Marsh

Transactional risk insurance 2022: year in review

Transactional risk insurance remains a critical tool for dealmakers amid a changing M&A landscape

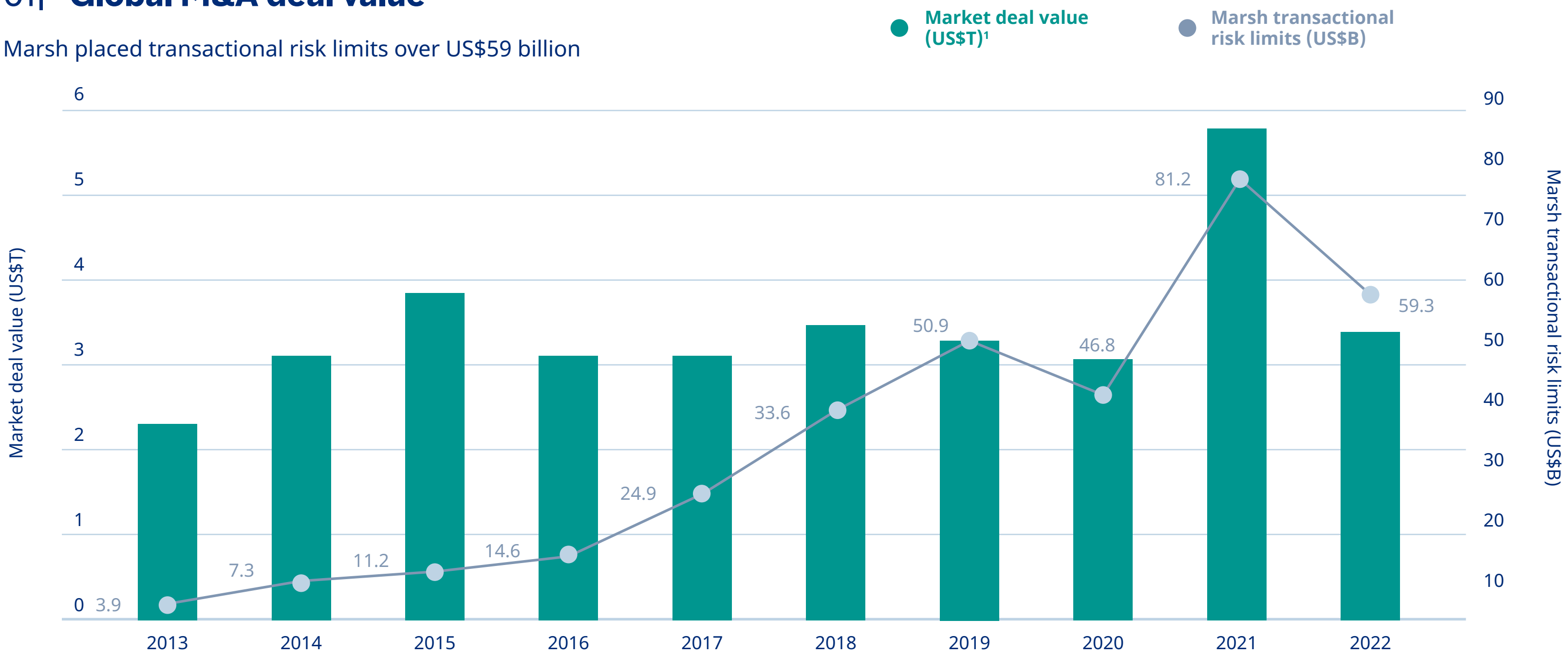
February 2023

M&A snapshot

Transactional risk insurance continued its rise in popularity in 2022, going from a once esoteric product to a mainstream feature on mergers and acquisitions (M&A) across the globe. Following the heights of 2021, the M&A landscape downshifted in the face of macroeconomic and geopolitical headwinds (see Figure 1). Despite a challenging environment, demand for transactional insurance remained resilient in 2022. Insureds continued to seek deal protection in the form of representations and warranties (R&W) insurance — as it is referred to in the US and Canada and warranty and indemnity (W&I) insurance elsewhere in the world — on transactions across all key industry sectors, increasingly supplemented by the use of tax and contingent liability insurance.

01| Global M&A deal value

Marsh placed transactional risk limits over US$59 billion



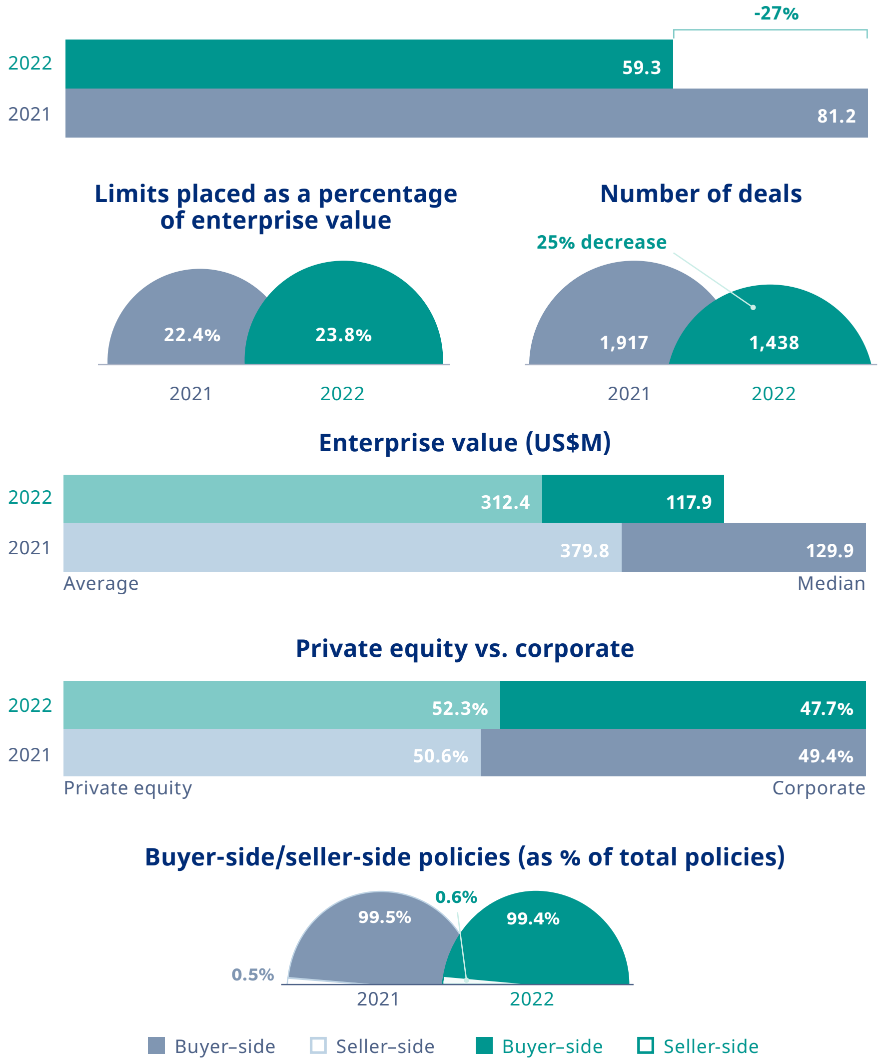
[1]Data sourced from IMAA as of announced date for global M&A market
*All values in US$ unless otherwise noted

Global trends

Marsh's *Transactional risk insurance 2022: year in review* provides an overview of the transactional risk insurance market during the year, across all geographic regions, and explores developments that are expected in 2023 and beyond. Key findings of the report include:

- Marsh experienced its second busiest year on record, globally placing transactional risk insurance limits of US$59.3 billion on over 2,200 policies across 1,438 unique transactions — representing over $420 billion in aggregate enterprise value (see Figure 2). While lower than the levels of 2021, this is significantly higher than the US$46.8 billion in limits placed by Marsh in 2020.
- Pricing on primary layer R&W insurance decreased dramatically in North America, falling more than 200 basis points from a record high at the start of 2022. Despite this drop, North America pricing remains higher than other regions. In EMEA (Europe, Middle East, and Africa) and Asia, primary layer W&I pricing actually increased slightly from the prior year, while pricing in the Pacific region declined from the year before.
- Underwriting capacity remained plentiful across the globe, with more than US$1 billion of limits available for a single transaction in North America and Europe; new market entrants have also expanded available capacity in Asia and the Pacific regions.
- Transactional risk insurance claims increased in all regions across the globe as compared with prior years.
- Marsh clients significantly increased their utilization of tax insurance, mostly due to better understanding of the product as well as increased sophistication and broadened appetite among tax insurance underwriters, particularly for non-M&A (i.e., balance sheet management) risks.

