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■ **ROUNDTABLE** August 2022

# MANAGING TRANSACTIONAL RISK

While global M&A activity in 2022 has largely returned to ‘normal’ following the record-breaking environment seen in 2021, market volatility and risk remain high in M&A agreements, commensurate with demand for transactional risk insurance. Regarded as a critical enabler by both buyers and sellers alike, transactional risk insurance is now an established deal solution in the M&A marketplace, with new entrants moving into the market and established insurers growing their existing capabilities. ■



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**FW: As part of transactional risk management, what key areas need to be considered during due diligence? To what extent are pressing time constraints affecting the level or quality of due diligence, and in turn potentially resulting in more post-deal claims?**

**Sherman:** Reliable due diligence must examine many aspects of the target company, including its operations, financials, market, opportunities and its growth potential. That breadth and depth of assessment requires a deep dive and a fair amount of time – a lot to accomplish in the restricted time typically available for due diligence in today's market. Given the time limitations, diligence will necessarily be more thorough in some areas and less in others, and the areas of greater risk must undergo greater diligence. When they do not, the chance of a post-deal claim increases, as does the chance of uninsured post-acquisition problems and failures. That obliges the buyer to have a system to identify areas of higher risk early in the diligence process and to properly focus on them. We also find that certain characteristics and factors of a target company's operations may help to foretell certain types of embedded risks. Claims experiences may be used as a pre-acquisition guide to help efficiently identify hidden risks that might otherwise be overlooked. In the end, some risks and resulting claims simply cannot be predicted or detected ahead of time; but some can, through a claims-driven efficient and informed risk management effort.

**Luxenburg:** While certain subjects, such as financial statements and taxes, are generally important on almost all M&A insurance deals, key diligence areas differ depending on the target's risk profile. For example, a technology company with few employees may result in a particular focus on cyber matters, whereas a manufacturing company with owned real property and many employees may result in increased focus on environmental and employee-related matters. One broader emerging trend is a focus on confirming the strength of the

target's customer and supplier contracts and relationships. Time constraints in underwriting presented real challenges in late 2021, but generally diligence presented to underwriters remained strong and supported underwriting. Through the middle of 2022, the market has established a deep capacity to handle a large deal volume, and 'bandwidth' is not presently a problem for underwriters, although we are closely monitoring deal volume and market bandwidth.

**Lessman:** Due diligence is a fundamental and integral aspect of each transaction, encompassing a broad spectrum of areas. In almost every deal, from an insurance perspective, general corporate dealings including capitalisation and authority, financial and accounting affairs, tax matters and employment and employee benefits, must be studied when framing the diligence domain. Moreover, based on the industry sector of the target company, other components such as regulatory, cyber security and privacy, environmental or product liability may also be factors. For both buyer and seller, the insurance streamlines and accelerates the negotiation of the agreement. Representations & warranties (R&W) insurance should not have an impact on the timeline of the sale and thorough due diligence is critical to minimise risk and post-deal claims.

**Pegram:** Assessing the areas of heightened risk of the target company and determining where diligence should be more heavily focused is as critical to a successful M&A transaction as the diligence itself. A typical diligence exercise should evaluate the target company's ownership, operations, finances, key business relationships, historic and current liabilities, such as litigation and liens, and labour and employment practices. However, target companies operating in nuanced industries may pose more unique risks that require a deeper level of diligence and expertise, such as the aviation, healthcare and pharmaceutical industries. One of the more difficult tasks in coordinating robust diligence is keeping within the rigorous timing of M&A transactions. As we saw transaction

timelines shorten in 2021 due to a record-breaking M&A season, buyers and their advisers were forced to make strategic decisions on where to focus diligence efforts. While we have recently seen more abbreviated forms of diligence memos prepared by buyers' counsel, it appears buyers and their advisers have generally continued to perform meaningful diligence where appropriate, which is also supported by the consistency we have seen in the percentage of claims notifications received over the past two years.

**De Berry:** No buyer wants to be disappointed in an acquisition, but truncated due diligence is sometimes required to win a deal. At such times, an attempt is made to capture major problems only. However, if the limits of the R&W programme are only 10 percent of the purchase price, and the seller has little or no indemnity obligation, the buyer remains exposed by truncated due diligence. On the other hand, some buyers fail to appreciate the services provided in more robust diligence and are happy to cut their budget as well as save time. We have seen a few claims that call into question the level of diligence performed. A few key areas are worth noting. First, financial statements. The scope of the financial statement representation and the degree to which a buyer's financial due diligence includes both an analytical and forensic review of the target's financials – as part of its quality of earnings – are broad underwriting concerns. Second, material customers. The scope of the material contracts and customers' and suppliers' representations, and the diligence conducted regarding their accuracy, have given rise, in our experience, to significant loss. Third, the condition of assets. The scope of the condition of assets representation and the diligence conducted regarding its accuracy have also given rise, in our experience, to significant loss. Finally, cyber. The scope of representations addressing cyber liability and cyber vulnerability, respectively, are concerns.

