Liberty Global Transaction Solutions™

2020 Claims Study

Exclusive insights driven by 10 years of data

Contents

Introduction

Liberty is one of the most experienced insurers in the mergers and acquisitions (M&A) insurance market and has been writing this class of business since 2010, initially via an Ironshore-owned-and-operated platform and, since January 1, 2019, as Liberty Global Transaction Solutions (GTS).

325+ notifications
10 years of data
The most comprehensive study of its kind

We have issued 2,000 policies during this period and now have a team of more than 60 specialists operating in 11 jurisdictions across the Americas, APAC and EMEA. This makes us one of the largest M&A insurance teams in the market and one of the few able to service clients' and brokers' needs on a truly global basis.

Our inaugural claims study — written by our dedicated claims counsel — provides an in-depth assessment of this key component in the lifecycle of a policy. It covers more than 325 notifications made over a period of 10 years, and is the most comprehensive study carried out by any insurer in the market to date.

"At Liberty GTS we are incredibly proud of our claims function. We were the first insurer to recognize the importance of having dedicated claims professionals with experience of handling M&A claims embedded within the M&A team to ensure that we give our insureds the quickest and best informed claims service possible," says Rowan Bamford, President of Liberty GTS. "The first formal Liberty GTS claims study is released during a year in which we have seen a great amount of uncertainty in the M&A space. It is apt that it comes at a time when potential insureds are more focused than ever on the strength and approach of their insurer's claims function, as well as the strength of their financial covenant."

> "We were the first insurer to recognize the importance of having dedicated claims professionals with experience of handling M&A claims embedded within the M&A team."
>
> — Rowan Bamford, President of Liberty GTS

Liberty GTS's **specialist in-house team** is dedicated entirely to servicing our claims.

At Liberty GTS, we recognize that a trusted and reliable claim service is at the heart of what we are selling — an insurance product that, following an insured loss, is designed to help an insured recover and move forward quickly. We have a specialist in-house team dedicated entirely to servicing our claims. Our claims counsel — Simon Radcliffe, based in London, and Nick Horsmon, based in New York, handle all of our claims and retain full control over the claim process and all related decisions, providing our brokers and our clients with a single, consistent point of contact. They are fully integrated within our business, giving them ready access to our underwriters — an essential requirement for ensuring a timely and informed response to a claim. It is unique in our industry and a crucial part of our commitment to offering a best-in-class service to our clients and brokers throughout the policy lifecycle, from indication of terms to the making of a claim and beyond.

"At Liberty our claims professionals afford the highest level of customer service while protecting our insureds' business and reputation in the event of a claim," says Kristin McMahon, Head of North America Specialty Claims. "The responsiveness, expertise and knowledge of the Liberty M&A Claims team is second to none; the team works collaboratively to expedite resolution of any post-transaction claim and corresponding policy pay-out, while providing our customers with full transparency into the M&A claims process."

> "Liberty's investment in a dedicated in-house global M&A claims team underscores our commitment to providing best-in-class claim support to our transactional liability insured and broker partners."
>
> — Kristin McMahon, Head of North America Specialty Claims

Section 1:
Notification trends

A sharp rise in the number of notifications received has resulted in increased scrutiny on claims handling.

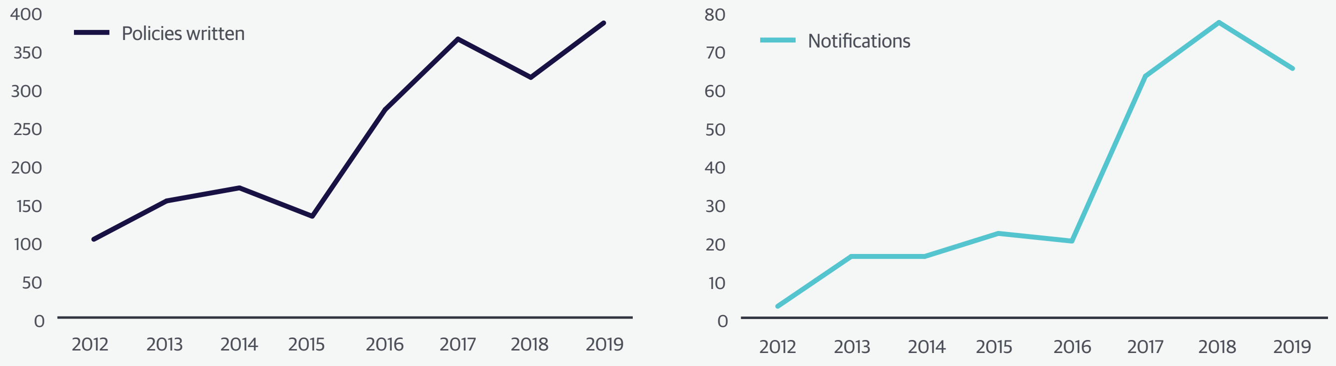
There has been a marked increase in the use of Representations & Warranties (R&W)* insurance over the last five years, driven by a sustained period of strong M&A activity and an increased awareness of the benefits of the product among dealmakers and their advisors — including examples of high-profile policy pay-outs, such as the €50m payment made by a Liberty-led insurance consortium to FSN Capital Partners in 2019.

Our policy count tripled between 2015 and 2017, and last year we bound more than 400 policies. Consistent with this increase in policy count, we have seen a corresponding increase in the number of notifications that we have received over the same period (see Figure 1).

Figure 1:

Notifications have risen sharply due to more policies being bound.

Our notification count has increased **250%** between **2015 and 2018.**



This trend has brought how insurers are set up to handle M&A claims into sharp focus and underscores the importance of partnering with a M&A insurer with an experienced claims team focused on providing best-in-class customer service. We discuss this issue in more detail in Section 10.

While an increase in policy count is one factor driving increased policy notifications, there are additional factors at play. Policyholders and their advisors are now more familiar with how the product works and when they need to make a notification, and are becoming more systematic about assessing whether they have a policy claim post-acquisition. These factors combined have resulted in a rise in the number of notifications received as a proportion of all policies bound.

The upwards trend in notifications underscores the importance of partnering with a M&A insurer with **an experienced claims team.**

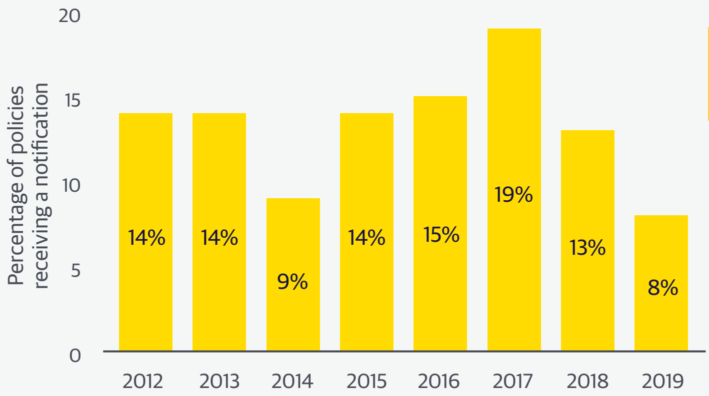
* Representations & Warranties insurance is usually referred to outside the U.S. as Warranty & Indemnity insurance (W&I)

"In the past R&W insurance was essentially something that helped solve a deal problem and get a deal over the line but then often forgotten about post-closing. Now it is also seen as an asset from which an insured can recover value in the future, and much greater thought is given from the outset as to whether a policy claim exists," notes Gareth Rees, Liberty GTS Chief Underwriting Officer.

To date, a notification has been made under approximately 19% of the policies we bound in 2017, which is an increase from a historical average of circa 14% between 2012 and 2015, and 15% in 2016 (see Figure 2). We are still receiving regular notifications on the policies we bound in 2018 and 2019, and expect that the notification rate for these years will catch up with or even exceed the 19% figure during the course of the next 24 months.

Figure 2:

Notifications have also become more frequent.



Notifications have been made under approximately 19% of the policies we bound in 2017.

"However, it is important to consider these statistics in context," says Simon Radcliffe, Head of GTS Claims. "Our data suggests no more than 25% of notifications will result in a request for a payment, and this hasn't changed dramatically over the years despite the increase in notification frequency. This is because many notifications are precautionary in nature or in respect of a matter presenting exposure within the retention. In this sense, there has not been a dramatic change in the fundamentals around transactional risk, and properly underwritten deals have not suddenly become riskier to insure."