02| Transactional risk insurance limits placed by Marsh decreased 27% year over year (US$B)

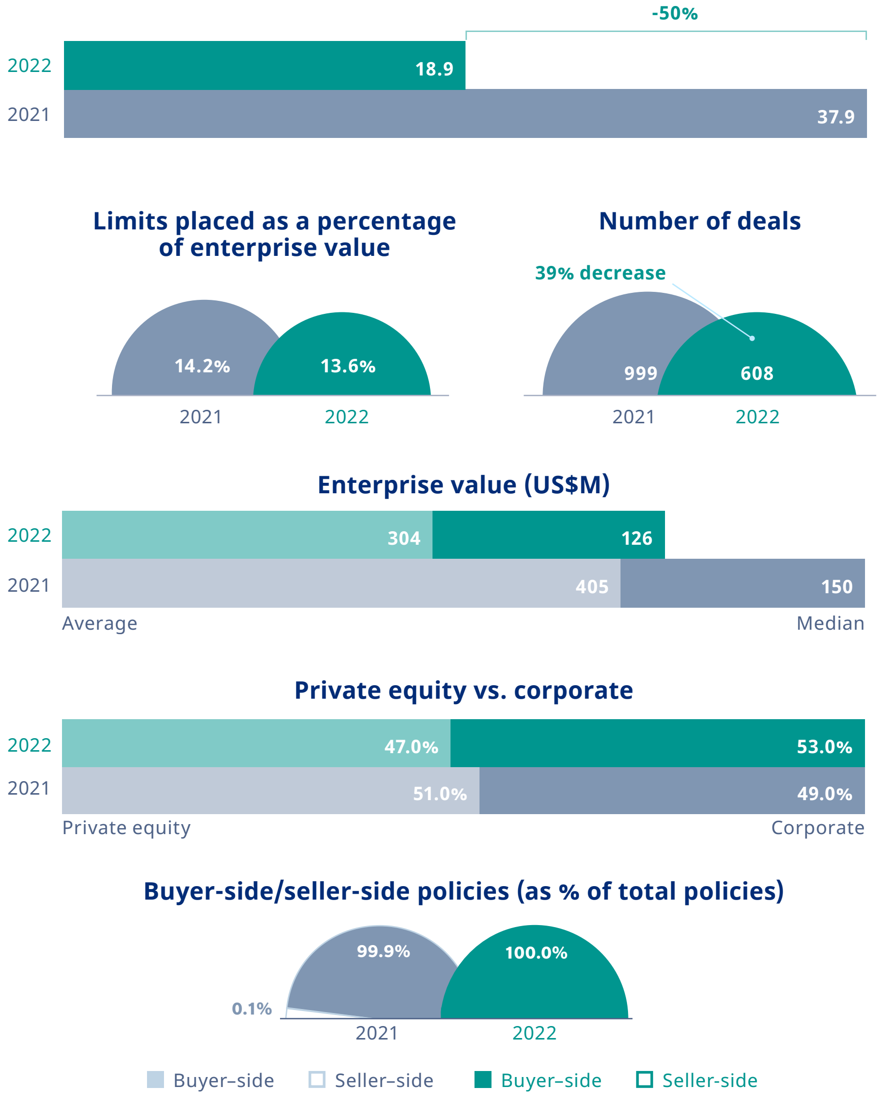


North America

Demand for transactional risk insurance remained strong in 2022, despite multiple challenges, including soaring inflation, supply chain constraints, rapid interest rate increases, volatile equity markets, and the conflict between Russia and Ukraine. These factors all contributed to a 38% decrease in aggregate deal volume in the region compared to the previous year. Notwithstanding the adverse deal environment, Marsh's North America team placed 1,007 transactional risk policies — primary and excess — on 608 unique transactions. This represented an increase of 4% over 2020, although a decrease of 39% from 2021. These policies represented US$19 billion in limits — similar to the aggregate limits placed by the team in 2019 and 2020 (see Figure 3).

Deal activity remained relatively consistent throughout the year, with the team placing roughly 250 policies each quarter. US M&A activity dropped in the final quarter of 2022 compared with both 2020 and 2021. The correlation between Marsh's results and M&A activity in the region demonstrates the enduring role of transactional risk insurance in the deal-making environment in North America.

03| North American limits placed (US$B)



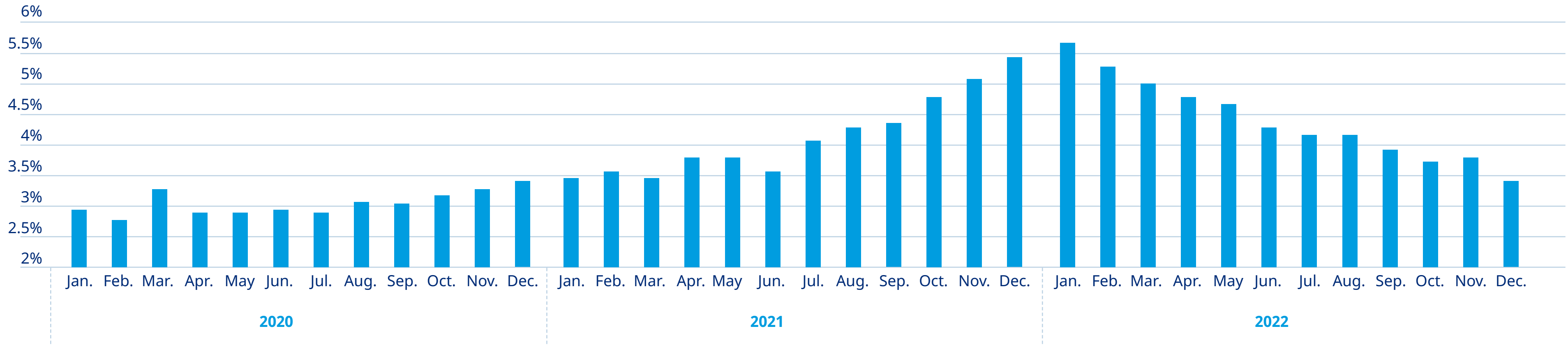
NOTABLE 2022 TRENDS

R&W insurance pricing normalizes after 2021 surge

Following a surge in pricing in 2021 — which peaked in January 2022 — rates for R&W insurance in North America decreased steadily throughout the year as price competition returned to the marketplace with more robustly staffed capacity providers forced to contend with diminished deal flow. Marsh's portfolio experienced its highest primary layer R&W insurance rates (expressed as a %, calculated by dividing the premium by the policy limit of liability) in a generation, reaching 5.7% for deals bound in January. As the deal-making environment softened, so did R&W insurance rates, with each quarter in 2022 featuring lower pricing than the immediately preceding quarter. Pricing settled more than 200 basis points lower for transactions bound in December — at 3.5% — than what was experienced at the start of year (see Figure 4).

The insured-friendly rate environment is expected to continue in the short-to-medium term. Many of 2022's macroeconomic headwinds are also evident this year and there is ample underwriting capacity in North America that has been bolstered by new transactional risk market entrants joining an already crowded underwriter landscape. That said, as R&W insurance claims activity continues to grow in both frequency and severity, some insurers may struggle to maintain profitability in this sector if rates slip and remain below 3%. This could lead to a contraction of available capacity or narrowing of coverage terms and conditions in the medium term.

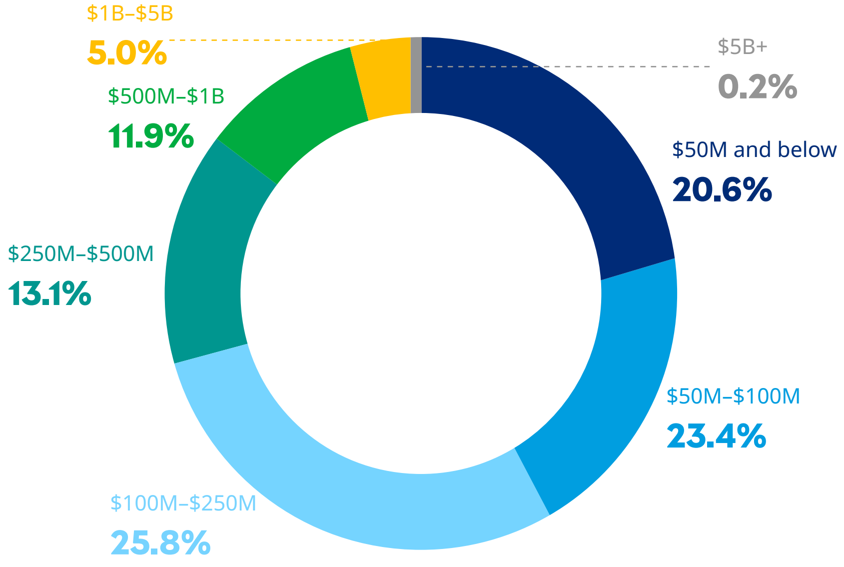
04| **North America primary layer R&W insurance pricing, 2020–2022**



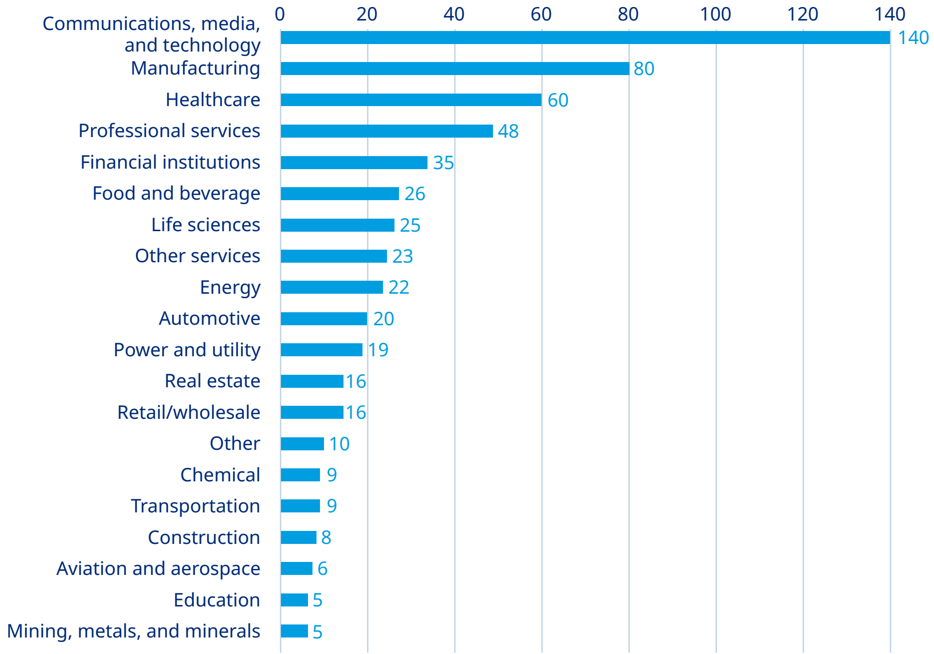
Consistent utilization of insurance across all transaction sizes and sectors

For Marsh’s North American portfolio, median transaction size retreated to US$126 million last year, down from US$150 million in 2021. This was more in line with 2020’s median deal size of US$130 million. Similarly, average transaction size decreased to US$304 million, down from US$405 million in 2021. The decrease in median and average transaction size in the transactional risk market mirrored the North American M&A universe more broadly. Financing challenges led to a pronounced decrease in the number of deals in excess of US$1 billion in enterprise value completed in the region, compared to the prior year. Marsh saw consistent utilization of transactional risk insurance and even distribution of policies across all transaction sizes, with no size tranche representing more than 26% of the overall portfolio (see Figure 5).

