



ETHOS SPECIALTY

Representations & Warranties Claims

Representations & Warranties insurance claims can be incredibly complex, often involving specific areas of law and financial rules that require vast expertise. Insurers need the where-with-all to deal with both U.S. and international regulations and laws as well as domestic and foreign tax regimes.

Ethos has in-house, dedicated staff who not only work through claims, but who also have a network of outside experts that can be engaged to assist with the handling and ultimate resolution of a claim.

This experience, in handling R&W claims on behalf of some of the largest players in this space, differentiates Ethos from some carriers who still believe in segregating claims and underwriting. Ethos believes that R&W claims should include the underwriting team who worked on the underlying transaction. Our goal is to resolve claims as quickly as possible, without jeopardizing the trust of our clients, while also maintaining the trust of our capacity providers.

CLAIMS DATA

Since its inception, Ethos Specialty Insurance has received notice of over 150 transactional liability claims and to date has effectively managed and resolved to completion a significant percentage of the reported matters. We have recovered for our Insureds a substantial number of first- and third-party payments totaling in excess of \$100M on various financial statement and material customer claims, as well as on a number of third-party consumer litigation, condition of asset, tax and other reported claims. We have achieved five eight-figure settlements in financial statement/material customer claims as well as and a fair number of low to mid seven figure claims. We partner with our Insureds and their counsel towards the common goal of fair and efficient commercial resolutions.

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Representations & Warranties Claims (continued)

CASE STUDY

Shortly after a \$150+ million transaction closed, the buyer received a whistleblower letter from a former senior accountant at the target company informing them that the newly-acquired company's financial statements had been falsified and improperly manipulated. The insured investigated and determined that the acquired company had indeed understated its cost of sales and related cost of sales expense, which in turn inflated its reported EBITDA by over \$3.3 million. The buyer relied upon the reported EBITDA figures and a transaction multiple of 11 to determine the purchase price and contended that since EBITDA was deliberately overstated and its financial statements manipulated to hide a deteriorating business, it overpaid for the acquisition by over \$35 million. In short, the insured believed that the company was "fundamentally a different business" than they thought they purchased.

The Buyer's forensic accountants concluded that at some point starting about 2 years prior

to the acquisition – at the CFO's direction – the accounting team began to deviate from its past accounting practices and engaged in an "earnings management" scheme in order to present the company as stable and profitable when, in reality, its results were actually declining. The CFO's goal was apparently to position the company for a successful acquisition which, given his impending retirement and a large transaction bonus due him, seemed to be the reason for the misdeeds.

It was determined that for the final three-month period before the transaction, the company reported only 34%, 22.8% and 4.9% of its actual monthly cost of sales. In other words, reported cost of sales declined 95% from April 2017 to March 2018 and in the final month only 5% of its total expenses were appropriately recorded. Neither the sell-side Quality of Earnings report, the target company's auditor, nor the buy-side accounting/financial due diligence report uncovered the accounting improprieties.

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ABOUT ETHOS

Ethos Specialty is a leading Managing General Underwriter (MGU) that develops industry-specific insurance programs and provides specialized underwriting services on behalf of high-quality carrier and syndicate partners. Ethos has developed, and is the underwriting manager for, multiple niche-programs across Property, Casualty and Transactional Liability Insurance.

DISCLAIMER

The information contained herein is offered as insurance Industry guidance and provided as an overview of current market risks and available coverages and is intended for discussion purposes only. Statements of coverage availability and scope are general in nature, subject to change and underwriting of any individual risk, and provide no guaranty or warranty of coverage, express or implied. The precise coverage afforded by any insurer is subject to the actual terms and conditions of the policies as issued. Insurance brokerage and related services are provided by Ethos Specialty Insurance Services LLC (California License No. 0M29989). The publication and delivery of the information contained herein is not intended as a solicitation for the purchase of insurance on any US risk.