



Representations and Warranties Market Review

Vanbridge is pleased to publish its second edition of *The U.S. R&W Insurance Market Review*. This edition evaluates and summarizes domestic R&W data for the years 2017, 2018 and 2019.

This data is beneficial to markets, reinsurers, law firms and clients alike.

About this report

Vanbridge is pleased to publish its second edition of the Representations & Warranties Insurance (“R&W”) review covering the North American market in 2017, 2018 including a preliminary review of 2019. For this report, several additional carriers participated, giving us a more accurate view of the market.

This report aims to provide, as accurately as possible, the state of the US R&W market using data gathered directly from insurers. We thank the following carriers for their willingness to partner with us in this effort: AIG, ASQ, AWAC, AXA XL, Beazley, Berkshire, Blue Chip, CFC, Chubb, Concord, Ethos, Euclid, Everest, Great American, Hartford, Liberty, QBE, TMHCC and Vale. Reasonable assumptions and estimates were incorporated where necessary to account for the non-participating markets.

We also extend our thanks to Excel Rain Man for their assistance in this effort. Excel is an independent third-party data management firm that assisted in gathering, compiling and calculating the data points presented in this report. Confidentiality was of the utmost importance to all parties involved in this effort. Vanbridge was not privy to any carrier information and underlying confidentiality arrangements were respected at all times.



Over the past three years,
the R&W market **continued**
to experience growth.

The Market

Over the past three years, the R&W market continued to experience growth in the number of placements, the amount of premium bound, and the amount of aggregate limits deployed. Overall capacity in the market also increased.

There are 21 markets actively quoting North American risks on a primary basis. Market capacity in the transaction liability market is estimated at \$2BB for any single transaction, including Tax Liability and Contingent Liability (although capacity for Specific Litigation may top out at ~\$1 BB).

Year over Year Data Points

Consistent with historical trends, buyers acquiring companies continue to be the predominant users of R&W. In 2016, 90% of policies placed insured the buyer. By 2018, the percentage increased to 99%.

Also of note is the increased use of the insurance by strategic buyers. While R&W has its roots in the world of financial transactions, strategic buyers now see the utility of the product in their transactions. In 2018, 43% of the reported policies insured strategic transactions while 57% insured financial transactions.

» **Transaction Volume**
2016 US M&A Transaction Volume: 12,720
2017 US M&A Transaction Volume: 12,646
2018 US M&A Transaction Volume: 12,890
2019 US M&A Transaction Volume: 11,304

» **Transactions That Purchased Insurance**
2016 # of Transactions that Purchased Insurance: 961
2017 # of Transactions that Purchased Insurance: 1,316
2018 # of Transactions that Purchased Insurance: 2,394
2019 # of Transactions that Purchased Insurance: 2,875

» **Total Limits Deployed**
2016 Total Limits Deployed: \$14.8BB
2017 Total Limits Deployed: \$32.4BB
2018 Total Limits Deployed: \$50BB
2019 Total Limits Deployed: \$64.8BB

» **Total US Premium**
2016 Total US Premium: \$526.5MM
2017 Total US Premium: \$753MM
2018 Total US Premium: \$1.25BB
2019 Total US Premium: \$1.5BB

» **Single Largest Limit Purchased**
2016 Single Largest Limit Purchased: \$500MM
2017 Single Largest Limit Purchased: \$1BB
2018 Single Largest Limit Purchased: \$1.5BB

¹Pitchbook 2019 Annual M&A Report – The final deal counts reported by Pitchbook are subject to change in subsequent reports. These changes account for late reporting of transactions after the annual publications. As of the date of this report, the annual numbers reflected in this report are those reflected in Pitchbook's most recent 2019 annual review.

Industry Breakdowns

Transactions were underwritten across a broad spectrum of industries. Although data was not reported in a manner that allowed for accurate percentage break downs in each sector, the following industries reported the highest percentage of transactions: automotive, consumer goods and services, energy, manufacturing, financial services, healthcare & pharmaceuticals, technology, and third-party service providers.