05| 2022 North America deal portfolio by enterprise value tranche



06| North America transactional risk — deal activity by industry (number of deals)



The trend of corporate and strategic buyers increasing their utilization of transactional risk insurance continued in 2022, and this trend is expected to continue in 2023. In 2022, for the first time in Marsh’s experience, corporate and strategic buyers represented a majority of insureds in programs placed by Marsh, purchasing approximately 52% of all policies. Private equity firms continued to be active users of the products, purchasing the remaining 48%.

Transactional risk insurance continues to be used by deal participants across all industries. According to Refinitiv, an LSEG business in the US, deal-making in the technology industry accounted for close to 30% of overall deal value in the region. It followed that communications, media, and technology (CMT) companies were involved in more transactional risk placements than companies in any other industry, accounting for more than a quarter of all deals placed by Marsh in the US and Canada (see Figure 6). While CMT deals led the way, the distribution of placements across other sectors remained remarkably consistent, when compared to the prior year, with the top five industry sectors occupying the exact same spots in both 2022 and 2021.

Insured purchasing patterns remain constant

Across Marsh's portfolio, median policy limits (as a percentage of enterprise value) remained steady — at 10% — in 2022, compared with previous years. The average limits purchased over the course of the year (as a percentage of enterprise value) were roughly 14%, also consistent with 2021.

In 2021 we observed sharp divergences in the relative amount of limits purchased, depending on transaction size. This trend persisted in 2022 (see Figure 7). For smaller deals — below US$50 million — the average limits purchased were around 21% of enterprise value. For midsize deals — US$100 million to US$250 million — average limits purchased were just over 11% of enterprise value. For large deals — US$2 billion or more — the average limits purchased equaled 6.5% of enterprise value.

Historically, corporate and strategic insureds have purchased more limits than private equity insureds on comparable deals. This trend continued in 2022 and is expected to persist in 2023.

Transactional risk insurance capacity remains plentiful

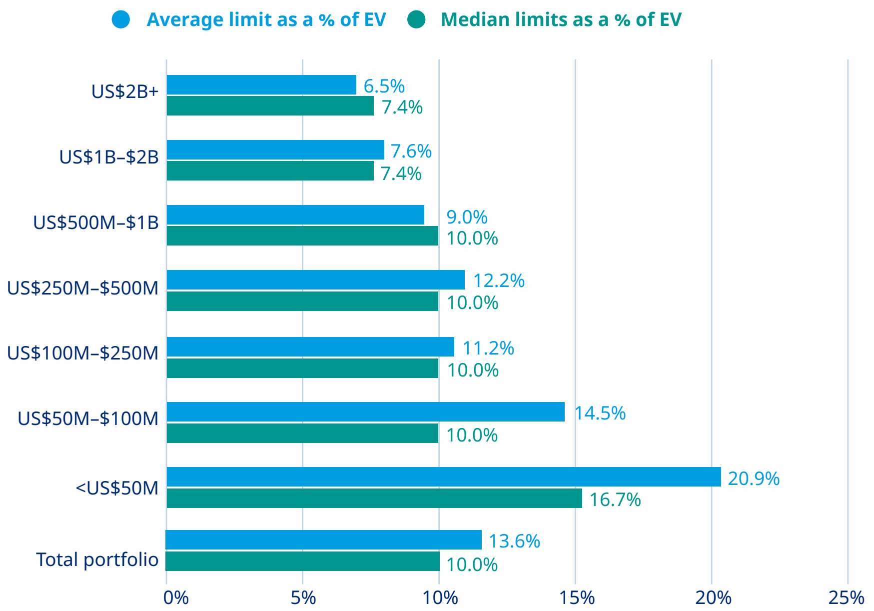
Despite a drop in M&A activity in the region, client demand for transactional risk insurance on the deals that were completed remained robust and insurers had no trouble meeting that demand. Similar to 2021, this year past saw a number of new underwriting teams — including Archer Transactional, Fusion, and Themis — break into the North American marketplace with no corresponding exits. One or two entrants are expected to join the marketplace in 2023, further expanding available capacity and underwriting appetite.

Total insurer capacity in North America continues to exceed US$1 billion in limits for any single transaction and more than 25 underwriters are presently offering terms on a primary basis.

No seller indemnity structures continue to advance

In 2022, Marsh continued to see a significant increase in the number of transactions structured without any seller indemnity, meaning that the seller does not have any contractual liability to the buyer for breaches of representations and warranties, other than for fraud. This structure — also known as a "public-style" deal — historically represented a small fraction of the overall private company transaction universe and was typically reserved for very large transactions, generally US$1 billion or more of enterprise value. However, it has become far more prevalent in recent years on smaller transactions — some even valued at less than US$50 million. In 2022, approximately 58% of the deals in Marsh's North American transactional risk portfolio featured no seller indemnity structures, up from under 25% in 2015. This trend may plateau, or possibly reverse slightly in 2023, as the deal-making environment proves more favorable to buyers than sellers.

07| North America limits purchased as % of enterprise value



Deductibles remain stable

Deductibles held steady at approximately 1% of enterprise value for most transactions in the middle market, with a dropdown feature to 0.5% of enterprise value at the 12-month anniversary of closing. Some insurers have begun offering slightly lower initial retentions (for example, 0.9% of enterprise value) on these deals. For larger transactions — those with enterprise values of US$300 million or more — it is common for the deductible to be 0.75% of enterprise value, or possibly even lower on transactions with an enterprise value in excess of US$2 billion.

Tax insurance

Total tax insurance policies bound by Marsh's North America team in 2022 were up slightly from 2021, fueled by growth in renewable energy placements and on balance sheet risk policies.

Use of tax insurance in the renewable energy sector was robust throughout the year. Coverage for investment tax credit projects — predominantly solar energy investments — remained in high demand during the year, while use of tax insurance in connection with M&A deals was flat in 2022. The Inflation Reduction Act of 2022 created or enhanced a number of renewable energy credits, and should lead to a significant increase in demand for tax insurance for renewable energy-related projects. The third principal area of tax insurance policies — those placed to allow corporates and pass-through businesses to manage balance sheet tax risks — also grew compared to the previous year. Asset managers and family offices continued to remain a growth area for tax insurance.

In 2022, new, tax-dedicated underwriters continued to enter the market, and numerous additional transactional risk players participated on large tax insurance towers, resulting in a downward-to-flat impact on premium rates and increased flexibility on policy terms. Overall, premium rates for tax insurance policies were relatively flat, compared to 2021, with primary rates settling at or below 3% by the end of 2022.

Claims

In 2022, Marsh clients in North America reported 178 R&W claims arising from 115 transactions. While these numbers represent an increase from 2021 figures, they are still below the peak of 2020, where we saw 255 claims on 131 transactions. Nevertheless, the number of reported claims increased each quarter in 2022. Due to the significant volume of placements over the last few years, and the typical delay between a transaction closing and a claim being reported, the number of claims are expected to continue rising throughout 2023.

Although the types of claims in 2022 followed historical patterns, the timing of claims was less predictable. The most common types of claimed breaches in 2022 related to compliance with laws (20%), financial statements (16%), and taxes (16%), which are all perennially among the most frequently reported breaches. However, insureds generally took longer to report claims in 2022 than in past years. Insureds typically report the majority of claims within 12 months of a deal closing, but in 2022, the percentage of claims reported within that period dropped to 46%, and the percentage of claims reported after 24 months increased to nearly 22%. Marsh will continue to monitor this trend.

Over the course of 2022, R&W insurers paid more than US$180 million on claims reported by Marsh clients (representing over US$245 million in recognized losses). Nearly 85% of the payments arose from claims relating to financial statements, material contracts, and compliance with law breaches.

OUTLOOK FOR 2023

Persisting macroeconomic and geopolitical headwinds will likely hinder a material rebound in M&A activity levels in North America during the first part of 2023. Dealmakers, however, anticipate an improving M&A market in the second half of the year, driven by expectations for the return of a more favorable financing market, coupled with private equity firms in the region sitting on more "dry powder" than ever before. Transactional risk insurance is anticipated to remain a key component of deals in North America, with insurers expanding their underwriting appetite to meet client demand. In the short term, the robust number of insurers pursuing a limited number of transactions will likely contribute to a relatively soft rate environment with the potential for some hardening in the second half of the year, assuming that M&A activity accelerates as currently anticipated.