**Rodrigues:** It may be easy to assume that more time spent on diligence would unearth issues giving rise to a claim. However,

when considering whether the level of diligence is a factor in the rising claim frequency, consideration must also be given to the scope of representations themselves. We have witnessed a broadening of representations over time and the broader the wording becomes, the more diligence is required to verify the accuracy of the representation. In any placement, fulsome diligence is critical to a streamlined R&W underwriting process. Underwriters expect to review written memos on the topics of legal, financial and tax at a minimum, whether these reports are prepared internally by the buyer or by its third-party advisers. In the current market, issues relating to employment matters, compliance with the regulatory frameworks to which the target is subject, condition of assets, material contracts, inventory, percentage of completion accounting and underlying insurance are areas of heightened scrutiny. We witnessed time constraint issues at the end of the year as a result of bandwidth among service providers. Buyers that took a lighter approach to diligence in trade for time savings were either declined coverage or accepted broader exclusions. Where timing is the issue, many carriers will allow for a conditional exclusion which allows the buyer some additional time, typically between signing and closing, to diligence the topic in question. We have not seen an uptick in claims where diligence was rushed, but have seen an increased rate of conditional exclusions recently.

**Friedman:** We have found that buyers are conducting typical diligence processes that are not limited by the purchase of R&W insurance. Typical processes include using internal or external resources to perform full scope legal, financial, tax, insurance, commercial, environmental and technical diligence for any given acquisition. For target companies with an international presence, we normally see buyers engaging local advisers, particularly for tax, legal and environmental matters. If the target's operations fall under the purview of any specialty regulatory regimes, it is expected those speciality areas will be included in the buyer's legal diligence.

**Turnham:** It is advisable for a buyer to consider all subject areas that represent either key value drivers or key exposures for the target business as part of due diligence. Legal, tax and financial due diligence will always be of central importance, with the specific areas of focus within each workstream being a function of the sector in which the target operates and its operational footprint. Further, due diligence workstreams, such as IT, commercial, environmental, operational and technical, insurance and cyber, might also be relevant depending on the nature of the business being acquired. The reporting format of due diligence has generally moved toward a 'red flag' or 'exceptions only' basis in recent years – as opposed to traditional 'long form' reporting – although in our experience this

does not necessarily result in a reduction in due diligence scoping as such, nor has it, of itself, led to increased claims. From a transaction risk insurance perspective, it is always important for a buyer to be able to demonstrate that its advisers have carried out a fulsome and appropriately scoped due diligence exercise regardless of the final reporting format. The recent slowdown in global M&A activity appears to have resulted in additional time available to buyers and their counsel to perform due diligence. It remains to be seen whether this is a lasting change in the market.

**FW: What are some of the common issues that surface post-close, which may have been detected or avoided with adequate diligence?**

**Luxenburg:** Claims and risks based on customer and supplier relationships have received attention of late. Customer relationships can be difficult to diligence, as deal and other considerations may limit the diligence buyers can conduct. For example, confidentiality concerns may prevent a buyer from talking directly with customers. In addition, not surprisingly, the supply chain challenges currently impacting companies around the world can create complexity and uncertainty with supplier relationships – some of which can result in issues covered by M&A insurance. As the market has become more comfortable with diverse valuation methodologies, certain types of financial-statement claims are becoming more frequent. For example, in deals where the target is valued based on recurring revenue rather than earnings before interest, taxes, depreciation and amortisation (EBITDA) multiples, issues can arise with the nature and reliability of that recurring revenue and its impact on the target's financials. From the underwriter's perspective, this heightens the need for thorough financial diligence that aligns with the scope of the relevant representations in the purchase agreement.

**De Berry:** There are a range of post-closure issues facing practitioners. First, a failure to properly true-up 'standard costing' for purposes of inventory and

“THE CLAIMS EXPERIENCE IS OF UTMOST IMPORTANCE AND AN AREA IN WHICH BOTH BROKERS AND CARRIERS SHOULD BE INVESTING TIME AND RESOURCES.”

NANCY RODRIGUES  
Vanbridge Solutions Group

costs of goods sold. Second, a failure to integrate a recently acquired division of the target with respect to billing systems. Third, a failure to detect an undisclosed altered relationship with a major customer. Fourth, a failure to recognise that a change of ownership would cause the loss of a licence. Fifth, a failure to recognise that a change of ownership would cause the loss of numerous leases in a certain state. Sixth, a failure to recognise that costs were not accurately calculated under long-term loss contracts. Seventh, a failure to confirm, on a sample basis, the accuracy of accounting for long-term contracts under the percentage-of-completion method. Lastly, a failure to inspect equipment for latent defects.

**Pegram:** We have recently noticed an uptick in claim notifications regarding customer and supplier relationships, material contracts, the condition and sufficiency of the tangible assets and revenue recognition. Each of these areas tend to both present unique challenges in diligence and carry the potential for significant post-closing loss. Allocating the appropriate time and resources to key areas that have an inherently higher risk profile could help buyers avoid experiencing future loss, which is why it is crucial to monitor breach and claim trends. It is important to note that, while adequate diligence will help buyers identify key issues that may result in a breach and associated loss, there are certain matters that may pose a significant risk of loss regardless of the amount of diligence performed prior to signing and closing, such as the potential for latent defects in high-value machinery. These areas should be taken into consideration when negotiating deal terms like indemnities and valuation.