Properly underwritten deals have not suddenly become riskier to insure despite the increase in notification frequency.

Section 2:
Deal size trends

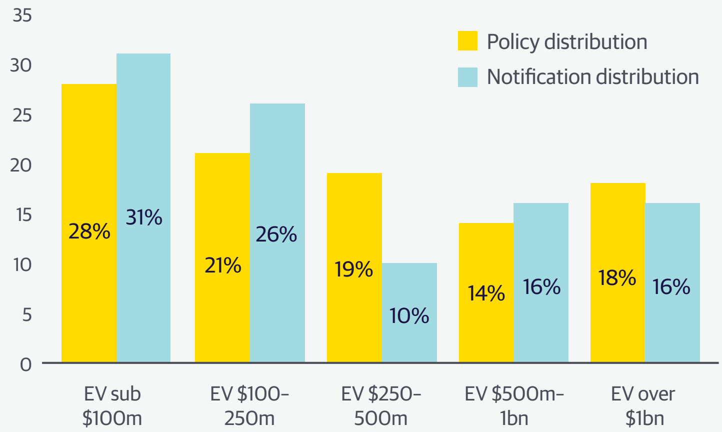
Smaller deals are more likely to result in a notification and account for our largest paid claims by value compared to larger deals.

Our data suggests that size of a deal affects the likelihood of receiving a notification. Smaller deals with an enterprise value (EV) of under $250m see disproportionately more notifications, whereas the largest deals with an EV of over $1bn see disproportionately fewer notifications (see Figure 3).

In contrast to other claims studies, we have found that **smaller deals see disproportionately more notifications** compared to larger deals.

Figure 3:

Smaller deals trigger disproportionately more notifications than larger deals.



Based on data from January 2010 – April 2020.

This stands in contrast to some of the existing claims studies in the market, which report that the largest deals generate the most notifications. But that finding is counterintuitive.

"We attach at a much lower point on smaller deals — with no policy retention in some cases — and this makes it more likely that a policyholder will submit a notification even if the impact of the issue is relatively modest," says William Lewis, Head of APAC. "Smaller deals are also much more likely to be primary buy-outs, in which case the target company will not have been through the rigor of institutional ownership, which tends to place a significant emphasis on accountability, clear reporting and improving compliance functions," he adds.

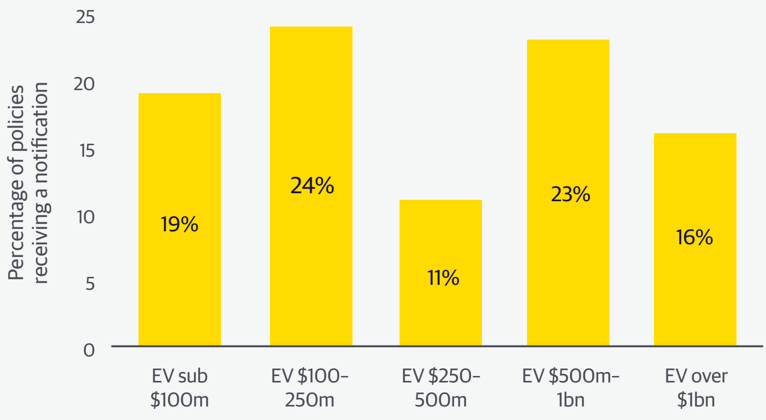
The notification rate is highest — 24% — for deals with an EV of between $100m and $250m (see Figure 4). This deal size bracket has also accounted for 40% of our paid claims by value during the period covered by the study. The smallest deals, with an EV of less than $100m, account for 27% our paid claims by value — a surprisingly large number considering that these types of deals tend to involve lower limits.

"We attach at a much lower point on smaller deals and this makes it more likely that a policyholder will submit a notification even if the impact of the issue is relatively modest."

— William Lewis, Head of APAC

Figure 4:

Notification frequency varies according to deal size.



Based on data from January 2010 – April 2020.

The notification rate is highest for deals with an EV of between **$100m and $250m.**

"This could be because, on smaller transactions, there is a potential risk that a buyer will spread its due diligence more thinly resulting in a less complete picture of the target," says Samuel Whiteman, Head of London and Emerging Markets. "In addition, there is a lot of capacity at this end of the market resulting in broader coverage and retentions being offered on these deals."

We have also seen a relatively high notification rate — 23% — on deals with an EV of between $500m and $1bn. However, because this is also our smallest data set, it is difficult to draw any firm conclusions from this.

The notification rate for deals with an EV of more than $1bn is 16%. However, only a small number of these have evolved into claims, which is why this deal size bracket only accounts for 6% of our paid claims by value.

"This is likely the result of larger deals being handled by highly sophisticated parties that engage experienced outside counsel who cover more areas of expertise, rather than relying on internal diligence," explains Hilary Weiss, Senior Underwriting Manager, Americas. "Parties that are able to effectively diligence the myriad of issues that arise in any given transaction are better able to navigate such matters, resulting in fewer claims down the line."

We have paid-out the most dollars on deals with an EV of between **$100m and $250m**.

Section 3:
Timing of notifications

There is a trend towards notifications being made earlier, with timing driven by deal size as opposed to region.

Our data suggests that we are most likely to receive a notification during the first 12 months of the policy period. We see noticeably fewer notifications 18 months after policy inception (see Figure 5).

There is no discernible variation in the data between our different regions, suggesting that the jurisdiction of the risk has little or no impact on this issue (see Figure 5).

There is a common view in the market that notifications are being received more quickly than they used to be. Our data from the policies we bound in 2017 supports this, with 63% of notifications coming in the first 12 months of the policy period (compared to the historical average of 57%). "This reflects the fact that policyholders are better advised now in terms of when they should be notifying an issue, and are actively considering from the outset whether any unknown issues that come to light after signing can be linked back to a breach of warranty," says Benn Wilson, Asia Manager.

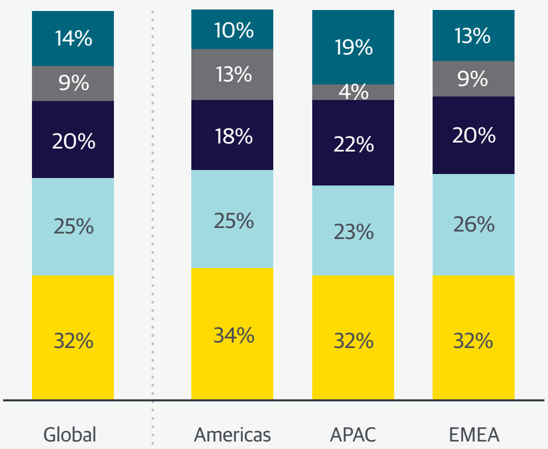
There is a notable divergence in the data when it comes to deal size, with the majority of notifications on smaller deals being made in the first year of the policy period, and the majority of notifications on the largest deals being made in the second year of the policy period (see Figure 6).

63% of the notifications we have received on policies bound in 2017 came within the first 12 months of the policy period.

> "Policyholders are better advised now in terms of when they should be notifying an issue."
>
> — Benn Wilson, Asia Manager

Figure 5:

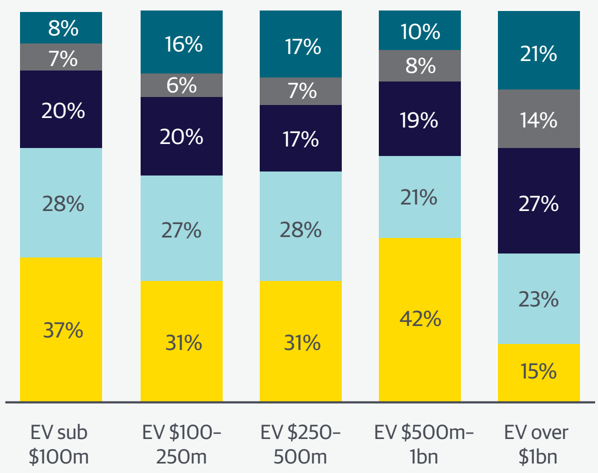
We receive the majority of notifications within 18 months of inception.



Based on data from January 2010 – April 2020.

Figure 6:

Notifications are made later on the largest deals.



Based on data from January 2010 – April 2020.

"It can take longer to identify an issue in a bigger, more complex business which may be operating from multiple sites across numerous territories, and for that issue to be brought to the attention of senior management," explains Geoffrey Lee, Australia and New Zealand manager. "We have often found on the larger deals that the first audit post-acquisition is a common trigger point for a notification."

