Marsh

2021 US and Canada transactional risk year in review

Demand for transactional risk insurance in US and Canada soars to record heights

February 2022

Marsh's US and Canada transactional Risk Practice: 2021 at a glance

Closed transactions:
+71%

Policies placed:
+78%

US$37.9 billion in total limits

Claim notices:
–42%

Average transaction size:
US$405 million

Median transaction size:
US$150 million

Total insurer capacity:
+US$1 billion
for any single transaction

As the world economy continued to recover from the COVID-19 pandemic and its myriad effects on people and businesses, global mergers and acquisitions (M&A) reached unprecedented heights in 2021, propelling the transactional risk insurance market to record levels.

After gaining momentum in the second half of 2020, M&A activity continued at a fast pace for the entirety of 2021, shattering records for both number of transactions as well as their aggregate value.

The transactional risk insurance marketplace followed a similar pattern, with an unparalleled number of deals throughout the year, resulting in record-setting insurance purchased in 2021. The US and Canada market saw a vast increase in the number of policies placed and limits purchased through 2021.

This report provides an overview of the transactional risk insurance market in 2021 and explores the challenges that are expected in the year ahead, including a continued increase in claims frequency and severity, rising prices, and a shortage of human capital within the underwriting community.

Key takeaways include:

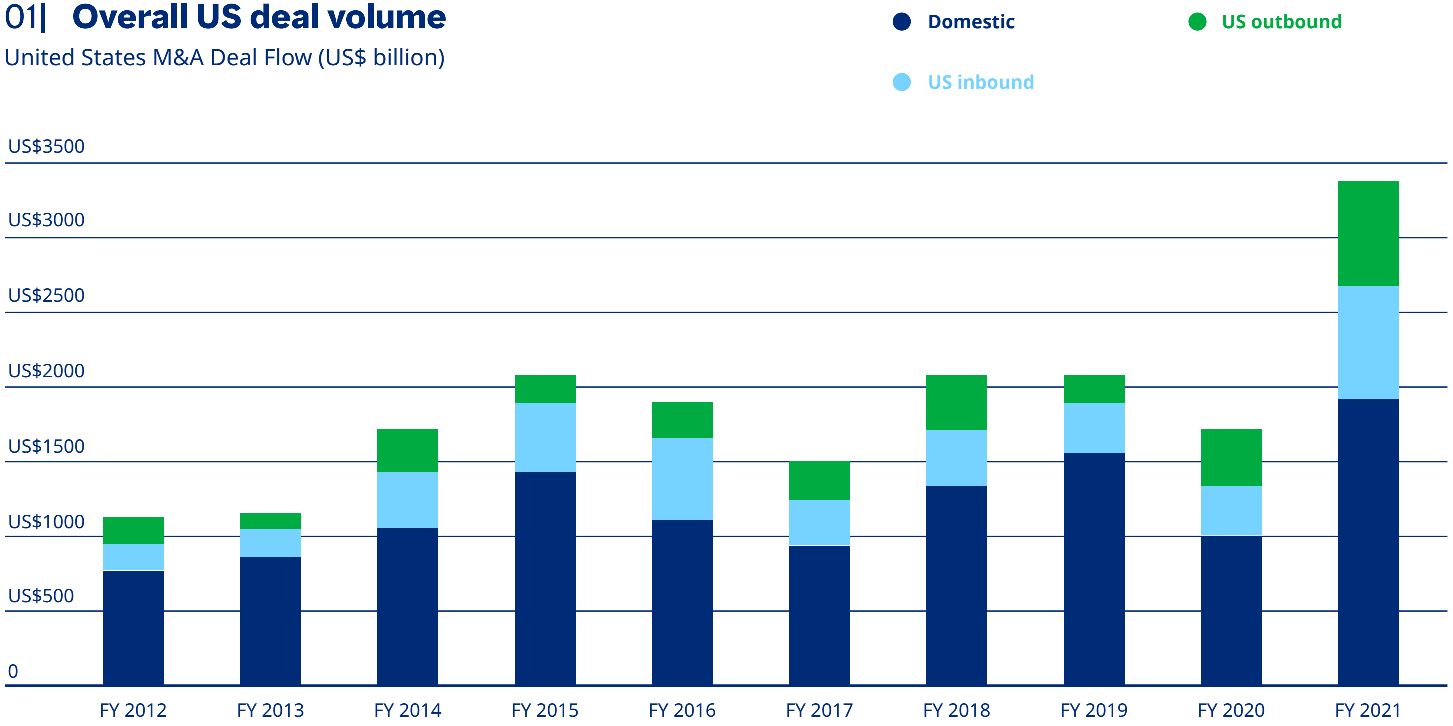
- Record-breaking M&A activity — both globally and in the US and Canada — led to increased interest in transactional risk insurance, while affirming the pivotal role that transactional risk insurance plays in the M&A marketplace.
- Insurers struggled to keep up with the growing demand, with declinations rising to new highs.
- Rates for representations and warranties (R&W) insurance increased significantly in 2021, continuing a trend started the previous year.
- As technology deals increased in 2021, communications, media, and technology companies outpaced other industries in the purchase of transactional risk insurance.
- Pandemic exclusions persist, with underwriters particularly conservative in regards to healthcare transactions.
- Claims frequency and severity are expected to continue increasing in 2022 and beyond.

