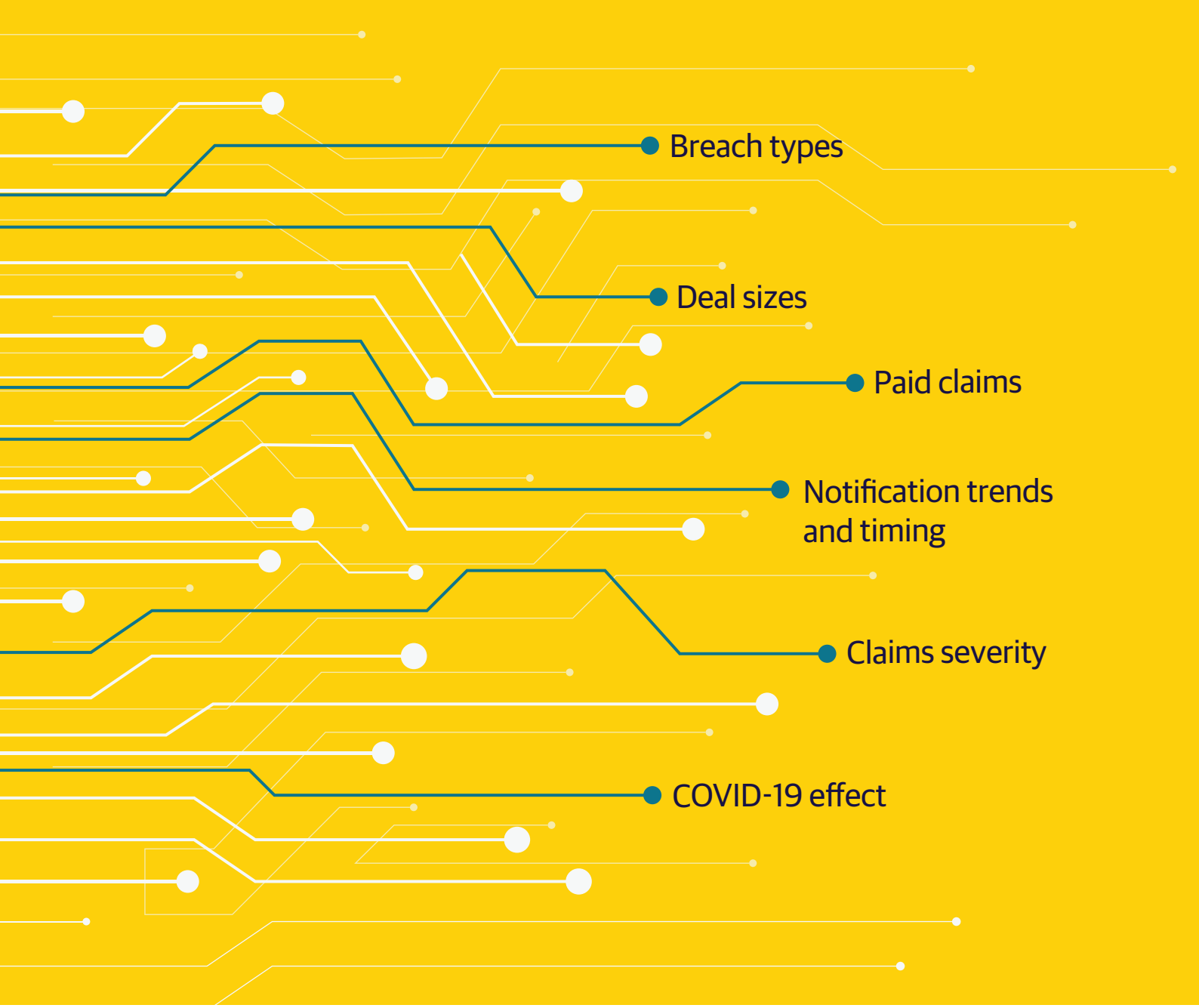


# 2021 claims briefing

Exclusive insights guiding global decision-making

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# Contents



# Section 1:
# Introduction

Liberty GTS is one of the largest and most experienced M&A insurance teams in the market, with a team of more than 80 specialists operating in 11 jurisdictions across the Americas, Asia Pacific (APAC), and Europe, Middle East, and Africa (EMEA). We are also one of the only M&A insurers in the market to have a team of dedicated claims professionals with experience of handling M&A claims embedded within our M&A underwriting team.

