



Transactional Liability Insurance CARE Presentation

C-28

June 3-4, 2019

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Antitrust Notice

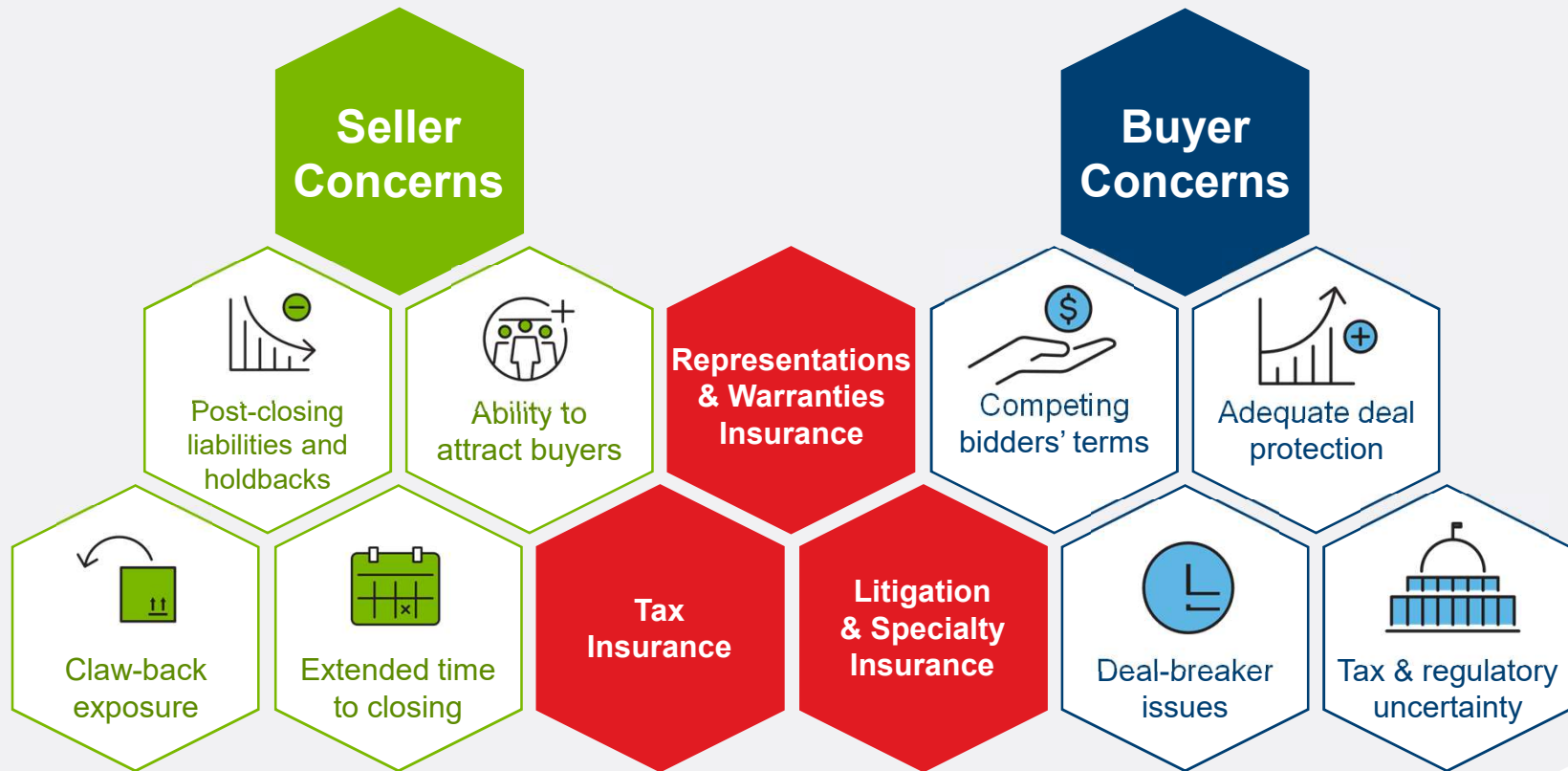
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Deal Risk Challenges...

Meet Transaction Liability Insurance Solutions

The strategic use of Transaction Liability Insurance can help buyers and sellers reach their goals.





UPDATE



M&A Insurance: Changing the Global Landscape

North America



40%
increase in the
number of policies
bound in 2018



688
policies bound
across all lines in
2018



\$26 B
in policy limits
placed by Aon in
2018

Global



39%
increase in the
number of policies
closed in 2018



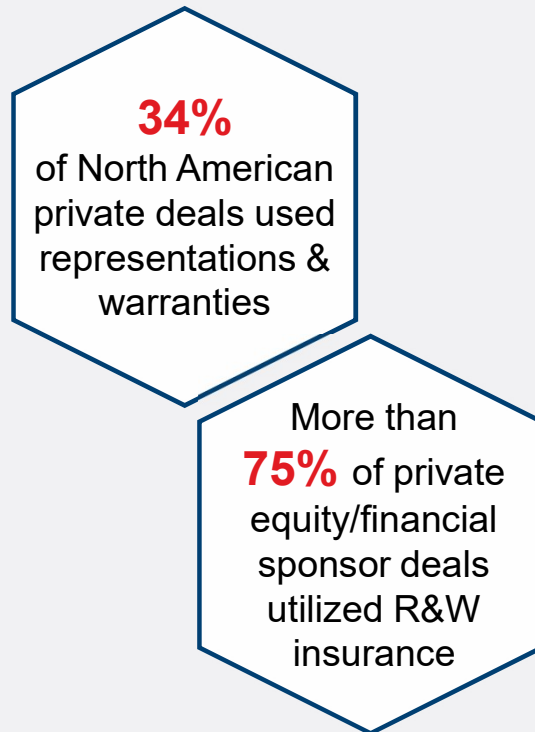
1070
policies bound
across all lines in
2018