Latin America and the Caribbean

Insurer appetite for Latin American deals increased in 2022. Despite the limited market in the region for transactional risk insurance, our team placed policies for assets located in Mexico, Chile, and Uruguay last year. There was a substantial increase in interest from clients in Brazil, Peru, Colombia, Argentina, Guatemala, Puerto Rico, and Panama.

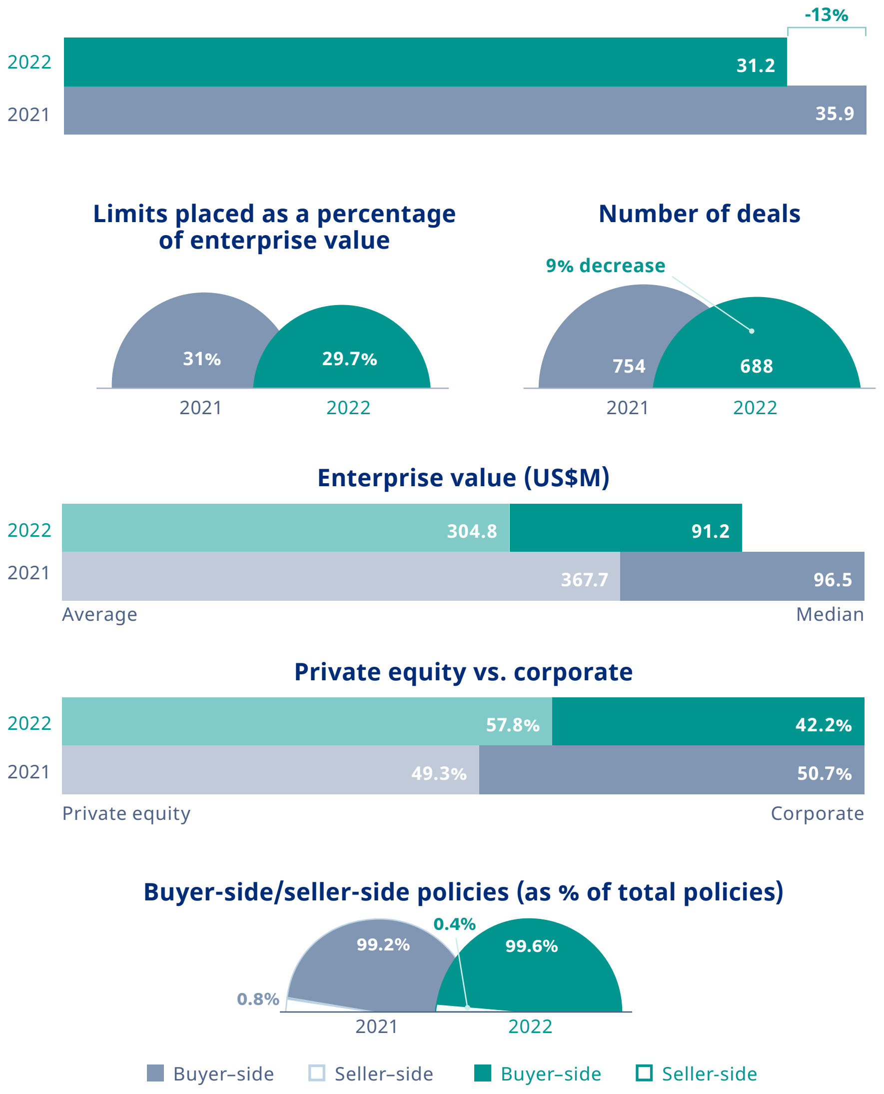
The region saw an increase in underwriting capacity and coverage expansion. More than 11 insurers have expressed interest — via their hubs in New York, London, and Spain — in underwriting Latin American transactional risk and are either already active in the region or seeking capacity to expand their coverage into these territories. Marsh has invested in regional resources to educate clients in Latin America and their legal advisors on the benefits of using transactional risk insurance.

Europe, Middle East, and Africa

The transactional risk market in Europe, the Middle East, and Africa (EMEA) experienced a distinct shift in 2022. The first half of the year was characterized by very competitive, seller-driven auction processes, often for transactions of larger sizes. The heightened demand for transactional risk insurance solutions during this period led insurers to be more selective on the transactions they wished to compete for and the terms on which they would engage with prospective insureds.

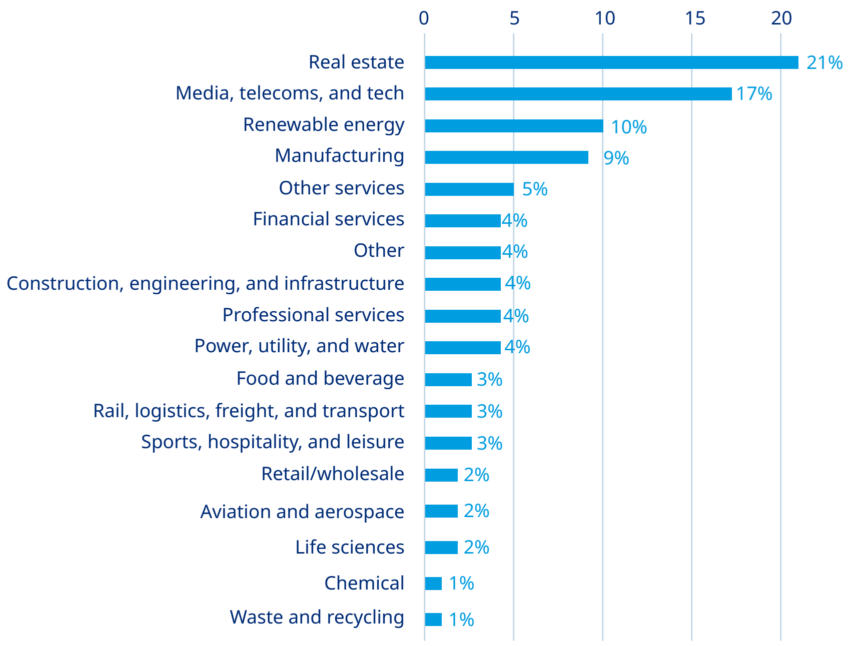
There was a significant shift in activity in the second half of 2022, driven by the numerous geopolitical and macroeconomic events taking place in Europe and globally. In certain countries and regions across EMEA, including in particular in the UK, Italy, and Central and Eastern Europe, the overall transaction volumes seen by Marsh remained broadly consistent in 2022, compared to the previous year. In many other parts of EMEA — including the Nordic countries, Benelux region, and Germany — there was a material reduction in transaction volumes when compared to 2020 and 2021. Across all EMEA, transaction timetables were significantly extended in the second half of 2022 and, generally, there was a shift in bargaining power from the sell-side to the buy-side. This was most markedly observed in lower valuations and a decreased intensity in deal tempo and timelines. This slowdown of deal timetables led to a smaller pool of placements proceeding to a formal underwriting process, although, as a result of the busier first half of the year, the total number of policies placed in EMEA was flat compared to 2021.

08| EMEA limits placed (US$B)

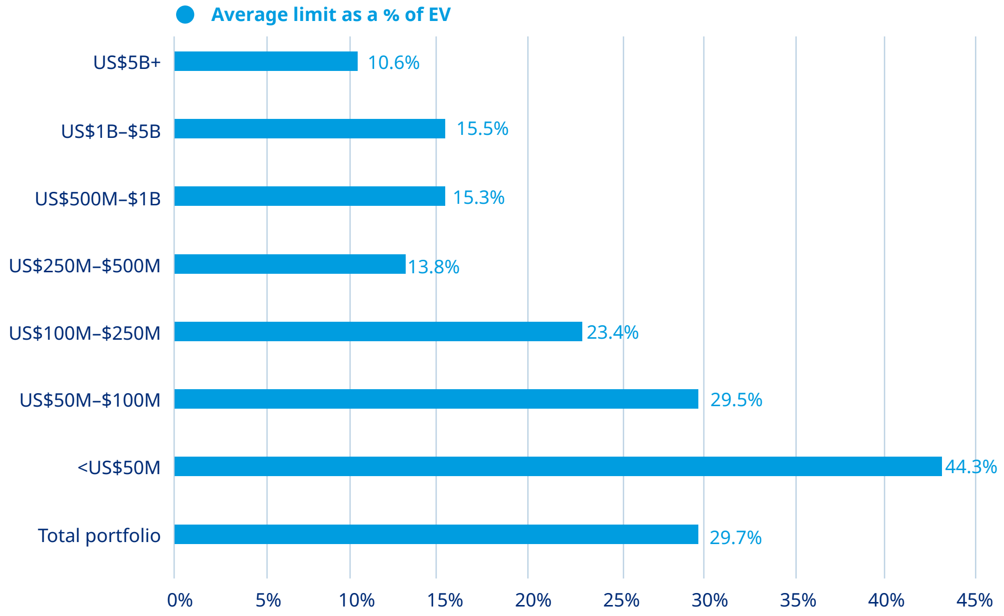


As a result, the behavior of insurers significantly changed in the second half of 2022. Some insurers — particularly those that had been successful in securing engagements in the first half of the year — sought to maintain their discipline on pricing, coverage, and process requirements established in the first half. A second group of insurers who had secured mandates to insure less transactions than they had targeted, sought to compete aggressively on price, leading to a softening of the pricing environment. This was a key driver of the decline in premium rates between the first and fourth quarters, with a significantly softer pricing environment at the end of the year. For the same reasons, several insurers have become more competitive on coverage, with a widening sector appetite, in order to secure appointments.