US AND CANADA TRANSACTIONAL RISK INSURANCE MARKET REACHES RECORD LEVELS

M&A activity reached unprecedented heights in 2021, including in the US. According to Refinitiv, M&A activity worldwide increased by 64% in 2021, compared to the previous year, and totaled US$5.9 trillion. This was the strongest annual period since records began in 1980. In the US, M&A activity totaled US$2.6 trillion during 2021, an increase of 82% compared to 2020 and the strongest annual period for US deal-making on record (see Figure 1). In 2021, US deals accounted for 44% of the total worldwide M&A activity.

01| **Overall US deal volume**

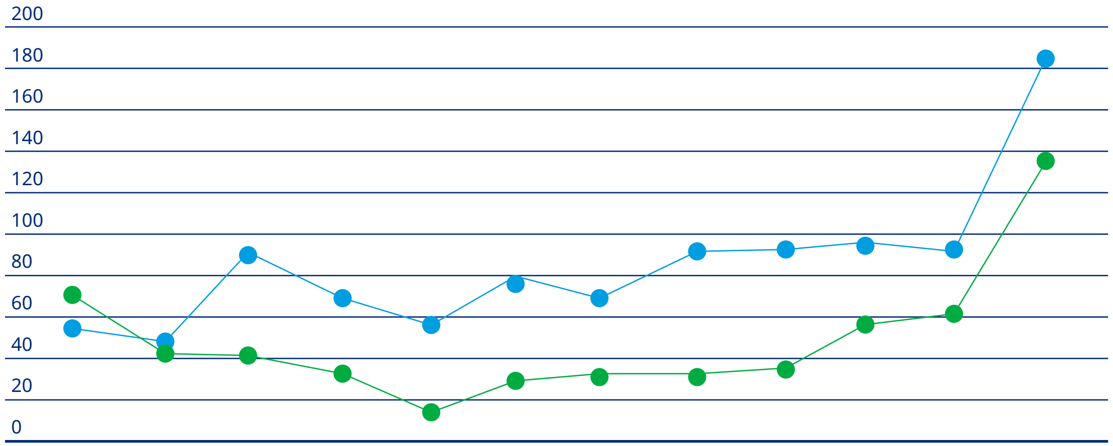
United States M&A Deal Flow (US$ billion)



Source: *Refinitiv*

Activity in the transactional risk insurance space shared a similar trajectory to the overall M&A market in 2021 (see Figure 2). Marsh's Transactional Risk Practice activity reflects what the US and Canada M&A market is experiencing at a broader level. Deal activity was robust throughout the year, with more deals closed quarterly by Marsh than in the immediately preceding quarter, and with each quarter's results materially outpacing both 2019 and 2020 activity. Specifically, in the second quarter of 2021, there was a 168% increase in deals closed compared to the same time in 2020. Likewise, Q3 saw a 172% increase in deals closed compared to Q3 of 2020. The dramatic year-over-year difference for Q2 and Q3 is due, in large part, to the severely depressed M&A market in mid-2020 resulting from the onset of the COVID-19 pandemic.