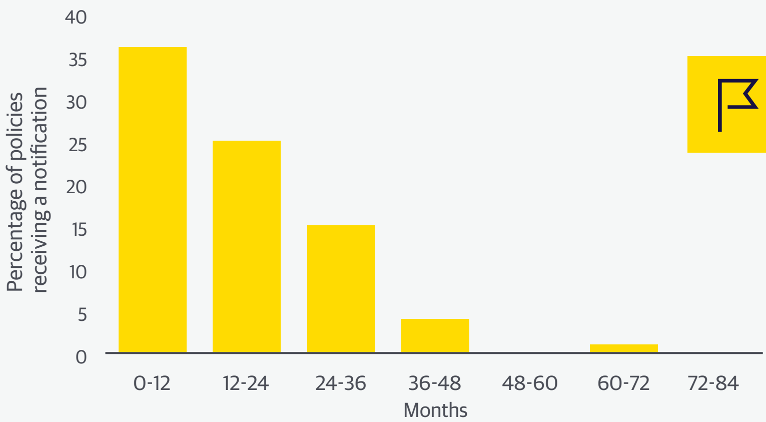
A R&W policy is long-tail in nature, with a typical policy period of two or three years in respect of the general warranties, and at least six years in respect of title and capacity and tax-related issues. Despite this, we see very few tax-related notifications beyond the third year of the policy period (see Figure 7).

"Based on our claims experience to date, most tax authorities will aim to – and in many cases are required to – commence a tax audit within one to two years of receiving the relevant tax return," says Jugdeep Singh, Head of Tax. "So it is not surprising that most tax notifications are made by the end of year three."

We see very few tax-related notifications beyond the third year of the policy period despite the long-tail nature of tax risks.

Figure 7:

Most tax-related notifications are made within the first three years of the policy period.



Most tax authorities aim to commence a tax audit within one to two years of receiving the relevant tax return.

Based on data from January 2010 – April 2020.

Section 4:

Common breach types

The most frequently cited breach type is tax-related, although many of these notifications are precautionary. Our most severe claims typically involve inaccuracies in the financial statements or material contract-related issues.

Tax is the most frequently cited breach type in the notifications we have received over the period covered by the study (January 2010 – April 2020). This holds across our three regions. Indeed, tax-related issues account for over one-third of the top eight breach types in both EMEA and APAC (see Figure 8).

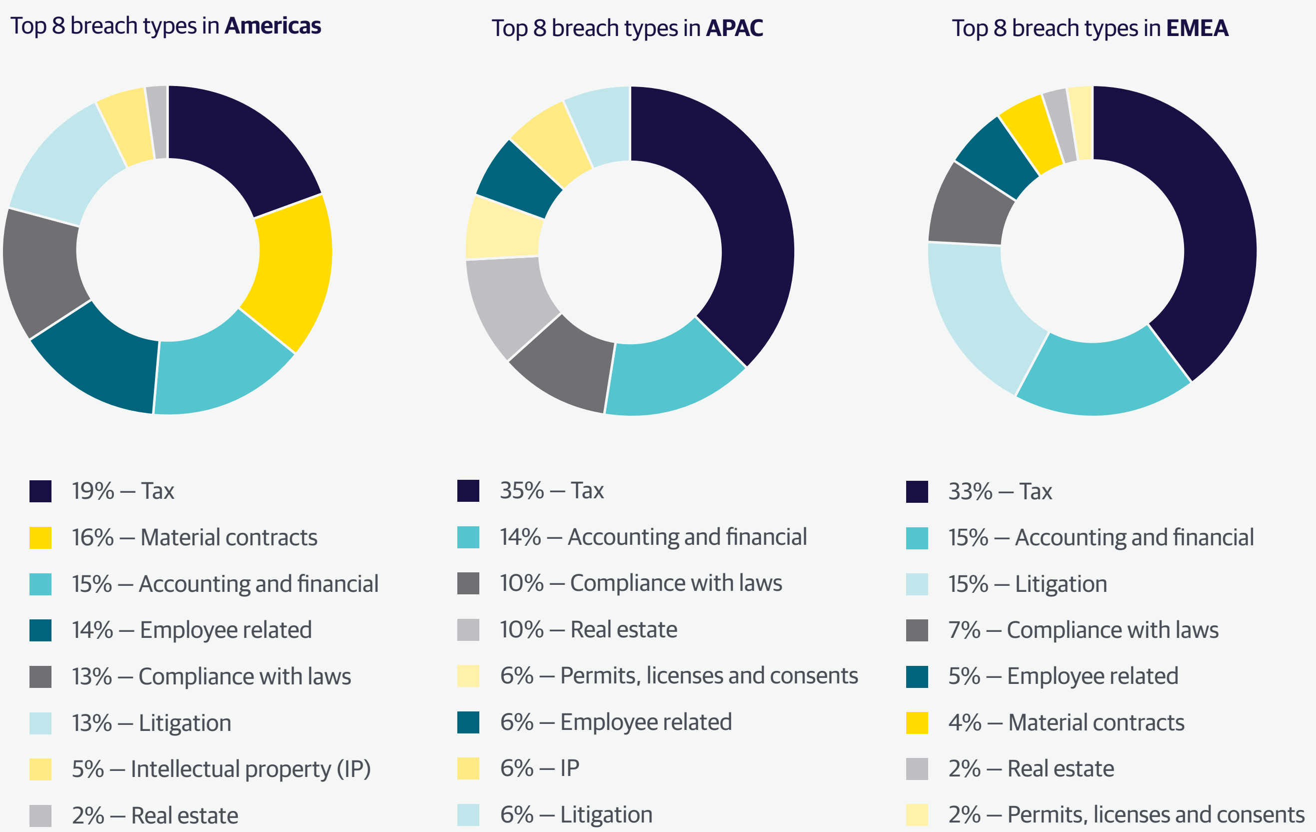
However, it is important to put this statistic in context. A significant number of these notifications are precautionary in nature and relate to the receipt of a notice of a mandatory tax audit that has yet to be conducted. Only a small percentage of these evolve into something more substantive, such as the commencement of a tax inquiry on a specific issue or the receipt of an assessment for unpaid tax.

Our data differs slightly from some other insurers in the R&W market, who typically report financial statement breaches as their most common type of breach.

Most tax-related notifications **relate to the commencement of a mandatory tax audit** and rarely develop into something more substantive.

Figure 8:

Tax is the most common breach type cited in our notifications across all regions.



Based on data from January 2010 – April 2020.

"Although at first glance this data might suggest that there is something lacking in the tax diligence, the reality is that tax-related issues are simply riper for the submission of precautionary notices to insurers at the outset of a routine audit or a tax inquiry," says Tom Roth, Senior Tax Underwriter.

This is especially true for specific jurisdictions, such as Germany. "The German tax authorities tend to conduct a routine audit of large corporations every three to four years. This makes it very likely that the target will be subject to tax audit within the policy period and that a corresponding precautionary notice will be filed by the insured," explains Markus Messinger, Head of Northern Europe.

Our claims payment data supports this conclusion. Tax-related notifications, while frequent, do not make up a material portion of our book from a paid claims perspective, irrespective of the jurisdiction or taxing authority at issue (see Section 11).

The second most common breach type relates to the accuracy of the financial statements. These claims can encompass a whole range of issues, given all that feeds into the accounts. We explore some of the more regularly recurring issues that we are seeing in Section 5.

Historically, we have seen a high number of notifications in the Americas relating to a breach of the material contracts warranties. These claims are also becoming more frequent in EMEA and APAC, making it our fourth most frequent breach type globally in 2019 (see Figure 9). The most common issues involve the failure to disclose information relating to a change in relationship (e.g., receipt of a notice of an intention to reduce orders, terminate a contract or change the terms of doing business), or an undocumented amendment to a key contract, including leases.