09| EMEA transactional risk — deal activity by industry (%)



10| EMEA limits purchased as % of enterprise value

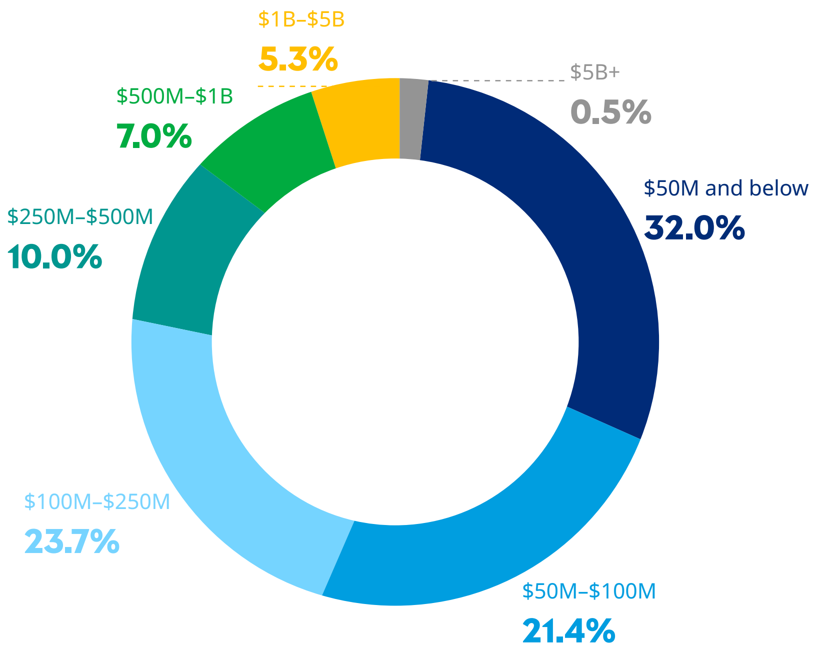


NOTABLE 2022 TRENDS

Pricing

The average premium rate increased from 1.2% in 2021 to 1.3% last year. However, the 2022 average is a blend of a higher rating environment in the first half of the year, resulting from heightened demand for the product, and a lower pricing environment in the second half of the year, as deal volumes slowed. In general, premiums remain relatively low, following multiple years of decreasing rates as insurers have competed for market share. There have been signs of underwriters looking to achieve longer term stabilizing of price slightly above the historic lows established in 2020. However, this is expected to vary according to the transaction profile and dynamic.

11| 2022 EMEA deal portfolio by enterprise value tranche



In some emerging market jurisdictions — including the Middle East, Africa, and Israel (see additional information on page 13) — the pricing environment has become increasingly more competitive, as insurers turned their attention to the less competitive areas of the market and sought to compete more aggressively in these regions. This same dynamic has also been seen in the tax and specific risk insurance market for the same reasons.

Processes

Following several years of accommodating compressed underwriting timetables and offering large numbers of non-conflicted “trees” with “clean teams” for multi-bidder processes, insurers became increasingly strict regarding their process requirements in 2022, notably with the time required to underwrite a transaction. This trend was particularly apparent in the first half of the year, driven by the increasing cost of claims and a recognition that the accelerated underwriting approaches seen during the frenetic activity in the second half of 2021 were unsustainable in the long term, both from a risk identification and underwriting bandwidth perspective. In the latter half of the year, insurers were more flexible and accommodating due to increased underwriting resources.

Large transactions and program placements

In previous years, insureds have generally preferred large, standalone limits of insurance from a single insurer. However, Marsh has generally advocated for a greater level of syndication of risk across multiple insurers to diversify exposure, which typically leads to a better process and outcome in the event of a claim. This approach has been adopted by the majority of insureds and has been well received by most insurers. Some insurers continue to prefer underwriting large, US$100 million-plus insurance limits, although these are typically syndicated across multiple capital providers behind the scenes. The trend for a greater number of program placements was also driven by increasingly larger transactions being insured in the first half of 2022.

Secondaries and public-to-privates

Insurers’ appetite for non-conventional W&I insurance placements continued to grow in the region last year, particularly in the case of secondary and public-to-private (P2P) transactions. There was increased activity in the general partner-led secondaries transaction space along with a number of P2P transactions also being insured across the EMEA region. While there was continued insurer appetite for covering these types of transactions, these deals accounted for a small proportion of the wider transactional risk insurance market, given the relatively limited number of transactions of this type that have a dynamic that is supportive of insurance. The number of insured transactions are expected to increase in this space.

Middle East, Africa, and Eastern Europe

Since the first policies were placed in the Middle East around eight years ago, W&I insurance has become a commonly used deal facilitation tool across the region with most activity relating to transactions in Israel, Dubai, and Saudi Arabia. Marsh has seen multiple new market entrants support transactions in the region, as insurers became increasingly familiar with the area and shifted away from the greater levels of competition in Europe. As it stands, there are roughly 10 insurers who will actively seek to quote cover for transactions in these jurisdictions. The same trend is apparent in several East European countries, including Romania, Bulgaria, Croatia, Slovenia, and the Baltics.

While insurer appetite for deals in Africa has not yet reached the same level of maturity as in the Middle East, both demand for the product and insurer appetite grew considerably in 2022. In particular, insurers targeted transactions in the infrastructure, telecommunications, renewable energy, and financial payment processing sectors. In 2022, Marsh insured transactions in the following jurisdictions: South Africa, Egypt, Kenya, Mauritius, Nigeria, Uganda, Rwanda, Ethiopia, Senegal, Jordan, Tanzania, Zambia, and Morocco, which demonstrates insurers' increasing familiarity and comfort in the region.

Tax insurance

The insurance of tax risks increased significantly in 2022, with limits in excess of US$2.4 billion placed in EMEA during the year. The uptick was driven by an increase in the number and size of tax risks insured in 2022 and is reflective of the growing sophistication and broadening appetite of tax insurance providers. In particular, there has been a substantial growth in the use of the product in non-M&A scenarios.

Insurers' appetite continues to expand, both in terms of the type of tax risks they will insure, and the geographical regions they are willing to cover. This has been most evident in southern Europe, where insurers are actively targeting the region, against a historical backdrop of limited appetite in these countries.

The specific risk insurance market is expected to follow these trends in the next few years, as insurers continue to invest in this product line.

Claims

There was a rise in claims notifications last year — the number of notifications increased 18% year on year — principally due to a substantial increase in the number of policies placed in 2021 (74% increase over 2020) and insureds' focus on returning to "normal" following distractions during the height of the COVID-19 pandemic.

Regarding breach types, the largest percentage (34%) of claims notifications related to tax issues, and in most cases, more than one claim was notified against the same policy. Compliance and disputes (which made up 24% of claims notifications) and financial statements (18%) remained common breach types, with breaches of contracts warranties being reported more frequently (16%).

As reported in Marsh's *Transactional risk global claims report 2022*, more established claims assessment processes have led to both an increase in claims payments as well as a quicker conclusion of claims processes. Insureds and their brokers are carefully considering carriers' claims process and performance when selecting an insurer to support a transaction.

OUTLOOK FOR 2023

Demand for transactional risk insurance is expected to remain robust in 2023 in the EMEA region. However, we expect transaction timetables to be extended as the market re-normalizes from a seller-driven, competitive environment. We expect new insurer market entrants this year. This should contribute to continuing competition between carriers, creating downward pressure on pricing and a willingness from insurers to provider broad coverage, while they maintain a greater focus on underwriting timetables.

Given the increase in deployed insurance capacity, combined with a less time-constrained underwriting environment, insurers are expected to focus more on product innovation and development in terms of:

- Broadening the categories of transactions to which transactional risk insurance products can apply (such as publicly-listed transactions and contingent liabilities).
- Breadth of cover, commerciality of underwriting, and claims performance in an effort to differentiate themselves in a competitive marketplace.

At the same time, a greater focus and consideration is expected from insureds when selecting their insurer, with a particular emphasis on their claims record. This will drive greater volumes of placements to insurers that regularly demonstrate positive underwriting and claims performance.

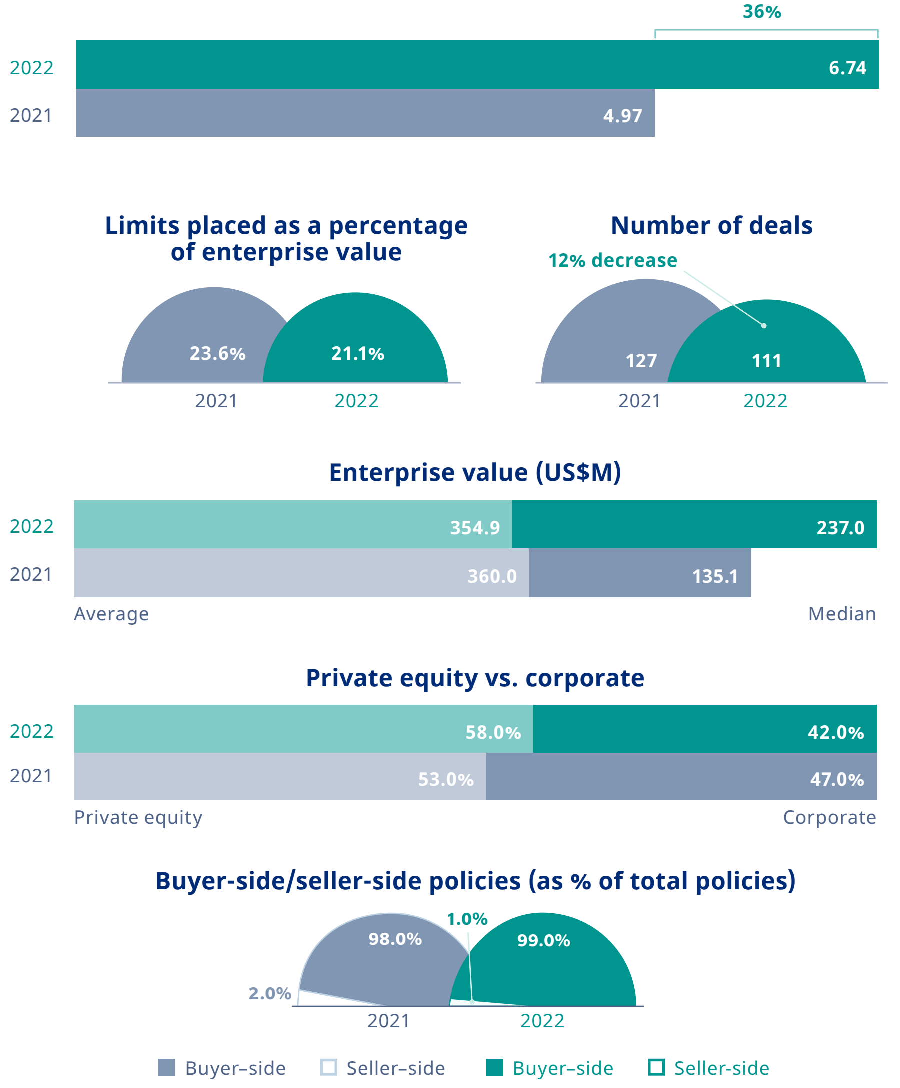
A number of new entrants into the market are expected to focus on insuring the transactions of small- and medium-sized enterprises (with enterprise values below US$50 million). This is expected to drive growth in a market segment that has been historically underserved.

