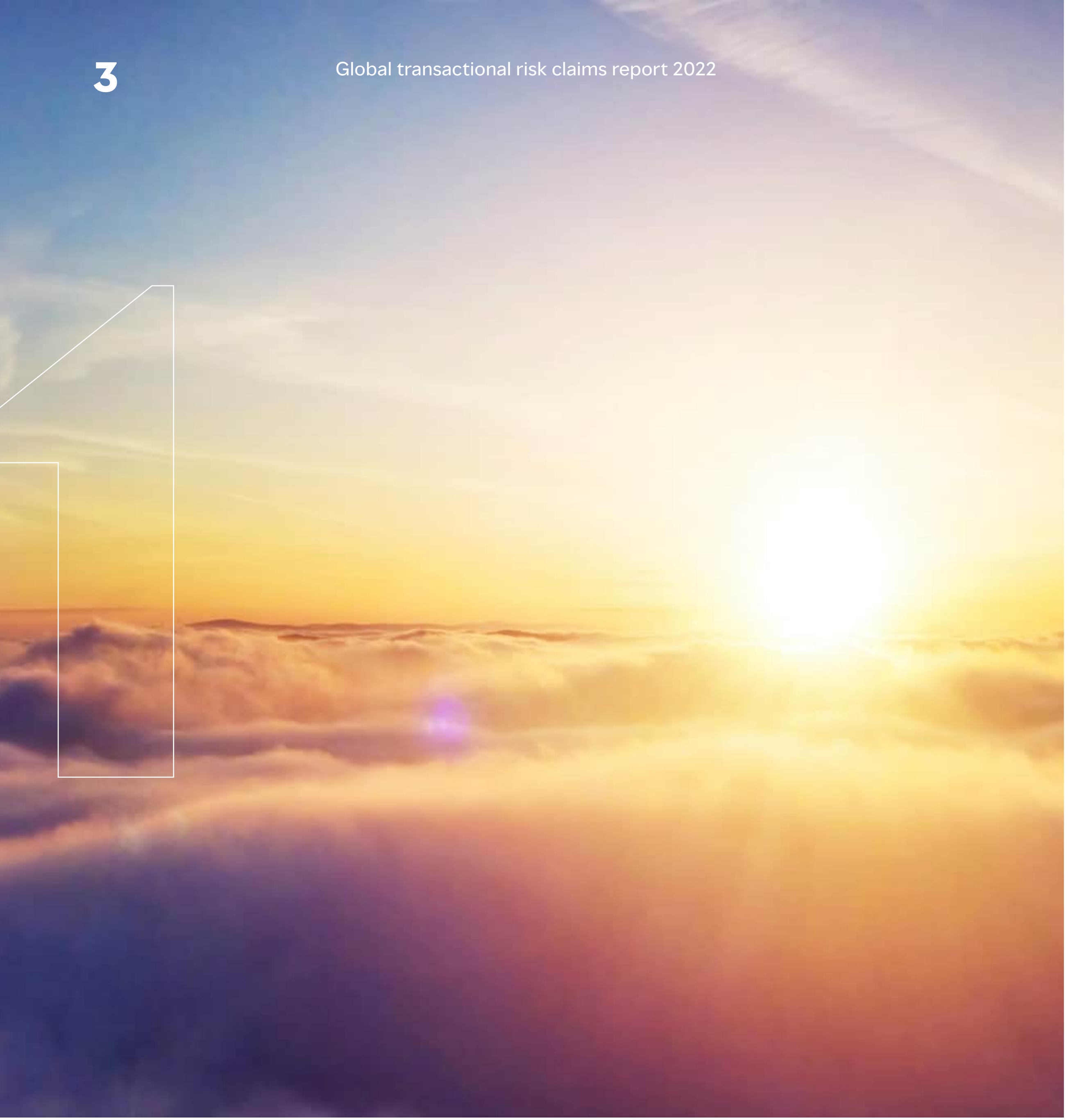
Marsh

Global transactional risk claims report 2022

Contents

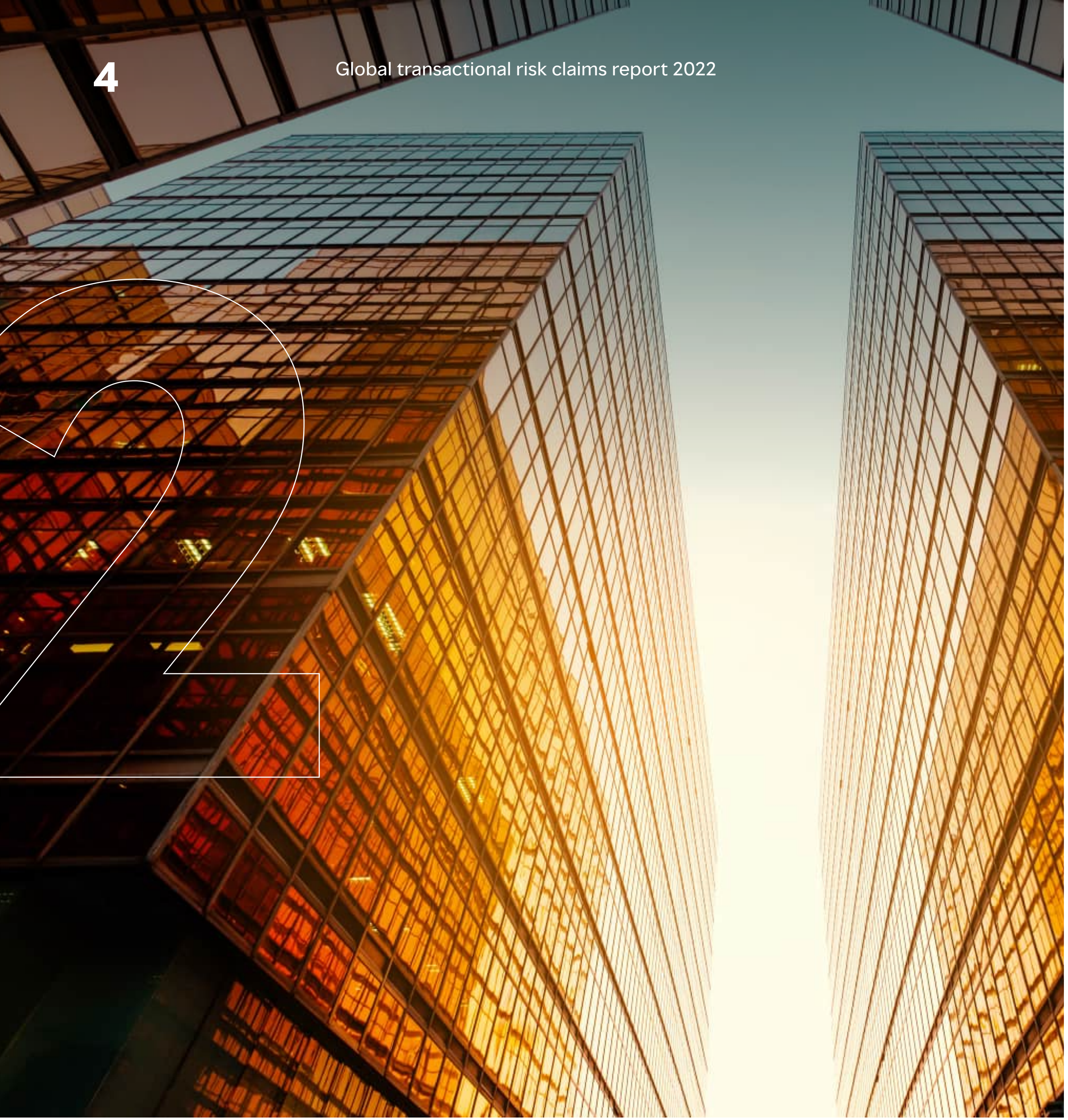


Introduction

The ever-increasing use of representations and warranties (R&W) insurance policies — also known as warranty and indemnity (W&I) policies — as a well-established M&A risk management and deal facilitation tool has led to a corresponding increase in claims activity globally.

In this report, we examine over 1,100 claims notified from January 2017 through December 2021 to R&W policies placed by Marsh in jurisdictions around the world.[1] During this period there was exponential growth in the use of R&W insurance in M&A transactions, coupled with a maturing claims profile. We also saw the unfolding of unprecedented global socio-economic and political events, including the COVID-19 pandemic, which have affected major economies. Our commentary, both at a global and regional level, focuses on the impact of those recent events on R&W claims, and outlines how we see the current claims landscape evolving.

1| This report does not include data from the Pacific Region for the years 2017 and 2018, which was not available. This report also does not incorporate claims data relating to specific tax risk or contingent risk policies.



Global snapshot

Claims notifications increased five-fold in the period 2017-2020, with a consistent year-on-year increase.

A decrease in notifications followed in 2021, likely as a result of the impact of the COVID-19 pandemic. We expect claim notifications to increase, starting from late 2022.

The percentage of policies that receive a claim has held steady at a global average of 14% to 16%[2].

Over US$500 million has been paid to Marsh clients by R&W insurers since 2017.

Financial statements and tax breaches remain the most commonly reported claims under R&W policies.

2| For policies where the notification period for most types of breaches has now come to a close.