\$38.4 B
in policy limits
placed by Aon in
2018

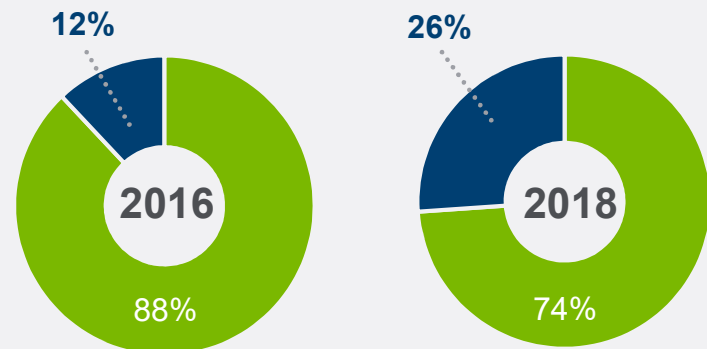
M&A Insurance: Demonstrable Impact

Aon estimates



Reflecting industry trends, Aon observed “no seller indemnity” policies increased

● No Seller Indemnity ● Limited Seller Indemnity

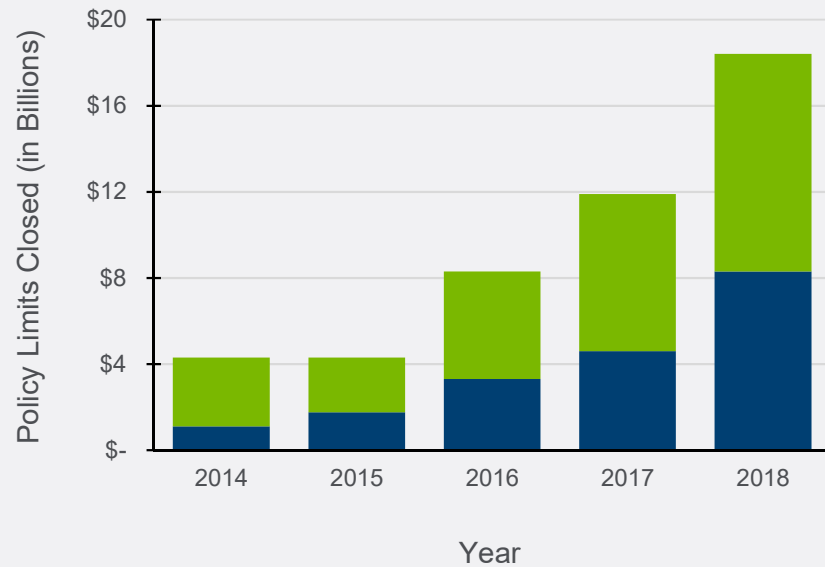


Pitchbook.
SRS Acquiom 2018 M&A Deal Terms Study, May 2018.