02| **Deals closed increased significantly in 2021**



	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21
2021 # of deals closed	48	45	86	67	59	78	71	88	91	98	86	181
2020 # of deals closed	72	43	42	36	16	24	28	28	35	58	62	139

INSURERS STRUGGLE TO MEET CLIENT DEMAND

The record-setting volume in transactional risk insurance policies placed and limits purchased experienced in the US and Canada challenged some insurers. While insurers continued to show their commitment to the sector, many struggled to meet the growing demand — particularly during the fourth quarter. Even with new underwriting organizations — such as Mosaic Insurance and RiskPoint — entering the North American market in 2021, and existing insurers deploying capital without interruption, demand for transactional insurance overwhelmed underwriters. As a result, Marsh saw insurer declinations increase to over 60% in the fourth quarter — well above historical norms that never exceeded 50%. This dynamic is the confluence of two principal factors:

1. A massive year-over-year increase in the number of submissions sent to insurers during 2021 reflecting historic M&A volume. For example, Marsh's total number of submissions to insurers increased to over 19,000 on 1,512 unique transactions — almost triple the number of submissions sent to insurers in 2020.

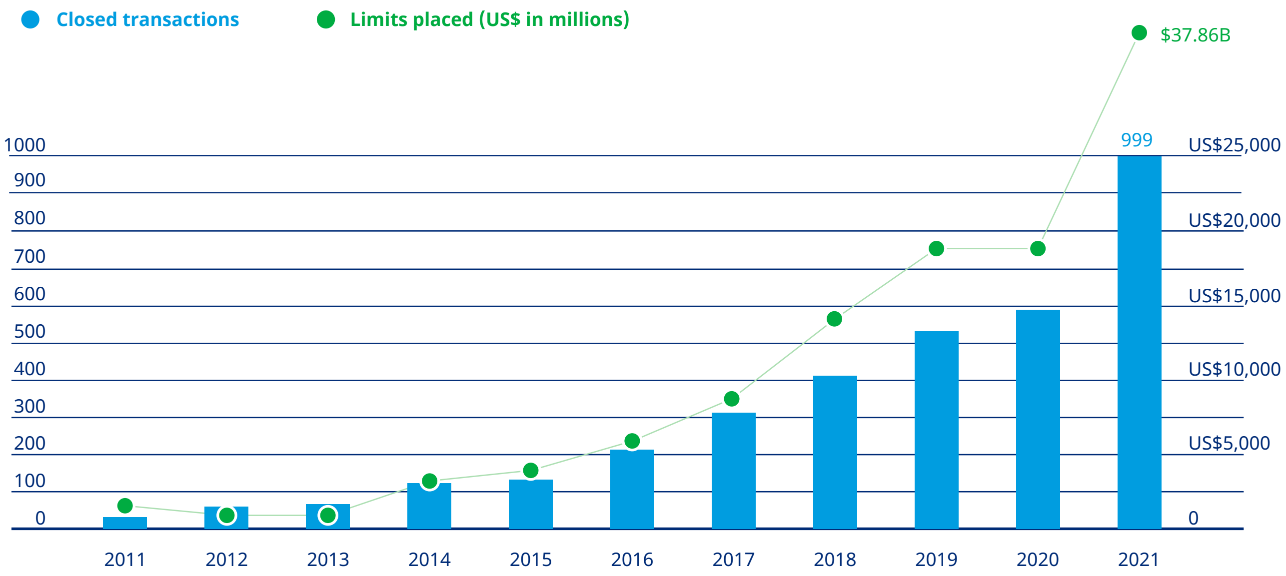
2. A "human capital shortage" among underwriters led to insufficient underwriting staffing levels to meet insured demand in many cases. While most insurers have confirmed their intent to add underwriting staff during 2022, we anticipate the human capital shortfall to persist in the short- to medium-term.

Total insurer capacity can exceed US$1 billion in limits for a single transaction and nearly 25 underwriters are presently offering terms on a primary basis.

GROWTH ACROSS ALL TRANSACTION SIZES AND SECTORS

Deal volume has been rapidly rising in the US and Canada despite challenges for insurers to meet demand. Marsh's US and Canada Transactional Risk Insurance Practice successfully completed 999 distinct insurance placements on mergers and acquisitions last year — a 71% increase over 2020. The team closed 366 deals during the fourth quarter, a 41% increase over the same period (and a 150% increase over Q4 2019).