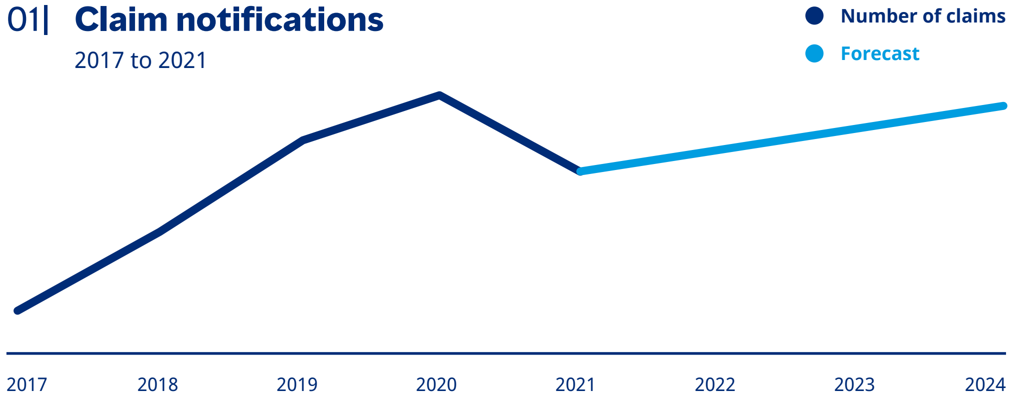
Global trends

Global claim notifications increased sharply over the last five years, peaking in 2020, with notifications increasing almost five-fold between 2017 and 2020. In 2021, Marsh clients notified 28% fewer claims than the preceding year. The rise and subsequent fall in notifications is likely due to the impact of the COVID-19 pandemic on global economies, with businesses likely more focused on survival and recovery during this period, rather than claims under R&W policies. The pandemic, and associated shutdowns in 2020, were closely followed by a record year for M&A activity, and for R&W policy placements by Marsh globally (over 1,900 placements) in 2021.

The percentage of policies that receive a claim has held steady at a global average of 14% to 16% for policies where the notification period for most types of breaches has now come to a close. Due to the consistency of the notification rate for mature policy years, the record number of placements in 2021, and the time lag — or "tail" — between policy inception and notification of a claim, we expect the number of notifications to begin to significantly increase again in late 2022, into 2023 and beyond.

01| Claim notifications

2017 to 2021



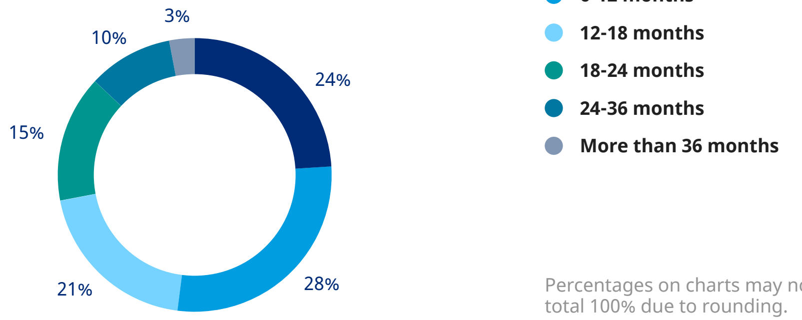
Over time, the majority of claims were consistently notified within a year from policy inception.[3] The percentage increases to approximately 73% for claims reported within 18 months for the period from 2017-2019 (for which the notification period is likely to have come to a close). The data indicates that most breaches are identified relatively quickly and usually within the first audit cycle after ownership of the target business. Although a small minority of claims have been reported after more than 36 months, those tend to be the exception and are likely to relate to tax breaches (for which the policy period is longer). Insureds are more familiar with the operation of R&W policies and the process of making claims, and therefore we expect notifications to continue to be made sooner following policy inception.

It should be noted that for placements within the last two years (2020 and 2021) the data shows a higher proportion of earlier notifications (within the first six months after the policy incepts). This is a natural consequence of when the policies were placed and, as these policies mature over time, we expect the notification periods to balance out and reach a consistent trend with previous years.

R&W insurers have paid over US$500 million to Marsh clients since 2017. As shown in Figure 3, claim payments have increased significantly since 2018, which is consistent with the exponential rise in use of R&W insurance and placement levels in the preceding years. Consistent with notification levels, total claim payments in 2021 were slightly lower than the prior year. This is likely due to a combination of relatively fewer claim notifications in 2021 alongside a general slowing of activity in the claims market as insurers focused their attention on COVID-19-related losses. Payments through the first half of 2022 have already exceeded 2021 figures, and, in view of the likely claims arising from the significant number of policies placed in 2021 and beyond, many of which will have higher limits based on enterprise value (EV), we anticipate claim payments to revert to a consistently increasing trend in 2022 and future years.

3| For North America, timing of notification is measured from the closing of the transaction.

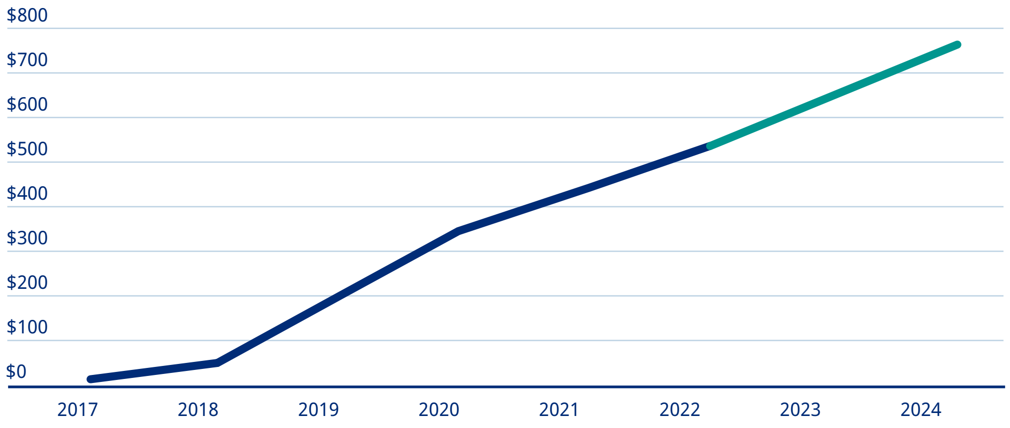
02| Time to notification



Percentages on charts may not total 100% due to rounding.

03| Aggregate claim payments over time

In millions (USD)

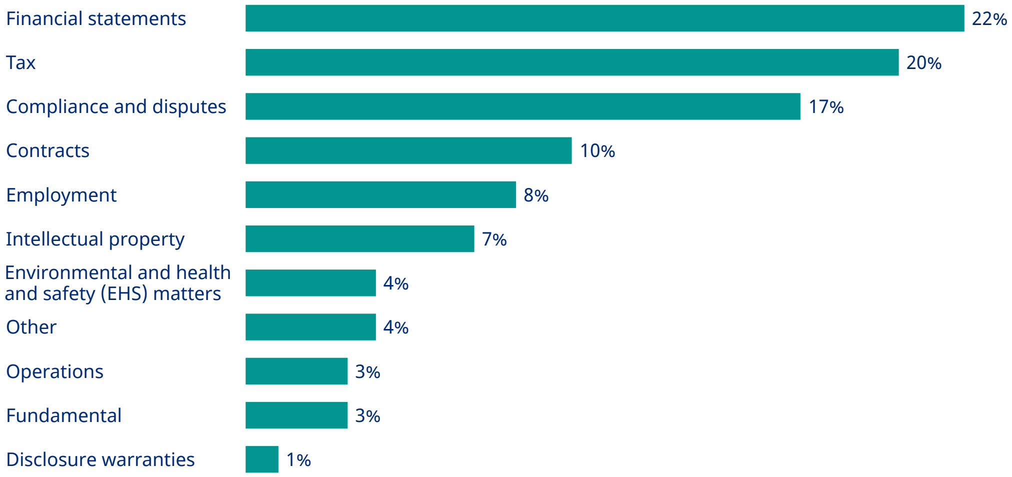


Breaches concerning financial statements, tax, and compliance/disputes are the most common and have consistently been so every year between 2017 and 2021. There are some year-by-year fluctuations among the other categories, although going forward we do not expect changes to the top three breach types.

Given that the ultimate exposures under R&W policies relate to the valuation of a business, it is unsurprising that financial statements breaches continue to dominate as the most commonly claimed breach type. Equally, given the intricacies of tax legislation across various jurisdictions, it is unsurprising that this forms the basis of the second largest breach type group when it comes to issues being identified post-completion. Tax authorities in a number of key jurisdictions — including the UK and Germany — have resumed activity in earnest following a slowdown during the early phase of the COVID-19 pandemic, and as they work to eliminate the backlog, we anticipate that tax issues will be more frequently identified and notified to policies over the next few years.

04| Types of breaches

2017 to 2021



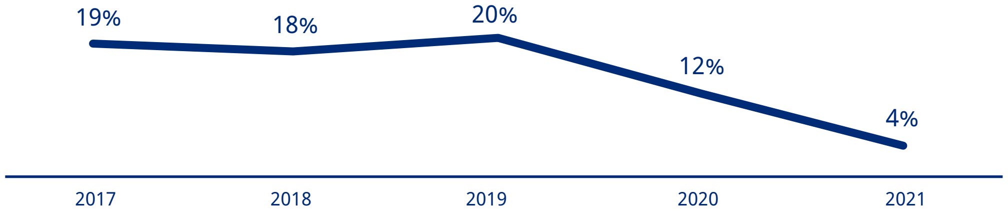
North America

CLAIM NOTIFICATIONS

The increased use of R&W insurance in M&A transactions has led to a corresponding increase in claim volume. The percentage of policies that receive a claim, however, has remained fairly steady at approximately 18% to 20% for matured policies (that is, transactions closed at least three years ago). Insureds can still report claims arising out of breaches of general/non-fundamental reps and warranties on policies that closed in the 2019-2021 period, so it remains to be seen whether policies from those closing years' experience a higher or lower percentage of claims. Nevertheless, nearly 20% of policies placed in 2019 have already received a claim, so we expect the final percentage for that year to be slightly higher than the average range.

The number of claims reported in 2020 (256) increased from 2019 (167), but 2021 saw fewer claims reported (155) than either 2019 or 2020. The growth in claims in 2020 appears to have resulted from an increase in policies placed, coupled with the negative economic effects of COVID-19. While 2021 saw a sizeable decrease in claims, we do not expect decreases to

05| Percentage of policies with a claim by policy year[4]



4| Chart reflects data as of 12/31/2021.

"We expect the industry average of claims on about 1 in 5 policies will continue to hold, and as such we predict claim volumes will continue to increase as more buyers and their counsel continue to understand the benefits of and continue to use RWI."

