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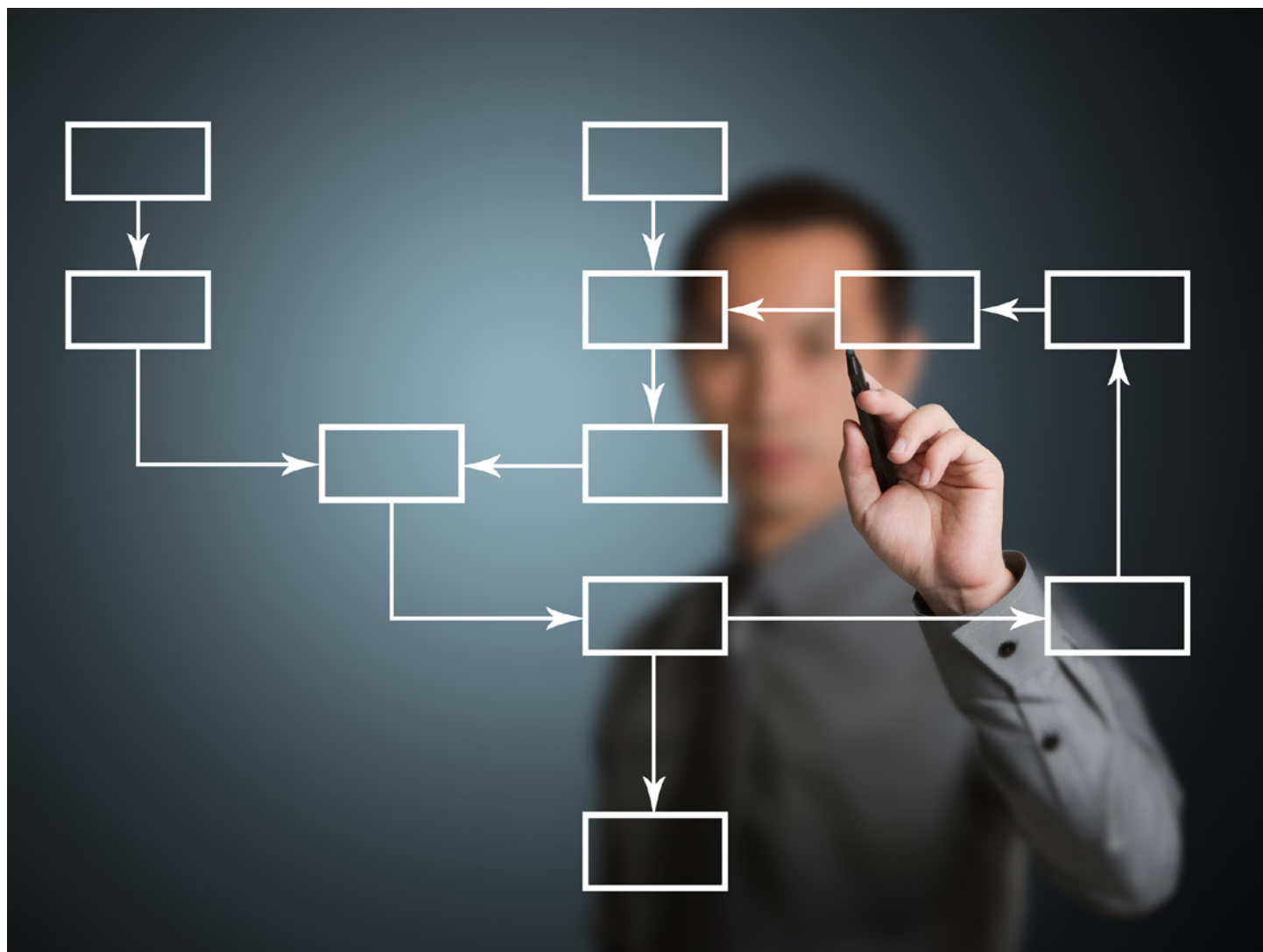
# Managing the reps & warranties claims process

FW discusses the reps & warranties claims process with Marc Sherman and Meghan Cardell at Alvarez & Marsal.