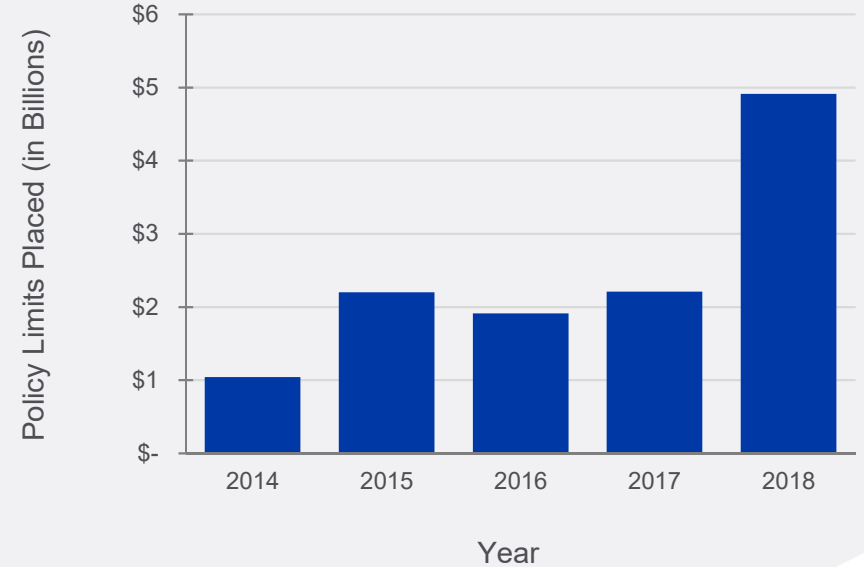
A Mainstay of the M&A Industry

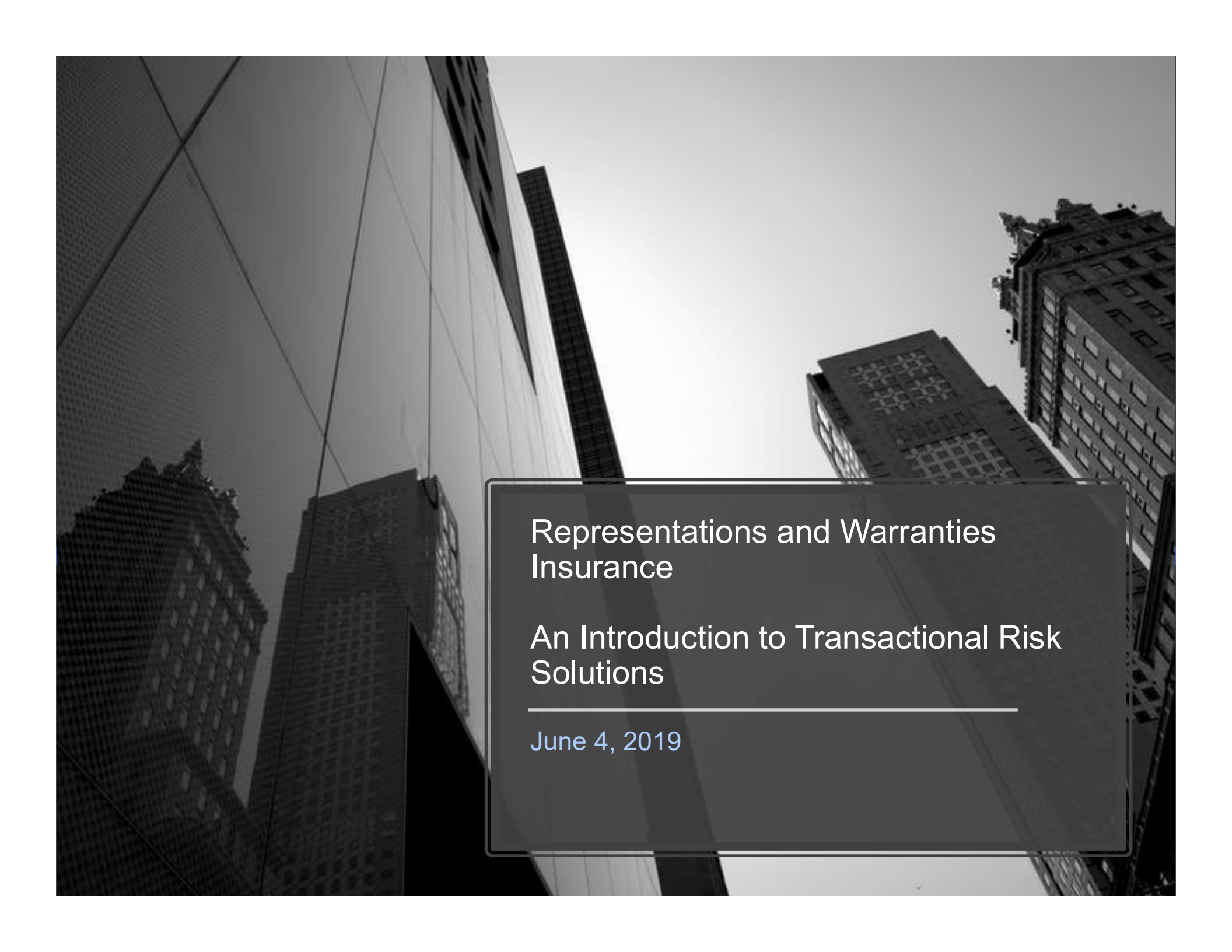
Amount of R&W Policy Limits Closed

● Corporate Policies ● Non-Corporate Policies



Amount of Tax Policy Limits Placed





Representations and Warranties Insurance

An Introduction to Transactional Risk Solutions

June 4, 2019

Transactional Risk Solutions

● UNKNOWN AND UNFORESEEN LOSS

Representations and warranties insurance provides for breaches of representations in an M&A transaction

- Buyer-Side Policy
- Seller-Side Policy

● IDENTIFIED AND KNOWN RISKS

- Typically identified tax issues/exposures
- Tax credit insurance
- Litigation buyout insurance
- Portfolio value/defaults
- IP/patent infringement



Tax Insurance

WHAT IS TAX INSURANCE?

- Tax liability or tax opinion insurance can help a company reduce or eliminate its exposure to the risk of a loss arising from a successful challenge by a tax authority to the expected tax treatment of a proposed or historic transaction, reorganization or other matter
- A contract of insurance

WHAT IS COVERED?

- Losses arising from the failure to achieve the expected tax treatment
- Losses include tax and defense costs, interest, penalties and taxes payable

Contingent Insurance

WHAT IS CONTINGENT INSURANCE?

- Ring-fence a specific exposure or trigger, often linked to an M&A transaction
- Examples include threatened or pending litigation, regulatory uncertainty, political risk or other one-off identified exposures

WHAT IS COVERED?