03| Marsh's US and Canada Transactional Risk Practice 2021 deal data

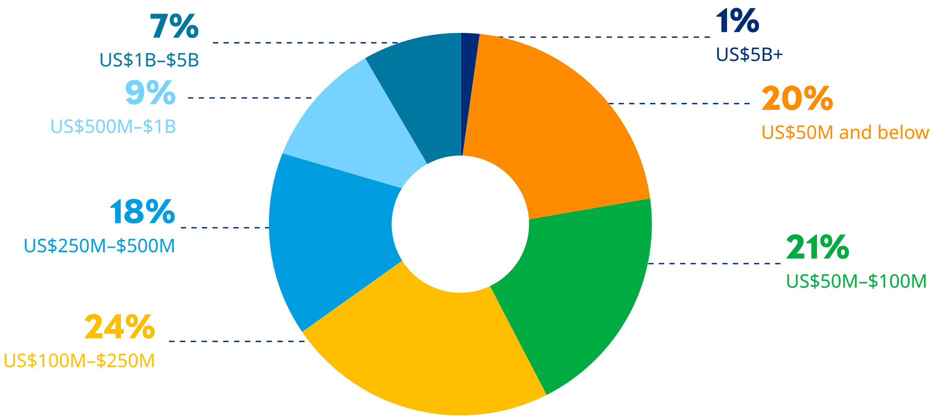


Source: *Global Research Team*

Key M&A players are increasingly seeing value in transactional risk insurance. This is reflected in the number of policies placed by Marsh. As part of the 999 closed transactions, our team placed 1,847 combined primary and excess policies; this was the second consecutive year our team has placed more than 1,000 transactional risk policies in a calendar year — representing a 78% increase over 2020. These policies represented US$37.9 billion in limits (see Figure 3) placed by our team on behalf of our clients — nearly doubling the limits placed in 2020 (the total was up 93%). These results are a sign of transactional risk insurance's enduring role in the deal-making environment in the US and Canada.

For Marsh, median transaction size increased to US$150 million in the US and Canada, up from US$130 million in 2020, while average transaction size increased to US$405 million, up from US$345 million in 2020, due to a pronounced increase in utilization of transactional risk insurance on larger deals. The number of placements made on deals in excess of US$1 billion in enterprise value more than doubled from the prior year.

04| 2021 deal count enterprise value tranche



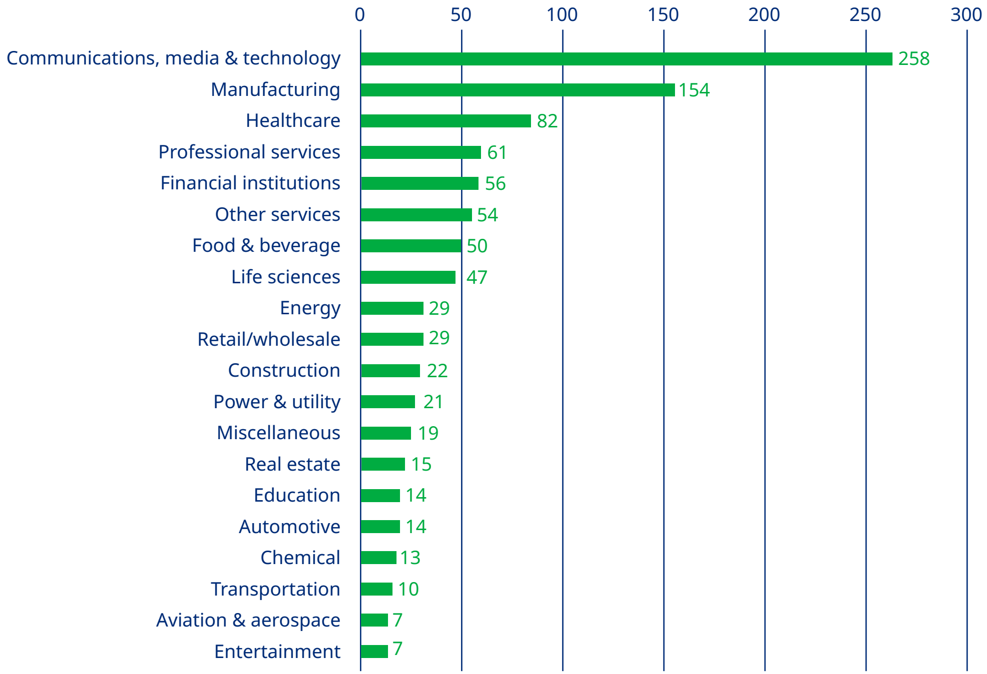
The Marsh team saw increased utilization of insurance and even distribution of policies across all transaction sizes, with no size tranche representing more than 25% of the overall portfolio (see Figure 4).