**Friedman:** The most common issues that arise are tax and financial statement breaches. Other common claims are related to condition of assets, material customers and suppliers, breaches of material contracts and third-party claims for potential regulatory violations. When thinking about issues that could be detected or avoided to prevent post-closing disputes,

“M&A COVERAGE HAS CONTINUED TO BECOME MORE WIDELY RECOGNISED AND MORE ATTRACTIVE TO BUYERS AND SELLERS. WE HAVE SEEN A CONSISTENT FLOW, AND DEAL PROGRESS REMAINS STRONG IN THIS SPACE.”

TORIA LESSMAN  
QBE North America

there have been claims related to the quality and condition of purchased assets that likely could have been avoided with more thorough inspection.

**Rodrigues:** Given the breadth of coverage afforded under an R&W policy and lack of detailed claims information, it is difficult to identify with certainty any trends across both claims and diligence that would have avoided those claims. We know that the representations most frequently giving rise to claims are financial statements, material contracts, compliance with laws and tax. The risk of breaches with respect to material contract claims in particular is high, suggesting that tweaks to the diligence process may have avoided the claims, for example conducting customer calls and reviewing the internal controls a target maintains with respect to the ‘administration of customer contracts’. These customer call discussions and accompanying notes have become standard diligence questions from markets, with some carriers mandating that call notes be available in order to insure the risk. More recently, the condition of assets representation has been cited as an area of increasing claims activity. In response to this trend, we now see that those transactions with asset-heavy operations will need to provide evidence of site visits and written reports assessing the assets. As claim trends emerge, the diligence

requirements imposed by the insurers evolve to reduce the claims frequency.

**Turnham:** The most common subject matter areas of issues of dispute under warranty & indemnity (W&I) or R&W insurance policies are generally accounting and tax claims. Among other reasons, this is due to both being technical areas involving areas of judgment on which experts may disagree. Fulsome and critical diligence is naturally key in mitigating risk in this area, although due to the nature of the subject matter it may not remove it entirely – hence the benefit of additional assurance from a transactional risk insurance policy. Other areas in which claims activity has risen in recent years are customer contracts, intellectual property and compliance with laws, both of which lend themselves to additional assurance – up to a point – through robust due diligence.

**Sherman:** Common issues that surface, or could surface, depend on the specifics of the target company and the industry. Generically, the most common issue we see is reserve adequacy. In many instances, we notice that the financial diligence process does not critically enough examine the apparent reasonableness – or unreasonableness – of each of the reserves given the industry, the nature of the accounts and the business operations. Reserve adequacy is not alone, however. There are many other detectable and



avoidable issues that fall in this category, some common and others not so common.

**FW: Are you seeing a growing appetite for M&A insurance, to help manage risks and see deals through to completion?**

**Friedman:** Although geopolitical and macroeconomic headwinds have arisen in 2022, buyers' unallocated capital remains strong, and we have observed a healthy pipeline of new deals seeking insurance in the beginning of the second quarter. The overall increase in submissions has been noticeable for strategic and private equity (PE) buyers alike. We have seen a growing number of strategic buyers incorporating R&W insurance into their acquisition processes, showing broad adoption and acceptance of the insurance as a useful dealmaking tool.

**Pegram:** Global M&A activity in 2021 was at an all-time high and, as a result, we did see an unprecedented surge in the demand for M&A insurance. This demand was driven by both record-breaking deal volume, as well as industry upswings. Sectors such as technology, media and telecommunications and healthcare saw a significant increase in deal activity that ultimately led to a spike in insurance requests for these areas. Buyers are increasingly turning to the M&A insurance market to support their transactions and manage potential loss even in these types

of unparalleled market conditions, and M&A insurance products have responded to those needs. Although we have seen some decrease in deal activity in 2022, we have not seen a significant decrease in the number of R&W submissions received year over year. This shows that buyers continue to trust M&A insurance products to enhance their bid in an auction, manage potential risks and pay claims for covered losses.

**Lessman:** Demand for both tax and contingent risks has increased, particularly judgment preservation insurance submissions. This growth is due, in part, to the increasing number of tax and contingent brokers entering the market. Another reason is the surging appreciation for the product. This transactional insurance suite of products can be presented as standalone risk solutions, yet can often be a successful means of risk transfer when removed from an M&A deal. Tax insurance is generally used to insure certain tax positions taken by the seller, when a buyer realises it may be liable for a tax exposure from an acquisition. The benefit of insurance is that parties involved can reduce or eliminate exposures to identified tax risk by procuring separate policies, which helps facilitate the deal closing and obtaining R&W insurance for the deal. The same can be said for contingent liability insurance.

**Rodrigues:** Interestingly, R&W was created as a deal facilitation tool – a way to allow smooth exits by sellers by eliminating the need for significant escrow requirements. The product has since evolved into a true risk transfer mechanism which is evidenced, in part, by the increased breadth of representations and increased claims activity. For these reasons, interest in the product continues to expand and coverage is now available for most industries and deal sizes. Carriers are once again taking the time to innovate and develop solutions for underserved portions of the market. Examples include addressing solutions for lower total enterprise value (TEV) targets, excess fundamentals only offerings, underwriting secondary transactions and investing in subject matter specialists who can efficiently underwrite challenging industries such as healthcare and upstream energy.