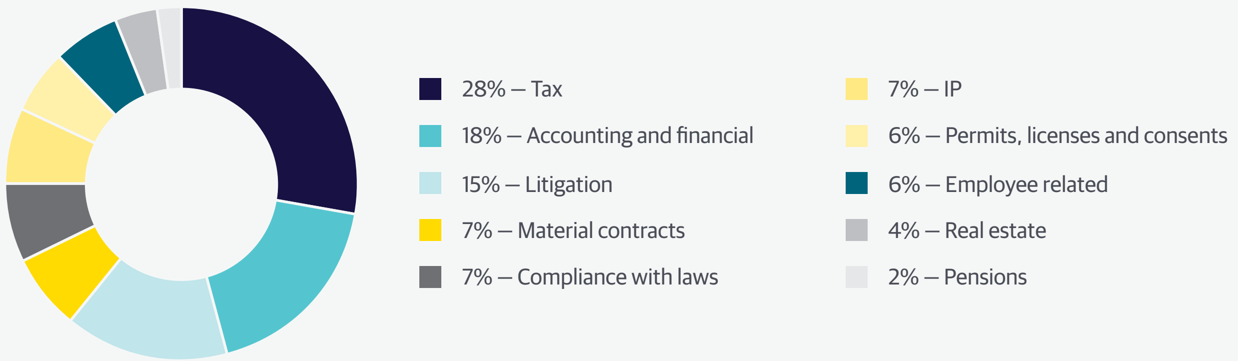
"It's not surprising that we are seeing an uptick in material contracts claims," says Scott G. Pegram, Senior Underwriting Manager, Americas. "It is a difficult subject area to properly diligence and involves understanding various factors that could negatively impact customer, supplier and other relationships. When these claims are submitted, we often see terminated contracts or reductions in purchase orders come to light after being buried away within the depths of the target's workforce, where they are harder to discover prior to signing the transaction and binding the insurance."

> "The reality is that tax-related issues are simply riper for the submission of precautionary notices to insurers at the outset of a routine audit or a tax inquiry."
>
> — Tom Roth, Senior Tax Underwriter

Material contract claims — already common in the Americas — are **becoming more frequent in other regions**.

Figure 9:

Breakdown of the subject matter of our 2019 notifications



In addition to occurring more frequently, R&W claims that relate to a breach of financial statements and/or material contracts warranties tend to be for larger amounts compared to other claims. This is due to the fact that, depending on the jurisdiction, losses resulting from such breaches are often calculated by buyers on a "multiple-of-EBITDA" basis as the breach will be alleged to reflect a reduction in target's recurring EBITDA, from which the purchase price may have been calculated.

"The calculation of loss in the R&W space can be complex and requires a partnership between insurers and their insureds during the claims process, often with the assistance of experts," explains Nick Horsmon, Head of GTS Claims for Americas. "Although we have paid several claims on a multiple-of-EBITDA basis in the past 12 months, we prefer to evaluate each claim individually. This way, we avoid taking overarching viewpoints on whether damages theories based on EBITDA multiples are inherently appropriate or not in the context of R&W claims."

We have also seen an increase in the number of notifications involving claims against the target by a third party, resulting in potential breaches of the warranties that focus on ongoing disputes or matters that could give rise to a dispute. However, most of these claims are resolved within the retention and/or are picked up by the target's business-as-usual insurance program. As a result, they do not make up a significant portion of our paid claims (see Section 11).

"The calculation of loss in the R&W space can be complex and requires a partnership between insurers and their insureds during the claims process, often with the assistance of experts."

— Nick Horsmon, Head of GTS Claims for Americas

Section 5:
Emerging trends

We are seeing a large number of claims relating to stock and inventory issues, as well as claims involving more niche issues, such as software licensing and health and safety. We expect that COVID-19 will lead to new trends emerging in the next 12 months.

The breadth and scale of our business means that we are well-placed to identify emerging claims trends, particularly those seen in multiple jurisdictions. Here's a closer look at some specific issues that are generating claims activity:

Stock and inventory

The majority of these claims involve slow moving, obsolete or damaged stock. We have also seen instances where stock that the buyer thought it was acquiring is said not to exist. Our experience is that stock-related issues are most common in retail and/or manufacturing businesses. These risks are heightened if the business is seasonal, manufactures products that are the subject of frequent updates, or holds stock that is susceptible to price volatility or physical damage. The risk is further heightened on locked-box deals where there will be no stock-take at or following closing as there might be on a deal structured with a closing-accounts purchase price adjustment mechanism.

"The reality is that stock can be a difficult area to due diligence, particularly on a deal that is moving very quickly," says Gareth Rees. "This has been exacerbated by COVID-19. A lockdown situation obviously makes it difficult to carry out any physical checks. Also, there will be many companies that have built up large quantities of stock as a result of the lockdowns but which may not have updated their policies around obsolete and slow-moving stock to reflect this. This is an issue of heightened underwriting focus for our team at the moment, particularly on deals that do not feature a stock-take at or following closing as part of a completion accounts price adjustment mechanism."

Accounts receivables

We have seen a number of claims relating to this issue in the last 12 months. Common allegations include the setting of inadequate bad debt reserves and errors in terms of quantifying a company's total accounts receivables. It is possible that we will see more claims like these in the coming months due to the economic fallout created by COVID-19. We are, therefore, paying much closer attention as part of our underwriting to the size of the accounts receivable figure in the accounts relative to the size of the balance sheet and asking more questions around this issue.

Software licensing

These claims are being driven by the increasing number of audits that are being carried out by or on behalf of on-premises software vendors. These audits often reveal a license shortfall or violation of varying seriousness, with the subsequent demands being unexpected and potentially onerous. The vendors may impose penalties or require that the new software necessary to rectify a shortfall is purchased at list price. They may also seek payment of support costs. We are focusing on this area in more detail during the underwriting process and expect it will also become an area of focus for buyers and their advisors during the due diligence process as target businesses become more digitally enabled and more reliant on licensed software.

Revenue recognition

The way that revenue is recognized and then booked for accounting purposes has been at the heart of a number of our more recent claims. It can be a particular issue for project-based work, where revenue is recognized over time and in line with costs as they are incurred (instead of in line with income actually received), and for long-term, multiple-element contracts. The risks are further enhanced by the fact that this is an area that is susceptible to fraud. We are increasingly looking for signs that management have been challenged appropriately in key areas of judgement associated with the entity's revenue recognition practices and sufficient evidence has been obtained to support those judgements.

Minimum wage legislation

These claims often relate to employees who have not been paid for working through mandatory rest periods or for working overtime. Blue-collar industries with a large employee base or sectors where workers are paid hourly rates at or just above the minimum wage are particularly exposed (e.g., retail, call centers, hospitality, etc.). The consequences of an issue like this can vary by jurisdiction, but include: claims by employees for additional pay (including holiday pay) by way of class actions; additional tax liabilities; and fines. Sizeable claims are not uncommon. It is increasingly important, therefore, that analysis is carried out on these types of deals into whether the target entity has a robust system in place for ensuring that workers are fully remunerated and are taking appropriate rest breaks, and what procedures are in place to monitor compliance.

Reclassification of contractors as employees

This continues to be an issue that results in a large number of notifications with the potential for significant consequences for a business, both in terms of increased tax liabilities and payroll costs. It is an area that is being increasingly scrutinized by tax authorities and we anticipate that they will become even more aggressive in pursuing this type of avoidance as part of a renewed attempt to increase tax receipts given the major state support we have seen for employees as a result of COVID-19.

Health and safety

We are seeing more claims relating to alleged breaches of health and safety laws and fire prevention legislation, especially in the real estate sector. These are, in part, a sign of the increased regulation in these areas, combined with a greater emphasis on compliance. These types of issues can often lead to significant remedial costs and disruption depending on the amount of work that needs to be carried out in order to achieve compliance with the relevant legislation. We anticipate that this will lead to buyers and their advisors focusing more on this area as part of their due diligence, with technical reports addressing this specific issue becoming more common.

Climate change

We have received several notifications on this issue, including a permitting issue relating to the EU Emissions Trading Scheme and an accounting issue relating to the value attributed to carbon credits in a set of financial statements. We see climate change as a significant (but underappreciated) risk area for businesses due to the increase in scrutiny on this issue, combined with the likely increase in related legislation over the coming years. A particular challenge for businesses and their auditors is the extent to which they have ensured that the financial impact of climate change has been appropriately factored into their accounts, for example, through impairments to goodwill or reductions in the useful economic lives of assets.

COVID-19

The changing landscape caused by COVID-19, and the resulting economic downturn, is likely to lead to new trends emerging in the next 12 months. This will inevitably feed into the underwriting process as underwriters look to scrutinize these areas more closely. Possible new areas of exposure include:

- an increase in third-party claims, including in connection with labor-related issues and material contracts that have been terminated on the basis of an apparent force majeure;
- an increase in claims relating to key customer insolvency where, pre-signing, there were circumstances that were known to the warrantors that indicated that the relevant customer was in financial difficulty; and
- an increase in claims relating to the incorrect use of the various job retention schemes that were implemented by national governments in the wake of COVID-19.