We are proud to be able to leverage this unique combination to provide an in-depth assessment into M&A insurance claims via our annual claims briefing. In this, our second briefing, we examine some of the claims trends that we have seen over the last 12 months and how these differ from previous years. This analysis includes revisiting a number of the findings in our inaugural briefing, released in September 2020, as well as examining some new data points. This year's briefing focuses primarily on the notifications that we have received and the claims that we have paid since 2018.

It is no understatement to say that 2020 was a roller-coaster year for the M&A industry: a strong first quarter, deal activity falling off a cliff in the second quarter due to COVID-19, and then a robust comeback in the final two quarters of the year (during which we insured a record number of deals). There has been little let-up in 2021, with transactions continuing apace in all regions of the world, fueling a big uptick in demand for M&A insurance.

> "This increase in deal-making is already starting to lead to an increase in claims activity. It is vital, therefore, 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. 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."
>
> — Rowan Bamford, President of Liberty GTS

## Global briefing takeaways

**Notification count is increasing.**
This is mainly driven by increased policy count, but also by the institutionalization of the claims process.

**Many notifications are precautionary in nature.**
Only about 35% of notifications involve a loss or potential loss that exceeds the retention.

**The speed of notifications is increasing.**
Around 57% of notifications were made within the first 12 months of the policy period in 2020, with (large) paid claims being much more likely to be notified early on in the lifecycle of the policy.

**We have not seen any dramatic changes in terms of claims severity.**
There was a slight fall in the number of "high" ($10m plus) severity claims in 2020, but those that we did receive were for higher amounts.

**Breach type**
There is a high degree of commonality in terms of the most frequent breach types that we are seeing across all of our regions.

**Emerging trends**
We have not seen a noticeable uptick in claims from COVID-19, but it may lead to new trends emerging down the line.

# Section 2:
# Notification trends

Our notification count rose across all of our regions in 2020 when compared to 2019, reflecting the increase in the number of risks that we have written over the last few years (see Figure 1).

Overall, we received 87 notifications across all of our regions in 2020: a year-on-year increase of approximately 40%. Although this looks at first sight like a significant increase, it is actually slightly less in percentage terms than the increase in the number of risks that we wrote over the same period. In 2019, we insured more than 380 risks. This rose to approximately 550 in 2020 — a record number and a 45% increase on 2019. We expect to exceed that figure by some margin again in 2021, meaning that our notification count is likely to continue to trend upwards in the years ahead.

Interestingly, COVID-19 did not lead to a sudden surge in notifications as some commentators predicted it might. Indeed, our notification count actually fell in the first few months of the pandemic — presumably because deal teams were focused on dealing with the considerable fallout from government-imposed shutdowns and stay-at-home orders. Conversely, this led to a jump in our notification count in May 2020 and June 2020 as some sense of normality resumed, resulting in a backlog of notifications being released. However, our notification count settled down again in Q3 2020 and actually trended downwards slightly during the last few months of the year.

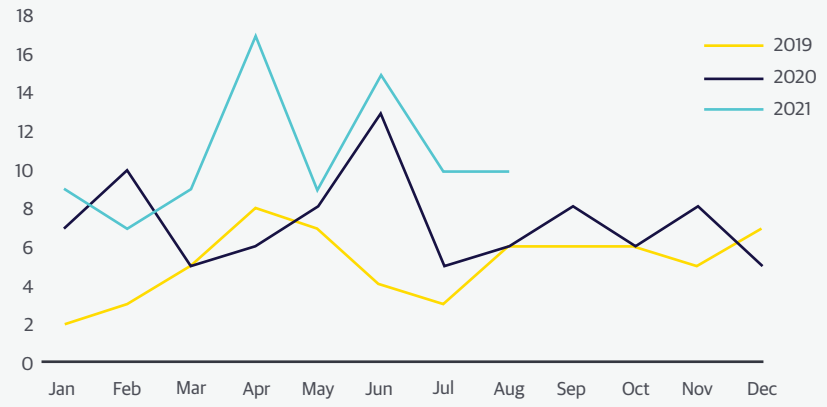
Overall, the EMEA region ended 2020 with a notification count that was not substantially dissimilar to 2019 (up only 17%). The Americas region saw a larger increase in notifications at around 40%. However, this was also the region that enjoyed the biggest increase in policy count over the same period. The APAC region saw the largest increase in notifications at around 90% (although in reality this jump was caused by only a handful of additional notifications due to the much smaller numbers involved).

### Key insights

- Notifications rose 40% year-on-year due to the growth of Liberty GTS's own book.
- Our data suggests that no more than 25% of notifications will result in a request for a payment.
- COVID-19 did not lead to a sudden surge in notifications, as some commentators predicted.
- Our EMEA region saw a noticeable uptick in notifications during Q1 2021 (see Figure 2). In Q1 2021 we received more notifications in EMEA than we did during the whole of the second half of 2020.