**De Berry:** Most certainly, R&W insurance has become a staple product though, in our view, still in growth mode. R&W insurance facilitates deals efficiently in terms of both cost and time. PE firms, in particular, have appreciated R&W insurance because it allows for a selling PE firm to distribute funds sooner and without as much or any holdback, and allows for a buying PE firm to help recover shortfalls in earnings due to a breach. R&W insurance's popularity with PE firms eventually led to strategic buyers being forced to bid with R&W insurance in lieu of – or for a reduction in the amount of – indemnity from the seller. In terms of litigation, we believe this type of insurance is now in growth mode. Litigation insurance benefits mergers and acquisitions but can also benefit litigants – and their counsel whose fees are contingent, and their funders – apart from M&A activity. In the context of M&A, the typical use for litigation insurance is when a lawsuit or regulatory audit or dispute has been scheduled and will be excluded from an R&W insurance policy, as known risks. Litigation insurance underwriters can take the deeper dive and underwrite the risk confronting the acquired company. If the sale is structured as an asset sale, litigation insurance underwriters can underwrite

“HAVING SIGNIFICANT HISTORIC CLAIMS EXPERIENCE IS ONE OF THE MOST IMPORTANT FACTORS THAT DRIVE BOTH A WELL-DEVELOPED CLAIMS PROCESS, AS WELL AS MORE INFORMED UNDERWRITING.”

SCOTT G. PEGRAM  
Liberty Global Transaction Solutions

the risk of successor liability for the buyer. Apart from the M&A context, however, the product is being used to preserve trial judgments on appeal – allowing a successful litigant to lock in or monetise its success – and to facilitate the financing of legal costs, allowing equal access to justice.

**Sherman:** Foundationally, over the past five to seven years M&A deal volume has increased steadily and significantly. 2020 brought a short-lived coronavirus (COVID-19) dip followed by 2021's record-setting deal volume of increased value. That growth trend in M&A activity translated into a heavier reliance on R&W insurance. New markets were launched in Europe and the US, and by the end of 2021, R&W capacity was largely consumed, proving the significant appetite for the product.

**Turnham:** 2021 was a record year for M&A activity generally and the M&A insurance market is also widely understood to have had its best year on record. Both the general M&A market and the M&A insurance market have repeatedly shown themselves to be robust and on an overall upward trend over the past 15 years, notwithstanding market disruption caused by regional or global events. W&I and R&W insurance development has been supported by greater product awareness among advisory and deal making communities and widespread investment from underwriting and broking teams, with the result that the product is now very well embedded in the M&A mainstream. It is expected that increasing M&A insurance placements in growing emerging markets such as Asia and Africa will help mitigate potential headwinds in traditional markets such as Europe and North America.

**Luxenburg:** We continue to see the wider adoption of M&A insurance from both strategic and financial buyers across deal sizes and types. There is now substantial claims data showing that insurers are paying claims, and the underwriting process is increasingly predictable and reliable; so, buyers' confidence in using the product is growing. In addition, sellers

“CLAIMS-PAYING REPUTATION, UNDERWRITING EXPERIENCE AND ABILITY TO EXECUTE FAST-MOVING DEALS IN A COMMERCIAL MANNER ARE ASPECTS THAT SHOULD BE CONSIDERED IN ANY R&W INSURANCE PLACEMENT.”

JON FRIEDMAN  
Euclid Transactional

continue to insist that buyers procure an M&A insurance policy to limit sellers' post-closing exposure, and some buyers prefer using M&A insurance because it allows the buyer to assert a post-closing claim against a carrier rather than the seller, particularly in instances in which sellers continue to have an interest or involvement in the business post-closing. While pricing has admittedly increased since pre-COVID-19 times, it has come back down since the late-2021 spike, and the M&A market continues to embrace M&A insurance as a critical risk-management and deal-facilitating tool.

**FW:** Could you outline some of the trends you are seeing in M&A insurance offerings, with regard to policies, coverage, terms, pricing, and so on?

**Pegram:** In the fourth quarter of 2021, the M&A insurance market was inundated with an overwhelming level of deal activity. Because of this, we saw pricing soar to previously unmatched heights. Since the start of 2022, deal activity has slightly lessened, transaction timelines have returned to pre-pandemic levels and the M&A insurance market has seen new entrants, as well as an increase in workforce. This has resulted in a more stable rate environment and more time to underwrite to certain high-risk issues, allowing insurers an additional opportunity to get comfortable with covering those risks if they have been adequately diligenced.

With respect to sectoral risks, there has been a focus on cyber and data privacy matters given the increase in global cyber attacks and the difficulty to obtain adequate underlying cyber insurance in current market conditions. We are also seeing lower enterprise values year over year, resulting in a decrease in large multilayered insurance programmes.