MEG GARDINER, CHIEF LEGAL OFFICER AT EUCLID TRANSACTIONAL, AND CHRIS ZIEMBA, MANAGING DIRECTOR AT EUCLID TRANSACTIONAL

"We expect there will be an increase in the number and severity in claims over the next two years because of the downturn in the economy and the increasing sophistication of insureds."

JOE FINNERTY AND BRIAN ROBINSON, PARTNERS AT DLA PIPER US LLP

"Breaches of financial statements, material customer, condition of assets, and tax representations all continue to be common breach types, many of which could be avoided or mitigated with heightened diligence."

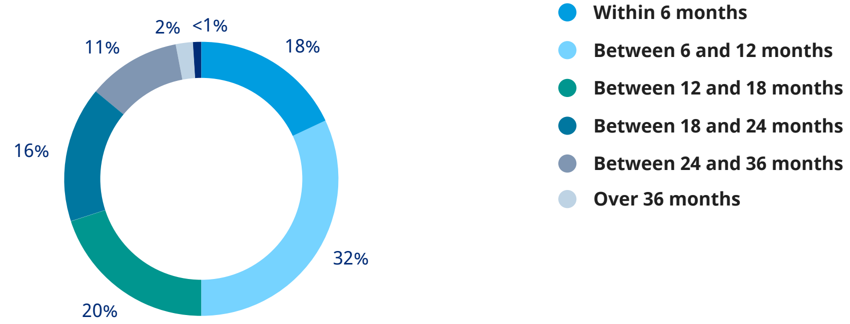
ANNA ROZIN, NORTH AMERICA M&A MANAGER AT AIG

continue and instead anticipate the number of claims to rise commensurate with the significant number of transactions insured during the past year.

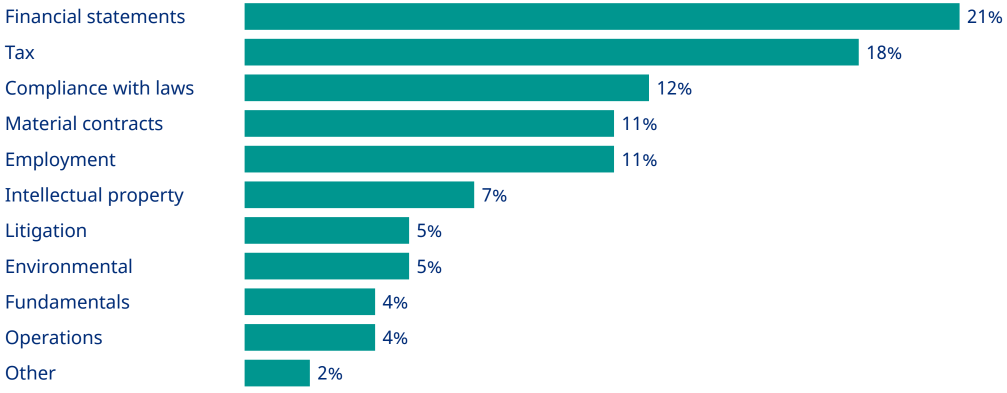
Similar to other global regions, the majority of claims in North America have been reported within a year of the transaction closing and 71% within 18 months of the transaction closing.[5] If that pattern continues, we anticipate a surge in claims through the end of 2022 in light of the nearly 1,000 M&A transactions for which Marsh placed policies in North America in 2021. A small percentage of claims (less than 1%) have been reported during the interim period between signing and closing, with nearly all of them occurring within the last two years. Notably, 80% of the claims reported after 18 months from the transaction closing date relate to third-party claims, such as tax audits or litigation. This is not surprising given that most first-party claims come to light relatively soon after the buyer takes ownership of the business after closing and financial statement breaches usually become known by the first audit cycle after closing.

The primary types of breaches leading to claim notices have stayed relatively consistent over time. Breaches of financial statements and tax representations and warranties tend to be the most common, followed by compliance with laws, employment, and material contracts breaches. While tax representation breaches constitute a large percentage of reported claims, many arise out of routine post-closing audits and have not led to a proportionate number of payments since many are resolved without any loss. In 2021, we saw an unusual increase in environmental breach claims, but we do not expect this increase to become a trend that persists since these claims were largely confined to a small number of policies that received multiple claims.

06| Time to notification from closing



07| Types of breaches



5| This data only uses policy years 2017-2019 to avoid influencing the data towards shorter notification periods for more recently closed policies. Note that 2020 and 2021 are not yet considered "matured" policy years and therefore we expect the percentage recorded to change over time.

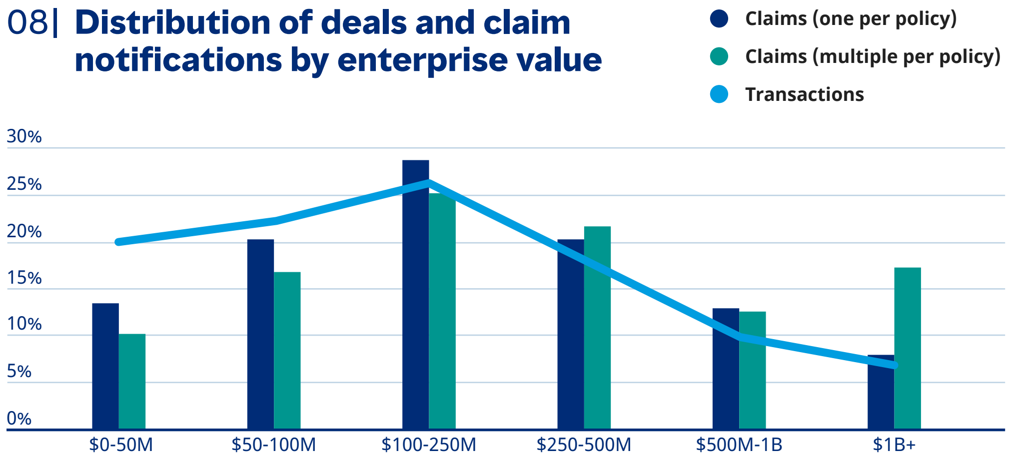
The majority of policies that received a claim — more than 60% — received only a single claim. Nearly 40%, however, received multiple independent claims, with the average being four claims per policy. In general, deals with enterprise values less than US$250 million saw fewer claims per policy than deals with larger enterprise values. In the time period analyzed, deals with claims and an enterprise value of over US$1 billion saw an average of over six claims and a median of five claims per policy, with one policy receiving over 20 claims. As a result, although deals over US$1 billion represent only 7% of the total transactions Marsh closed in the 2017-2021 period, those deals generated 17% of the claims when counting multiple claims per policy.

Deals with enterprise values less than US$100 million represented 41% of all deals that closed between 2017 and 2021; yet only 33% of the reported claims arose from those deals, when discounting for multiple claims on a single policy. In contrast, deals with enterprise values above US$500 million comprised 16% of deals and 20% of reported claims. When accounting for multiple claims on a single policy, the contrast is starker. Only 26% of the total reported claims were attributable to deals with enterprise values less than US$100 million while 29% of all reported claims were attributable to deals with enterprise values greater than US$500 million. In each individual year analyzed, larger deals (above US$500 million EV) produced an outsized share of claims compared to the number of transactions.

Close to one-third (32%) of claims made between 2017 and 2021 were first-party claims while the rest (68%) were third-party claims. This is generally consistent with the year-by-year data of claims made on policies placed between 2017 and 2019, a period for which transactions are unlikely to receive additional claims. Looking at recent trends, the percentage of first-party claims reported has remained relatively consistent at 25-30%, suggesting there has not been an increase in the rate of first-party financial statements breaches that tend to be more severe. Nevertheless, financial statements breaches did comprise the majority of first-party claims between 2017 and 2021. In contrast, the predominant breach types in third-party claims have been tax, compliance with laws, employment, and intellectual property.

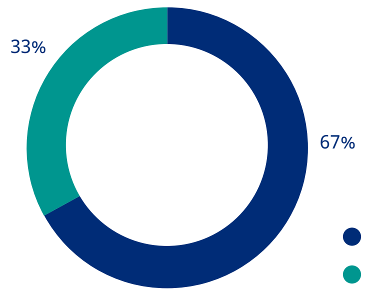
There are more claims on transactions with at least some seller indemnity than on those without a seller indemnity structure. This is consistent with the fact that it has been more common to place insurance policies on deals with a seller indemnity compared to "public-style" transactions (where there is no seller indemnity). However, no-seller indemnity transactions have become more popular in recent years (making up about 50% of placements in 2021), and we will continue to track any trends with respect to claims on these policies in more recent policy years.

08| Distribution of deals and claim notifications by enterprise value



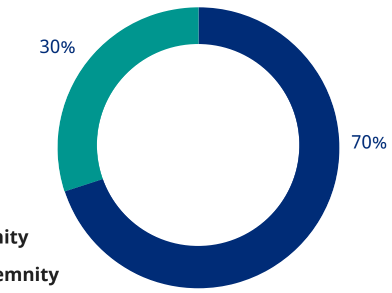
09a| Seller indemnity on deals

2017 to 2019



09b| Seller indemnity on claims

2017 to 2019



Seller indemnity

No seller indemnity

“

Financial statements (including many inventory claims) and material contracts/ customers remain at the top of the list with respect to severity, along with claims arising from breaches of condition/ sufficiency of assets reps.”

MEG GARDINER, CHIEF LEGAL OFFICER AT EUCLID INTERNATIONAL AND CHRIS ZIEMBA, MANAGING DIRECTOR AT EUCLID INTERNATIONAL

“

We are most commonly engaged to facilitate the coverage analysis for claimed breaches of financial statement representations and material contracts/ customer representations.”

JOE FINNERTY AND BRIAN ROBINSON, PARTNERS AT DLA PIPER US LLP

“

RWI claims activity has been remarkably consistent over the last several years in terms of breach types and frequency. However, the market has seen a significant spike in claims severity, with material claims over US $10 million becoming more common, which has contributed to a pricing correction in North America.”

