequence to the speed, and maybe taking a breath and doing just a little bit more diligence can avoid. As Marita said, "They want to make sure they're getting what they're paying for."

Taking those couple of additional extra steps on the diligence will not only help them in the deal flow on the front end, but also will avoid potentially having to access the rep and warranty policy that they've put in place. Again, it is striking that right balance and, as you said, certainly the insurers are going to want to slow this process down because they're seeing the consequence of things moving as quickly as they had over the last couple of years.

One of the other things that Marita talked to us about last time, as a trend that she's seeing in her space is, a bit more diligence around compliance, and really recognizing the globalization of business today. Through your insurance lens, or through our collective insurance lens, what's going to come out of that on the rep and warranty insurance side?

- Eric Jesse:** I think that's something that the carriers are already concerned about, in terms of any target that has any relationship with Russia or Ukraine, there's an automatic exclusion that's going to be added regardless of the issue. Regardless of whether the target owned a Russian subsidiary 10 years ago, that's going to exist. This is something the carriers are always asking, these questions about foreign operations or foreign relationships. So, that's always coming up. If the target is purely domestic, then it's not an issue. But when it's not, then the carriers are going to expect that global trade diligence is conducted and, in many cases, foreign diligence is ongoing.
- Lynda Bennett:** What company is purely domestic anymore? Anybody that has a website isn't domestic anymore. One of the other things that Marita talked about last time, that's another topic that's near and dear to us, not only for reps and warranty but for cyber insurance as well, is the ever-increasing need to have greater focus, and attention, and diligence around data and data security and privacy. What do you think the rep and warranty insurers are going to do on the underwriting side of that? Are we through the deal activity that you've already been involved in, placing policies for the first half of 2023? Are you seeing more exclusions, different wordings to these exclusions around the data privacy and cyber issues?
- Eric Jesse:** On that issue, what we often are seeing, sometimes it might be just an upfront exclusion that you learn about at the proposal stage. When that happens, what we try to see, and where we're able to land just realistically, is that the R&W insurer will sit excess of a cyber insurance policy. That seems to be the market standard that we're able to get, and that's how we try and avoid the broad-based exclusion.
- Lynda Bennett:** One thing I've been thinking about in that space, or on that issue is, this may have pricing blow back because we know that, on the cyber insurance market side, the scope of coverage that cyber insurers are willing to provide seems to be getting tighter and getting diminished. So one of the things we've got to keep our eye on, with the rep and warranty insurers is, are we going to start to see premiums creep up when the rep and warranty insurer understands they're going to be closer to sitting in the first position on those claims because the coverage just simply isn't available from the acquired company?
- Eric Jesse:** I think that that's a possibility. What I see impacting pricing more is just the broader market conditions, if there's really demand for the policy, but I think that can be a factor for sure.
- Lynda Bennett:** That's one of the things I want to hone-in on before we wrap up today. I think we posed the question to Marita last time, and now I'm going to let you and I weigh in on it. Is this rep and warranty policy built to last? You started today's episode by talking about the fact that you were identified a little bit as a pot stirrer, or maybe a naysayer that this coverage is going to go away. Marita assured us that our livelihood remains intact, this product will be around, but you had some insightful comments to share in our report about how we need to move this product forward in a productive way, so that all stakeholders see value in keeping it as part of the deal process.

**Eric Jesse:** It was very good to hear Marita talk about reps and warranty insurance remaining an important part of the deal flow. That's really the goal of our report, is to make sure it continues that way. We note that, yes, the claim process has become a little bit more difficult since our 2020 report, in terms of claim payments or negotiating claim payments, but claims are still getting paid, so this is a good thing. But what we want to avoid is, we want Marita to be able to be making those comments years from now about R&W insurance remaining an important part of the deal.

What we've seen is, as claim activity has increased significantly, there's bumps in the road because, all of the sudden, the carriers are experiencing these claims, and just not sure about how to properly manage that process and manage the expectations. So hopefully, there's going to be a course correction. Look, what I heard from people at the conference was, recognizing the importance of communication and expectation setting. So we haven't really seen that in recent years, but hopefully we're going to see that going forward.

**Lynda Bennett:** Right, exactly. You said it very well, to smooth out those bumps, we really need to have greater communication and management of expectations on both sides, as to what is reasonable. Striking that right balance of what is reasonable to request and expect, to then get to that commercial negotiation table to resolve claims that come up when these policies are sold. Well, I think we've covered it for today, Eric. Do you have anything else to add?

**Eric Jesse:** No, I think we're good.

**Lynda Bennett:** All right. Well, thanks for joining us today. We look forward to having you come back and have a listen for our next episode.

**Eric Jesse:** Of course. Take care.

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