Asia

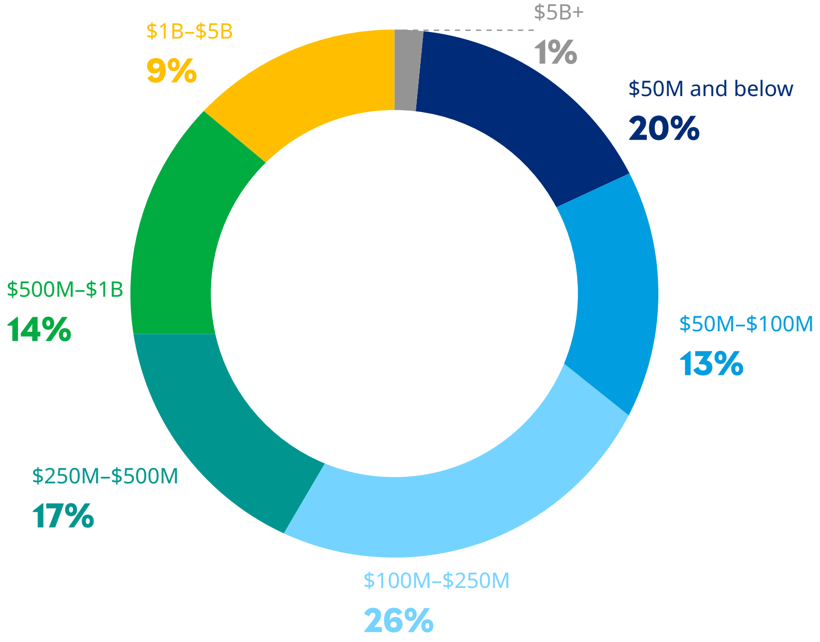
Global macroeconomic and geopolitical pressures weighed heavily on overall M&A activity in Asia in 2022. The effect was most pronounced in North Asia, mainly due to foreign exchange volatility for dealmakers in Japan and South Korea, Greater China's pandemic controls, and rising interest rates across the region. In spite of the challenging circumstances, transactional risk insurance placements in 2022 remained resilient, helped by the continued stability of Southeast Asia's M&A market and the strength of the market in India. Overall, closed deal counts decreased only slightly — by 12% — compared to 2021's record-breaking levels, total limits placed grew by 35.6% over the previous year, and the combined number of primary and excess policies placed by Marsh Asia increased from 197 in 2021 to 205 in 2022.

The average premium rate for Asia increased slightly from 2.25% in 2021 to 2.32% in 2022. As with Marsh's experience in EMEA, this average was a blend of an elevated pricing environment during the earlier part of the year that shifted downwards in the second half. This change was mainly due to reduced deal activity easing constraints on underwriting bandwidth and increased competition between insurers for engagements throughout the region.

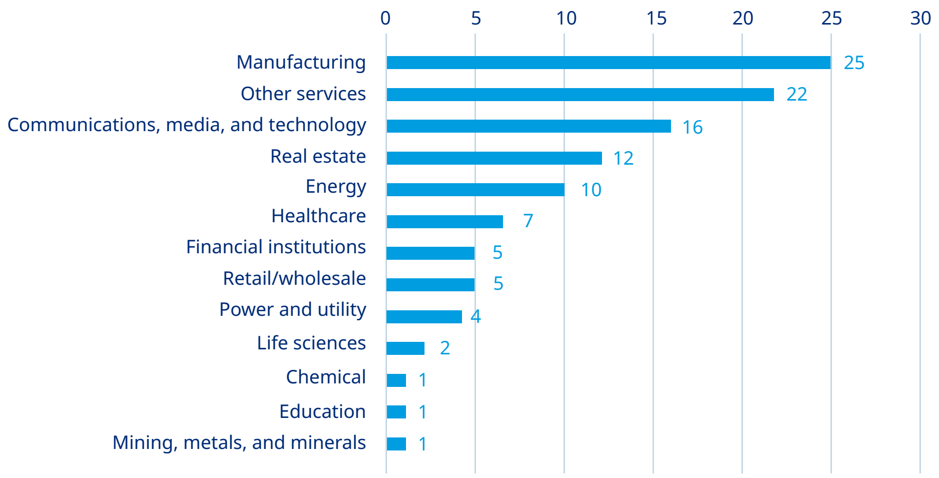
12| Asia limits placed (US$B)



13| 2022 Asia deal portfolio by enterprise value tranche



14| Asia transactional risk — deal activity by industry (number of deals)



NOTABLE 2022 TRENDS

Expanding market capacity for Asia W&I risks

Asia has traditionally been relatively underserved, in terms of dedicated W&I insurance capacity; we started 2022 with only six insurers having underwriters based in the region and core appetites for Asia transactions. Over the course of 2022, insurers (such as Mosaic Insurance, RiskPoint, and Volante Transaction Services) made new investments in the region, with a view to joining the incumbents on the ground. At the same time, there was an increase in global appetite (primary and excess) for transactions in Asia. We expect a significant expansion in available market capacity in 2023, with limits in excess of US$550 million to be generally available for a single transaction, thus reducing the need to turn to non-core insurers in EMEA, whose appetites have tended to be more selective.

Rising interest in fundamental warranties coverage

In 2022, there was increased interest in policies providing coverage for fundamental warranties only (such as title and capacity). When used on a standalone primary basis, these policies can be pivotal deal-enablers by providing buyers with increased protection over key risks, such as sellers' ownership of the target and their ability to enter into the transaction.

Continued growth in India

Demand for W&I insurance in India continued to grow in 2022, with an increase in the utilization of the product on mid-sized deals with values between US$500 million and US$1 billion. Premium rates remained largely on par with 2021, with the average rate dipping slightly from 2.6% to 2.55%, year on year. However, primary terms became increasingly competitive in the last quarter of 2022, with pricing improving considerably, as more insurers competed for engagements. This was driven by recessionary fears, a cooling pipeline of deals in other regions, and new market entrants.

Southeast Asia stable

While deal activity was more muted than usual during certain times of the year, demand for W&I insurance in Southeast Asia remained consistent and the number of deals closed by the Marsh Asia team were the same as in 2021. The average premium rate in the sub-region increased from 1.5% to 1.9%, year on year. This uptick is likely due to a higher proportion of placements for manufacturing targets outside of Singapore that tend to command higher premiums. Another contributing factor is the reduced proportion of pure real estate transactions that are typically priced much more competitively. The pricing for such pure real estate transactions and other businesses in Singapore fell to extremely competitive levels in 2022, as insurers competed to add these risks — perceived as being generally safer — to their portfolios.

Local insurers solidify gains in Japan

There was a slight reduction in deal count in Japan in 2022, with activity levels improving in the second half of the year, and the majority of policies covering domestic targets. The average premium rate increased slightly from 2.3% to 2.4%, year on year, while domestic W&I insurance cover remained popular, a trend that started in 2021. The number of deals closed with coverage provided by local Japanese insurers edged past those covered by international carriers for the second consecutive year. Japanese insurers' appetite has grown beyond their traditional focus on smaller, domestic transactions, and they are now able to offer terms for transactions with values as high as US$800 million; in the past these would only have been insured by international carriers. Japanese insurers are currently offering capacity for insured limits of up to approximately US$85 million for a single transaction, and this is expected to increase during 2023. Given the competitive pricing of the local product and its expanding coverage, plus the advantage of an underwriting and claims management process in the native language, the local offering is expected to gain further popularity in the Japanese market.

Challenges for South Korea

South Korea saw the largest drop in deal count in the region. Insured outbound, cross-border transactions outnumbered domestic transactions, with the latter seeing a higher incidence than usual of transactions that failed to sign and/or close. This largely appeared to be due to parties' inability to agree on the purchase price or buyers experiencing difficulties securing external financing on acceptable terms. The average premium rate for South Korean targets rose significantly, from 2.4% in 2021 to 3.1% last year. This was due to constrained underwriting appetites that were partly influenced by caution over a recent increase in claims notifications in the sub-region, and partly by the fact that many of these transactions were in more difficult sectors — such as waste management — or had large values in excess of US$1 billion.