ANNA ROZIN, NORTH AMERICA M&A MANAGER AT AIG

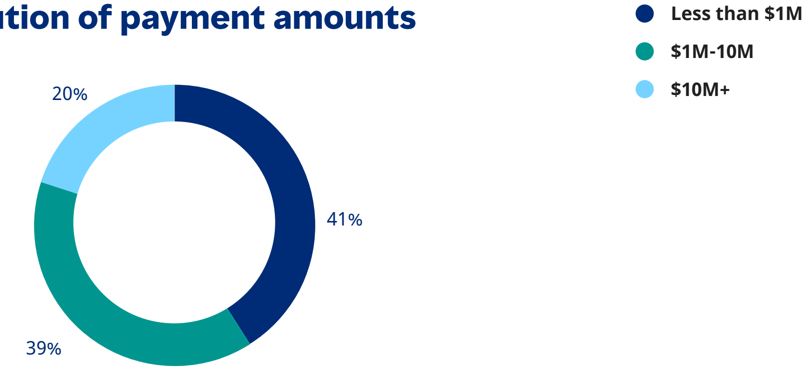
PAID CLAIMS

Marsh has helped clients recover hundreds of millions of dollars of insurance payments under R&W policies, with individual payments in North America ranging from less than US$50,000 to tens of millions of dollars. The majority (80%) of claim payments made between 2017 and 2021 have been less than US$10 million. On average, payment amounts have represented 28% of policy limits, with payments of less than US$1 million averaging only 6% of policy limits and payments greater than US$10 million averaging 81% of policy limits (including some full-limit losses). Of the claims paid to Marsh clients during this period, the majority of paid claims relate to breaches of financial statements representations, despite representing only 21% of reported claims.

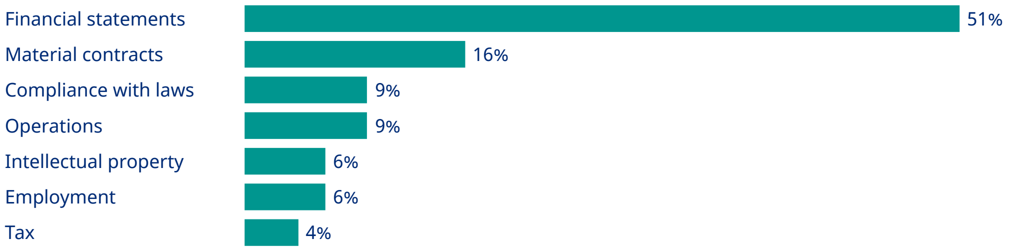
Financial statements breaches represent a disproportionate share of paid claims principally because 67% of financial statements claims calculated loss as a multiple of EBITDA, which can substantially increase the amount of loss claimed under a policy. Almost all paid claims involving a multiple of EBITDA relate to breaches of financial statements representations, though insurers have also paid claims based on an EBITDA multiple for breaches of material contracts representations.

Smaller deals saw a higher number of payments during the 2017-2021 period, but larger deals received a disproportionate share of payment dollars. When accounting for multiple claim payments on individual policies, 71% of claim payments arose out of deals with enterprise values up to US$250 million. This aligns with the trend of smaller deals typically having lower retentions, which are more likely to be exhausted even when the loss amounts are relatively small. Larger deals generally have substantial retentions that require significant loss to fully exhaust. Larger deals, however, also tend to have higher policy limits

10| Distribution of payment amounts



11| Paid claims by breach type



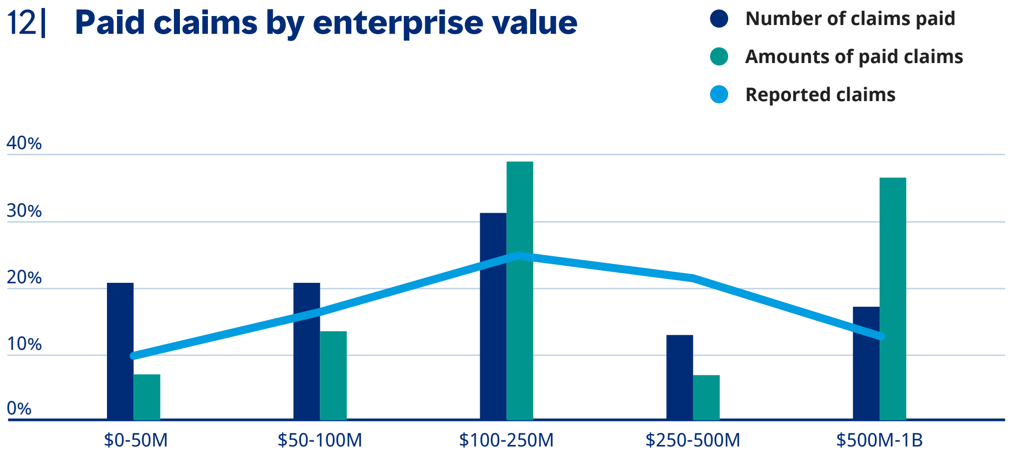
available to cover losses, and due to some eight-figure payments on deals with enterprise values above US$500 million, those deals accounted for 36% of the total amounts paid between 2017 and 2021.

One-third (33%) of paid claims were paid within a year of the initial claim notice and 83% were paid within two years of the notice. There are several reasons some claims may not be resolved quickly. Certain claims may require an exhaustive investigation and involve extensive documentation that needs to be collected and analyzed. The iterative process of adjusting a claim can often result in multiple exchanges of information as additional information sometimes raises more questions. And in some claims, third-party disputes linger in protracted litigation, which delays final resolution of the insurance claim. Nevertheless, the size of a claim is not determinative of the time to resolution; we have seen seven and eight-figure claim payments made within six months of the claim notice as well as more modest six-figure payments take more than two years from the claim notice.

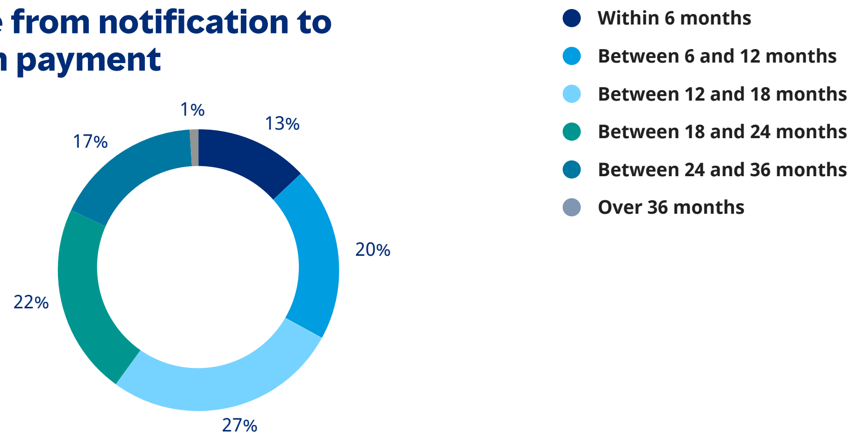
DENIED CLAIMS

Only a small minority of claims have been denied outright by insurers. Of the 674 claims reported between 2017 and 2021, only 35 claims (5%) received coverage denials; most of these were based on an applicable policy exclusion or an issue known by the insured prior to the transaction. Of the 35 denials, insureds accepted the insurer's coverage position in the majority of those claims. Only five claims — less than 1% of claims reported — have escalated to the point of coverage arbitration or litigation. The data mirrors our anecdotal experience that the vast majority of claims resolve amicably with the carriers.

12| Paid claims by enterprise value



13| Time from notification to claim payment



EMEA

The picture painted by our previous claims data analysis in 2019 was of an insurance product in early maturation, with a growing and evolving claims market as both insurers and insureds became more familiar with the product and handling of claims under W&I policies. We saw a steep rise in claim notifications in the period 2016-2018, as well as a corresponding decrease in the amount of time it took for claims to be both notified and resolved by insurers. We concluded that W&I insurance was “coming of age”, and was then, by virtue of notified and paid claims, a proven risk transfer mechanism.

The years subsequent to that claims report have been extraordinary in terms of global political, economic, and societal events, as well as for mergers and acquisitions generally. As a result, the insurance market has been looking more closely at exposure management. Our most recent data illustrates the impact of global events on claims activity in EMEA.

Increased M&A activity in 2021 corresponded with a significant rise in the use of transactional insurance. Across EMEA in 2021, Marsh placed close to 1,000 transactional risk policies for deals with an aggregated enterprise value in excess of US$277 billion and with total limits in excess of US$35.9 billion. We have seen an increase in market capacity, as well as the resurgence of larger deals with an EV of over US$1 billion being insured. The expected average “tail” or period between a policy incepting and a claim being notified is currently between six and 18 months. As a result, following a reduction in the number of claims being notified in 2020, and unprecedented placement levels in 2021, we predict a surge in claims notified to W&I policies — as well as other transactional liability policies, such as contingent risk and specific tax risk policies — towards the latter half of 2022 and well into 2023, and beyond.

Claims remain a “hot topic” of discussion for buyers of W&I insurance, with an insurer’s claims record being a key differentiator and an important part of insurer selection at placement. Clients are ever more interested at a very early stage in how claims decisions are made, how promptly an insurer responds to claims, and ultimately how likely an insurer is to pay a claim. Our data indicates continuing improvement in the claims process within the EMEA market, and we have experienced an increase in market capacity with numerous new entrants to the market, all keen to establish a good claims record. We anticipate that new entrants will potentially start to look beyond the established claims process model, to new innovative ways of adjusting W&I claims, particularly when it come to quantifying and agreeing loss.