Section 6:
Jurisdictional trends

We are seeing more notifications in jurisdictions that have only recently started using the product on a regular basis.

With offices on four continents, fluency in 13 languages, and an ability to structure global risks in unique ways, Liberty GTS has underwritten countless cross-border deals, irrespective of the jurisdiction of the target operation, entity domicile, or governing law.

Our spread of claims is equally global in nature. We have received notifications in 33 distinct jurisdictions. The largest proportion of our notifications concern targets with primary operations in the United States. Over the past three years, approximately half of all claim notices received fall into this category. This reflects the fact that we write significantly more policies in this jurisdiction. The remaining half of our claims are spread mainly across the U.K., several distinct countries in Europe, Singapore, and Australia.

Of course, some jurisdictions are more heavily scrutinized during the deal process. It is not uncommon for claims to arise based on breaches occurring in jurisdictions that are not the primary base of the target company's operations (e.g., where a foreign government body other than the one governing the target's primary locale commences a regulatory or tax inquiry to the target's past behavior or legal filings, triggering a notification).

We are starting to receive more notifications in connection with deals where the target is headquartered in jurisdictions that have only recently started to use the product on a regular basis. Southern European deals in particular have attracted a slightly higher rate of notifications relative to number of policies issued, with French, Spanish, and Italian deals responsible for approximately 10% of notifications in 2019 (see Figure 10). "Historically, these jurisdictions have been more litigious in nature and arguably have more aggressive tax authorities than their Northern European counterparts. We have also seen clients quicker to notify relatively minor matters or matters which are prima facie excluded from cover," explains Nicholas Lunn, Head of Southern Europe. "This is something which continues to inform both our underwriting approach, coverage and pricing," he adds.

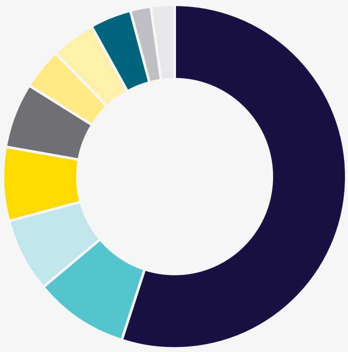
We expect to see an acceleration in the geographical spread of our notifications in the coming years as the product continues to gain traction across the globe. Our claims function is uniquely placed to deal with this challenge head on. This is evident in our ability to work collaboratively on a global basis and leverage the critical partnerships that we have already established with legal and accounting advisors across multiple territories. This groundwork ensures that each claim is considered in a thoughtful and timely manner, regardless of the issue or governing law.

> "Historically, [France, Spain, and Italy] have been more litigious in nature and arguably have more aggressive tax authorities than their Northern European counterparts."
>
> — Nicholas Lunn, Head of Southern Europe

We have received notifications involving **33 distinct jurisdictions.**

Figure 10:

Breakdown of 2019 notifications by the main jurisdiction of the target (top 10 only)



- 55% – U.S.
- 9% – U.K.
- 7% – Germany
- 7% – Australia
- 6% – Italy
- 4% – Netherlands
- 4% – Malaysia
- 4% – France
- 2% – Singapore
- 2% – South Africa

Section 7:
Sector trends

Most notifications stem from deals in the industrials sector, yet all sectors are represented.

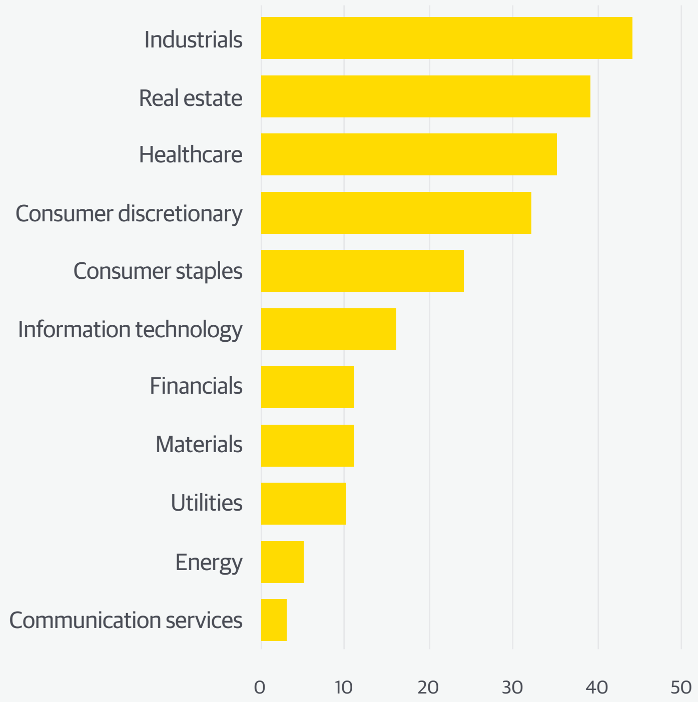
Our notifications are spread over a large number of different sectors, demonstrating that the increased appetite for R&W insurance and the resulting rise in claims activity is not sector specific.

A breakdown of our notifications by sector based on the Global Industry Classification System (developed by Standard & Poors) shows that a significant number of our notifications arise from industrials deals (see Figure 11). This broadly defined category encompasses industry groups such as manufacturers of capital goods, providers of commercial and professional services, and transportation. We have also received a large number of notifications in connection with real estate deals (includes office and retail real estate investment trust [REITs]), healthcare deals (includes providers of healthcare equipment and services, pharmaceuticals, and technology), and consumer discretionary deals (includes retail, textiles, consumer electronics, household appliances, and hotels/restaurants).

The increased appetite for R&W insurance, and the resulting rise in claims activity, **is not sector specific**.

Figure 11:

The industrials sector is responsible for the most notifications.

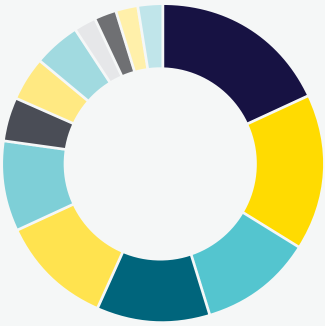


Based on data from January 2010 – April 2020.

A closer look at our data reveals that we have seen more industrials notifications on deals in the commercial services and supplies sub-sector and the machinery sub-sector than in other sub-sectors, such as building products or trading companies (see Figure 12).

Figure 12:

Our industrials sector notifications are spread over a wide number of sub-sectors.



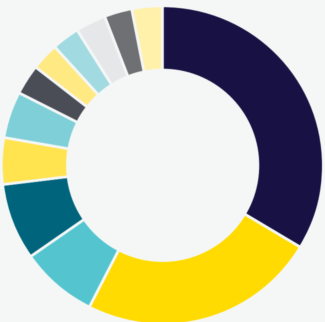
Based on data from January 2010 – April 2020.

Our real estate notifications principally relate to deals involving retail and office REITs, with the former seeing the highest number of notifications (see Figure 13). This is likely to be because retail deals typically involve a multi-tenant site, meaning more leases and more potential for disputes. "The fact that we see so many real estate-related notifications does beg the question whether the insurers that are aggressively targeting this sector by offering ultra-low prices and coverage for risks that most of the market excludes (such as construction defects and accuracy of rent-rolls) have properly appreciated that these deals are not without risk, particularly given the low attachment point," comments Samuel Whiteman.

Real estate notifications feature highly, illustrating that these deals are not without risk.

Figure 13:

Retail and office REITs make up the majority of our real estate notifications.

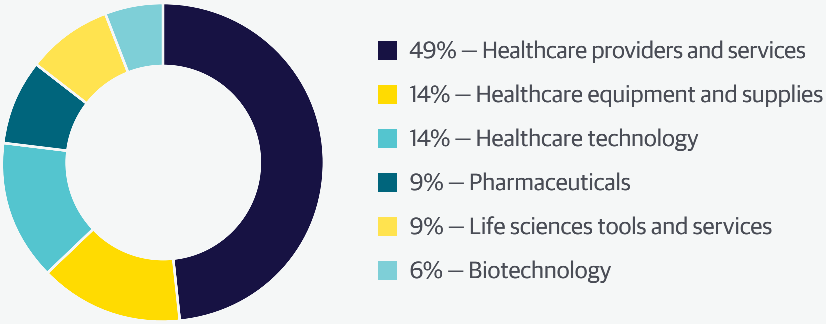


Based on data from January 2010 – April 2020.