- Specific defined triggers are policy specific and manuscripted

Typical Uses of the Coverage

BUYERS

Risk Management Uses

- Increase maximum indemnity/extend survival period for representations and warranties
- Elimination of seller post-closing credit risk
- Provide recourse when no seller indemnity available (competitive auction, public company, bankruptcy)

Strategic Uses

- Distinguish bid in auction process
- Less costly than the increased consideration for seller indemnification
- Protect key relationships

SELLERS

Risk Management Uses

- Reduce contingent liabilities/make a “clean break”
- Distribute sales proceeds
- Protect passive sellers

Strategic Uses

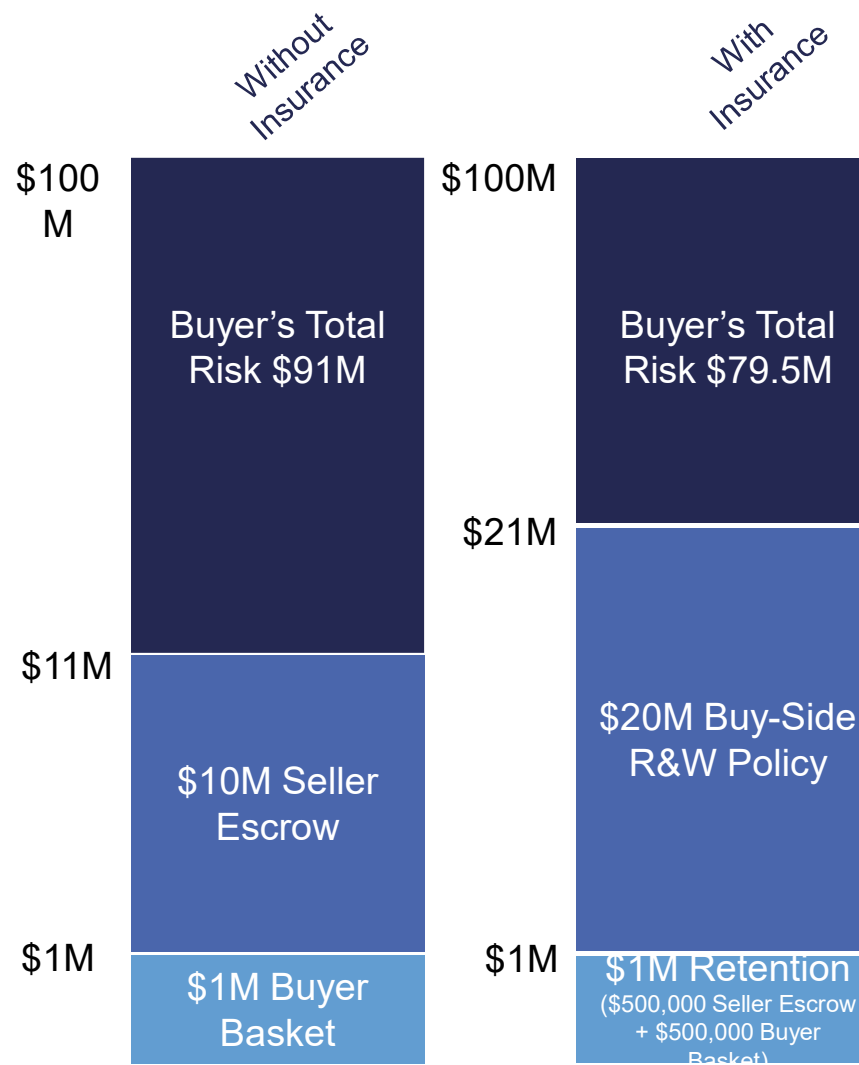
- Attract best offers by maximizing indemnification
- Include representations and warranties insurance as the sole remedy in draft agreements in auction

Buyer-Side Policy Example

The buyer wishes to distinguish its bid in an auction but maintain at least \$20,000,000 protection against loss resulting from sellers' breach of representations and warranties

The seller is only offering a \$10,000,000 indemnity

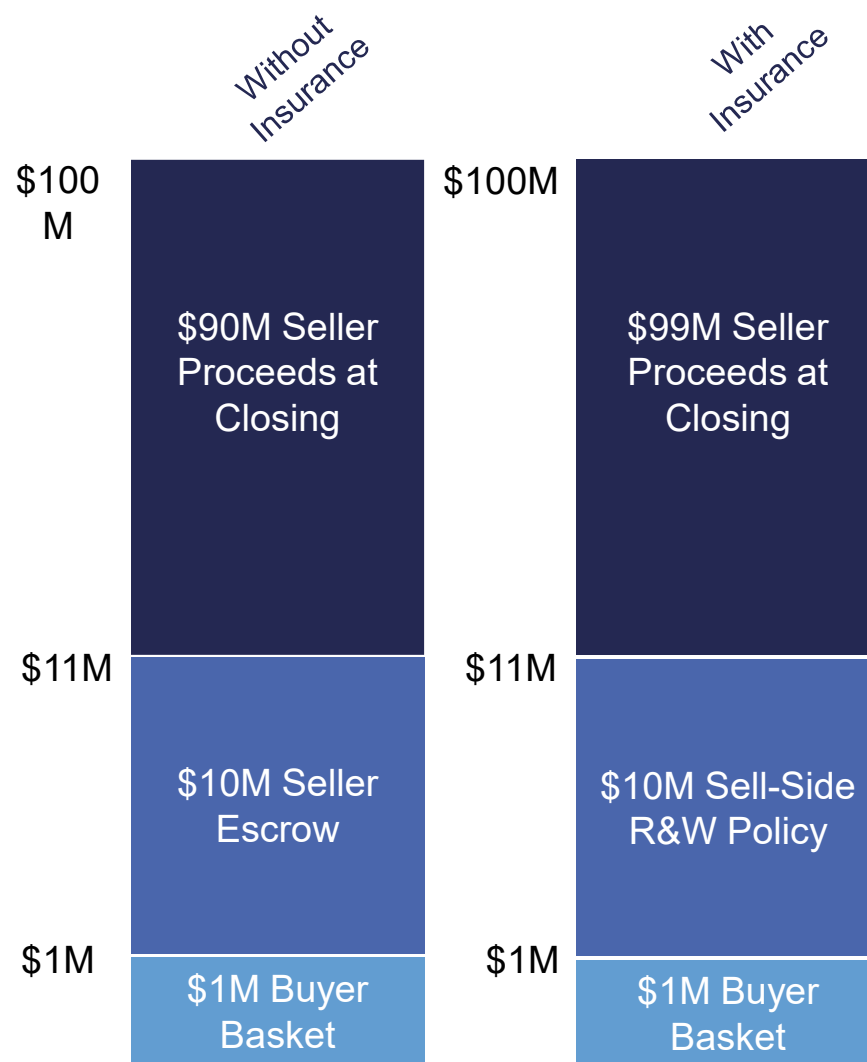
The buyer distinguishes itself from other bidders by replacing the majority of the sellers escrow/indemnity cap with a buyer-side representations and warranties policy