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## THE PANELLISTS



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Marc Sherman is a managing director and partner at Alvarez & Marsal, resident in Washington, DC. He specialises in forensic accounting, corporate restructuring and transactional insurance. He previously was managing partner of forensic services and regional managing partner of corporate finance, business valuation, restructuring and turnaround services for a Big Four firm. He is a CPA and member of the bar. His clients include large transactional insurance carriers and underwriters in the US and Europe.



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Meghan Cardell is a director at Alvarez and Marsal. Her experience is in forensic accounting, valuation and calculation of economic damages, with a specific expertise in the area of transactional insurance. She has assisted various transactional risk insurance carriers in the US and Europe by providing damages, lost profits, financial statement/accounting and other expertise to evaluate transactional liability claims across industries. She is a certified public account and a certified fraud examiner.

**FW: Could you provide an overview of the role representations & warranties (R&W) insurance plays in M&A transactions? What are the key benefits it provides to buyers and sellers?**

**Sherman:** Representations & warranties (R&W) insurance has significantly increased its importance in the mergers & acquisitions space. Where R&W insurance was purchased in a small percentage of transactions six to seven years ago, the majority of transactions now take advantage of it. R&W insurance is beneficial to both the buyer and seller in a transaction. For the buyer, it provides a mechanism to shift risk in specifically negotiated areas to a business partner that understands the risks they are taking on and has a history of paying claims when those instances occur. This makes for a more businesslike and predictable resolution to representation and

warranty breaches. For sellers, especially in today's private equity active environment, it allows more leeway for reduction of holdbacks and escrows and permits sellers to finalise the sale of an investment and allows for faster distribution of proceeds to investors. It also allows sellers to move on after the sale without the overhang of potential future obligations.

**FW: What are the most common types of claims made against coverage under an R&W insurance policy?**

**Cardell:** Claims are made against a wide variety of representations in acquisition agreements but there are certain areas that generally see more claims activity than others. Financial statement representations have been and continue to be among the most common types of claims. Given that valuation impacts are often associated

with these types of claims, they also tend to reflect a significant portion of the larger claims made. In the past few years, we have also seen an increasing number of claims against material contracts or material customer representations, as well as claims against representations related to the condition and sufficiency of physical and IT assets.

**FW: What areas of R&W coverage and claims under R&W policies are often misunderstood by policyholders?**

**Sherman:** R&W insurance compensates a buyer – the insured in a buyer-side policy – for losses incurred within policy limits that are caused by a breach of the enumerated representations & warranties negotiated in the acquisition agreement between the buyer and seller. Those representations & warranties are underwritten by the

insurance company based on their very specific language and meaning and do not extend to the buyer's expectations that are outside of that specific language.

**FW: In your experience, what are the key attributes of an efficient, developed and well-organised claims process? What factors influence how quickly claims are processed and resolved?**

**Sherman:** Insurers view R&W insurance as a partnership to shift specified risk, and the process to validate and pay a claim works best when it is a collaborative process between the insurer and insured. The efficiency of the claims process requires active cooperation and participation by the insured and insurer, and their advisers. Claims submission and resolution is a process. The claim must be validated by the insurer and that process is most efficiently achieved when the insurer can walk in the shoes of the insured to understand in detail the acquisition, the issues and the impact. That process and the outcome are frustrated when faced with roadblocks and limitations. The claims process requires a fair amount of information and data and a willingness to provide real cooperation. The process loses its efficiency and effectiveness

when either of the parties or their advisers treat the process like an adversarial encounter rather than a collaborative process. Efficiency and results are furthered when the claims process is thought of as a culmination of the deal process rather than the beginning of a dispute. The dispute mindset and approach often comes from historical seller and buyer post-acquisition disagreements and has no place in the R&W insurance claims process. It is very detrimental to efficient claims resolution. You can analogise it to the different way of thinking between a litigator and a deal lawyer.