The largest portion of our healthcare notifications are associated with deals involving healthcare providers and related services, with many of these relating to healthcare facilities, such as care homes (see Figure 14). We have seen far fewer notifications in connection with deals in the pharmaceuticals or biotechnology space reflecting our cautious underwriting approach to these sub-sectors, which do not form a significant part of our book.

Figure 14:

Deals involving healthcare providers and related services account for the majority of our healthcare notifications.



Based on data from January 2010 – April 2020.

"Though we view healthcare providers and healthcare services as a riskier area within the healthcare sector, we have a broad appetite for healthcare deals and touch most of the industry."

– Victoria Rosales, Senior Underwriting Manager, Americas

"Though we view healthcare providers and healthcare services as a riskier area within the healthcare sector, we have a broad appetite for healthcare deals and touch most of the industry," explains Victoria Rosales, Senior Underwriting Manager, Americas. "Our underwriters are especially careful to make sure there is adequate diligence in billing/coding, regulatory compliance, and cyber," she adds. "Unlike many breaches discovered within a standard audit period, billing/coding issues can take longer to uncover. This means we may start to see those claims come in from older policies."

Our data also shows that, at the other end of the spectrum, we have received relatively few notifications on infrastructure deals, despite the fact that we are very active in this space. "Infrastructure deals are invariably high-quality assets, owned by sophisticated investors and typically sold as part of competitive processes," says Nicholas Lunn. "We tend to see well-structured deals with clients and advisers who are familiar with the benefits of using the product. Coverage has rapidly evolved from simpler real estate target businesses and to date the notifications history of more complex infrastructure deals across various sectors appears to have followed a similar relatively low trajectory."

Notifications involving **infrastructure deals are under-represented** compared to other sectors.

It is important to note that this data reflects, in part, that we insure a significant number of deals in the sectors where we have seen the most notifications (industrials, real estate and healthcare). It is not necessarily a sign, therefore, that deals in these sectors are inherently riskier to insure than deals in other sectors.

Section 8:
Claims severity

High-severity claims are still uncommon, although the Americas has seen slightly more of these types of claims compared to our other regions.

A key data point for all stakeholders in the R&W insurance industry is claims severity.

How we define severity:

Low-severity claims involve a precautionary notification or a claimed amount of less than $1m.

Medium-severity claims involve a claimed amount of $1m to $10m.

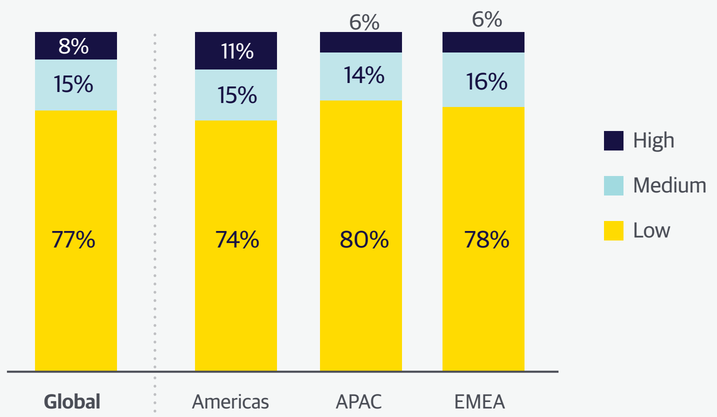
High-severity claims involve a claimed amount of $10m+.

Our data shows that of all claim notifications received globally since 2010, 77% are low-severity, 15% are medium-severity, and 8% are high-severity (see Figure 15).

Globally, **77% of our notifications are "low-severity."**

Figure 15:

The Americas region sees more severe claims, but more than 75% of all claims globally are low-severity.



Based on data from January 2010 – April 2020.

The spread of severity is similar by region, except for a slightly higher degree of high-severity claims reported in the Americas region as compared to EMEA and APAC. This could be due to the slightly higher rate of materials contracts claims in this region, which, as discussed above, tend to be larger in value.

"The reality is that for an issue to impact a business by more than $10m (net of the retention), something fairly significant and unexpected has gone wrong," says Rowan Bamford. "That is still quite rare, particularly given that institutional investors and their advisors often know where to look for problems based on their experiences from previous deals."

It remains to be seen what impact COVID-19 will have on this issue, although we have yet to see the jump in notifications that some commentators have predicted, with our monthly count being no higher and, in some cases, lower in recent months compared to at the beginning of the year.

It is possible that this may change in the coming months to the extent that more deals don't perform as expected, resulting in more cases of "buyer's remorse." However, an insured will still need to overcome the usual hurdles in order to make a successful claim, including establishing that there has been a breach of an insured warranty, and these warranties will invariably only speak to events that existed as of the date that they were given or at a historic point in time — an important point bearing in mind that the deals that are most likely to be affected by significant COVID-19-related exposures are those that signed prior to the pandemic.

Of course, regardless of the impact of COVID-19, large losses will still occur from time to time and, when they do, the key to the outcome of the resulting claim is often the strength of the balance-sheet of the insurer in question, coupled with the experience and speed of response of its claims handling team.

> "For an issue to impact a business by more than $10m (net of the retention), something fairly significant and unexpected has gone wrong."
>
> — Rowan Bamford, President of Liberty GTS

We have **yet to see a discernable impact** on our notification count due to COVID-19.

Section 9:
The claims process

The claims process requires collaboration from the outset, with transparency and communication being key to a successful resolution.

Unsurprisingly, the claims process has come under much more scrutiny as a result of the increase in claims activity, although this has led, in turn, to a greater appreciation among both insureds and their advisors towards what the process involves (see Figure 16).

Figure 16:

The claims process

Stage 1 **Discovery**	Stage 2 **Notification**	Stage 3 **Policy investigation**	Stage 4 **Possible follow-up**	Stage 5 **Coverage response**	Stage 6 **Payment of claim**
Insured discovers actual or potential breach event or third-party claim	Insured submits claim notice to Liberty GTS	Liberty GTS commences investigations	Possible follow-up requests and correspondence	Liberty GTS issues coverage response	Liberty GTS pays a covered claim

The key point to note is that there will be a period of investigation following receipt of the claim notice. It is more than likely that this will involve the insurer making requests for additional documents or information. There are some cases that are sufficiently straightforward that we can deal with them in-house, and we are much better placed to do that than other markets because of our specialist in-house claims function. In some cases, however, outside counsel or other experts may need to be instructed to assist with investigations, such as with a particularly complex claim or where the claim involves foreign law issues.

The length of the investigation period depends on a variety of factors, such as the quality of the claim notice and supporting material, and the completeness of responses to requests for further information or documents. The type of claim can also be a relevant factor. We find that third-party claims and claims under the tax indemnity tend to be more straightforward to deal with. Claims alleging multiple breaches of warranty and involving complex accounting issues are likely to take longer, particularly if they require expert input.

In our experience, evaluating quantum is often the more difficult and time-consuming part of the claims process, particularly if the relevant measure of loss is the diminution in the value of the shares in the target company. Focusing on this issue at the outset maximizes the chances of a swift resolution. From an insured's perspective, this means articulating a clear position on loss at an early stage (ideally with the benefit of expert input in particularly complex cases) and being prepared to justify this by reference to any relevant documents and/or evidence, including by producing the valuation model used in some instances.

Claims that involve **multiple breaches and complex accounting issues** usually take longer to investigate.

The experience of the relevant insurer is also critical to a timely resolution of a claim. An established insurance carrier writing the business directly for its own account will have been through the claims process many times over – it will understand the challenges involved and its experienced claims handling team will be well equipped, therefore, to deal with them. In addition, an insured will only have to deal with one decision-maker throughout the claims process – a key consideration bearing in mind that both speed and clarity of response can be critical in a claims scenario.

In our experience, the claims process is getting quicker and more efficient. Our most recent payment – a $8.75m payout in respect of a breach of a material contract warranty – was agreed in nine months. Our goal is to make the process even smoother, by ensuring, for example, that any requests for further information and documents are both proportionate and relevant to the claim. We want our clients to have confidence in the process and we work hard to eliminate surprises. Our claims counsel are committed, therefore, to being open and transparent about the status of investigations and timings, regularly checking in with our clients and brokers during the claims process and always being available to discuss the status of the claim.

Setting out a **clear position on loss** with supporting evidence at an early stage is critical.

Section 10:
Claims handling

Insurers are being increasingly judged on their claims service, but there are significant differences in terms of how individual insurers are set up to handle M&A claims.