Seller-Side Policy Example

Private equity firm is preparing to sell a portfolio company through an auction process for \$100,000,000

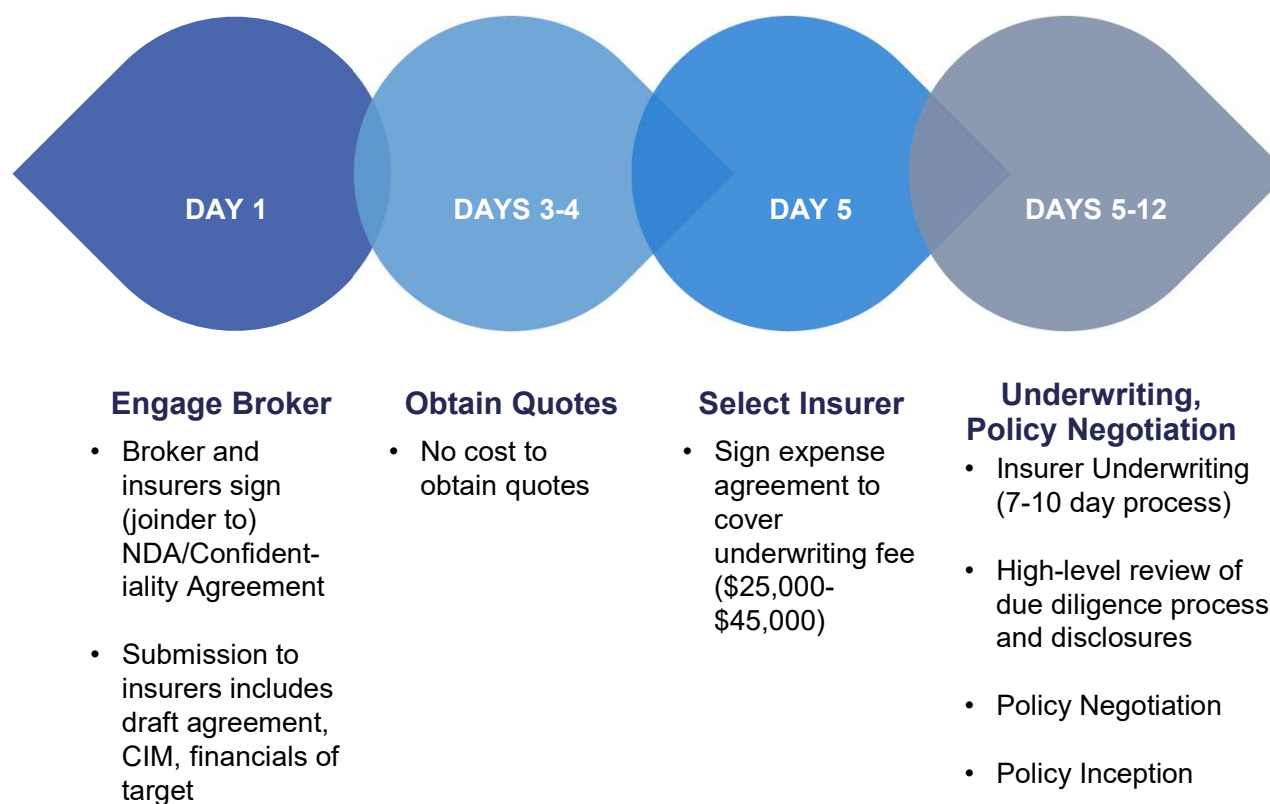
Private equity firm does not want any surviving indemnities or escrow post-closing.



Policy Highlights

<p>Customized Coverage</p> <p>Unique to each individual transaction</p>	<p>Limit</p> <p>Typically 5% to 20% of deal value</p>	<p>Term</p> <p>Three years for general representations and six years for fundamental and tax representations</p>	<p>Non-Cancellable Policy</p> <p>Ensuring coverage remains intact for the duration of transactional liabilities</p>
<p>Coverage for Transactions of Any Size</p> <p>Target transactions between \$20M-\$5B, with majority between \$50M-\$500M</p>	<p>Retention</p> <p>Typically 1% of the transaction value at inception</p>	<p>Premium</p> <p>2.5% - 3.0% of policy limit purchased</p>	<p>Underwriting Fee</p> <p>Typically \$25,000 - \$45,000, in addition to premium</p>

Process and Timeline





CARe Presentation Reps & Warranty Reinsurers' Perspective

June 3-4, 2019

Rick Ramotar, FCAS, MAAA



Before we begin...