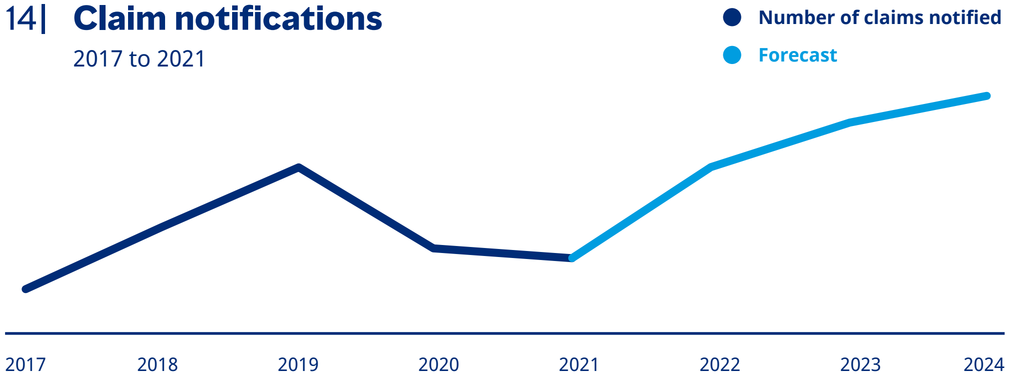
CLAIM NOTIFICATION LEVELS

Following an exponential rise in W&I claims notified between 2009 and 2019 (due to significantly increased M&A activity and consequent use of insurance as a deal facilitation tool), the EMEA region saw an average downturn in claims notified over the course of 2020 and 2021. Notifications decreased by 28% between 2019 and 2020, with a further 5% decrease registered between 2020 and 2021.

There are some interesting variances within the region. While the UK experienced a decrease in notifications in 2020 from 2019 levels, notifications peaked in Continental Europe in 2020, followed by a general slowing in 2021. From a UK perspective, this is likely due to the impact of lockdown restrictions during the COVID-19 pandemic on the UK economy, as well as businesses focusing less on M&A activity and claims over 2020, rather looking inwards to business sustainability.

14| Claim notifications

2017 to 2021



In Continental Europe, the drop in the number of claims notifications in 2021 may be explained by the slight decrease in the number of policies placed the preceding year. As our data demonstrates, claim notifications are generally made within the first six to 18 months after the inception date of the policy, with the majority of notifications being made within the first 12 months after inception.

The variation in notification trends between the UK and Continental Europe, and within Continental Europe itself, may be a result of the differing levels of restrictions imposed by different European governments as a response to COVID-19, which may have meant that certain European economies were impacted less, or later, than the UK.

Given the extraordinarily high levels of M&A activity, and policy placements, throughout 2021, we expect a noticeable increase in claim notifications over the course of the second half of 2022 and into 2023. This time lag is due to the "tail" between policy placement and claims being discovered and notified to insurers. We anticipate a spike in claims at the latter end of 2022 and over the following months as notification rates return to normal following COVID-19, alongside the continued exponential growth of the use of the product in M&A transactions in EMEA. In addition, it remains to be seen if the potential for current and predicted inflationary and recessional economic activity could further accelerate this trend due to the counter-cyclical nature of claims normally expected in a recession.

"We think the volume of W&I insurance claims is likely to increase, partly reflecting a continued increase in the percentage of deals with insurance and partly due to the current economic uncertainties which many commentators think will continue for at least the next 1-2 years. An increase in claims may be tempered by improved pre-agreement due diligence and more effective use of limitations in W&I policies."

NICK ANDREWS, PARTNER AT BDO LLP

RATIO OF CLAIMS TO POLICIES PLACED

The region saw an increase in the proportion of claims against the number of policies placed into the insurance market in the period leading up to 2017, in part due to the provision of broader policy coverage, as well as greater familiarity of insureds with their W&I policies and how to make a claim.

The 2017-2019 period saw the ratio of claims to policies holding steady at 11% (against a slightly higher 10-year historic average of 13%).

We do not consider the years 2020 and 2021 to be "closed" years for the purposes of claims notification, due to the two/three year policy period for general warranties (and seven year policy period for tax warranties), and the generally accepted "tail" between policy inception and notification. Consequently, we expect the proportion of claims against policies placed for the 2020-2021 period to climb higher over the course of 2022 and into 2023.

IMPACT OF DEAL SIZE

When it comes to whether the size of the deal (based on EV) has an impact on the frequency of claims, our data paints an interesting picture. At a global level, our data shows that the highest proportion of notifications arises in the US$100 million to $250 million EV bracket. Either side of this bracket, the proportion of notifications is smaller, with the up to US$50 million bracket and the US$100 million to – US$500 million bracket having the lowest proportion of claims notified. However, consistent with what we saw in North America, the largest deals of over US$1 billion tend to experience a high proportion of claims notified.

However, our data shows that for EMEA specifically, smaller deals with an EV up to US$50 million have the highest frequency of claims, with approximately 12% of deals in this EV bracket experiencing a claim. The proportion of claims versus deal size then tracks steadily down through the EV brackets, rising again at the higher end of the EV scale, as deals of over US$1 billion experience an uptick in claims. It is difficult to determine the reasons for the higher notification rate on small and medium enterprise deals in EMEA when compared with other regions. However, the greater volume of small cross-border transactions in Europe, combined with less granular due diligence being conducted for deals of this size, may be leading to a greater proportion of issues not being discovered in the diligence process, which become apparent post-completion.

In general, deal sizes are increasing and therefore, we expect to see more frequent notifications in the higher brackets. Additionally, we note that policies related to larger deals generally receive multiple notifications, which may create a higher claims ratio in respect of that EV bracket.

15| Notification rates by enterprise value

Over the last 10 years,

13%

of policies placed have been notified with a claim*

Over the period 2017-2019,

12%

of policies placed on deals with an EV of up to US$50m have received a notification

* Excluding claims that have been notified direct to insurers.
Policy years 2020 and 2021 are not yet closed and, therefore, we expect further notifications.

TIME TO NOTIFICATION

In our 2019 EMEA claims report, we made the observation that the time between policy inception and notification of a claim appeared to be decreasing over time due, primarily, to the increasing familiarity of insureds with the way in which their policies operated and how to make a claim. The years since our last report are a continuation of this trend, with most claims being notified within six months of policy inception, and the vast majority of claims being notified within 12 months of inception. We believe this shows that the product is beginning to reach maturity from a claims perspective. With the correct guidance, insureds are becoming used to notifying in a timely manner after inception, instead of leaving notification until the end of the policy period as a "laundry list" item. If this trend continues, we expect that a high number of claims will be notified over the course of 2022 due to the significant number of policies placed in 2021 by Marsh's EMEA team.

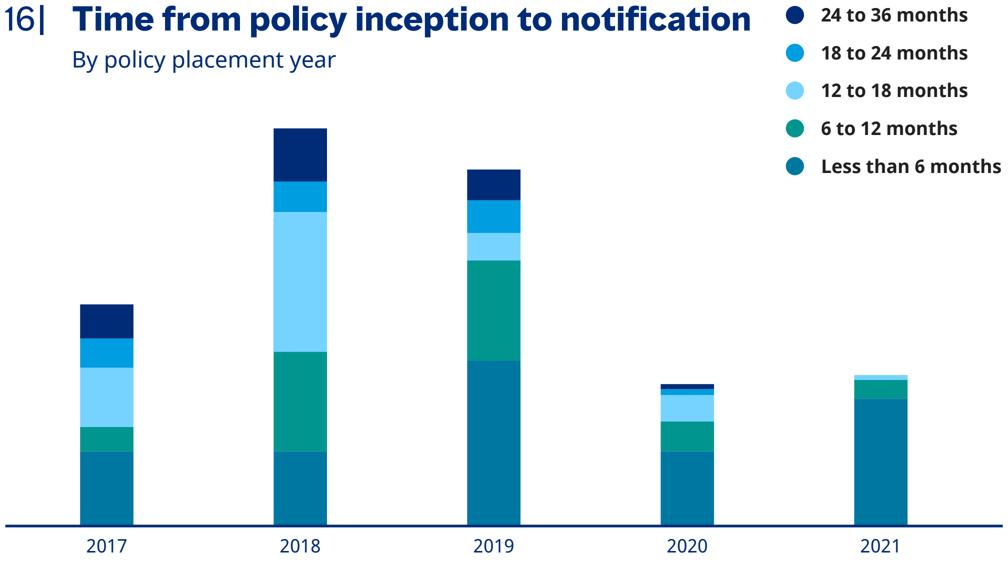
NOTIFICATIONS BY BREACH TYPE

During the 2017-2021 period, financial statements and tax warranties have remained the largest sources of claims, together comprising approximately 44% of claims notified in EMEA. This is roughly consistent with data reported in 2019. However, the percentage of tax breach claims (31%) notified in 2019 were higher than the average notified during the 2017-2021 period, which stood at 19% of claims notified.

This would indicate that the last few years have seen a drop in tax breaches notified in EMEA. Compliance and disputes remains the third most frequent breach type notified, largely driven by claim notifications in Continental Europe.

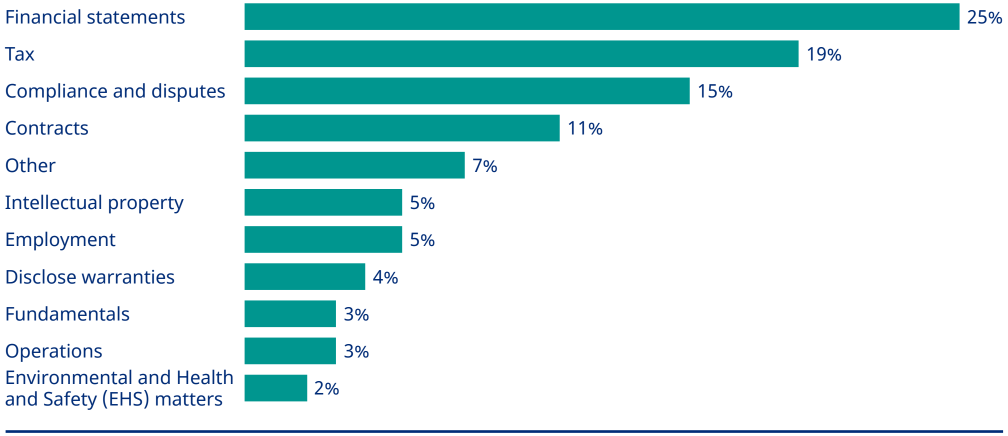
16| Time from policy inception to notification

