The Inaugural West Coast M&A/Private Equity Forum

Force Dispersal: Exploring Market Trends in RWI

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R&W insurance

Risk transfer to an insurer mirrors a traditional seller indemnity and works “back-to-back” with a purchase agreement.
R&W INSURANCE: WHY PARTIES USE IT

BUYERS

RISK MANAGEMENT USES
• Provide recourse when no or limited seller indemnity is available
• Ease collection concerns
• Increase maximum indemnity and extend survival periods
• Satisfy lenders’ requirements for additional security on transaction

STRATEGIC USES
• Enhance bid in auction process
• Protect key relationships with executives (e.g., avoid post-closing claims against managers)

SELLERS

RISK MANAGEMENT USES
• Free up sale proceeds for immediate distribution (reduce or eliminate escrow or holdback)
• Reduce or eliminate post-closing contingent liabilities
• Protect passive sellers

STRATEGIC USES
• Attract best offers by maximizing indemnification protecting buyers
• Set bidders’ expectations regarding seller’s post-closing indemnity obligations
CURRENT R&W INSURANCE MARKETPLACE
Heightened Risks Areas vs. Exclusions

- Impact of COVID-19
- Data security/Technology Errors & Omissions/Cyber
- FLSA, wage and hour and employee classification
- Environmental
- Foreign operations
- Anti-bribery/anti-corruption
- Recent M&A transactions
- S-corp status
- Material customer/supplier relationships
- Product liability/product recall
- Industry-specific concerns, e.g., billing/coding and government reimbursement for healthcare deals

- Known issues
- Uninsurable fines and penalties, e.g., SEC fines, criminal fines
- Pension funding
- Asbestos and PCBs
- Collection of accounts receivable
- Net operating losses
- Covenants
- Transfer pricing
- Purchase price adjustments
- Tax liabilities resulting from pre-closing reorganization
- Breach of which the deal team members had actual knowledge prior to the effective date of the policy
UNDERWRITING TIMELINE:
AN IDEAL PROCESS
WE UNDERSTAND “DEAL TIME” AND CAN GO FASTER IF NEEDED

DAYS 1-2
Engage broker and obtain underwriter NDAs

DAYS 3-6
Obtain quotes (non-binding indications) from underwriters
- No cost to obtain quotes
- Key documents include draft purchase agreement, target’s annual financials, CIM and LOI (if available)

DAY 6
Select Underwriter
- CAC provides memo analyzing pros and cons of each proposal
- Execute expense agreement to formally select underwriter

DAYS 6-10
Underwrite policy
- Provide data room access and tax, financial and legal diligence
- Participate in 1-2 hour call with underwriter and Insured’s deal team and advisors
- Negotiate policy terms

SIGN
Bind Coverage
- Execute declaration that buyer has no knowledge of breaches
High-level overview

2021 saw record-breaking global M&A activity, which led to R&W market constraints relative to both underlying capital capacity and underwriter bandwidth. RWI insurers became increasingly selective, conservative, and were able to obtain record prices.

2022 M&A-R&W activity remains robust, but has returned to historical norms, and the R&W market has also returned to historical norms. Key points:

| • As of Q3 2022, carriers quote rates have normalized, appetites have broadened (i.e. challenging risks are receiving more traction than at the end of 2021), and new players have come online. |
| • Non-traditional transaction types and structures are finding strong underwriter interest, such as secondaries transactions and take-private transactions, minority investments, real estate, and true one-offs |
| • Tax Insurance and Contingent liability products are increasing in popularity. |
| • Much softer overall market, but not a soft market; buyers can typically leverage multiple quotes to obtain most favorable terms |
2022 overview: Premium

- Premiums continue to trend lower
- Coverage scope broadening
- Softer market conditions expected to continue
- Underwriting fees, broker minimum fees, and taxes impact “cost per million” for deals under ~$65M
2022 overview: Retention

Retentions remain at 1.0% of EV for most targets with valuations from $30M-$200M.

Larger deals generally command lower retentions as percentage of EV.

For deals below $30M-50M, minimum retentions often apply.

Both limited seller indemnity and no seller indemnity restructures remain common, NSI predominates.

NSI pricing typically 10-15bps higher.
Key trends: Deal size and structure

**Deal size and structure**

- Carriers have continued to reduce their appetite for carve-out transactions (in reaction to claims)
- Carve-out targets generally lack audited financials rendering them higher-risk from the underwriter perspective
- Policies will contain language qualifying breaches of financial statement representations by the fact that the Target has not previously operated as a stand-alone entity

- RWI is available for deals of all size though minimum premiums and retentions will apply
- During times of high deal volume, carriers tend to prioritize deals >$75M to maximize premium

- The average limit purchased remains at ~10% of enterprise value, even on larger transactions (>$/500M). However, above $1B in enterprise value, Buyers commonly purchase closer to 7.5% of EV in coverage. For deals below $50M in value, a $5M limit is the most typical.
- Increasing interest in excess fundamentals and tax coverage; rate can be as low as .30% of the excess limit amount
Key trends: Scope of coverage

Data privacy and key operational liability risk

Reacting to broader loss developments in cyber insurance lines, RWI carriers are taking a more restrictive posture on deals where cyber exposure is a material concern.

• Proposing broad data privacy/cyber security exclusions or
• Requiring that coverage for cyber matters under the RWI policy will only be “excess of and no broader than” adequate underlying cyber coverage
  – *Not limited to “tech” targets*
• This approach is often applied to material environmental, E&O, and product liability/warranty/recall exposures

Buyers should ensure their R&W broker/advisors are working closely with buyers’ property & casualty insurance brokers to avoid gaps in coverage. R&W underwriters will seek to confirm:

• commercial reasonableness and overall robustness of a target’s underlying insurance coverages;
• that the transaction will not create the risk of uninsured claims that can fall to the R&W policy, i.e. that “prior acts” coverage exists for underlying claims-made policies.
# Key trends: Reigning in the Reps

**Deemed changes/required changes**

Carriers sought to pare back the scope of numerous reps, including items they view as challenging to underwrite, inherently forward-looking, or otherwise relating to key drivers of loss.

However, the current competitive landscape is arresting this trend.

Agreement comments can materially impact the scope of coverage. Areas of interest to carriers:

- Financial statements reps, where beyond “GAAP + fairly presents”
- Customer and Supplier Representations
- Forward-Looking Statements including the collectability of Accounts Receivables
- Statements of “adequacy” or “sufficiency,” i.e. a financial accounting system being “adequate” to deliver accurate outputs
- The requirement that references to ‘notices’ in certain representations be qualified by written or knowledge requirements
- Representations regarding the impact of the Coronavirus
Key trends: Rollover and Minority Investments

Thresholds remain fluid

- Loss proration when rollover at or above 30% post-close ownership percentage
- Typically rollover seller/investor is required to sign No Claims Declaration, stating they are familiar with the reps and are unaware of any breaches. **Violations of the rollover NCD results in claim payment being prorated.**
- In nearly all cases, non-prorated coverage is not available where the buyer acquires less than a majority of the equity. Exceptions are very rare and typically require, at minimum, a showing of effective control.
Thank you!