**Lessman:** Over the last few years, M&A coverage has continued to become more widely recognised and more attractive to buyers and sellers. We have seen a consistent flow, and deal progress remains strong in this space. The portfolio is made up of a positive blend of deals in the small to middle market space, coupled with a significant number of larger market opportunities. The pricing trend continues to be favourable for R&W insurers.

**Rodrigues:** Competition remains robust in the US market, with 20-plus carriers. Policies remain broad but are likely to include more amendments to the definition of breach – that is, amending representations that would give rise to a breach under the policy – than in prior years thanks to savvy negotiations by deal counsel. This point, in particular, has become a differentiator for clients in selecting a primary carrier, as their approach to mark-ups can vary widely from market to market. Over the past few months, a spotlight has been placed

on amendments in the agreement which limit the seller's liability for fraud, and, consequently, limit the insurers' subrogation rights. Some carriers will disregard the language for purposes of the policy while others require that the offending provision be deleted in order to proceed to underwriting. From an economic perspective, limits purchased are still hovering around 10 percent of TEV. Retentions have held steady, and pricing has normalised from the fourth quarter of 2021, landing in a more stable range of 3.5 to 4.5 percent of limit.

**Turnham:** In W&I and R&W, there is increasing insurance market appetite for complex deals in terms of deal structure, cross-border deals involving multiple jurisdictions, and emerging markets transactions. After a pricing stabilisation in the fourth quarter of 2021, following years of almost continuous downward pressure, pricing in 2022 has, to date, returned to the level seen for most of 2020-21 – at an extremely competitive level, with rates generally at low levels, less than 1.5 percent for 'European' style coverage, for all but very large or complex deals. Enhancements such as lower, or no, retention and de minimis for fundamental warranties, removal of umbrella exclusions for matters disclosed in due diligence reports, and longer policy periods for general warranties, are widely available. Growth in the 'specific risk' policies for tax and contingency

continues with significant pressure on pricing and terms in the tax market.

**Luxenburg:** M&A insurance underwriters are increasingly attuned to other lines of insurance that, in their view, should cover losses before they reach the M&A insurance policy. Depending on the industry, there may be increased focus on diligence of the target's cyber, technology errors and omissions (E&O), environmental, product liability, professional liability and other relevant insurance coverage. In some instances, the target's risk profile results in underwriters requiring that the M&A insurance policy offers coverage only 'excess of and no broader than' adequate underlying insurance – which, depending on the underlying policy, can be a material coverage-limiting term. By understanding these issues early in the process, we can clearly present the issue to underwriters, advise clients of any material gaps in coverage and work toward solutions. Pricing has fluctuated since the end of 2021. Unlike some other lines of insurance where pricing is primarily based on loss ratios, pricing shifts in M&A insurance will depend on underwriter bandwidth – the opportunity cost of turning down other deals during a busy market has a disproportionate impact on the cost of a policy. Recent history suggests that M&A insurance costs more in the fourth quarter, when deal flow is generally at its peak for the year.

**Sherman:** In terms of conventional R&W coverage, M&A deal size has trended higher, resulting in more deals with higher policy limits. As deal volume approaches or exceeds capacity limits, pricing has slightly moved higher, which is also healthy for the continuity of the product. Outside of traditional products, related but different products are becoming mainstream, most notably tax indemnity and contingent liability coverage.

**De Berry:** We believe that in the US there is a trend toward insurers deeming certain representations as modified for purposes of R&W insurance. Broad representations that would depict a company as perfect unless disclosed otherwise in schedules are often too difficult for parties, or the insurer, to vet. Pricing had, in our experience, increased in 2021 but appears to be steady now. Policy provisions remain insured-friendly with many law firms and brokers each touting its own 'private label' form. Moreover, more complex tax issues and larger tax insurance programmes are now available and can benefit public companies as well as middle market, privately held companies, and PE funds and other entities taxed as partnerships. We have seen an immediate demand for tax insurance for pending tax controversies and for partnerships in liquidation. In terms of litigation, we have seen a large demand by successful plaintiffs desiring to monetise a trial judgment subject to appeal by obtaining judgment preservation insurance and providing a lender with a collateral assignment of the trial judgment and the insurance to support a non-recourse loan.

**Friedman:** The growth in the number of deals with zero seller indemnity versus a limited seller indemnity has been an interesting development in recent years. This is likely associated with sellers' negotiating leverage, but also demonstrates buyers' comfort in accepting this construct and a maturation of the product. With the unprecedented surge in deal activity in 2021, bandwidth constraints on R&W insurance carriers coincided with a premium increase of approximately 35 percent compared to 2020. Although

“WE CAN ENVISION A DAY WHEN ACQUISITION AGREEMENTS WILL BE MORE STANDARDISED AND DUE DILIGENCE ESSENTIALS WILL BE ACCEPTED AS COMMONPLACE IN M&A.”

DAVID S. DE BERRY  
Concord Specialty Risk, LLC



the rate increases have eased somewhat in 2022, higher premiums have been necessary to expand underwriting and claims capacity to meet growing demand for R&W insurance.

**FW:** How important is claims experience when it comes to dealing with a breach and achieving a swift and efficient resolution? In your opinion, are there areas in which the process could be improved?