- Different words, Same thing
 - Transactional Liability = Transactional Risk Insurance = Reps & Warranties = Mergers & Acquisitions
- 1st Party cover
 - Essentially guarantee cover
- Deductibles
 - Typically 1% of Deal Price, but reduces after 1st year
- Usually 6 year terms
- Subject to Non-Disclosure Agreements



Source of reinsurance

- Some standalone
 - Coverholders/Large established carriers
- Usually packaged with other lines
 - Typically financial/professional lines
 - Difficult to exclude from package programs in current market
 - Usually small % of premium relative to total program
 - But grows very fast...

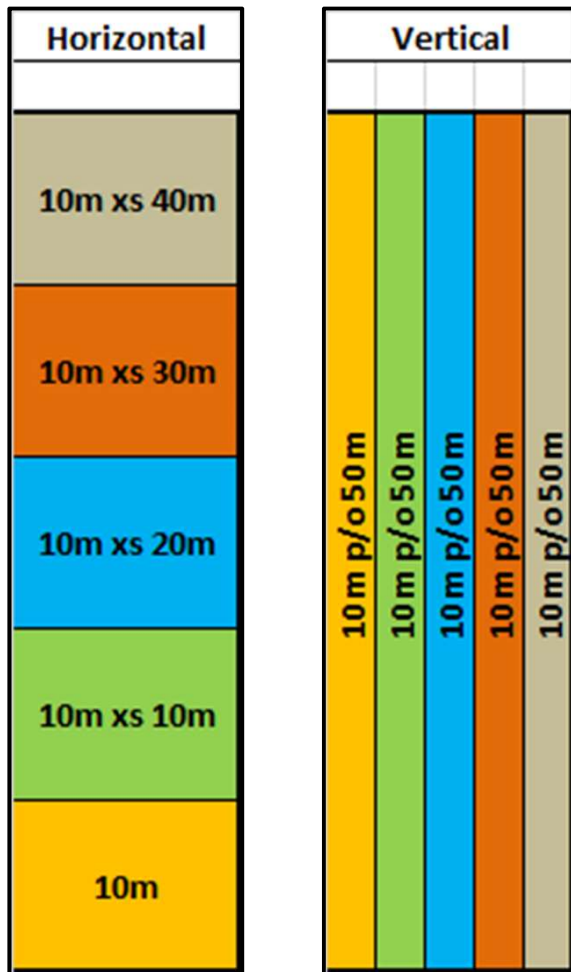


Let's talk reinsurance

- Simply put: Large Limits are involved so need reinsurance to control risk/potential downside
- What type of reinsurance
 - Majority of business comes via Quota Share
 - Sharing of risk
 - But, it can be QS of excess layers
 - Excess of Loss / Aggregate covers
 - Less common but it may be coming....



Aggregation



- Horizontal
 - Multiple layers from different cedents
- Vertical
 - Multiple shares from various cedents
- Combo of both

As a result, reinsurers may have more exposure than primary companies



Control Aggregation

- The easy part
 - Can monitor which cedants are participating on which coverholders
- The hard part (or rather the unknowns)
 - Non-recurring business: every deal is new
 - Can only monitor aggregation after the business is written
 - May not even be possible if deal names are not provided with bordereau
- Know your cedents, their risk tolerances and appetites