The trend of corporate and strategic buyers increasing their use of transactional risk insurance continued in 2021, and we expect 2022 to bring more of the same. In 2021, private equity firms continued to represent a slight majority of insureds in programs placed by Marsh — purchasing approximately 51% of all policies.

Transactional risk insurance continues to be used by deal participants across a number of industries. According to Refinitiv, in the US, deal-making in the technology industry totaled $1.1 trillion during 2021, an increase of 71% compared to 2020 levels, accounting for 20% of overall value. The number of technology deals increased by 34% compared to 2020 levels. It followed that communications, media, and technology companies were involved in more transactional risk placements than companies in any other industry, accounting for more than a quarter of all deals completed by Marsh in the US and Canada (see Figure 5).

05| Transactional risk — Top 20 industries

Communications, media, and technology companies led all industries in transactional risk insurance placements in 2021.



Source: *Marsh*

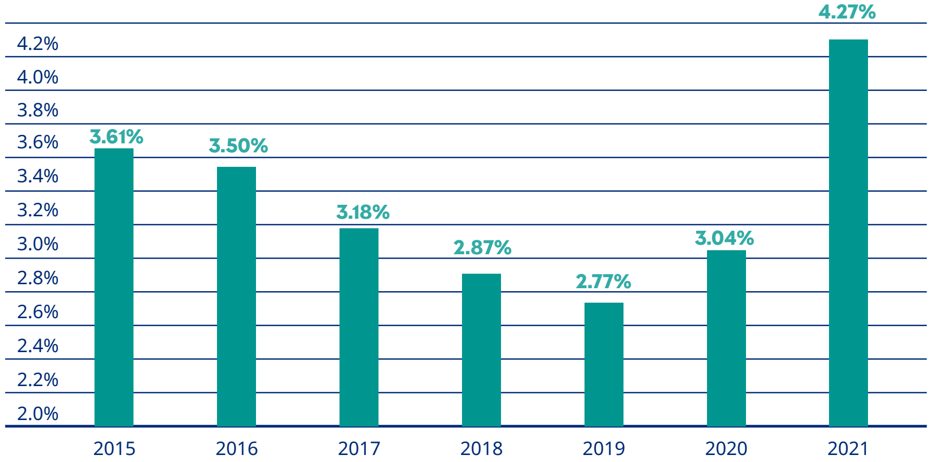
"SURGE PRICING" IMPACT ON TRANSACTIONAL RISK

"Surge pricing" during the flood of deal activity in the second half of the year, particularly in Q4, which was exacerbated by human capital constraints, led to significant pricing increases. Rates for representations and warranties (R&W) insurance registered their first annual increase in six years in 2020, with a slight (less than 10%) increase for primary layer risk. Rates increased exponentially in 2021, with primary layer pricing across the Marsh portfolio increasing more than 40% on a year-over-year basis.

Primary R&W insurance rates increased across the Marsh portfolio in the US and Canada by just over 40%, to an average of 4.27% rate on line (ROL), which is calculated by dividing premium by policy limits (see Figure 6). 2021 marked the first year of primary rates sitting above 4% in over a decade. The price increase is partly due to growth in both the frequency and severity of transactional risk claims. The primary layer increased steadily each quarter in 2021, with rates for policies bound or closed in Q4 averaging 5.6% according to Marsh data.

This pricing surge has begun to recede slightly in the first quarter of 2022, as demand for the insurance comes off the record growth registered during the fourth quarter of 2021. However, claims concerns continue to influence insurers' approaches to pricing. In light of steady demand amid a robust M&A market, together with the continued uptick in claims activity, we expect the high-rate environment to persist in the short- to medium-term, although the presence of recent market entrants could help to offset some of the pricing pressure. Any sustained downturn in M&A activity and resulting decrease in submission flow to insurers should reverse this trend and result in lower prices for insureds.

06| R&W insurance pricing increased by over 40% in 2021.



Source: *Marsh*

PANDEMIC EXCLUSIONS PERSIST AMID RETURN OF DISCIPLINED UNDERWRITING

While the blanket COVID-19 exclusions demanded by insurers during the earliest phases of the pandemic are no longer as prevalent, the pandemic and its impacts on target companies remain a key focus of the underwriting process. Two years into the pandemic, insurers are better able to focus specifically on the distinct impacts of the pandemic on each target company. That said, insurers continue to almost universally exclude losses arising from non-compliance with provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and Paycheck Protection Program (PPP) loans.

