

# 5 Buyers' Counsel Tips For R&W Insurance Underwriting Calls

By **Bryan O'Keefe and Gena Usenheimer** (September 21, 2021)

In every transaction utilizing representations and warranties insurance, or RWI, the key part of the RWI process is the underwriting call — the two-hour window for the insurer and its counsel to hop on the phone and ask the buyer and its advisers about the important issues necessary to underwrite the insurance product.

Even though the underwriting call is critical for all parties, and RWI is more popular than ever, little has been written on how the buyer can have an effective underwriting call and walk away with a minimal number of exclusions — or none at all.

It's important for buyer's counsel to recognize that underwriters and their attorneys derive no joy from an underwriting call that goes poorly. In fact, underwriting counsel like for nothing more than to report back to their client that the buyer performed thorough due diligence on the target and that, with a minimal number of supplemental requests, the policy can be underwritten with little risk. Yet, time and again, this isn't what happens.

RWI is designed to be a collaborative process between the buyer/insured and the insurance carrier issuing the policy. In that spirit, we have compiled our top five tips for an effective underwriting call. By setting forth what insurers are hoping to see and hear on calls, we hope that buyers and their attorneys can better appreciate the insurers' perspective and provide the sort of content that will result in fewer exclusions — a win-win for everyone.

## 1. Never rely solely on the rep.

While this seems basic, every week, we hear buyers' counsel, even from prestigious AmLaw 100 law firms, state that they became comfortable around a specific issue not because of due diligence but because the seller provided a rep on the subject, and nothing has been disclosed against it. This response usually gives the insurer, who is assessing the sufficiency of due diligence to support the accuracy of the reps, little comfort.

The reality is that while the reps are supposed to be fairly negotiated — and some sellers do this better than others — many sellers do not aggressively negotiate reps when they know RWI will be used as there are bigger fish to fry in the deal, such as purchase price.

As a result, buyers must be comfortable with the reps due to their own due diligence, independent analysis and judgment, and legal work. In many instances, this also involves going beyond a simple confirmatory request with the seller and doing thorough due diligence — of the type that was common before RWI became in vogue. After all, the insurance is not a substitute for true buy-side due diligence.

In the same vein, there are certain areas that insurers frequently label as heightened risk — environmental contamination, wage and hour compliance, and products liability matters — all fall into this bucket.

If the buyer's due diligence is revealing a material foot fault in one of these areas, or



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another area identified as a heightened risk, it is usually better if the buy-side counsel addresses the issue long before the underwriting call and considers other mechanisms to resolve the problem, such as a special indemnity from the seller or a purchase price reduction.

Otherwise, the parties should not be disappointed or surprised when the insurer starts asking tough questions. Replying that the buyer is relying on a rep or a management representation that there are no issues is usually not going to get you over the hump when it comes to heightened risks.

If the underwriting counsel are asking about a specific issue and the buyer hasn't done any work on it, then it's better to say that you will circle back on the issue. Insurers are usually amenable to giving the buyer another bite at the apple through a supplemental request.

But banish "relying on the rep" from the RWI vocabulary.

## **2. Understand materiality in the context of the RWI policy, not just the transaction.**

It has been our experience that many specialist attorneys working for the buy side do not appreciate the basic economics of how RWI works. This can lead specialists to avow that an issue is not material even though it clearly is — at least in the context of the RWI policy.

Here's a refresher on how RWI works.

RWI typically insures 10% of the enterprise value of the deal. The policy will contain a deductible that is ordinarily 1% of the policy limit. The policy premium runs somewhere between 3%-4% on most deals these days.

Why are these numbers so important? We frequently hear specialists say that a particular issue is not material in the context of the transaction. That might be true. And yet an exclusion still could be the right outcome under the RWI policy.

That's because what's material in the transaction is exponentially larger than what is material to a RWI insurer. If you have a \$100 million deal, the insurer has a \$1 million buffer on all losses under the policy versus a premium of only \$300,000-\$400,000. This risk calculus is very different from what the buyer might consider material against the full \$100 million purchase price.

The best buy-side lawyers understand this dynamic and are not quick to cavalierly dismiss issues raised by underwriting counsel.

Here's a good rule of thumb for specialists working for buyers: If the underwriting counsel is asking about the issue on the call, then the issue is material. Insurers get two hours on the call — every minute counts. They are not filling the space with fluff.

## **3. Be truthful.**

In every deal, there is a certain amount of expected lipstick on the pig — that is, buyers putting the best spin on certain issues to try to maximize insurance coverage. That's fair game. But more and more, we have seen buyers' counsel taking things to another level — outright lies that are later exposed as such in supplemental requests.