Primary Rates, Retentions and Policy Terms

As of the date of this report, pricing trends continue to demonstrate downward movement, with rates on line (“RoL”) coming in as low as 2.4% for primary programs. Decreases in primary placements drive down the premiums on excess layers as well, bringing overall rates lower.

In 2017, 59% of reported transactions had retentions of 1% or less. In 2018, the percentage of placements with 1% retentions increased to 86%. Retentions below 1% are commonly seen in larger transactions (~\$500MM+), so it is reasonable to conclude that the submissions into the market in 2018 represented larger transactions.

While markets may charge higher premiums on transactions with no seller indemnity, the impact is not significant.

Pricing and retentions continued to decrease year over year.

Primary Limits and Premium

Limit Range	2017	2018
<10MM	3.12%	3.13%
10MM -20MM	3.05%	2.86%
21MM -30MM	2.68%	2.63%
31MM -40MM	3.02%	2.79%

Policy Terms

Over the years, the forms have undergone significant changes from the original base wording to a point where there is arguably little room for improvement from the insured’s perspective. For additional premium, some markets will agree to affirmative coverage for multiples (which may be subject to a cap on the multiple if deemed excessive) and for interim breaches (if the interim period does not extend beyond a specified time frame).

Excess Limits & Premiums

Although markets were unable to report excess placements and average ROLs with specificity, the data showed that excess pricing saw an even greater downward pricing trend than primary placements. Excess layers are priced as a percentage of underlying carriers’ premiums, so decreases in primary pricing resulted in excess premium decreases. This, coupled with strong market competition, made excess placements very attractive for buyers.

Claims

From responses to our survey questionnaire, as well as publicly available claims studies, it is generally agreed that the reps listed below give rise to the majority of claims.

01. Financial Statements

02. Undisclosed Liabilities

03. Employee Matters

04. Tax

05. Material Customers

06. Material Contracts

07. Condition of Assets

08. IP/Infringement

Parties on all sides of the table are keenly focused on claims activity. Both the insureds and their counsel want to know that “the insurance works.” From the insurers’ and reinsurers’ perspectives, the continued viability of the product will be a function of profitability, largely driven by the frequency and severity of claims experience as a percentage of premium. Given the confidential nature of the transactions, markets are constrained in their discussion of specific claims. That said, it is undeniable that claims frequency and severity are increasing, with one respondent noting that claims had increased “by approximately 25-30% overall with [the] average size of claims also increasing by a little more than 30%.”



Claims

One can point to a number of reasons for the spike in claims - - from the sophistication of the insureds and their counsel to the breadth of the R&W coverage.

The very existence of R&W has afforded buyers more avenues (via broader representations in the M&A agreement, for example) to assert claims they may not have been able to bring under traditional indemnity arrangements with sellers. Over the years, the coverage has allowed for increasingly aggressive M&A negotiations while an abundance of capacity has driven down rates and expanded coverage.

When R&W coverage first entered the market in the late '90s, claims activity was very limited. As the use of R&W became common practice several years ago, the number of markets entering the space increased, creating competition and compelling underwriters to assume broader risks in order to win business. At the same time, buyers' counsel began pushing for broader terms in the underlying transaction documents while releasing sellers from any meaningful obligation to stand behind the representations. This dynamic lessened the incentive for sellers to push back on broader reps, as the majority of the risk would be transferred to insurers.

The intricacies of deal negotiations are changing as well. Legal professionals have noted that aggressive sellers -- particularly in the auction process -- put pressure on all parties to bring transactions to a close quickly. During the diligence process, the focus is on critical issues with less focus on the "nits" which may give rise to larger losses later, particularly when the loss lends itself to the application of a multiple or diminution in value.

Future Underwriting Considerations

Changes in the underwriting process are inevitable. As with any insurance product experiencing heightened claims activity, the market will likely tighten.

In order to facilitate a placement, parties should be aware of these trends so that expectations and transaction agreements can be managed to meet underwriters' expectations.