In addition to the persistence of COVID-19 exclusions, insurers staked out more conservative underwriting positions than in recent years. Coverage under R&W policies for environmental, cyber/data privacy, and professional liability/E&O risks is increasingly covered only on an “excess of and no broader than adequate underlying insurance” basis — if not excluded outright. Deal-specific exclusions in the areas of sales use and tax and wage and hour/FLSA compliance remain commonplace.

Underwriters were increasingly conservative when it came to healthcare transactions. While our team closed over 80 healthcare deals, there was considerable waning in insurer appetite as the year progressed. Primary layer pricing for healthcare deals rose to 5.7% ROL in the fourth quarter, while policies consistently contained government payor billing and coding, corporate practice of medicine, and other healthcare-regulatory exclusions, narrowing the scope of coverage.

We anticipate insurers will continue to take a conservative underwriting approach for healthcare R&W policies in the short– to medium–term.

OTHER NOTABLE 2021 TRENDS

Rise in no seller indemnity structures

A long-term trend that persisted in 2021 is the significant increase in the number of transactions that feature no seller indemnity, meaning that the seller does not have any contractual liability to the buyer for breaches of representations and warranties, other than 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, typically US$1 billion or more of enterprise value. However, it has become far more prevalent in recent years, driven by usage in smaller transactions — some even valued at less than US$50 million. For the first time in our history, in 2021 more than half (52%) of the transactions in Marsh’s US and Canada transactional risk portfolio featured no seller indemnity structures, up from under 25% in 2015. We anticipate that this trend will continue in the short- to medium-term.

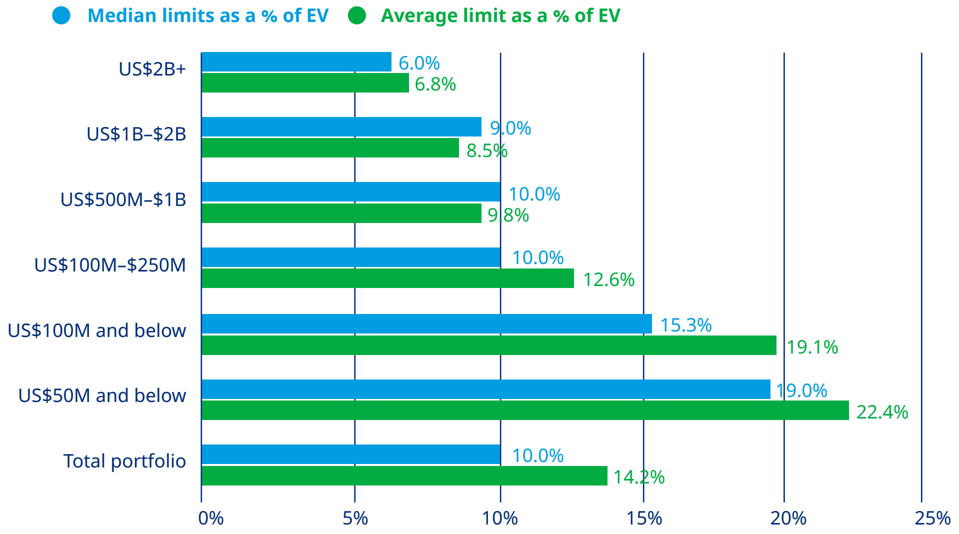
Deductibles remain stable

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. On larger transactions — those with enterprise values of US$400 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.

Variances in relative size of limit purchased

The average and median enterprise value per insured transaction in the US and Canada increased over the prior year — average enterprise value went up to US$405 million, from US$345 million in 2020, while median enterprise value went up to US$150 million, from US$130 million. Median policy limits — as a percentage of enterprise value — remained steady across Marsh's portfolio, at 10%. We did, however, see a meaningful increase in the average limits purchased — as a percentage of enterprise value — to 14.2%.

07| Transactional risk insurance overview



In 2021, we witnessed sharp divergences in the relative amount of limits purchased, depending on the size of the deal. For smaller deals — below US$50 million in enterprise value — the average limits purchased equaled 22.4% of enterprise value. For midsize deals — US$100 million to US$250 million in enterprise value — average limits purchased equaled 12.6% of enterprise value. For large deals — US$2 billion or more in enterprise value — the average limits purchased equaled 6.8% of enterprise value.

Historically, corporate insureds purchased more limits than private equity insureds on similarly sized deals. This trend continued in 2021 and is expected to persist in 2022.