Greater China awaits

There was a significant increase in insurer appetite for transactions across Greater China, with more non-binding indications received for potential transactions. However, circumstances were not as conducive to deal-making as other Asian sub-regions. Many processes either stalled or were aborted, as buyers avoided making commitments pending further clarity on the sub-region's overall direction, whether with respect to politics or pandemic controls. Despite the more difficult environment, average premium rates for deals closed decreased from 2.6% in 2021 to 2.4% last year. Reduced pricing, coupled with the loosening of pandemic controls in China, should result in a more favorable M&A environment and improved transactional risk insurance utilization in Greater China in 2023.

Tax insurance

Tax exposure related to claiming capital gains tax exemptions under India's tax treaties has been the most common tax risk that parties in Asia have sought to insure for many years. However, we saw a wide variety of new tax risks insured in 2022, alongside an overall increase in insurer appetite for tax risks in Indonesia, China, and Vietnam where tax insurance was previously unavailable. New risks included those relating to transfer pricing, interpretation of indirect transfer rules (in Indonesia and China, for example), and classification of trading gains versus capital gains.

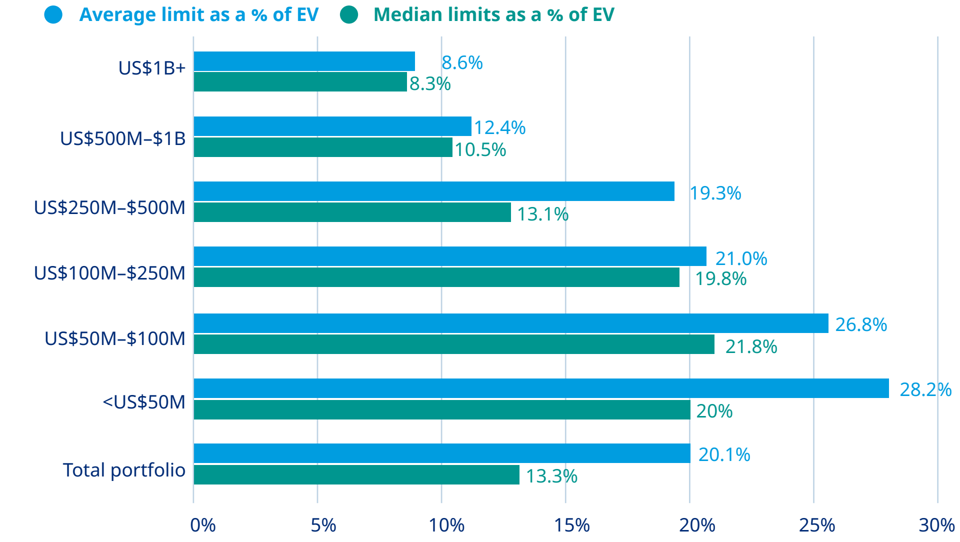
Claims

Last year we saw the highest number of claim notifications ever recorded in the region, with total claim notifications rising approximately 30% compared to 2021. This increase, however, was exclusively driven by several deals recording multiple claim notifications during 2022. Analysis of the rate of deals receiving at least one notification on their policy showed that the claims rate remained steady in 2022, at around 10%, compared to 11% in 2021 and 9% in 2020.

Litigation warranty breaches became the leading category of breach across Asian warranty claims filed in 2022, accounting for 55% of all claims filed during the year. For comparison, litigation warranty breaches accounted for around 7% of all claims made between 2017 and 2021. The majority of these filings also related to concurrent breaches of other warranties, including those relating to financial statements and tax. The catch-all approach of filing a claim under multiple categories of breach, including litigation, featured in half of the claims made in 2022. Therefore, it is too early to determine whether this is a trend or an anomaly, and we will continue to monitor the data.

Among the claims payments made in 2022 was the largest W&I claim payment recorded by Marsh in Asia, concerning a US$11 million compliance breach in Japan. The breach event and loss was verified, adjusted, and paid within seven months of the date of notification, making the process seamless and efficient for all involved.

15| Asia limits purchased as % of enterprise value



OUTLOOK FOR 2023

Demand for transactional risk insurance solutions in Asia is expected to remain steady in 2023, and may even improve. Premium rates are anticipated to continue to drop from their previously elevated levels in 2021. This is mainly due to the expansion of market capacity for W&I insurance and the arrival of new insurers generating increased competition. Insurers will also be incentivized to turn to meaningful product differentiation as a way to improve upon and retain their market shares. Similarly, for tax insurance, the use of cover to mitigate tax risk arising from M&A transactions is expected to grow in 2023, driven by a wider understanding of this product in the region in recent years coupled with a rise in insurers' appetite to insure Asian tax risks.

Pacific

There was a healthy level of M&A activity in 2022 and a continued reliance on W&I insurance as a market standard practice for mid- and large-sized deals in the Pacific region. Deal activity was down from 2021's record levels, but compared favorably with pre-pandemic years. The mounting macroeconomic and geopolitical pressures, including higher inflation and interest rates, created significant uncertainty for dealmakers. This led to the region experiencing a drop in deal flow and transaction closings during the second and third quarters.

Notwithstanding the challenging deal environment, Marsh placed 82 combined primary and excess W&I policies in 2022, compared with 81 in 2021. A robust deal-making environment in the first quarter that carried over from 2021 and a resurgence in deal volume in the fourth quarter greatly contributed to this outcome. The policies placed represented US$2.3 billion in limits, only 9% down from 2021 (see Figure 16).

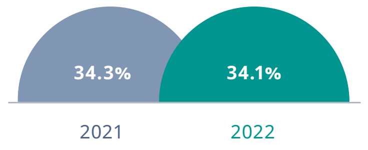
NOTABLE 2022 TRENDS

Pricing recalibrates

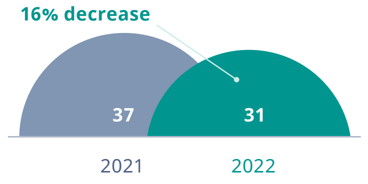
Following a surge in premium pricing in the final quarter of 2021, rates for W&I insurance started to normalize from the start of 2022. While the reduced deal flow and easing of insurer resourcing constraints resulted in a downward revision of rates, the median primary layer insurance rate of 1.7% was nevertheless approximately 35% higher than during the 2017 to 2020 period. This recalibration of premium rates was expected, given the increased frequency of claims and a growing insurer sentiment that premium rates of closer to 1% would be unprofitable for them.

16| **Pacific limits placed (US$B)**

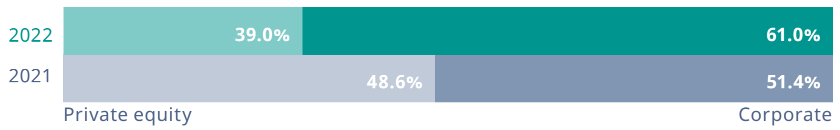
Limits placed as a percentage of enterprise value