**Rodrigues:** The claims experience is of utmost importance and an area in which both brokers and carriers should be investing time and resources. Ongoing communications and responsiveness are critical. An introductory call sets the tone for the negotiation. Clients must realise the position of the carrier and the fact that they need to be quickly caught up on both the breach and loss calculation, as well as the original diligence. The speed with which documentation is shared factors heavily into the speed of an outcome. That said, establishing breach and loss can require significant information exchanges which clients should ensure are thoughtfully prepared and tailored so as to avoid unnecessary delays by carriers when assessing documentation. More is not always better. On the issue of ‘loss’, specifically, the application of a multiple is nuanced and requires thoughtful discussion from both parties.

**Luxenburg:** M&A insurance is only useful if claims are paid fairly and efficiently. It is critical that the claims process be managed properly to achieve a swift and efficient outcome. This is a place where insurer experience matters and where a broker strives to add value. A broker not only assists with the claims process and facilitates the exchange of information, but also advocates for fair and efficient coverage for clients throughout the process. The key to claims success is multifaceted. In our view, insureds that keep four guiding principles in mind will have the best results during the claims process. First, start with the assumption that the carriers want to support their insureds by paying

“M&A INSURANCE IS ONLY USEFUL IF CLAIMS ARE PAID FAIRLY AND EFFICIENTLY. IT IS CRITICAL THAT THE CLAIMS PROCESS BE MANAGED PROPERLY TO ACHIEVE A SWIFT AND EFFICIENT OUTCOME.”

ALEX LUXENBURG  
CAC Specialty

legitimate claims for loss. Second, the initial notice is just that, an initial notice. Your claims notice is not your last chance to communicate with the carrier. Notice the claim early and work to fill in the details in an iterative way as more information becomes available. Third, claims resolution is a process and requires the exchange of information. If the insured is guarded in the exchange of information, the claim may take longer to resolve. Finally, a good quarterback can make the difference. That can be an experienced attorney or broker, but someone needs to be pushing the process forward regularly and consistently.

**Sherman:** Claims experience benefits everyone. Not unlike other things in life, experience is a superb coach, teaching us how to do things better – resulting in more efficiency and greater effectiveness. Having more experience in the claims process also means that insurers have had more opportunity to learn from policyholders what works better, and what does not. That helps to streamline the insurer’s future claims process and achieve a more collaborative approach, making the process easier and more understandable for the policyholder. There is always room for improvement, and that not surprisingly comes from more experience.

**De Berry:** A claims professional must understand M&A agreements and practice and is frequently assessing accounting

standards in numerous areas, such as contract law, insurance law and tax matters. Thus, the relative degree of experience, sophistication and integration of claims professionals and underwriters is paramount in achieving a swift and efficient resolution. The industry, as a whole, has been paying claims, including large claims, but often the process can be truncated when the insurer or its managing general underwriter (MGU) or managing general agent (MGA) has the sophistication to discern and evaluate the germane issues without undue reliance on outside professionals.

**Friedman:** Buyers of R&W insurance are obviously interested in having an efficient claims experience. Continued claims paying has demonstrated the viability of this product and has helped buyers avoid post-closing disputes. We understand having a well-staffed and commercially-minded claims team is crucial when buyer’s make carrier placement decisions as the number of policies and claims within the industry continue to grow over time.

**Turnham:** Claims experience is critical in managing and executing an expeditious and fair claims process – this goes to the very essence of the product. In a fluid M&A insurance marketplace which has seen significant movement in underwriting teams in recent years, it cannot always be assumed that a claim will be dealt with by either the

underwriters who underwrote the insurance policy or a dedicated claims team acting for underlying insurers with significant experience of complex M&A matters. It is therefore critical for an insured and buyer to consider claims capability as part of their selection of insurer, both in terms of insurers' underlying security and the nature of the claims personnel with whom the insured and its advisers will actually be dealing with in the event of a claim. Generally, claims processes that run smoothly involve full provision of information from insured to insurers at an early stage of the process.

**Lessman:** The claims experience and its expeditious resolution are crucial when dealing with a breach. The carrier must deliver excellence across the claims experience after the transaction, with the support of seasoned attorneys and a claims group with specialised expertise. Given the materiality and complexity of some claims, settlement is rarely a simple process. However, we believe that making a claim through your insurer may be easier than the existing alternative of claiming directly against a seller. The continued maturing of these insurance offerings brings improved data and analytics. Claims experience data will ultimately shape the breadth of coverage, deployment of limits and adequacy of pricing.

**Pegram:** Having significant historic claims experience is one of the most important factors that drive both a well-developed claims process, as well as more informed underwriting. The M&A insurance market has seen a substantial number of claims since its inception and has paid insureds for covered loss, providing insureds trust in its products. With this historic claims activity, M&A insurers have noticed certain trends in the available claims data that help both the insurers and insureds hone in on key risks to analyse during future diligence and underwriting processes. Insurers with dedicated M&A claims teams are also able to use these trends to quickly identify potential areas of investigation once a claim notification is received, which leads to an expedited claim timeline. As we have seen insureds increasingly turn their focus toward the timing of claim determinations, the use of historic claims data will continue to play a material role in future claim scenarios. One area that deserves the utmost attention is communication. By establishing an open line of communication early on in the claims process, insurers are able to streamline document requests and avoid unnecessary follow-up questions that add to the length of the claims process. Insureds and their advisers should feel comfortable being collaborative and transparent with their view of the potential breach and claimed loss, as insurers generally share the same desire for a swift

resolution and are willing to provide reciprocal transparency to get there.