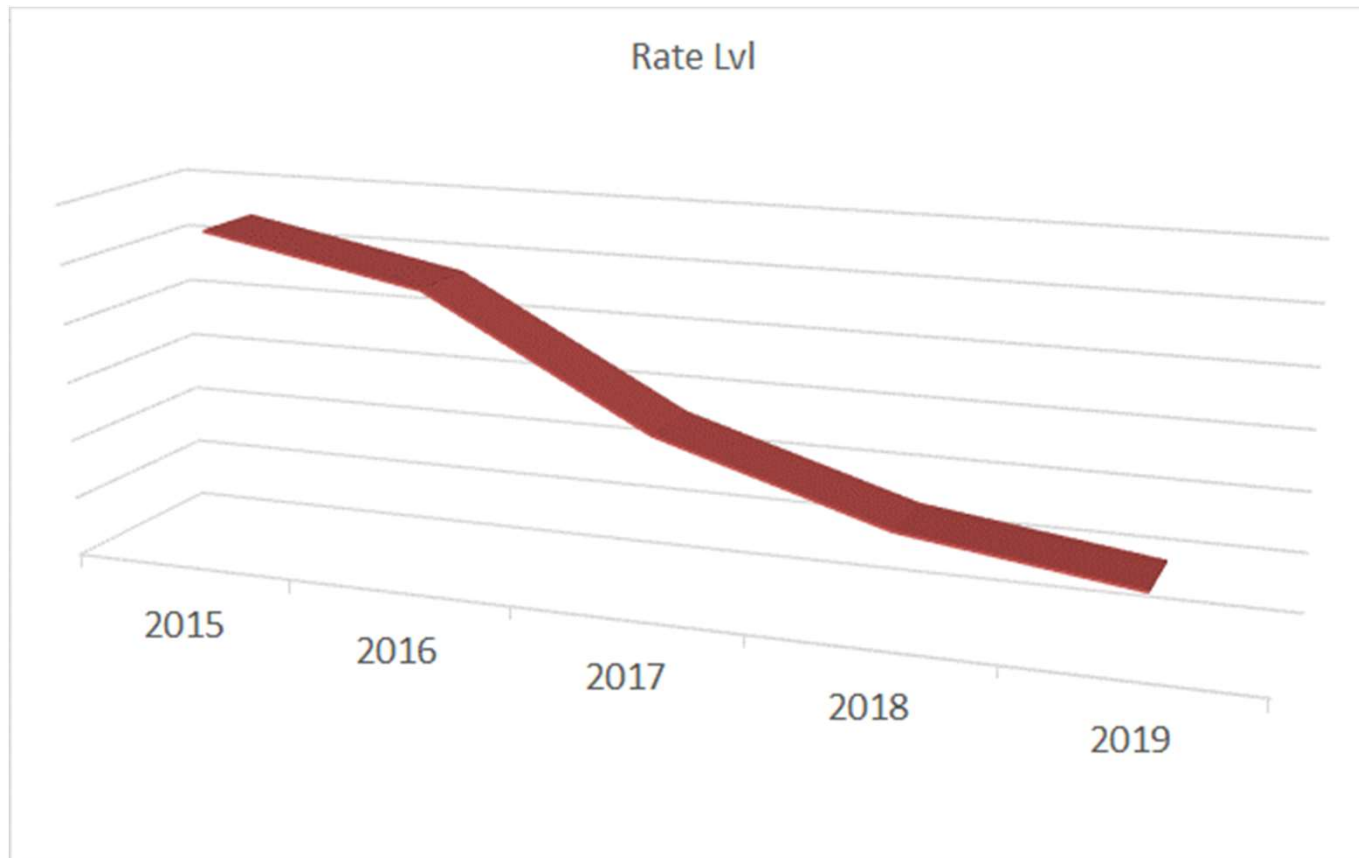


Let's talk Pricing – early days

- Niche Product
 - Few players: AIG, coverholders
- Healthy rates
- Tight terms
- Performance
 - Very good: LR in the 40's and lower



Rates going down



Business Growing Fast...

INCREASING USE OF R&W INSURANCE IN DEALS SIGNIFICANT GROWTH IN NORTH AMERICA IN LAST 7 YEARS

2017

- \$8.83 billion in limits / 303 closed deals

2016

- \$6.03 billion in limits / 212 closed deals

2015

- \$4.26 billion in limits / 159 closed deals

2014

- \$2.73 billion in limits / 130 closed deals

2013

- \$1.34 billion in limits / 66 closed deals

2012

- \$1.43 billion in limits / 51 closed deals

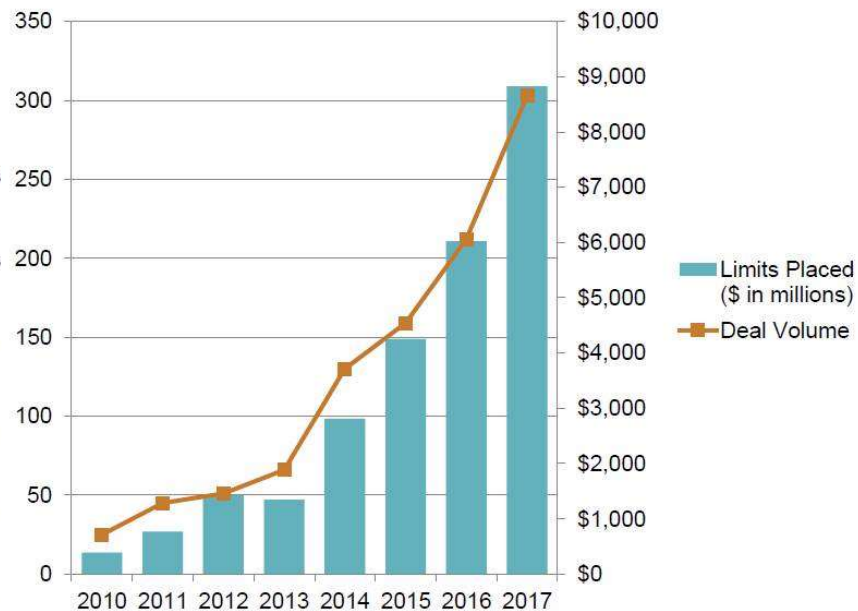
2011

- \$767 million in limits / 45 closed deals

2010

- \$387 million in limits / 25 closed deals

North America Market Statistics for Marsh only



Development – short or long

- Market chatter is this has a short tail as claim will be made once 1st audit cycle is complete
 - 20% frequency
- Based on Swiss Re internal analysis, the average development is longer between 3 to 5 yrs
 - Given the rapid growth in this business and the length of development, **losses have not caught up to premium**



R&W -Other Pricing Aspects

- Non-Renewable business
- Market Pricing - ROL based on what price would get the deal done
- Are all deals the same?
 - Industries, States, Countries
- Terms & Conditions are key drivers
 - Very different today than when product started
- How are excess layers being priced?
 - No credible increased limits factors



Tax Opinions

- Specific form of cover
 - Meant to cover tax treatment
 - Pricing is an issue
 - How does one price for tax risks
 - We're reinsurers, not tax experts
 - Bigger issue is potential for aggregation
 - Copy cat world
 - Multiple companies following the same tax advice could face similar issues if tax authorities rule against a particular tax treatment



Contingency Deals

- Meant to cover adverse development on a specific item preventing a deal from closing
 - Almost a facultative type cover
 - Could be anything: pollution, pension, underfunding, IP rights, liability/asset valuation
- Pricing is market driven
 - Very low rate on lines for high limits
 - Akin to taking a bet: “Pick a ROL and pray”
- Large Potential for aggregation



Key Take-Aways

- Still Green: Losses haven't caught up to premium
- Aggregation
- Market penetration increasing (Growth)
- Pricing / Rates going down
- Terms/Conditions expanding

Important to be realistic about this business and understand the risk



And Finally...