Our experience is that there has been a notable shift in the mindset of insureds in the last few years in terms of what is important to them when selecting their insurance carrier, with a much larger emphasis on claims service. This is particularly the case for insureds who have already been through the claims process, such as FSN Capital Partners – a Danish based private-equity fund that secured a €50m policy limit pay-out under a Liberty-led policy in 2019.

"Our experience re-affirmed to us not only the value of a W&I policy, but also the benefits of taking out a policy with an insurer that is dedicated to and focused on claims outcomes and has the balance sheet strength to pay when called upon," says Thomas Broe-Andersen, Partner at FSN Capital Partners (Investment Advisor to the FSN Capital Funds).

However, the reality is that not all M&A claims experiences are the same; they can vary, sometimes significantly, depending on the experience and reputation of the insurer and its claims handling team. This makes it increasingly important for insureds to look beyond the lowest premium and nonessential coverage add-ons, and to scrutinize at the outset how an insurer will respond in a claims scenario if the deal doesn't go as expected. A key consideration, in this context, should be whether a claim under the policy will be handed off to a generalist claim handler with little or no experience of the product, or be dealt with by an experienced and specialist in-house claims counsel who has full control over his or her own processes and decisions.

The recent influx of new entrants into the market – largely mono-line Managing General Agents (MGAs) – makes this more important than ever. In many cases, their M&A claims handling capabilities have not been properly tested. We have found that, despite this, some insureds do not always appreciate that MGAs are not the risk-taker for the purposes of the policy. In addition, they usually have little or no authority to handle or to settle a claim, meaning that decisions have to be referred back to the panel of insurers that provides their capacity instead. This can lead to a more protracted and unpredictable claims process, particularly if the underlying insurers concerned don't have any specialist R&W claims experience.

Another issue we often see with MGAs is that, frequently, the insurers that provide their capacity may choose to exit the M&A market entirely or back a different MGA. They can do this with relative ease because they have not invested in the people and infrastructure necessary to write the business directly for their own account. From an insured's perspective, this can mean the insurer handling their claim no longer has interest in the M&A insurance market or the MGA that wrote the risk. The impact of COVID-19 is likely to exacerbate this issue as more insurers look to reassess how they deploy their capital.

"It is vital that insureds give proper thought to which insurer or entity will be sitting behind its policy and how that entity is set up to handle claims," says Nick Horsmon. "Selecting an insurer that relies on its own strong supply of capital and has a specialist in-house M&A claims handling function, like Liberty GTS, can save time and money down the line in the event that it becomes necessary to make a claim under the policy."

> "Our experience re-affirmed to us not only the value of a W&I policy, but also the benefits of taking out a policy with an insurer that is dedicated to and focused on claims outcomes."
>
> – Thomas Broe-Andersen, Partner at FSN Capital Partners

Insureds need to give **proper thought at the outset** to which insurer or entity will be sitting behind its policy.

> "It is key when placing transactional insurance that you have confidence in the financial strength of the insurer and that you are clear that should a claim arise it will be dealt with in a timely manner by true experts."
>
> – Daniel Cavanagh, Managing Director, London Strategic Land

Section 11:
Paid claims trends

The true value of a M&A policy lies in the ability and willingness of the insurer to honor covered claims, whatever their size and whenever they arise.

A proven track record of paying claims — especially large claims — has become a key consideration in selecting an insurer.

The ongoing fallout from COVID-19, and the resulting claims that this is generating among other lines of business in the insurance market, means that more emphasis is also being placed on the credit rating of insurers and the size of their balance sheet.

Key findings from paid claims data

This year alone we have already paid out $36m as of the end of April 2020 and, in the last 12 months (April 2019 – April 2020), we have been involved in individual payments of more than $20m in each of our key regions (being the Americas, APAC and EMEA). This includes a €50m policy limit payment to FSN Capital Partners, referred to in Section 10.

This year alone we have already paid out **$36m** as of the end of April 2020.

Our data reveals:

- A significant number of payouts relate to breach of the financial statement warranties, both in terms of number and value.
- The industrials sector accounts for the largest portion of pay-outs by value, followed by the healthcare sector.
- The Americas region accounts for just under 50% of payouts by value.
- Smaller deals have resulted in the most paid claims by value and policy limit payouts.

Paid claims by breach type

Our data shows that 26% of our paid claims relate to a breach of the financial statements warranties (see Figure 17). This reflects the fact that notifications that cite this warranty as having been breached are more likely to relate to a quantifiable issue as opposed to being precautionary in nature. We have also found that claims of this nature can be for significant amounts. Indeed, they account for around 63% of our paid claims by value over the period covered by the study. That is far in excess of any other breach type (see Figure 18).

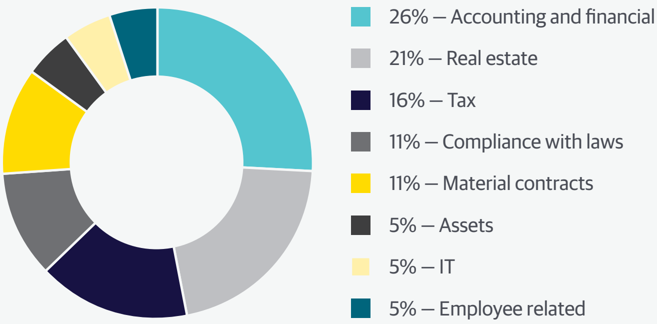
"The largest claims we see tend to relate to this issue, so it should be no surprise that it accounts for our largest payouts," says Simon Radcliffe. "We expect this trend will continue. This also helps explain why we tend to avoid deals where a large part of diligence is carried out by internal teams as opposed to external advisors."

> "The largest claims we see tend to relate to this issue [breach of the financial statements warranties], so it should be no surprise that it accounts for our largest payouts."
>
> — Simon Radcliffe, Head of GTS Claims

In our experience, claims that relate to a breach of material contract warranties can also be costly, making up 14% of paid claims by value. This issue can be magnified if the material contract that is the subject of the claim involves a key

Figure 17:

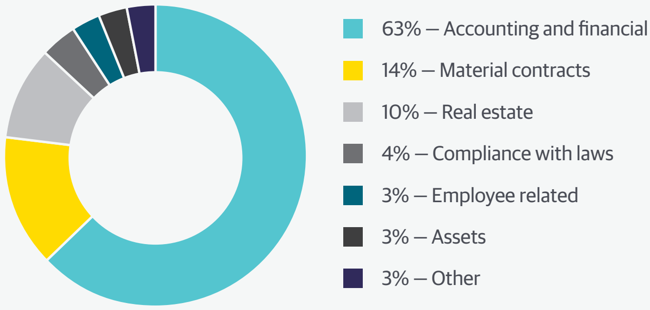
Most of our paid claims relate to a breach of the accounting and financial statement warranties.



Based on data from January 2010 – April 2020.

Figure 18:

We have paid out the most dollars for breaches of accounting and financial statement warranties.



Based on data from January 2010 – April 2020.

customer and is, therefore, particularly valuable to the business. For example, we paid out over $15m recently to an insured that discovered post-signing that — in breach of the term of a material contract — a key customer had been overcharged by the target for a number of years.

Despite the high number of tax-related notifications that we receive, these have only translated into 11% of our paid claims. This is because, as discussed earlier, a lot of these notifications relate to the commencement of a routine tax audit and do not develop into a claim. For the small proportion that do develop into claims, the loss is often relatively low in value.

"Tax losses tend to be one-off, nonrecurring issues. You rarely get a situation where the resulting claim is quantified by reference to a transaction multiple — it is nearly always based on the amount of the unpaid tax liability," explains Simon Radcliffe. "This explains why our paid claims in this area collectively account for just 2% of paid claims by value."

Over the period of this study, we have written a large number of risks involving deals in the real estate sector — especially in the early years. This helps explain why real estate-related issues form a relatively high portion of our paid claims by number (21%).

We have also paid a number of claims that involved a breach of the compliance with laws warranty. However, these types of claims have tended to result in low-level losses and only make up 4% of our paid claims by value.

Paid claims by sector

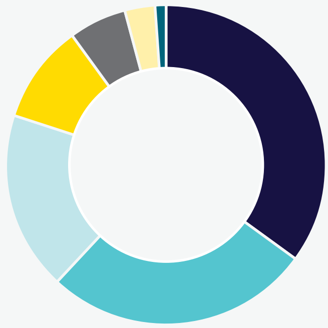
The industrials sector accounts for 35% of our paid claims by value (see Figure 19). The majority of these claims relate to manufacturing risks.