By policy placement year



17| EMEA notifications by breach type

2017 to 2021

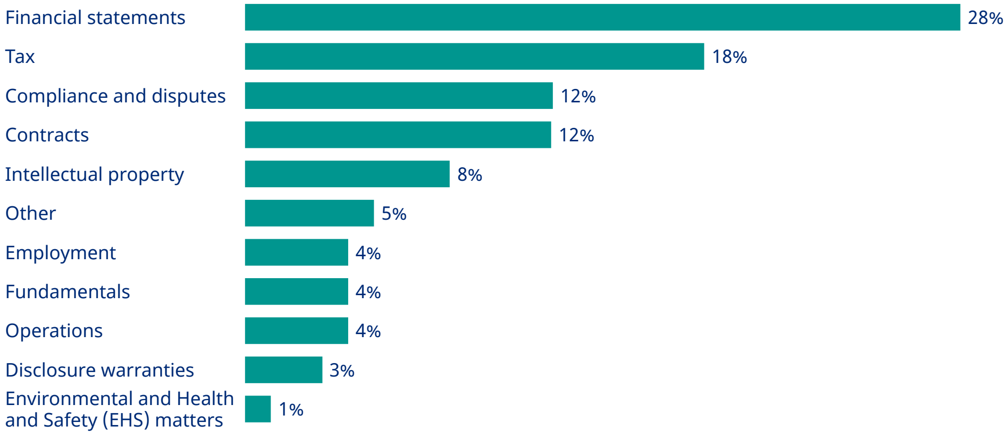


In the UK, the overall picture is significantly weighted towards financial statement and tax breaches, although consistent with the rest of the region, tax breaches are slightly down from the percentage reported in 2019. From a UK-specific point of view, we might speculate that this is a result of reduced tax authority activity during pandemic-related lockdowns and beyond, due to the “work from home” approach taken by some government bodies and the reported backlog that ensued.

Continental Europe shows a slightly different picture. The top three breaches are similar to the UK, but tax and compliance and disputes breaches top the list on the continent, with financial statements in third place. The level of scrutiny of the local tax authorities might be higher in some jurisdictions (notably France and Spain) than in others, resulting in a higher percentage of tax claim notifications. In Italy we saw a relatively large number of notifications related to compliance and disputes breaches.

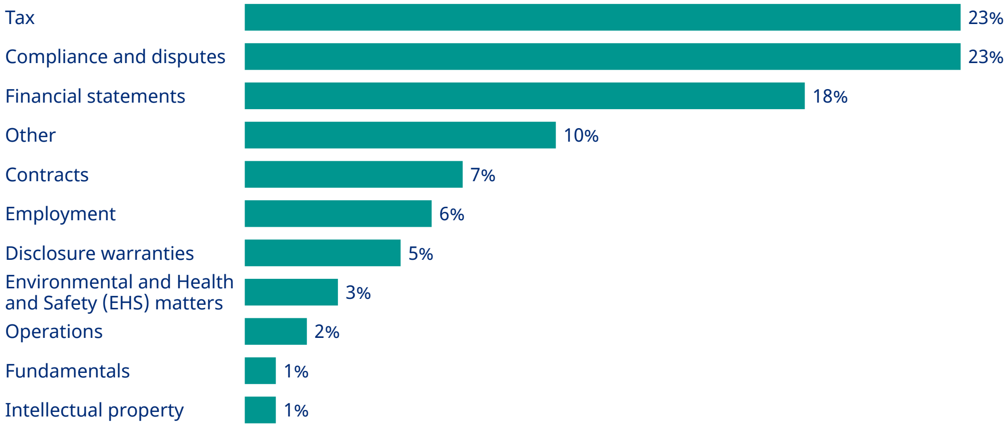
18| UK notifications by breach type

2017-2021



19| Continental Europe notifications by breach type

2017-2021



NOTIFICATIONS BY INDUSTRY TYPE

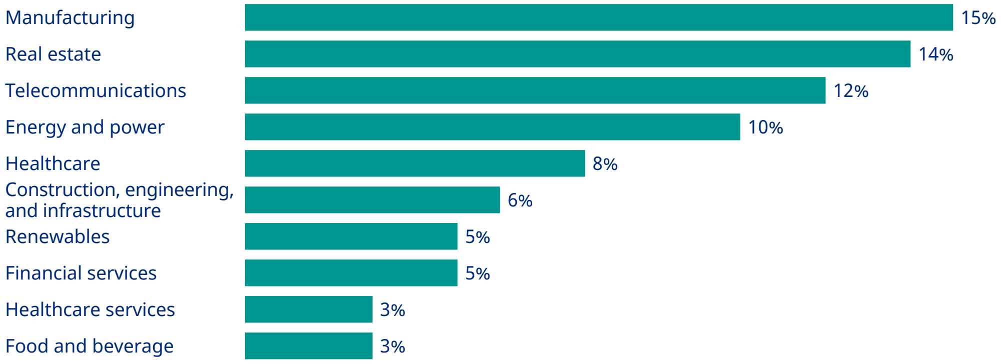
To date, although claims emerge in all industry types, EMEA notifications have been primarily focused in the manufacturing, real estate, and telecommunication sectors.

During the 2017-2021 period, the UK industries producing the highest number of notifications to W&I policies have been real estate, energy and power, and telecommunications. This profile is largely consistent with and proportionate to the policies placed by Marsh in each sector.

In Continental Europe, most notifications arise from policies related to manufacturing companies. Apart from the usual financial and tax risks and third-party claims, these businesses are prone to various types of issues, such as environmental, health, and safety issues.

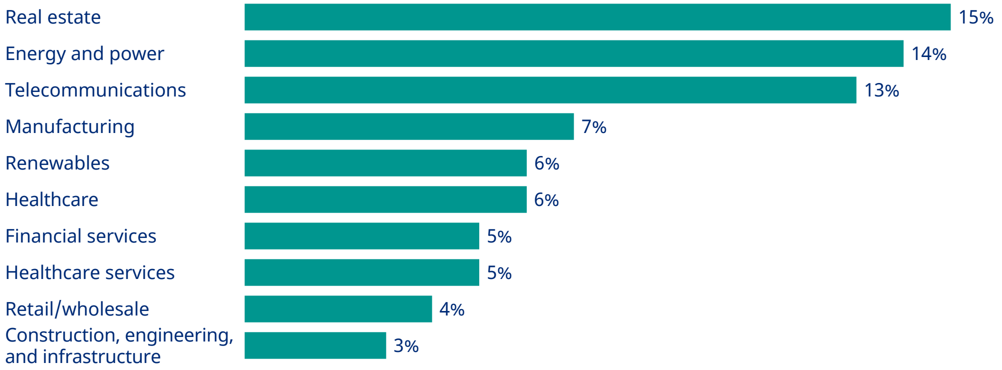
20| EMEA claims by industry — top 10

2017 to 2021



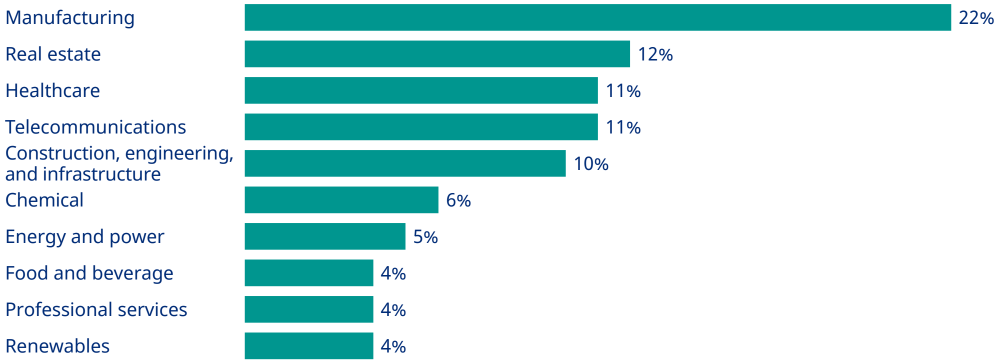
21| UK notifications by industry — top 10

2017 to 2021



22| Continental Europe notifications by industry — top 10

2017 to 2021



PAID CLAIMS

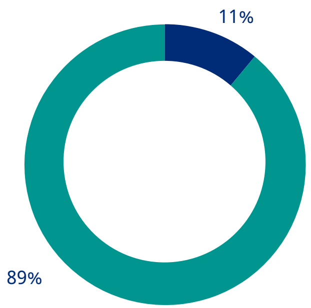
To 2021, the percentage of "to date" paid claims has improved, with 89% of closed claims paid and 11% denied by insurers.

Our five-year data from 2017 to 2021 also shows an extremely consistent level of claims being paid and denied across the EMEA region. The position in the UK appears even more favorable — between 2017 and 2021, only 4% of closed claims were denied by insurers, meaning 96% were paid, settled, or agreed within retention. This positive data suggests that insurers have been following through on their stated philosophies to pay valid claims. It remains to be seen, however, how the prospect of a UK recession, as well as increased placement levels in 2021 and consequent expected claims activity, may impact payment and denial rates in the years to come.

23| EMEA claims paid

To date

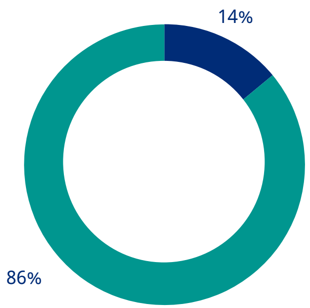
Denied
Paid



24| EMEA claims paid

2017 to 2021

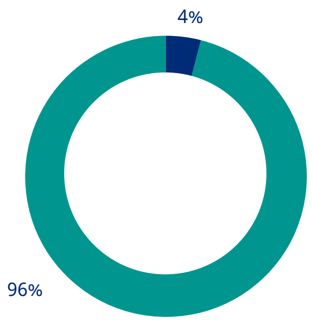
Denied
Paid



25| UK claims paid

2017 to 2021

Denied
Paid



Communication is key, insureds should seek to engage with insurers up front and openly, and that needs to be reciprocated by insurers. Once a claim progresses, good communication channels and regular updates between insurer and insured can help to ensure a smooth resolution.”

NICK ANDREWS, PARTNER WITH BDO LLP

The pandemic is not over yet and it has undoubtedly stretched and tested businesses and their employees in ways never before experienced... It will be a while before the full effect of the pandemic has shaken out and we have a better picture of its impact on claims.”

