

Transactional Insurance Solutions

2022 year in review

Introduction

After reaching record-breaking highs in 2021, M&A deal momentum slowed significantly in 2022 in the face of continuing global economic uncertainty. In some respects, lower deal volume was expected; many experts viewed 2021 an outlier year and predicted a natural market correction. Broader macro-economic volatility and uncertainty in the debt markets, however, led to a particularly slow fourth quarter. Per [Bloomberg Law](#), 2022 had the lowest fourth-quarter M&A deal volume in the past six years, and it was also the first fourth quarter since 2018 in which there was not an increase in deal volume from the third quarter.

The representation and warranty insurance (RWI) industry, which was naturally buoyed by 2021's extraordinary deal activity, similarly felt the reverberations of tempered deal activity in 2022. Several new insurers entered the market and other insurers hired additional underwriters in anticipation of continued, strong deal flow. However, with only moderate deal activity, insurers encountered heavy competition for each risk, which resulted in a buyer-friendly term environment in late 2022 (and continuing into 2023).

Although RWI activity moderated in lockstep with the broader M&A market, other lines of transactional insurance — contingent liability and tax — saw growth accelerate during 2022. Contingent liability remains the fastest-growing area of transactional insurance, and several insurers and brokers have added specialized roles to manage these placements. Similarly, the pipeline of tax insurance opportunities has remained strong even in times of low M&A activity, as more financial and corporate clients become aware of the utility and scope of tax insurance solutions both within the context of an M&A deal and with respect to ordinary-course business planning.

This year in review addresses 2022 market trends in transactional insurance, including RWI, tax and contingent.

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Representations and warranties insurance



Rates

From our clients' perspective, the most direct and beneficial effect of the 2022 deal environment was the substantial decrease in the cost of RWI across virtually all deals.

At the start of 2022 and particularly with respect to policies bound in early January, rates remained in the high 4.0% rate-on-line (RoL) range as insurers held firm to rate increases implemented in 2021. However, as deal activity moderated, insurers increasingly assumed a more competitive pricing posture. During the second half of 2022, average rates lowered to between a 3.0% – 4.0% RoL and, during Q4, rates were lower than at any other point in 2022. The average rate for new submissions in December 2022 was 3.3% RoL; on several particularly strong risks, our team secured terms with rates in the high 2.0% RoL range.



Retentions

Historically, RWI policy deductibles (or “retentions”) have held fast at around 1% of enterprise value for deals with a total enterprise value (TEV) below approximately \$300M (subject to insurer minimum retention requirements on deals below \$25M TEV). During the competitive deal environment of 2022, however, WTW secured sub-1.0% retentions for its clients on transactions below \$100M in TEV. In Q4 2022, the average retention lowered to .95% for deals between \$50M – \$150M in TEV and .80% for deals between \$150M – \$350M in TEV. Deals above \$350M in TEV averaged a .70% retention. Whether the reduced retentions will represent a “new normal” in the broader RWI market remains to be seen; however, this development strongly favors buyers and, when coupled with the competitive rate environment, points toward 2023 as being a uniquely advantageous time to purchase RWI insurance.

In addition, WTW has continued to see an uptick in public-style exits, in which sellers are able to achieve a total walk-away from the transaction without any residual liability for breaches of representations and warranties, except in the case of fraud. Over 82% of the RWI policies that WTW placed in 2022 were for so-called “no seller indemnity” (NSI) deals in which there was no indemnity escrow in place for purposes of rep breaches. We predict that NSI deals will continue to dominate the private and public M&A landscape as buyers, sellers and their counsel have grown more comfortable with and reliant upon the RWI product.



Market updates and trends

2022 saw some notable developments in the RWI market, most of which served to expand the scope and quality of coverage available to our clients.

Increased capacity

- 2021 saw three new insurers enter the RWI market in the second half of the year, and two additional insurers entered the market in 2022. There is well over a billion dollars of deployable, per-deal capacity and, in contrast to underwriters' deal selectivity in 2021, the universe of underwritable deals has widened. Certain insurers that had previously avoided perceived “higher-risk” industries — most notably, healthcare — have reentered the space, and others are broadening their appetites for the first time.