Tax insurance pricing continues to fall

Tax insurance policies bound by our team in 2021 were up significantly from 2020. In line with the strong increase of volume in R&W coverage, there was a material increase in M&A-related tax insurance policies, compared to prior years. The percentage of revenues, policies, and limits placed for M&A transactions were significantly higher in 2021, compared to 2020 and 2019, and continues the trend of a higher concentration of M&A-related tax insurance placements.

Utilization of tax insurance in the renewable energy sector was mixed. There continued to be strong demand for coverage focused on tax basis for investment in tax credit projects, and these were predominantly solar energy investments. Tax insurance protecting the production tax credit for many wind projects was either no longer required to secure financing, or was placed on hold, pending visibility on what tax-related legislation (if any) may be enacted in 2022; this was mostly the result of legislation to extend the renewable energy tax credits, pandemic-driven updates to safe-harbor guidance, and uncertainty (or possibly relief) surrounding what is being proposed in the now-stalled Build Back Better legislation.

While usage of tax insurance in connection with M&A deals increased in 2021, renewable energy production tax credit insurance activity was softer than in 2020. The third principal area of tax insurance policies — those placed to allow corporates to manage balance sheet tax risks — remained flat compared to the same period last year. We anticipate balance sheet risk management to be an increased area of focus in 2022 as a result of increased IRS enforcement.

In 2021, we continued to see new, tax-dedicated underwriters enter the market and numerous additional transactional risk players participate on large tax insurance towers, resulting in downward pressure on premium rates and increased flexibility on policy terms. Such trends stood in stark contrast to the experience in the R&W insurance space. In fact, the rate on line for tax insurance policies decreased significantly from 2020 to 2021, with primary rates settling below 3% by the end of 2021. In light of the increasing delta between pricing on tax insurance policies relative to R&W insurance policies, we expect an uptick in tax insurance pricing in 2022.

As previously forecast in 2020, tax insurance has strengthened its foothold as a cost-effective risk management tool and we expect that to continue into 2022.

Decrease in claims

In 2021, Marsh clients submitted 155 claims to R&W insurers on 94 transactions. These figures represent a shift downward from the 256 claims submitted on 132 transactions during the 2020 calendar year. The impacts of COVID-19 likely played a factor in the reduced number of claims submitted in 2021 compared to 2020, when increased financial strain may have led to more claims. Given the increased volume of placements in 2021, we expect the number of claims to rise in the coming years.

In the last two years alone, R&W insurers paid approximately US$160 million to Marsh clients — representing over US$200 million in recognized losses.

Of the claims registered during 2021, the most common type of breaches related to financial statements (18%), employment (16%), environmental (15%), and compliance with laws (14%). These figures are generally consistent with prior years, except there were fewer claims related to tax breaches and more claims related to environmental breaches in 2021. Environmental claims, however, consisted of multiple claims made on only a small number of transactions, so we do not expect this trend to continue in future years.

Claims handling by R&W insurers remains an integral part of insurer selection at the outset of the underwriting process. In recent years, insureds have increasingly focused on selecting an insurer with strong claims abilities with respect to both process and payment history.

Managing transactional risk in 2022

The extraordinary activity levels of 2021 confirmed the role that transactional risk insurance continues to play in the M&A marketplace. Amid a busy M&A market, Marsh placed more transactional risk insurance policies than ever, solidifying our role as a pre-eminent risk advisor for M&A deals. The expanded use of transactional risk solutions by smaller enterprises and for some of the largest deals finalized in the US reflects the essential role they can play in deal processes.

At the same time, increases in claims frequency and severity are expected to continue in 2022 and beyond, as are corresponding rate increases for transactional risk insurance products. That means it is more important than ever for businesses involved in mergers and acquisitions to carefully consider their risks and work with the right risk advisors.

Specifically, those involved in mergers and acquisitions 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 nature of your unique transaction. The right advisor can help you understand the risk appetites, preferences, and capabilities of various insurers and help guide you through the underwriting process.
- Robust data and analytics. Along with your 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 things turn contentious with your insurer following a loss.

About Marsh Transactional Risk

The US and Canada Transactional Risk Practice at Marsh is comprised of 40 dedicated insurance professionals whose sole focus is R&W 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 and their advisors on the most complex M&A transactions, often under significant time pressure.

For more information, contact your Marsh representative or:

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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 of 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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