- It's not necessarily bad, it's just a mystery
 - Actuarial View: This product is still in its infancy
 - Losses have not caught to premium
 - Losses are also subject to Non-Disclosure Agreements
- Evolving product
 - Lots of benefits for buyers/sellers so not going away
 - Being involved → Gain experience/knowledge
- Be part of the market; but be realistic
 - Knowledge → power to make better decisions and inform your company decision makers





TRANSACTION LIABILITY: CLAIMS



Transaction Liability Insurance & Claims

Policies that Incepted between 2013 – 2018*

Aon has been notified of **249** R&W claims on policies placed beginning in 2013

Claim Percentages



*Given typical lag in claim notification, we expect additional claims to come in throughout 2019 in line with prior years

Representation & Warranties Policies

Buy-side

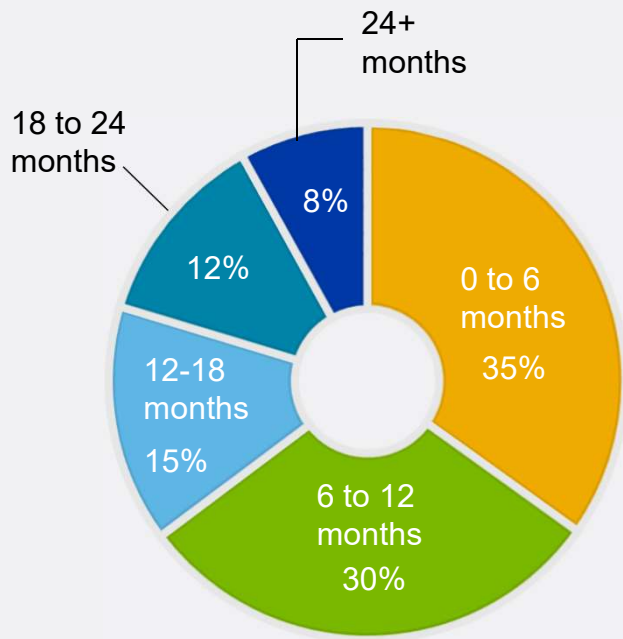
- 229 Claims
- 14% policies

Sell-side

- 20 Claims
- 42% policies

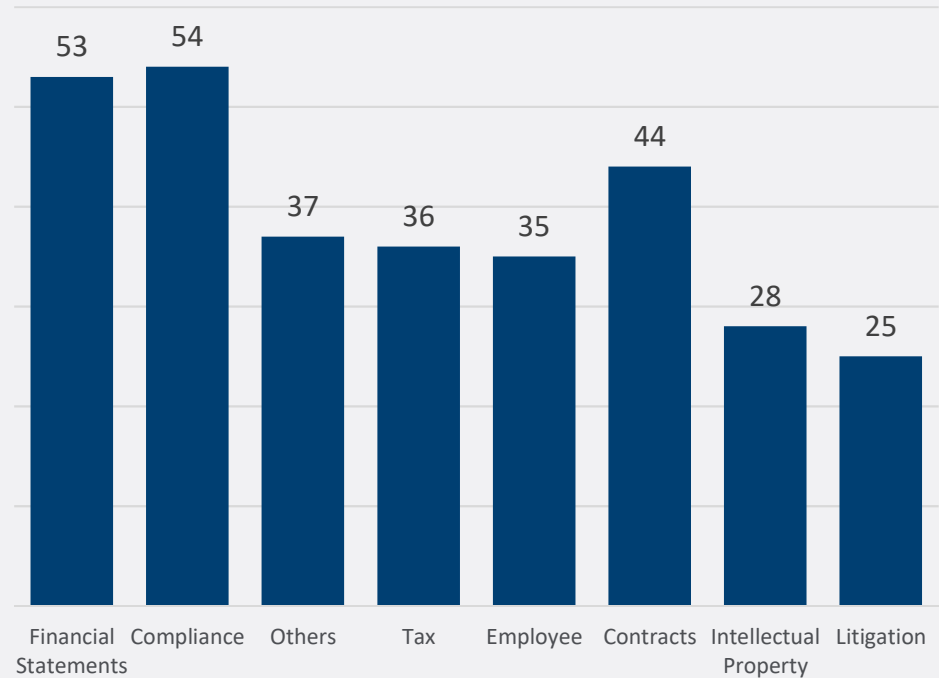
Trends in Claims

Trends in Claims: Closing to Claim Notice



Median: 10 months
 Mean: 11 months
 Range: 3 days - 53 months
 Before closing: 15 months

Types of Breaches



Examples of "Other"

- Environmental: 8
- Product Liability/Recall/Warranty: 10
- Condition of Assets: 9
- Healthcare: 4



QUESTIONS?



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