Broader underwriting appetite for unique deal structures

- **Secondaries:** As structured secondaries transactions become more prevalent in private equity, the use of representation and warranties insurance in connection with secondaries deals continues to rise.
- **Smaller transactions:** Insurers have broadened their appetites to provide coverage on deals that historically had been viewed as prohibitively “small” in deal size to justify RWI coverage. WTW has placed coverage on deals as small as \$8M in TEV.
- **Minority investments:** WTW has also seen increased client interest in — and an increased willingness from insurers to offer — RWI for minority investments. RWI on minority deals tended to be infrequent in the past, given that the RWI underwriters' diligence expectations did not align with the scope of buyers' diligence in such transactions. Additionally, insurers held firm that target-level losses in a minority investment must be prorated for policy purposes in respect of the buyer's pro rata post-closing ownership of the target. However, we have seen an increase in the number of successful RWI placements on minority investments, as buyers have become more familiar with the RWI process and underwriters have become more comfortable with assessing the risks inherent in minority investments.

Expanded coverage

- **Interim breach coverage:** In an increasingly competitive marketplace, WTW continues to push insurers to broaden their coverage offerings and provide clients with new and better value propositions. One such offering is coverage for interim breaches, which are generally excluded under RWI policies. Although the occurrence of interim breaches (breaches of the representations and warranties that both occur and are discovered during the interim period) remains rare, especially on deals with a relatively short interim period, a buyer may be interested in this coverage enhancement for deals with longer interim periods (e.g., > 90 days) and in other limited circumstances. Insurers continue to be willing to offer this coverage, subject to certain caveats around the length of the interim period and other deal-specific matters.
- **Agreement comments:** One benefit of RWI is that it eases pressure around the negotiation of the seller representations and warranties in the purchase agreement (and associated indemnification provisions). However, as the increasing popularity of RWI insurance continued to facilitate an expansion in the scope of the sell-side representations and warranties in purchase agreements, insurers began to push back on certain representations that they viewed as either incapable of being supported by buy-side due diligence or that were excessively buyer-friendly. Accordingly, RWI insurer comments to the purchase agreements were particularly heavy in 2021. Often those comments simply serve to make a broad representation effectively underwritable (for example, adding in “written” qualifiers), but in some instances the comments resulted in substantial carve-backs to coverage. Throughout 2022, WTW successfully pushed insurers to limit the number and scope of their comments on the purchase agreement, because an overly conservative approach with respect to the purchase agreement could quickly transform competitive terms into undesirable ones.
- During the bid and underwriting processes, insurers continued to focus on financial statements, material contracts, and material customer and supplier representations, as well as industry-specific representations regarding healthcare, government contracts data privacy, and so on. These representations also give rise to some of the most frequent and severe types of RWI claims. Underwriters are also paying increased attention to labor and employment-related representations (and associated due diligence), particularly with respect to wage-and-hour law/FLSA-type compliance, as these issues frequently give rise to claims.
- **Underlying insurance:** Insurers have historically underwritten the availability and robustness of other lines of commercial insurance in to cover a target’s pre-closing exposures, especially along particularly impactful lines of coverage, such as cyber, environmental contamination and product liability. Throughout 2020 and 2021, RWI underwriters increasingly positioned their policies as sitting “excess of” or “excess of, and no broader than” these other lines of coverage, which would require a buyer to pursue and exhaust the underlying insurance policy before pursuing recovery under the RWI policy. In the increasingly buyer-friendly RWI environment of 2022, WTW frequently succeeded in reversing this trend, with insurers agreeing to underwrite the adequacy of a target’s underlying commercial insurance without sitting specifically excess of such insurance. At WTW, we are often able to leverage our M&A insurance diligence capabilities to provide RWI insurers with comfort around the underlying insurance that is or will be available for (or on behalf of) a target company.
- **Latin America:** Over the course of 2022, WTW saw a noticeable increase in deal activity in Latin America and an increase in insurer appetite for risks located in this region. Current geopolitical circumstances have drawn attention to Latin America as a solid emerging market. Investors have diversified their risk as sanctions on Russia and reduced exposure to China have developed during the past two years. In particular, such countries as Colombia, Brazil and Argentina have enacted several policies that nurture investment in technology-driven ventures and clean energy generation. Although a limited number of RWI insurers currently have appetite for risks in Latin America or with significant Latin American exposure, the market has opened enough to create a competitive environment. WTW has worked on several Latin American placements and has a broker dedicated to placing Latin American risks.