SIMON RADCLIFFE, HEAD OF GTS CLAIMS AT LIBERTY GLOBAL TRANSACTIONS SOLUTIONS

Over the last five-year period, the overall picture shows the time between notification and claim payment has dropped significantly in EMEA, with the vast majority of claims in 2019 being resolved and paid within an 18-month period. In 2019, a good proportion of claims were paid within six months of notification, an extremely positive outlook. It should be noted that 2020-2021 will be “open” years for a large number of claims and therefore we should know the resolution period for these claims in the months to come.

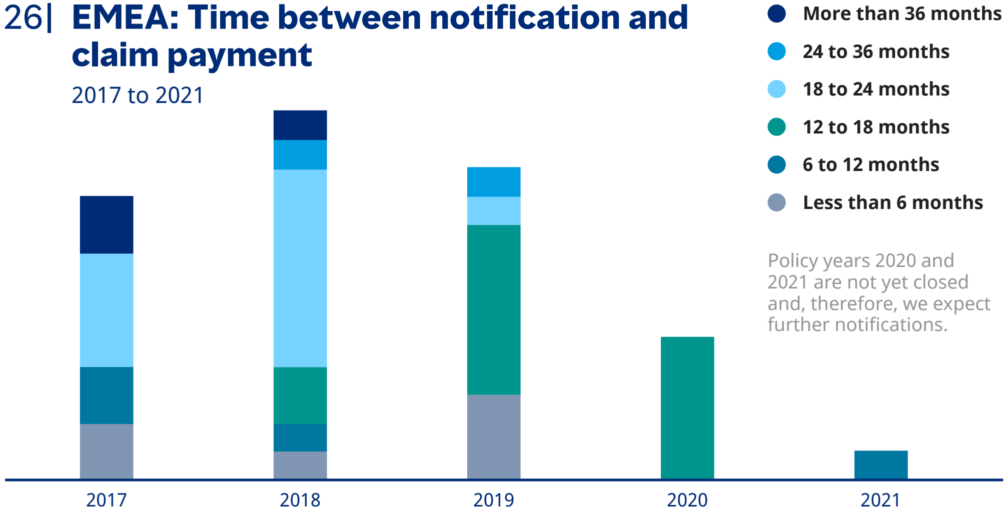
In general, we continue to see faster claim payments in situations where insured clients are well-prepared at notification stage with detailed evidence to substantiate their claim, and where insured and insurers are able to work together transparently and collaboratively throughout the process in provision and analysis of information.

The region experienced a brief period of decrease in claim payments in 2020, potentially due to insurers dealing with and suffering significant COVID-19 losses in other lines of business during that period of time, but also potentially reflective of a cautious claims approach as a result of the economic impact of the pandemic. However, 2021 saw an uptick in claim payments and that trend is expected to continue over the next few years, particularly as we expect a flurry of notified claims with potentially larger policy limits and lower retentions. It remains to be seen how the global pandemic will impact insurers’ approach to coverage and claims generally in the longer term.

We note that some newer entrants to the EMEA insurance market are looking to create a more streamlined and collaborative approach to claims, including through use of alternative dispute resolution and joint experts, which, if the established market follows suit, we predict should continue to improve the claims process for all parties.

26| EMEA: Time between notification and claim payment

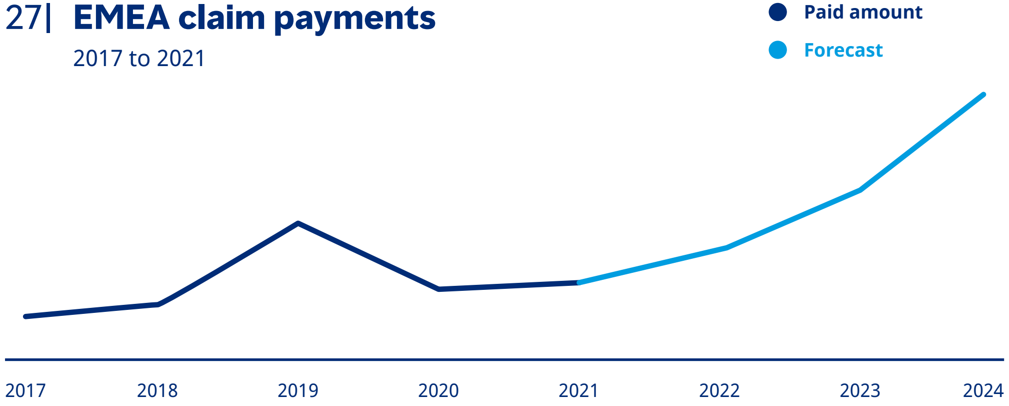
2017 to 2021



Policy years 2020 and 2021 are not yet closed and, therefore, we expect further notifications.

27| EMEA claim payments

2017 to 2021



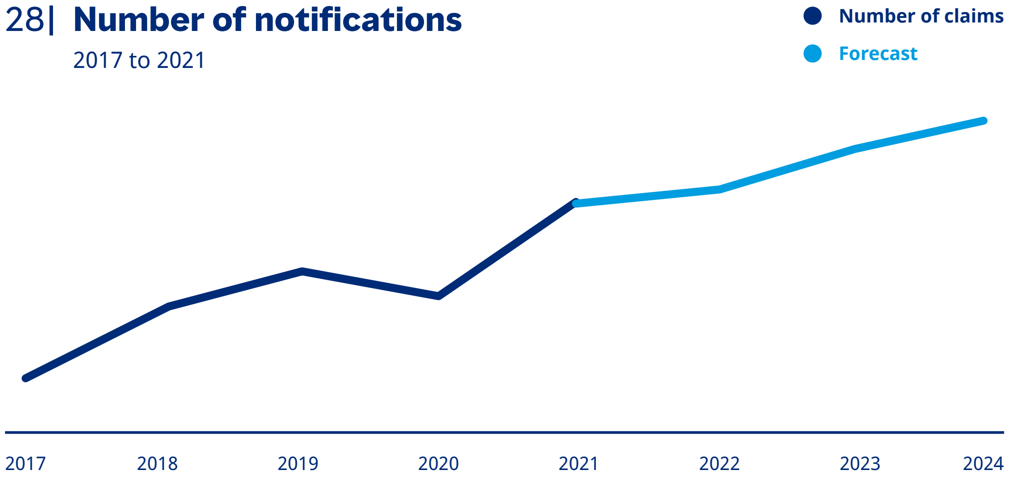
Asia Pacific

Our Asia Pacific clients are seasoned users of W&I insurance and recognize its merits as a deal facilitator that effectively transfers the risk associated with a breach of warranties to the insurance market. The responsiveness of this product in terms of indemnity granted and claims paid, as well as a tried and tested claims management process amongst insurers, has further entrenched W&I insurance as a feature of M&A in the region. Insureds are recognizing the benefits of early notification and a well formulated claims submission with sufficient supporting evidence to substantiate the quantum of loss in paving the way for a successful claims outcome.

In recent years, the number of W&I insurance policies placed in Asia Pacific has increased exponentially. We observed a rapidly growing claims count, with the volume of claims in 2021 more than three times the volume in 2017.

28| **Number of notifications**

2017 to 2021

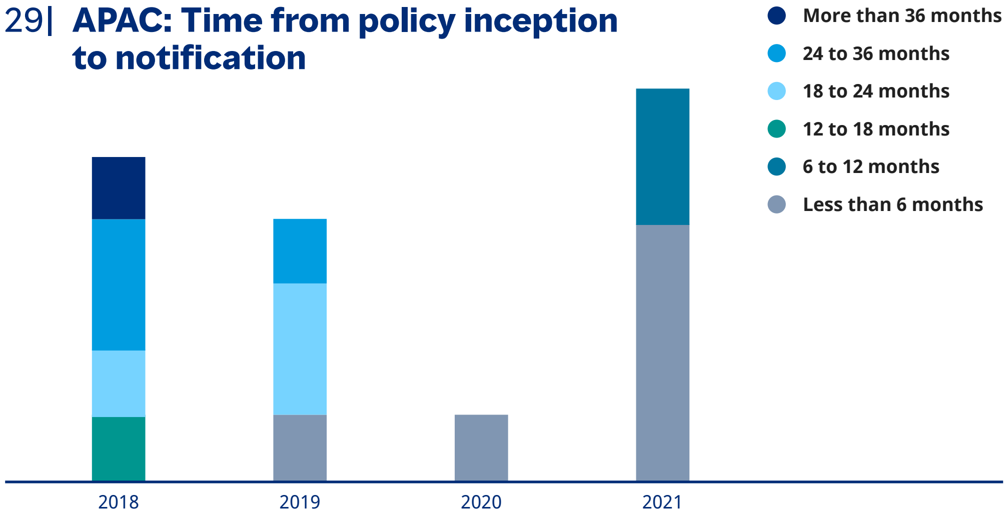


The overall increase in claims is largely due to insureds having a more sophisticated understanding of the product, insurers providing an effective and streamlined claims process, and quality advocacy on behalf of insureds. Claims payments in the first half of 2022 have been substantial.

With the number of claims notifications trending upwards and W&I insurance becoming an M&A market standard across the Asia Pacific region, we expect a sustained increase of W&I claims going forward.

Our data shows that insureds are notifying insurers earlier, as evidenced in 2021 where a majority of notifications were made within the first six months of policy inception. In advance of a claim materializing, insureds are also acting prudently in notifying insurers of facts that may give rise to a breach of warranty, which is required as an early measure to preserve their right to claim under the policy. Notifications in respect to matters that sit below applicable retentions are more routinely made on a precautionary basis.

29| APAC: Time from policy inception to notification



CLAIMS LIFECYCLE

Claims can have a significant lifecycle, which has resulted in a large number of open claims in the region. This is commonly due to lengthy forensic investigation processes, multiple submissions, and in particular, the time taken to prepare quantum evidence in support of the claim. To resolve claims efficiently, it is important to prepare a comprehensive submission, including materials that substantiate the quantum of loss. Formulating an early, well-laid out plan is critical and should be carried out with the insured’s broker and other advisers.