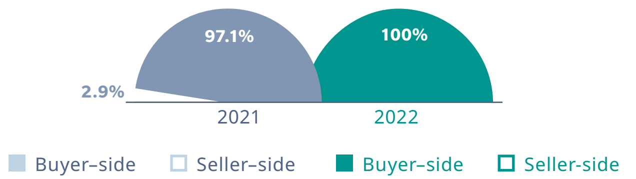
Number of deals



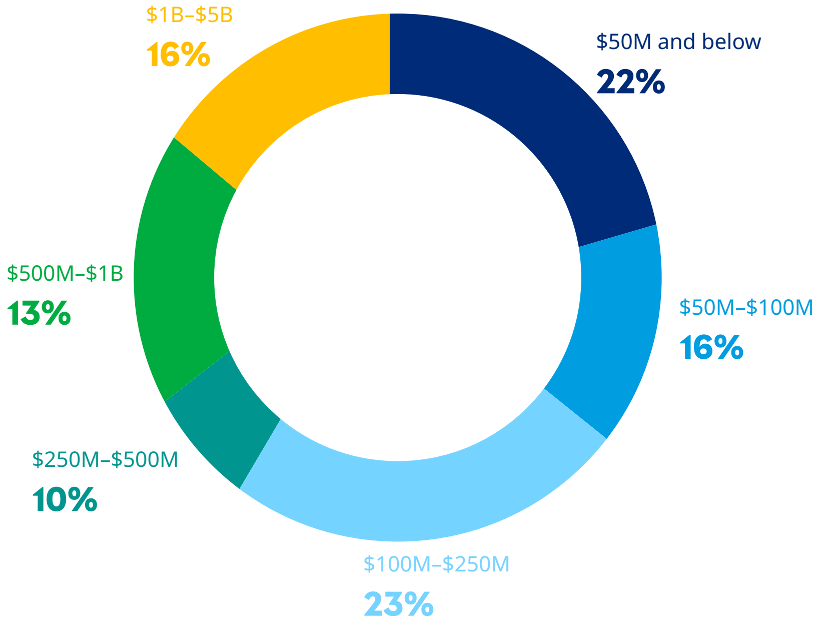
Private equity vs. corporate



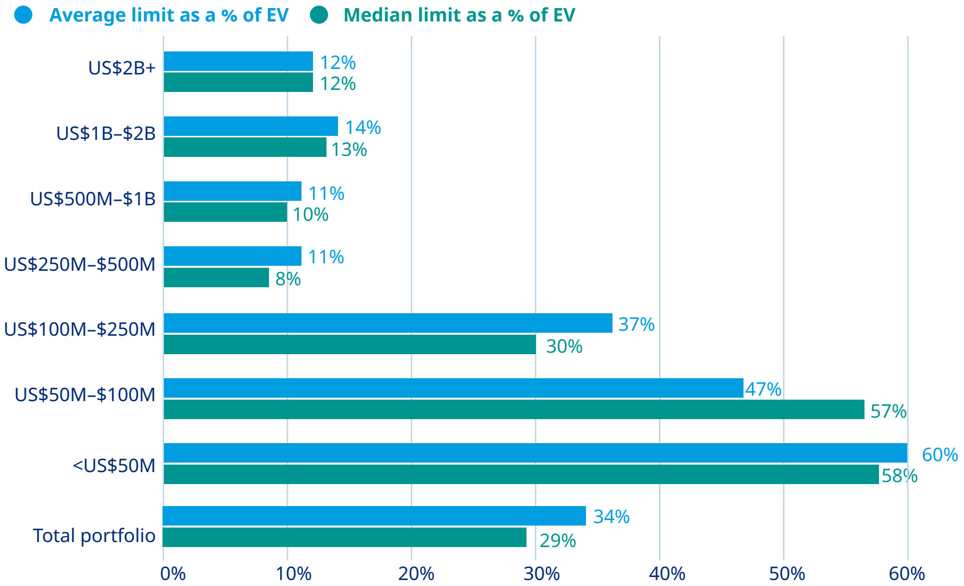
Buyer-side/seller-side policies (as % of total policies)



17| 2022 Pacific deal portfolio by enterprise value tranche



18| Pacific limits purchased as % of enterprise value



Large deals had different pricing dynamics in 2022. Transactions with an enterprise value in excess of US$1 billion attracted much higher pricing for the first (or primary) layer of insurance (see Figure 17). Although the variance in primary rates between large and small deals is moderated by Marsh's syndication of risk through the insurance tower, it is notable that premium rates for the first US$40 million of limit of a large (above US$1 billion) deal was 3.5% or more, while this figure was generally below 2.5% for deals smaller than US$1 billion.

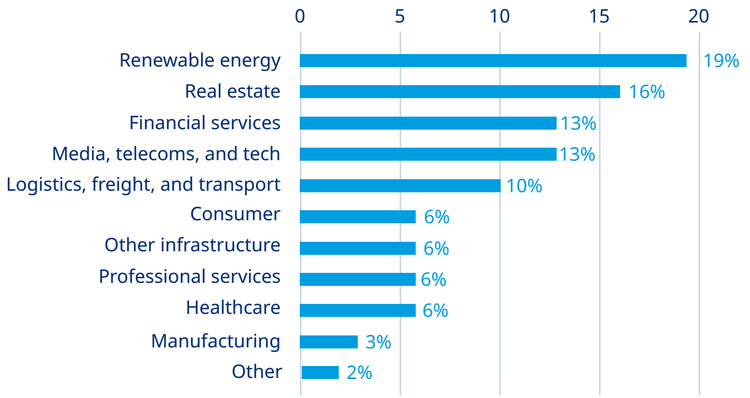
Looking ahead to 2023, there is reason for optimism, in terms of both pricing and insurance coverage. There is increased competition among insurers in this region, with a number of newer entrants to the market, and more anticipated in 2023. This bodes well for insureds, as new insurers typically seek to differentiate themselves and incumbents battle to protect their market share.

Utilization of insurance across transaction sizes and sectors

The average transaction size in Marsh's Pacific portfolio was US$254 million in 2022, down from US$502 million in 2021. The decrease in average transaction size in the W&I insurance market aligned with the M&A landscape more broadly in the region. There was a relatively even utilization of W&I insurance across all transaction sizes (see Figure 17).

The average policy limit purchased as a percentage of enterprise value remained steady at 34%. In nominal terms, the limit procured generally corresponds with the size of the deal. However, the average and median limits per transaction broadly followed a sliding scale, with a proportionately lower percentage procured as the deal size increased (see Figure 18). This is a common pattern when observing the capacity taken out on a per deal basis.

19| Pacific transactional risk — deal activity by industry (%)



Corporate and strategic buyers accounted for 61% of the deals in which W&I insurance was placed, with private equity firms making up the remainder. This continued an upward trend of corporate acquirers utilizing W&I insurance and signifies the widespread popularity of the product across all types of investors and deals.

W&I insurance was purchased by deal participants across all industries and sectors. Renewable energy and real estate companies represented more than a third of Marsh's portfolio in the Pacific in 2022. Insurance was also placed for a number of other large infrastructure deals, including telecommunications, utilities, rail, and ports.

Robust insurance market

The insurance market was able to meet client demand throughout the year, with insurers demonstrating a keen underwriting appetite and flexibility in providing commercial coverage. Additionally, access to a deeper pool of insurers meant it was possible to procure particularly large limits, often in the vicinity of US$500 million, without exhausting available insurance capital.

New underwriting teams entered the Pacific marketplace in 2022, including Berkshire Hathaway Specialty Insurance, Vale Insurance Partners, and Volante. There are now nine underwriters offering terms on a primary basis in the region. Another one to two carriers are expected to enter the region in 2023, further expanding available capacity.

Sellers initiating the W&I process

A notable theme observed in the second half of 2022 was the uncommonly high number of W&I processes that were initiated and structured on the sell-side, accounting for about 70% of the transactions Marsh worked on in the fourth quarter. The bulk of these transactions were run as competitive auctions, with a clear objective of achieving nil recourse (that is, a clean exit) for the sellers. Controlling the W&I process helped both sellers and bidders to gain an early understanding of expected cover and premium costs, and potential seller indemnities could be managed between the parties as early as possible during deal negotiations.

Tax insurance

Tax insurance continued to develop in the region in 2022, with insurers willing to underwrite a wide variety of risks and pricing coming down to historically low levels. The validity and utilization of tax losses was the most common tax risk for which insurance was pursued in 2022. This risk area is expected to remain a constant source of inquiry as corporates and private equity portfolios seek to protect their balance sheet for utilized losses and those carried forward to future years. In the coming years, the tax insurance market is expected to experience robust growth, driven by material tax risks identified in M&A deals and equally tax exposures which arise due to non-M&A transactions, such as corporate restructures.

Claims

The past few years have seen a significant increase in the number of claims. This is largely a function of the growing number of W&I policies placed and the long tail nature of the claims period. Insureds are becoming more sophisticated and knowledgeable about the way their policy should respond when losses arise post-transaction. The most common areas of warranty breach continue to be financial accounts, tax, and employment.

Two of the claims paid over the course of 2022 were in response to losses arising from employee underpayment and construction costs, with Marsh clients paid approximately US$10 million and US$5.5 million, respectively. These are good examples of the effectiveness of W&I insurance and the financial protection it affords deal parties when they might otherwise have had limited recourse.

OUTLOOK FOR 2023

Participants in the Pacific M&A market appear to be approaching 2023 with cautious optimism. The unprecedented amount of capital that is yet to be invested by private equity firms, including superannuation funds, and a potential easing of debt markets later in the year are expected to encourage deal-making activity. The positive sentiment is tempered by persisting macroeconomic headwinds and concerns about a potential recession, particularly as buyers and sellers attempt to find common ground from a valuation standpoint. In any case, the W&I insurance market appears to be in a strong position and is well placed to provide the capacity and underwriting capability to support M&A activity throughout 2023.

Conclusion

Last year proved to be a challenging but resilient year for the transactional risk insurance marketplace, marking the second busiest year on record for Marsh, as the company continued its role as the preferred risk advisor for private equity firms and corporate buyers and sellers on major M&A deals around the globe.

Transactional risk insurance remains an established and critical deal solution in the global M&A marketplace, and is now widely adopted across industries, geographies, and transaction sizes. Tax and contingent risk insurance solutions continue to expand their role in the transaction environment — a trend that is anticipated to persist. Given ongoing macroeconomic and geopolitical headwinds, an uneven and unpredictable year is expected for M&A in 2023, with activity levels varying between regions. Transactional risk capacity should be plentiful across the globe and conditions are expected to remain favorable in most regions, which may lead to a lower pricing environment than experienced in 2020 and 2021. At the same time, increases in claims frequency and severity are expected to continue in 2023 and beyond. This means it is more important than ever for principals and dealmakers involved in M&A activity in 2023 to carefully consider their risks and work with the right risk advisors backed by a global team.

Specifically, M&A deal participants should seek to work with risk advisors that can offer:

Dedicated transactional risk expertise. Advisors with experience working on M&A deals can help identify potential challenges during the deal process for which insurance and other strategies can offer solutions. They can also help build insurance programs with terms and conditions aligned to specific risks.

Market knowledge, relationships, and insights. Not every insurer is the same, and it is important to select the right one, given the unique nature of each transaction. The right advisor can offer guidance on the risk appetites, preferences, and capabilities of various insurers and help insureds navigate the underwriting process.

Robust data and analytics. Along with a broker's experience in working on previous transactions, peer benchmarking and other analytical tools can inform critical decisions about how to structure insurance programs, including selecting appropriate coverage limits.

Claims experience. Advisors with a history of working on complex transactional risk claims are uniquely positioned to provide guidance in the event dealings with an insurer take a contentious turn following a loss.

Marsh's Global Transactional Risk Practice includes more than 120 dedicated insurance professionals whose sole focus is R&W/W&I insurance, tax insurance, and other M&A-related insurance products. The team consists of former M&A lawyers, tax advisors, litigators, bankers, and seasoned risk management professionals who pride themselves on providing best-in-class service and advice to clients on the most complex M&A transactions, often under significant time pressure.

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About Marsh

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