Claims

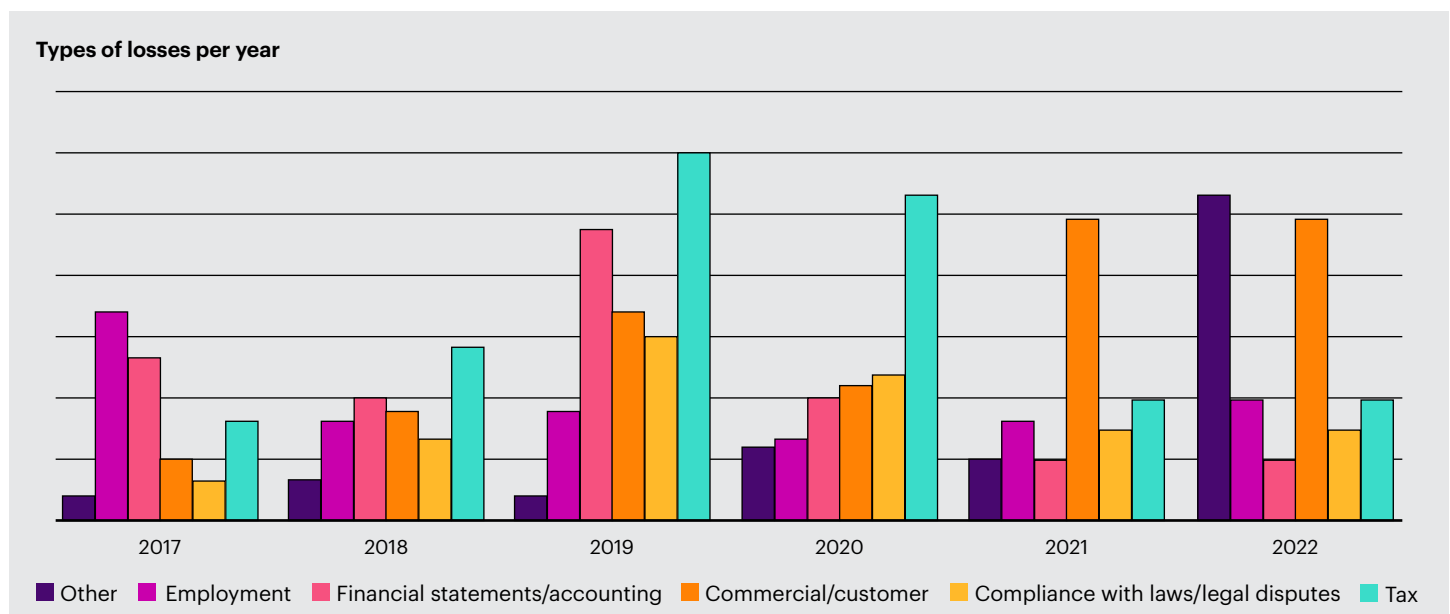
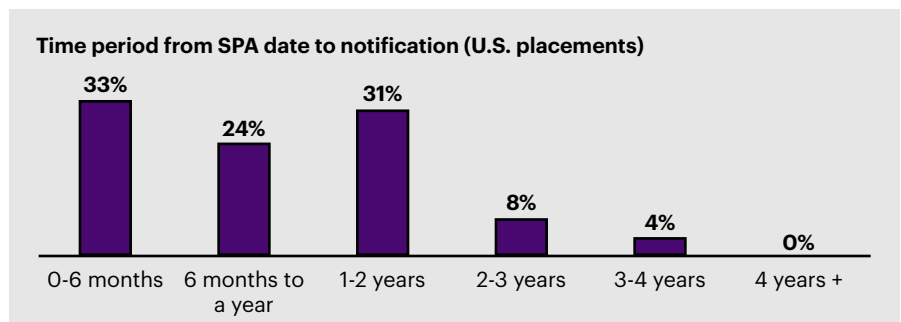
Historically, claims have been noticed on approximately 20% of RWI policies placed; this frequency continued in 2022. In terms of timing, most claim notices are delivered within the first 18 months following the closing of the transaction, and last year no notices were made after four years from time of binding. The subject matter of claims in 2022 remained in line with historical trends, with financial statements and tax-related breaches constituting the most frequently noticed claims. Of course, other claims continue to impact our trends, and we saw a continued increase in claims stemming from the loss of a material customer or supplier.