PAID CLAIMS

While a comparatively small percentage of claims have been paid in the region, this must be considered in light of the long-tail nature of the claims in a relatively young product line, and a number of open claims notifications remaining under ongoing assessment. We anticipate these may result in (potentially significant) claim payments in the next one to two years. The claims payment forecast is strong, with indemnity having been confirmed on some of these matters across Asia Pacific, and parties working towards reaching a landing on quantum before the claims are settled and payments made.

It is important to be mindful that the policy responds to unknown risks, noting a large number of denials were made on the basis that the factual circumstances surrounding the breach event were fairly disclosed to the insured prior to acquisition. This should be considered when contemplating the ultimate outcome of the claim.

APAC CASE STUDY: US$2 MILLION RECOVERED FOLLOWING EXTENSIVE FORENSIC INVESTIGATION BY MARSH CLAIMS SPECIALISTS

A company in Malaysia identified issues with claims receivables figures after integrating the accounts of a newly acquired company.

While the acquiring company had relied on disclosed amounts as current assets, further investigation showed that the acquired company's claims receivable balance included non-existent material amounts, which were therefore not recoverable.

The insurer's initial response to the acquiring company's claim was that it was unable to understand how these accounting errors could have led to a breach of the financial statements warranty.

Thorough investigation uncovers widespread misstatements

Marsh Claims Solutions' team of forensic specialists reviewed statements of accounts, invoices, and sample screenshots of the accounting systems to identify entries believed to be wrong and show what the accurate values should have been.

Following extensive investigative work, the team identified misstatements spread across thousands of individual transactions, numerous spreadsheets, and in both old and new accounting systems. Marsh's forensic accountants worked to determine how the acquired company was recording its data, identify the likely nature of errors and why they might have happened, and calculate the overall impact to the recorded numbers in the deal's financial statements.

The size of the claims book meant that looking at each transaction would take several years and delay resolution of the claim. Instead, the team reviewed samples of the different types of accounting errors that caused variances in the reported claims receivables. This approach was accepted by the insurer with the understanding that a granular investigation approach would have lasted years.

It was finally determined that the errors stemmed from procedural lapses and failure of internal controls. Marsh's claims advocates explained the basis of the client's claim during multiple sessions with the insurer, sharing the investigation, findings, and overall premise of the claim and answering the insurer's questions. This proved vital in clarifying coverage issues and areas of further investigation in a timely way with the insurer.

Successful claim resolution

The thorough investigation by Marsh's claim specialists quantified the loss at US$2 million and the insured was able to obtain full indemnification two-and-a-half years from the date of notification.

The client was satisfied with the result and the collaboration throughout the process, appreciating that Marsh's claim specialists were able to frame the situation, identify what had to be investigated, develop the best arguments, and expertly negotiate with the insurer, leading to a successful claim outcome.

Similar to our global counterparts, Asia Pacific insureds identified tax and financial statements as the leading categories of warranty breach. In fact, the breach of these warranties accounted for more than half of the notifications filed with insurers, with compliance-based breaches following closely behind.

FINANCIAL STATEMENTS

These warranty breaches are prevalent across all sectors and industries and commonly arise as a result of financial accounts misstatements, failure to comply with accounting rules, and overstatement of profits. The buyer usually uncovers the issues that give rise to a breach in the post-acquisition period when delving into the operations of the business and whether matters have been correctly accounted for in the pre-acquisition financials.

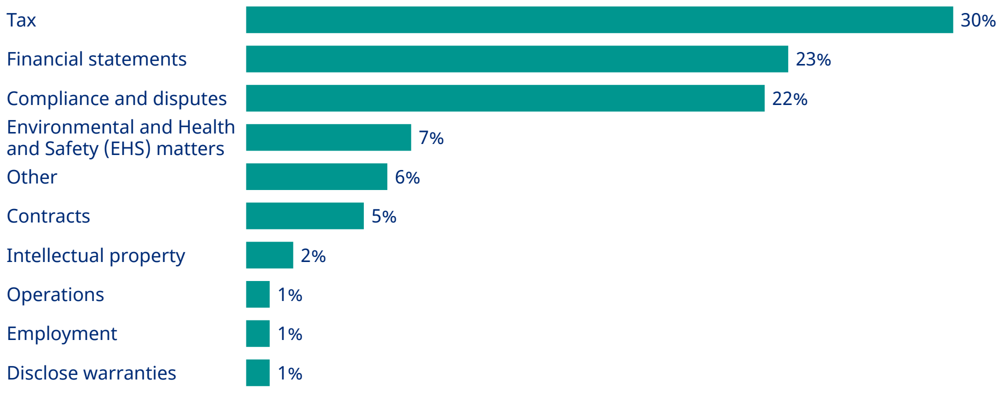
TAX

Tax issues continue to plague buyers in the post-acquisition period as filings are retrospectively reviewed by the tax authorities, often a few years after these have been lodged. Inquiries and audits are common in the post-filing stage and may sometimes lead to additional assessments a while after the initial examination is completed. This prompts prudent insureds to file earlier and precautionary notifications to reserve their rights under the policy in the event that an audit or formal additional assessment is launched. With the computation burden resting on taxpayers, and with a number of business-incentive schemes being made available (particularly as a result of the pandemic’s effect on the economy), there may be incorrect deductions or interpretations of these schemes as reported in corporate tax filings. These often include wrongful claims of non-deductible expenses, or simply inaccurately computing the total tax payable.

COMPLIANCE

As the next most common type of breach after tax and financial statements, compliance risks continue to affect some insureds — for instance, compliance breaches are the leading category of breach in Japan. In particular, achieving compliance with all applicable regulatory requirements in multi-jurisdictional businesses is challenging. These warranties are also quite broad and capture a wide area of risks that are not necessarily caught even during a robust due diligence process.

30| APAC notifications by breach type



FIVE BEST PRACTICES FOR CLAIMS

1. At the time of claim notification, have a call with your insurers to provide a verbal overview of the claim and allow them to ask any preliminary questions. Opening lines of communication early leads to a better and more collaborative claim process and exchange of information.

2. Be prepared to provide all documentation necessary to substantiate the loss calculations and to explain the calculations to the insurers and their advisors.

3. Provide copies of invoices from outside advisors to the insurers on a regular basis. This helps keep all parties aligned on the erosion of the retention and facilitates identification of any invoicing issues sooner rather than later.

4. For third-party claims, or settlements with the seller, keep insurers apprised of all settlement discussions and obtain any necessary consent prior to settling the underlying matter.

5. Report claims of any size, even if there is a question over policy coverage. Even if the loss is initially expected to stay within the retention, the loss can erode the retention for any future claims, and a small claim might ultimately turn into a larger claim after further investigation. We always recommend a precautionary approach to notification.

“

Early communication and information sharing is critical to a smooth claims process”

ANNA ROZIN, NORTH AMERICA M&A MANAGER AT AIG

“

Openness, responsiveness, and communication with the insurer is the key. An open line of communication with information and data flow between insureds and insurers and their advisors is critical for an efficient claims process. The faster the insured can download and impart as much information and documentation as possible to the insurer, the easier it is for the insurer to assess the claim.”

MEG CARDELL, SENIOR DIRECTOR AT ALVAREZ & MARSAL

“

Insureds should understand from the outset that the insurer is at an information disadvantage and be willing to provide the information needed to substantiate the claim as cooperatively and expeditiously as possible.”

JOE FINNERTY AND BRIAN ROBINSON, PARTNERS AT DLA PIPER US LLP

Conclusion

The events of the last couple of years have no doubt had an impact on R&W (W&I) claims at a global level. It remains to be seen how the consequences of the COVID-19 pandemic will fully play out, and we continue to anticipate further significant political and economic global changes over the coming years. As inflation increases and recession looms in many regions, we are yet to see how this will impact M&A activity and consequently the transactional risk claims market. However, over time, R&W policies have proven to be not only an indispensable tool for deal facilitation, but also a valuable risk transfer mechanism. While we have experienced the short-term impact of COVID-19 in terms of fluctuations in claim notifications, we have also seen continuing major improvements in time to resolution, claims handling from our experienced insurers, and claims payment levels.

Equally, while many predicted that 2021 would be an unusual year in terms of M&A activity and placement levels, to date in 2022 we have continued to see regular use of R&W policies in transactions. Recent placement levels, along with increased capacity, higher limits and lower retentions, lead us to expect a boom in the claims market over the coming years.

The manner in which claims are dealt with is changing and we are adapting to those new higher volumes. There is scope for continued improvement and specialism in the R&W claims market, as well as greater streamlining of the claims process. The value of R&W insurance is evident — now is the moment for all involved in the R&W insurance market to innovate on claims and be in a better position to achieve optimal results for purchasers of R&W insurance when claims do arise.

ABOUT MARSH CLAIMS SOLUTIONS

Globally, our team includes over 800 expert claims professionals — including loss adjusters, advocates, lawyers, and forensic accountants — across more than 40 countries. We support private equity and corporate clients to pursue claims under transactional risk policies, including representations and warranties/warranty and indemnity, tax policies, contingent risk, and specific risk. Marsh has successfully optimized our full cradle-to-grave claims service, including advocacy and forensic advisory services, to achieve positive claims outcomes for our clients.

When claims do arise, they can be large, complex, and time-consuming to resolve. The interplay between the insurance policy and the underlying transaction documents, extensive deal documentation, and valuation of the claim can add to the complexity.

Against this backdrop, organizations can benefit from expert claims support. Our private equity and mergers and acquisitions claims colleagues understands your industry, and we offer comprehensive claims management negotiation and resolution services to help clients navigate complex insurance claims.

Our specialists lessen the burden of clients when managing a claim by supporting claim quantification and preparation, as well as advocating on our clients behalf with insurers and negotiating the final settlement.

ABOUT MARSH

Marsh is the world's leading insurance broker and risk advisor. With around 45,000 colleagues operating in 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. With annual revenue nearly $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit marsh.com, follow us on LinkedIn and Twitter or subscribe to BRINK.

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