"Manufacturing businesses are often comprised of multiple complex assets, including proprietary IP and high-value capital assets used in the production facilities and processes," says Benn Wilson, Asia Manager. "Not only do these assets generate a large proportion of the value of the business, especially when projected over time, they can also require more sophisticated accounting and tax governance. This increases our risk across various categories of warranty. When combined with other common sources of claims that are also relevant for a manufacturing business, such as material contracts and value of inventory, it is not surprising that deals in this sector generate a significant proportion of our paid claims by value."

The **industrials sector** accounts for 35% of our paid claims by value, with many of these relating to manufacturing risks.

Figure 19:

We have paid out the most dollars on deals in the industrials sector.



Based on data from January 2010 – April 2020.

Historically, the healthcare sector has accounted for a material portion of our paid claims by value (27%). Despite this, we retain a broad appetite for deals in this sector that are within our risk profile. We expect to see an upsurge in these types of deals over the coming months as the COVID-19 pandemic causes healthcare systems and investors to rethink partnership and acquisition opportunities.

The consumer staples sector makes up 18% of our paid claims by value. A specific sub-sector that has resulted in a number of paid claims is the food and beverage sector. "There is no obvious driver behind this," says William Lewis, "although many companies in this sector have complicated supply and distribution agreements and are susceptible to stock-related issues; it is also a highly regulated area, which creates an additional element of risk if businesses have not been compliant."

Our paid claims in the real estate sector consist of a number of low-level losses and a small number of more significant payments. These payouts account for 10% of our paid claims by value. The low-level payouts are in part a by-product of the fact that we attach at a much lower point on these deals — at nil in many cases. The more significant claims that we have seen in this area have tended to stem from the poor physical condition of, or defects to, the property. These types of losses are now excluded by most insurers in the market.

Paid claims by region

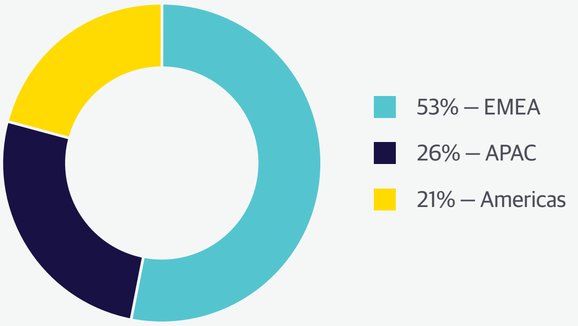
The EMEA region has seen the most paid claims over the period covered by the study (53%), followed by the APAC region (26%). This is not surprising since these are our longest-running books of business (see Figure 20).

We only began writing risk in the Americas in 2016, which partly explains why it accounts for just 21% of paid claims to date. Despite this, the majority of our paid claims by value (45%) are in connection with risks where the main operations of the target business are situated in the Americas (see Figure 21). A key reason for this is the different style of cover offered in the Americas, which tends to be broader with less exclusions and a more restrictive approach to what is treated as having been disclosed against the warranties. The measure of damages is also different, such that an insured is often able to recover on an indemnity basis of loss. These factors combined mean that there are typically less obstacles for an insured to overcome to establish that it has a valid claim in the Americas, although this is reflected in the higher cost of the product for this style of cover.

Historically, the **healthcare sector** has accounted for a material portion of our paid claims by value.

Figure 20:

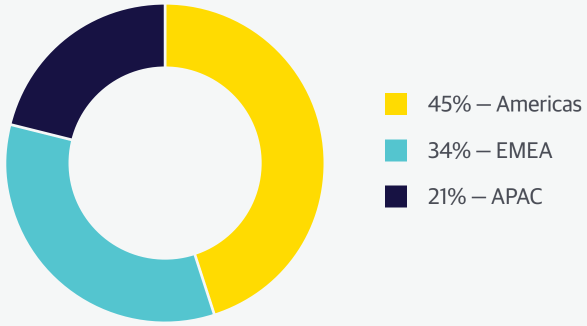
We have paid the most claims in EMEA.



Based on data from January 2010 – April 2020.

Figure 21:

We have paid out the most dollars on Americas deals.



Based on data from January 2010 – April 2020.

The majority of our payments in EMEA, which account for 34% of paid claims by value, have been in connection with risks where the main jurisdiction of the target has been in the U.K. or in Germany. This reflects the long-standing use of the product by dealmakers in these jurisdictions.

However, we are increasingly making payments in new jurisdictions where we have not previously paid claims, including our first claim in Denmark last year and in the Netherlands earlier this year. This is a trend that we expect to continue as our book continues to diversify driven by the increasingly global take-up of the product.

Our APAC region accounts for 21% of our paid claims by value. The majority of these claims have arisen in Australia, with one notable $4m payment made in connection with a New Zealand risk last year.

We are paying claims in **new jurisdictions** where we haven't previously.

Paid claims by deal size

The majority of our paid claims by value — 67% — relate to smaller deals with an EV of under $250m. We looked at some of the potential explanations for this in Section 2. The largest number of full limit losses on deals also falls within this deal size bracket.

Conclusion

The M&A insurance industry is entering a critical phase in its lifecycle; the current market presents a number of challenges for insurers, with an oversupply in capacity combined with a significant drop-off in deal flow and an increase in claims activity, set against the backdrop of the emerging risks caused by COVID-19. It is possible that this will prompt some significant changes, including shifts in pricing and coverage.

Fundamentally, the appetite of some insurers may start to wane for this class of business. There are already reports that some MGAs are struggling to secure the level of capacity they currently enjoy.

However, for insurers — like Liberty GTS — that are willing to take a long-term approach, the outlook remains very positive as the strong reputation that the product has garnered among dealmakers and their advisors in recent years drives continued growth and new opportunities. It is vital that, in this context, confidence in the product and how it responds in a claims scenario is maintained. An important part of this is being open and transparent about claims capabilities and experiences. Our claims study is a key component of this.

It is vital that **confidence in the product** and how it responds in a claims scenario is maintained.

Our study demonstrates that:

- we have taken the lead over other markets by investing in our claims function, making it one of the centerpieces of our client offering in the process;
- part of our commitment to our insureds involves providing them with access to a dedicated claims professional that understands both the product and the claims process, and maintains full control over decision making; and
- claims are being paid, helping our insureds to recover, and then move forward quickly.

We are proud to share our success stories and hope that by doing so we can encourage wider discussion about claims and their importance to the continued success of this product.

Simon Radcliffe
Head of GTS Claims
+44 7483 067698
simon.radcliffe@libertygts.com

Nicholas Horsmon
Head of GTS Claims for Americas
+1 (212) 208 2866
nicholas.horsmon@libertygts.com

Special thanks is attributed to the Global Risk Solutions (GRS) Claims Strategy, Planning and Analytics team within Liberty Mutual for the development of this study.

About Liberty GTS

Liberty GTS has the ability to deploy **up to $200 million per risk** for transactional risk protection.

In-depth experience

The Liberty GTS team is one of the most experienced teams in the world. Our underwriters close in excess of 500 deals a year and average nearly a decade of direct M&A experience each across a variety of industry sectors. Our team comprises mainly of qualified corporate or tax attorneys who practiced in our local jurisdictions before moving to the insurance sector. Furthermore, our team is multilingual, fluent in 13 languages, such as Mandarin, German, French, Italian, Swedish, and Spanish.

Exceptional claims service

We have a dedicated M&A claims team with private practice and Lloyd's market experience that specializes in dealing with complex M&A claims. This team works closely with our team of underwriters from contract inception, so they are well-versed on all the details of the agreement. In the event of a claim, our entire team works together to ensure a timely and considered response. While this paradigm may seem obvious, it's unique in our industry.

Financial strength

Offering protection for the long haul, Liberty GTS is backed by industry icon Liberty Mutual Insurance. Today we are the sixth largest global property and casualty insurer based on 2019 gross written premium. We also rank 77th on the Fortune 100 list of largest corporations in the U.S., based on 2019 revenue. As of December 31, 2019, we had $43.2 billion in annual consolidated revenue.

Superior process

While we have one of the largest teams in the industry, our underwriters have direct access to our senior management throughout the M&A process. Our streamlined approach enables us to accomplish more with faster response times and flawless execution. Liberty GTS has the geographic breadth required for complex, cross-border deals. The global Liberty GTS team collaboratively works together to provide the most sophisticated solutions to complex transactional risks.