**FW: What essential advice would you offer to acquirers on how to properly manage transactional risk?**

**Turnham:** First, consider the key value drivers and exposures applicable to the business, and conduct a well-scoped and fulsome due diligence exercise in respect of such areas through appropriately qualified advisers on a sensible timeline. If there are any major limitations around due diligence scope or access to information, it will be important to identify and address these early in the process. Second, use W&I and R&W insurance to provide additional assurance in respect of any undisclosed issues that emerge post-closing – to the extent these qualify as breaches of warranties which are covered by the insurance. The choice of insurer will be key here, both in terms of the insurer's proven execution and service capability, but also in respect of its claims-handling record. Third, consider whether any known specific risks, which will not be covered by a W&I or R&W policy, may be appropriate for coverage under a tax contingent risk policy. Early consultation with an M&A broker and legal opinions from qualified advisers as to the level of risk will be important here in assessing what may be possible.

**De Berry:** Sellers would do well to conduct legal, tax and accounting 'audits' prior to sale. It can be beneficial for the seller's accounting evaluation to entail what a buyer's quality of earnings report might entail – with a particular focus on working capital items, customer churn, and any inconsistent application of accounting principles, in addition to unusual or non-recurring income and expense items. This could allow the seller to cure deficiencies, or get them insured, before they become deal issues. It would also facilitate the ask for a truncated due diligence period on the part of the buyer. Buyers would do well to vet the target's virtual data room and disclosure schedules to assure both are thorough, complete and in sync with each other. Purchasers of R&W insurance

“ IN W&I AND R&W, THERE IS INCREASING INSURANCE MARKET APPETITE FOR COMPLEX DEALS IN TERMS OF DEAL STRUCTURE, CROSS-BORDER DEALS INVOLVING MULTIPLE JURISDICTIONS, AND EMERGING MARKETS TRANSACTIONS. ”

CHARLES TURNHAM  
Ambridge Europe Limited

would do well by avoiding the underwriter who provides the quick and easy ‘yes’. Prefer an underwriter that seeks balanced representations and can help identify heightened risks at the onset. That is the underwriter that can guide the process smoothly and will be prepared at time of claim.

**Friedman:** I would suggest buyers carefully consider the carrier they will choose and weigh factors beyond price to determine which carrier will be the best partner going forward. Claims-paying reputation, underwriting experience and ability to execute fast-moving deals in a commercial manner are aspects that should be considered in any R&W insurance placement.

**Sherman:** While post-close claims bear out that many issues are realistically undetectable during due diligence without a 100 percent sweeping deep dive, they also teach us that there are both operational and financial failures that likely could have been identified pre-close with relatively marginal effort and are feasibly detectable and avoidable.

**Lessman:** Although cost is a fundamental consideration in choosing an insurer, ease of underwriting and a positive claims experience can provide peace of mind. When pricing considerations are at the forefront, regardless of other important factors, such as an insurance carrier’s technical capabilities, business resiliency and enterprise risk management, the money saved may prove to be irrelevant. Cheaper is not always better. We would also recommend that buyers and sellers choose an insurer that is transparent at every step and makes the entire process as efficient as possible, while keeping the deal on schedule. Parties should work with their insurance brokers to understand the carrier’s process and appetite for risk. Further, be aware of an insurance carrier’s experience with consistently delivering policies for fast-paced transactions and claims payments. A collaborative underwriting process with an insurer that understands a buyer’s due diligence strategy

“EMPLOYING INSURANCE PRODUCTS TO MANAGE TRANSACTIONAL RISK IS RELATIVELY NEW AND STILL MATURING. SO FAR, USE OF EXISTING PRODUCTS HAS PROVEN ITS VALUE TO THE MARKETPLACE.”

MARC SHERMAN  
Alvarez & Marsal

and is familiar with the buyer’s advisers can help win deals, leading to better long-term results.

**Luxenburg:** Acquirers can properly manage transactional risk by communicating with their broker early in the process – typically three weeks or so prior to the deal signing. Involving a broker early lets parties forecast areas of concern and importance, get ahead of potential issues and allow for the broadest possible coverage without delay to the underwriting process. The insurance ‘market’ is often dominated by order-takers rather than creative problem solvers – that is something we fight against. Each deal brings a unique set of challenges, and the M&A insurance market is full of experienced professionals who can create bespoke solutions as issues arise. Taking this approach, instead of simply rinsing-and-repeating an off-the-shelf process, drives the best results.

**Pegram:** Pay close attention to the due diligence process and to which areas resources are allocated. By identifying higher-risk and more complex issues early on in diligence, buyers can dedicate adequate time and effort into assessing those issues, which may ultimately lead to broader coverage from the insurer. Risk assessment should also be viewed from both a prospective and historic lens. We often see deal teams take a lighter touch to investigating certain issues that can be

remedied post-closing or can be bolstered once the buyer has implemented its own procedures within the target company. Although this may be the case, significant historic liability associated with these issues could be lingering, resulting in future loss or a potential coverage exclusion based on insufficient diligence and information provided to the insurer.