**FW: Once a claim has been submitted, what is the process to investigate whether a breach has occurred and to assess the amount of any resulting loss? To what extent does this process involve navigating complex legal, accounting and valuation issues?**

**Cardell:** Once a claim is submitted, the insurer will begin a process with the insured to understand the claim details and determine what information will be needed to validate the claim. It is critical that an insurer be able to validate the facts, confirm that a breach has occurred, and determine the amount of the loss and that the loss is fair compensation for the breach. An important factor for policyholders to understand is that the insurer and its advisers are working at an information deficit compared to the insured. The insured lived and understands the acquisition, the acquired company and its records and the facts driving the claimed issues. With that exceptional knowledge, the best way to start the process is for the insured to impart as much of that knowledge to the insurer and its advisers as early as possible in the process. Generally, an initial call between the parties to start that information download is highly effective. The insurer is then able to issue more targeted document requests based on a more informed understanding of the facts – which makes the process easier and more efficient for all parties. From that point forward, the process is a matter of the insurer requesting, and the insured

providing, documents and information on an iterative basis sufficient for the insurer to complete its validation process. The process indeed involves understanding and dealing with complex legal, accounting and valuation issues. Most transactions are complex and the claims that arise from the representations and warranties in the transaction are often similarly complex. That requires that insureds and insurers each evaluate those elements early in the claim process, confer and develop a common understanding from which they can work toward resolution of the claim. Notwithstanding the complexities, a common understanding is not typically difficult to achieve in our experience. There are often complex issues related to the facts of the claim, valuation and questions of coverage. Working collaboratively through those difficult issues results in the best outcome in the end.

**FW: Is there a benefit for policyholders to engage the assistance of forensic accountants in the claims process?**

**Sherman:** There is a clear benefit to the efficiency of the process when a forensic accountant is engaged by the insured to help analyse and explain the data. However, just as with other advisers, the forensic accountant is only helpful when the goal is to present an unbiased analysis and result. Many forensic accountants' primary business is to serve in the role of a litigation or dispute expert witness. That experience may lead some forensic accountants to behave as if the claims process is a dispute rather than a cooperative fact-finding and analytical endeavour. The efficiency of the process and its effectiveness will be swayed greatly if the forensic accountant wears the wrong hat into the R&W insurance claims process, or if the insured chooses the wrong adviser.

**FW: When choosing between R&W insurance policies on offer, how important is it for parties to evaluate a potential insurer's claims experience and claims-paying track record?**

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MEGHAN CARDELL  
Alvarez & Marsal

**Cardell:** In our experience, the claims process is a very important piece of the R&W insurance experience. As such, claims experience plays an important role in the insureds' choice in purchasing and using R&W insurance products. Where insureds experience, or are aware of, efficient claims processes and fair claims assessments, that typically has an increased importance on the insureds' decision making about the use of R&W insurance and the choice of the right provider for that insured. In our experience, one of the things that insureds value most from an insurer is transparency and communication throughout the claims process. As more insureds have gone through the claims process, we believe they have also learned how cooperation and communication from their end as well can make the process smoother and more efficient for all, leading to a better and quicker result.

**FW: How do you expect the claims process for R&W insurance to evolve in**

**the months and years ahead? Where are we likely to see further improvements being made?**

**Cardell:** The claims process has evolved over the years, as both insurers and insureds have gained more experience and confidence with the process and the outcomes – and we expect that to continue as the number of submitted claims continues to increase in the future. Time will bring even greater understanding of how the product works, the claims process and the experience of recovery, all of which will allow for more informed and effective interactions between insureds and insurers. We expect to see further maturity in the claims process as the industry builds more experience on both the insured and insurer sides. The more experience that the parties have with communicating and resolving complex and difficult issues, the more efficient and effective it will be when the parties face similar issues and questions in the future. ■

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