While buyers' counsel might think they are being clever, good underwriters and their counsel can spot Pinocchio from a mile away. Many underwriting counsel practices have a high volume of work and develop an instinctual sixth sense for when someone is fibbing. And like every other facet of life, once you are exposed as lying about an issue, your credibility will be shot — both in this deal and every deal thereafter.

The far better approach is candor when it's obvious there's an issue. Underwriting counsel will appreciate it — and if there is a borderline call later on another exclusion, you may be more likely to get the benefit of the doubt.

One final point that is often overlooked: The rules of professional conduct governing attorney behavior apply on underwriting calls just the same as any other legal interaction. You wouldn't lie in answering discovery responses from opposing counsel. This exercise is no different.

In fact, given that your representations on the underwriting call are being used to induce the insurer to underwrite a policy worth tens of millions of dollars in most instances, the financial stakes are arguably even higher here. Treat it as such.

#### **4. Be prepared.**

Underwriting calls are still filled with specialists who are generally unprepared for the call. One or two minutes into their section, it becomes obvious the person has jumped on the call at the last minute and can barely remember any of the basic details of the deal, let alone the nuances that can sometimes form the basis for legitimate carrier concerns.

This is a costly disservice to the buyer, who has spent a pretty penny on due diligence and gone through an extensive process to obtain RWI coverage in the first place.

What's more, it is unnecessary, as almost all RWI carriers provide agendas or topic lists for the call at least 24 hours ahead of time, essentially giving the buyer's counsel a road map of the questions that will be asked. While underwriting counsel sometimes supplement their questions during the call, they are typically around issues that are obvious in the deal and should not be a surprise.

Our recommendation is that buy-side specialists annotate the answers to the questions ahead of time and be thoroughly prepared to discuss the topics on the agenda. It also helps if you have at least walked through mentally how you want to address the issues.

We can tell when someone is offering a thoughtful answer that relates to the due diligence that was performed and when someone is answering on the fly, thinking about what they are saying for the first time as the words come out of their mouths. Be the former, not the latter.

#### **5. Be persuasive.**

Far too often, we encounter buy-side attorneys who act as if the underwriting counsel call is ruining their day.

Why?

The most generous interpretation is that, after spending months on a deal, now, at the very last minute, another attorney is asking basic questions about the target company — e.g.,

has there ever been a tax audit? Do the employees sign confidentiality agreements with present tense assignment language? In the fast-paced deal world, it must seem to some specialists that surely there is a better use of one's time. We appreciate this concern.

Here, again, further context on the logistics of the RWI process may be helpful. Placing the RWI policy is the last piece of the puzzle in the deal. The carrier is not selected until the very end of the deal. And after the carrier is picked, the carrier then, and only then, engages its outside underwriting counsel.

From there, underwriting counsel have to become familiar with the deal in a very short period of time — sometimes less than 48 hours. In fact, it is not uncommon for all the due diligence reports to arrive 24 hours prior to the call. Adding to this pressure is the fact that most underwriting counsel are operating high-volume practices.

So, the deal that the buyer has been living with for months, the underwriters and their counsel have been living with for days, maybe only hours, and are usually juggling this deal in between multiple other underwriting calls, sometimes on the same day.

Against that backdrop, we hope that buy-side attorneys appreciate why the questions are being asked in the manner they are being asked.

But even if buyers' counsel do not want to understand this dynamic, here's another, perhaps more important reason, to take a different tone on your next underwriting call: It's a lousy way to represent your client.

Remember, your client's goal is to get out of the underwriting call with the fewest exclusions possible. What's the best way to do that? By persuading the underwriting counsel that you have thoroughly investigated the issue. Like any other walk of life, you'll almost always win more bees with honey. Short answers are going to get you nowhere.

At the end of the day, the carrier holds all the cards — the carrier alone determines how the policy is underwritten and the number of exclusions. Buyers' counsel should approach the underwriting call as an important opportunity to represent your client and as an exercise in persuasion, not as a petty annoyance.

## **Conclusion**

Ultimately, the best underwriting calls are a collaborative exercise between the participants, including buyers' counsel and underwriting counsel. After all, it is in the buyer's best interest to obtain the policy, and the carrier's best interest to underwrite it, with a minimal number of exclusions.

By following the recommendations we have set forth above, we hope that more calls reflect this cooperative spirit and that buyers have a better understanding of what the insurer's needs in order for the call to be successful.

RWI is a fantastic product that has revolutionized mergers and acquisitions. Let's work together as attorneys to ensure that the next underwriting call is a success.

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