**Rodrigues:** Prompt and thorough communications are critical to a successful R&W placement. Substantial discussions should take place prior to selecting a carrier. All parties should have a clear understanding of what diligence will be required for underwriting along with the agreed exclusions, heightened risks and agreement-specific amendments prior to commencing underwriting. Carriers should work to manage the length of their call agendas and follow-up questions, focusing on transaction-specific issues rather than a set checklist of questions. Acquirers should know that additional diligence findings will lead to minimal exclusions and a cleaner policy. Lastly, to the extent possible, affording sufficient time between the underwriting call and signing and closing benefits the acquirer and results in a more thoughtfully negotiated policy.

**FW:** Looking ahead, how do you expect the process of transactional risk management to evolve? What new

### strategies and techniques are coming into play?

**De Berry:** We can envision a day when acquisition agreements will be more standardised and due diligence essentials will be accepted as commonplace in M&A. We see coverage expanding in such a scenario. Meanwhile, as the economy goes through its cycles, M&A insurance adapts. We envision solutions for distressed companies during times of recession, with tax return insurance and tax controversy insurance becoming staple products. We also see litigation funders and law firms with litigation teams working on a contingent fee arrangement using litigation insurance as a matter of course.

**Friedman:** The maturation of the product and understanding of due diligence expectations has made the R&W insurance underwriting process more efficient over time. Legal counsel have pre-negotiated forms which require little to no back and forth. Relationships with buyers and their advisers should be viewed as partnerships, with a familiarity with deal teams and their diligence processes over multiple transactions a key factor contributing to the increased speed and efficiency of the underwriting and claims experience.

**Sherman:** Employing insurance products to manage transactional risk is relatively new and still maturing. So far, use of existing products has proven its value to the marketplace. I believe that more products will be developed as it evolves. In terms of continued risk management through current insurance products, insurers have significant insight into heightened areas of risk in M&A transactions, informed by their tremendous claims experience. Hopefully, time will continue to strengthen the partnership between insurers and insureds for the pre-acquisition identification and prevention of acquisition risk and failures and the enhancement of pre-acquisition risk management.

**Lessman:** In the years ahead, we expect transaction insurance products will continue to thrive and remain in

considerable demand. As businesses further comprehend the value of transactional risk insurance, coverage will be more widely used. The protection it provides to both buyers and sellers, such as smoothing M&A negotiations and improving deal outcomes, is unparalleled. Furthermore, we imagine the due diligence process will become easier as participants better understand not only the product but also the diligence needed during the process. Innovation and technology will continue to play a meaningful role, guiding ease of doing business. From a customer experience perspective, this means balancing automation with a human, personalised approach.

**Luxenburg:** The M&A insurance process continues to be refined in ways that suggest the product will continue its growth in adoption on M&A transactions. As underwriters gain experience, they get even better at delivering a fair and smooth underwriting process. Furthermore, buyers and their advisers are now keenly familiar with the M&A insurance process, which is important because key parties now have an informed expectation of their role. As the M&A insurance marketplace continues to thrive, choosing quality third-party advisers that can help the client get the most out of the M&A insurance marketplace is a key strategy and technique that can help unlock value in an efficient and sophisticated insurance product.

**Pegram:** We expect a continued push to streamline the transactional risk process from both insurers and insureds. As claims data becomes more readily available, the M&A insurance market will be able to make more informed and timely decisions in both underwriting and claims settings, leading to increased efficiency in the overall underwriting process. Insurers and insureds alike have also taken greater strides in technological offerings to truncate diligence and underwriting timelines, as well as better predict certain high-risk issues to keep in mind when considering a potential transaction. We believe the sophisticated collection, analysis and use of data in the M&A insurance market will be top priority

in the coming years, which has already begun with the release of annual claims studies from a couple of insurance carriers in the market.

**Rodrigues:** The intersection of insurance and capital markets is an evolving area that will further expand the role of ‘transactional risk’, which today extends beyond R&W to include tax, litigation, judgment preservation, contingency and other bespoke risks. Solutions for ‘uninsurable risks’ are constantly reviewed to see whether and how these risks can be managed. Technology will play a larger role in the underwriting process, with brokers and carriers investing in technologies to improve execution. In summary, the market has been and will continue to be creative and responsive to the need to transfer risk inherent in the overall valuation process.

**Turnham:** As claims activity continues to rise, claims capability and proven record of an insurance carrier or MGA will be key in offering assurance to clients around the performance of the product in the event of a claim. Due diligence will remain central, with a likely increasing emphasis on workstreams which, historically, may have had lesser prominence – for example cyber, technical, operational, commercial and insurance. Environmental, social and governance (ESG) diligence is another area which is expected to feature heavily in acquirers’ due diligence in future years. As M&A insurance becomes ever more integral to M&A processes, it is likely that users of the product will use it with increasing sophistication in respect of limit options and use of specific risk policies to address identified issues. ■

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