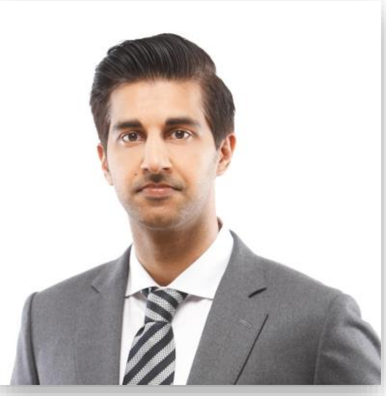
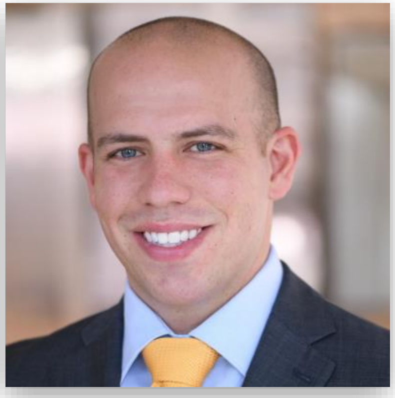
Force Dispersal: Exploring Market Trends in RWI

Moderator



Pavan Jawanda
Partner,
McCarthy Tétrault LLP



Thomas Bonfiglio
Senior Vice President,
Transactional Liability,
CAC

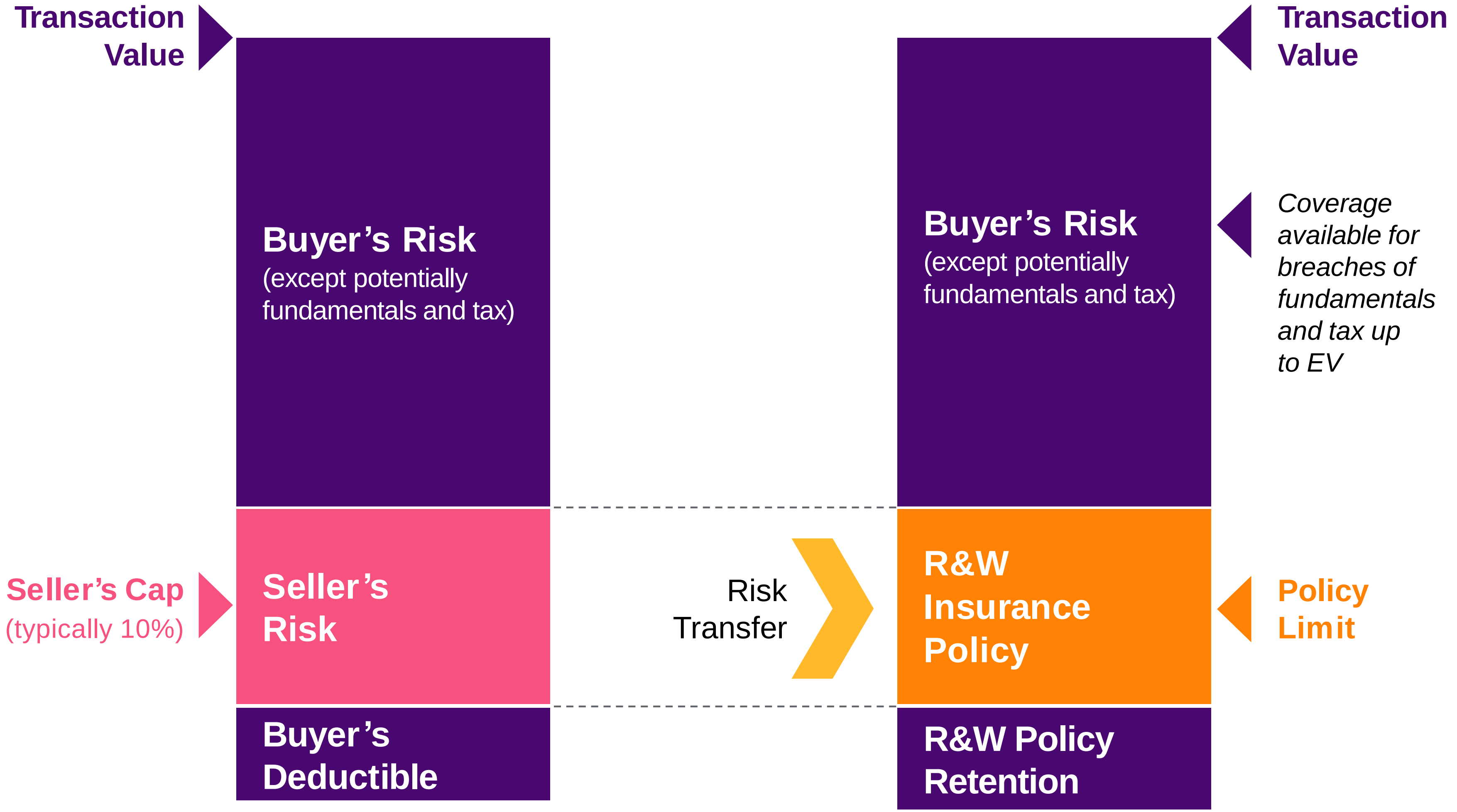
Craig Lilly
Partner,
Reed Smith LLP

Zac Padgett
Partner,
Orrick Herrington &
Sutcliffe LLP

Dan Waxman
Director,
Willis Towers Watson

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

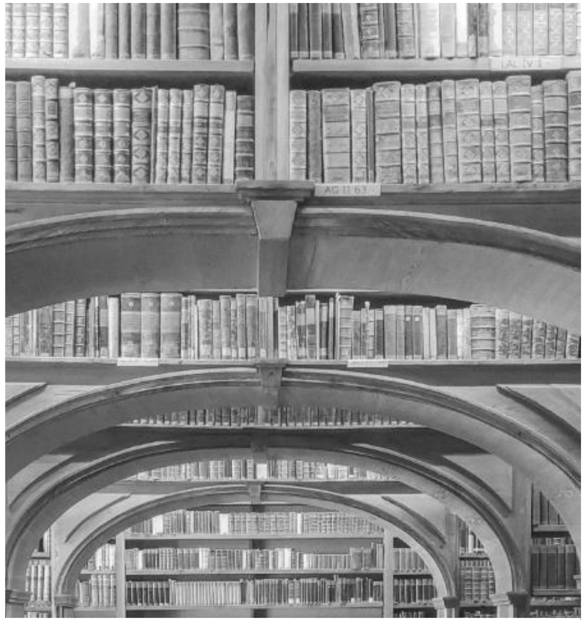
CURRENT R&W INSURANCE MARKETPLACE

AIG
ASQ Underwriting
AXA
Berkshire Hathaway Specialty Insurance
THEMIS
cfc
Berkley Professional Liability

beazley
DUAL
Liberty Specialty Markets
ambridge
ETHOS
Fusion
EVEREST

rp | underwriting
CHUBB
VALE Insurance Partners
Great American Insurance Group
Tokio Marine HCC
Concord Specialty Risk

The Hartford
Euclid Transactional — The Right Angle for Risk
BlueChip Underwriting Services
QBE
mosaic Insurance



COVERAGE DISTINCTIONS

Heightened Risks Areas vs. Exclusions

Heightened Risks Areas

- 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

Exclusions

- 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

Premium

Overall premium trends

- **Premiums continue to trend lower**
- **Coverage scope broadening**
- **Softer market conditions expected to continue**

Minimum economics

- **Underwriting fees, broker minimum fees, and taxes impact “cost per million” for deals under ~$65M**

2022 overview: Retention

Retention

Overall retention trends

- **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**

LSI VS NSI

- **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

Carve-out transactions

- 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

Deal size

- 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

Limit purchased

- 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!