WTW's claim team helped clients recover approximately \$200M in insurance recoveries from transactional risk insurers in 2022. We have found that claims are being paid efficiently within a maturing transactional risk market, with several insurers developing strong, positive reputations for their claim handling process.

The calculation of losses — and specifically the application of a multiple (commonly EBITDA and revenue) — has been the most frequent source of contention in claim disputes. In a departure from prior years, 2022 saw more insurers protract the claim process (i.e., burdensome information requests, excessive follow-ups and calls) due to disagreements around the application of multiplied damages. Consequently, several disputes have moved close to or into dispute resolution (e.g., arbitration and mediation), which was less common prior to 2022.

At WTW our brokerage and coverage teams work closely together to ensure that an insurer's claim history (and, just as importantly, its ability to run a smooth and collaborative claim-handling process) is a key consideration when selecting an underwriter for each deal.

A few key claim highlights are below:



Tax insurance



2022 was a year of continued maturation for the tax insurance industry. WTW saw triple-digit growth in both tax insurance submissions and placements. Most notably, we saw a rise in tax insurance placements for stand-alone tax risks involving valuation, residency, partnership-level audit risks (following the implementation of the BBA partnership audit rules), and other tax risks linked to employee retention credits and renewable energy credits. We have also seen a strong demand for tax risks originating from Canada, Latin America and Europe.

Several new insurers entered the tax insurance market in 2022, which fostered a favorable and competitive pricing environment. There are now more than 20 insurers offering to cover tax insurance risks on a primary basis. Existing insurers have also continued to invest in headcount and have broadened their appetite for tax risks. Insurers are now open to covering tax risks that are in active litigation with the IRS as well as transfer pricing risks.

We expect strong demand for tax insurance to persist in 2023 as individual taxpayers and their tax advisors continue to discover the product's benefits. In particular, we expect the [Inflation Reduction Act \(IRA\)](#) to drive increased demand for tax insurance. The IRA allocated [nearly \\$80 billion](#) in new funding to the IRS, with over half of those funds earmarked for increased enforcement.

A tax insurance policy generally provides coverage for contest costs and, following the passage of the IRA, we expect taxpayers to seek out tax insurance for this feature alone for certain risks. Additionally, the IRA included the largest clean energy tax credit package in U.S. history, and we expect investments in the U.S. renewable energy sector to accelerate significantly with its passage. Tax insurance is regularly employed by the sponsors and capital providers in the renewable energy space to provide effective protection against the loss of ITC or PTCs from a successful challenge by a taxing authority.

The following case studies provide two examples of insurance solutions developed by WTW to address our client's specific tax concerns.



1. Bankruptcy – Tax refund:

Our client, a bankruptcy trustee, filed a tax refund claim with the IRS on behalf of a bankruptcy estate. The refund was paid to the bankruptcy trustee but remained subject to further IRS and JCT review. The trustee desired to distribute the refund to the creditors of the bankruptcy estate, but the trustee was concerned that the IRS could later potentially seek to claw back the refund. WTW structured a customized tax insurance policy that allowed for the immediate distribution of the cash refund to the creditors of the bankruptcy estate.