Markets are routinely highlighting problematic reps during the quoting stage and looking to limit the scope of overly broad reps both in the NBIL and during the underwriting process. Changes include a return to the more balanced iterations seen historically. Examples include subjecting the "No Undisclosed Liabilities" rep to a GAAP standard, qualified (in part or whole) by knowledge and/or limiting the scope of the rep to "liabilities" only (rather than liabilities and obligations); maintaining the materiality modifier (for purposes of determining if a breach occurred) in representations for which a multiple could be claimed, such as those relating to Material Contracts, Material Customers and Material Suppliers; requiring contract and litigation reps to refer to written notices (and striking references to "verbal" notifications); and, requiring written support from diligence professionals relating to matters that were orally addressed during diligence calls.

In addition, carriers may require evidence of customer calls prior to closing, adequate underlying insurance for business risks such as E&O, Cyber and Product Liability, oftentimes requiring that the target maintain specific levels of coverage.

From a claims management perspective, markets are focusing on the amount of fees incurred by an insured in establishing the loss amount associated with first-party claims, drawing a bright line once the proof of loss has been submitted. The rationale behind this approach is that once the proof of loss has been submitted, any fees incurred thereafter are likely to arise from a disagreement between the insured and the insurer over the actual loss amount. At this point, carriers view the additional fees incurred as only exacerbating the loss to be paid under the policy - essentially "funding the claim against themselves."

Taking a more aggressive approach to claims management, some carriers have established an internal "watch list" of insureds and counsel who appear to have been "overly aggressive" in claiming a breach and/or in asserting losses and/or in selling a company that, for example, engaged in alleged financial manipulation.

With respect to the enhancements discussed earlier in this report, markets will continue to offer those terms on attractive transactions for additional premium.

With all these dynamics in play, we anticipate tightening in the market with respect to coverage terms, pricing and retentions along with increased scrutiny on the amount of losses being sought in claims.



Conclusion

The market for transactional risk products remains stable but under watch. With respect to R&W in particular, carriers are keeping a watchful eye on claims activity and the issues giving rise to claims. We expect to see more scrutiny on deals and premium charges for aggressive terms. We anticipate tightening across the market and that carriers will seek to deploy limits on other types of transactional risks that can help balance and sustain the R&W businesses.

Despite the current trends, carriers remain dedicated to offering meaningful coverage that facilitates transactions, while underwriting the insurance in a sustainable manner.

About Vanbridge

We are solution focused. Always.

We understand that many M & A transactions create unique, deal specific risks that don't fit into the confines of an existing product. We work to develop solutions using not only insurance capital but alternative capital resources as well.

Vanbridge, an EPIC company, was conceived out of the desire to better serve the alternative asset management community by bridging the traditional insurance industry and capital markets, allowing them to tap into the best aspects of both. Our goal was to build a boutique firm that provided all the services related to insurance, reinsurance and the capital markets in a single organization. We succeeded.

Today, Vanbridge focuses on our alternative asset management, corporate and individual clients to solve risk related issues utilizing insurance and alternative capital. Our unique structuring and plan design techniques support various client objectives including cost reductions and enhancements to investment strategies that strengthen long-term financial performance. Vanbridge also provides advisory and liability management services to assist clients in evaluating, designing and executing options to manage risk and maximize the enterprise value of their businesses.

What makes us different is the strength and flexibility of our business model and our ability to provide a full range of insurance and alternative capital solutions without the limitations of a siloed approach.

Vanbridge is an EPIC company and is headquartered in New York, NY.





Greylen Erlacher Mardy
Principal
gerlacher@vanbridge.com
646.572.9362



Kyle Binnington
Managing Principal
kbinnington@vanbridge.com
646.572.9351



Nancy Rodrigues
Principal
nrodrigues@vanbridge.com
917.733.3293



Vanbridge, an EPIC company
1140 Avenue of the Americas, 8th FL
New York, NY 10036
www.vanbridge.com