2. ECI withholding:

Our client was concerned that it could be held primarily liable for withholding taxes related to a non-U.S. investor's position in the company. The potential exposure exceeded one hundred million dollars. WTW structured an insurance solution that protected our client from any liability resulting from any such under-withholding.

Contingent insurance





State of the contingent risk insurance market

Contingent risk insurance — which transfers known legal and regulatory liabilities to insurers — is the fastest-growing product line in the transactional risk marketplace. 2022 was another year of significant growth, fueled on the client side by widespread interest in and adoption of contingent risk insurance by law firms and a diverse array of corporate clients. Insurers responded to this increased demand by launching dedicated contingent risk practice groups and, in some cases, expanding headcount in existing groups. In particular, the number of insurers offering primary capacity for contingent risk insurance policies significantly expanded this past year.

The types of legal risks being insured have broadened. Insurers have become increasingly receptive to “portfolio” contingent risk policies in which the policy covers several distinct litigated matters, as opposed to a single case. We anticipate that this trend will continue, and more clients will embrace contingent risk insurance as a systematic and holistic approach to legal risk transfer.

WTW's Contingent Risk Solutions Group places a variety of contingent risk insurance policies. Looking ahead to 2023, we expect that much of our work will focus on three core offerings:

Judgment preservation insurance locks in the value of a judgment issued by a court or arbitral panel and provides coverage if the judgment is reversed or reduced on appeal or remand. Judgment preservation insurance effectively sets a floor on a plaintiff's recovery from a lawsuit. We have worked with multiple clients interested in using judgment preservation insurance as a tool to attract non-recourse investments, which accelerates their receipt of cash proceeds at a competitive cost of capital.

Adverse judgment insurance limits a defendant's exposure from a pending or threatened lawsuit. Throughout 2022, we saw significant interest in this product from two main sources:

1. **Private equity clients** acquiring targets facing major litigation, who used adverse judgment insurance as a tool to avoid potential deal-killing indemnities.
2. **Corporate clients** litigating cases with potential “black swan” exposures that far exceeded the limits of their existing liability insurance, who used adverse judgment insurance to provide balance sheet certainty.

Litigation funding portfolio insurance insures the principal amount, and potentially part of the expected yield, of a portfolio of litigation funding investments. In 2023, we expect to see more litigation funders proactively incorporate contingent risk insurance into their investments by purchasing insurance simultaneously with funding a deal, as opposed to insuring the investment after the fact.

Case studies: Two examples of how WTW assisted clients in managing contingent exposure



1. Our client planned to make a major strategic corporate acquisition, but the transaction was threatened by a regulator. The worst-case scenario for our client — being forced to divest the target — would have resulted in an exposure of several hundred million dollars. WTW structured a novel contingent risk solution, which attributed a dollar value to this potential injunctive harm and provided significant downside protection to our client.



2. A litigation funder wanted to expand its investment portfolio. In service of that effort, the funder worked with WTW to insure its existing portfolio of litigation funding investments. WTW structured an insurance solution that eliminated the risk of adverse selection to the insurance market. The policy included a reduced upfront premium in exchange for a back-end revenue share between our client and the insurer, which aligned the parties' incentives and reduced our client's immediate out-of-pocket costs.

The transactional insurance landscape evolves rapidly. Our team of expert brokers leverages their deep knowledge of the market to secure optimal outcomes for our clients as part of our unwavering commitment to client advocacy. Working collaboratively, we are committed to the principle that our clients' success is our own.

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At WTW (NASDAQ: WTW), we provide data-driven, insight-led solutions in the areas of people, risk and capital. Leveraging the global view and local expertise of our colleagues serving 140 countries and markets, we help you sharpen your strategy, enhance organizational resilience, motivate your workforce and maximize performance. Working shoulder to shoulder with you, we uncover opportunities for sustainable success — and provide perspective that moves you. Learn more at wtwco.com.



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