Figure 1:

**Notification count — global view**



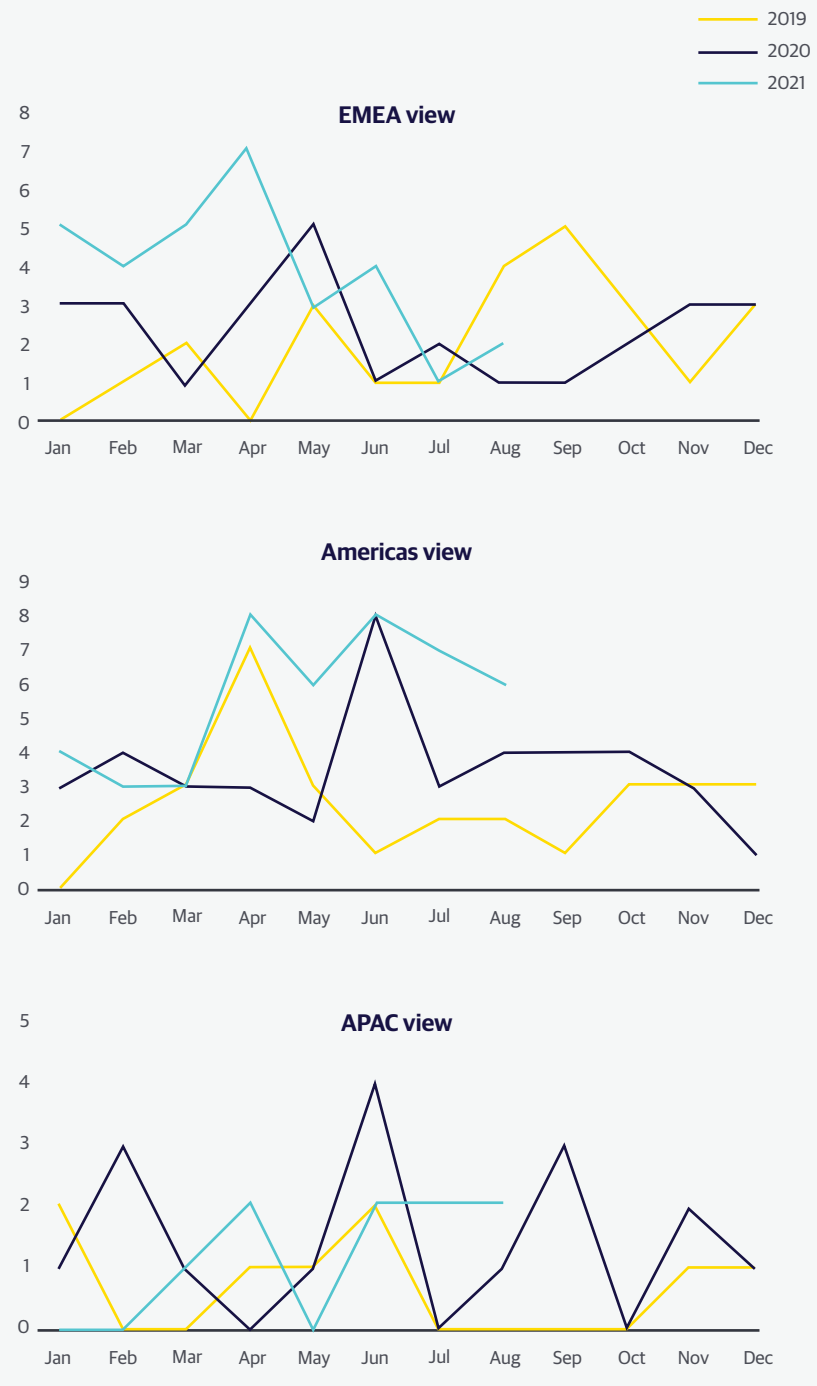

Data based on notifications received between January 1, 2019 and August 31, 2021

**Our EMEA region saw a noticeable uptick in notifications during Q1 2021** (see Figure 2).

Our notification count in the Americas and APAC regions remains largely unchanged thus far in 2021, but we have seen an uptick in notifications in the EMEA region during the same period. Indeed, in Q1 2021 we received more notifications in EMEA than we did during the whole of the second half of 2020. This included a number of "medium" severity ($1m-$10m) and "high" severity ($10m plus) claims. However, the early signs are that this might just be an anomaly, as our EMEA notification count has dipped during the last few months. The lack of a sustained increase in significant claims activity reduces the likelihood that there is a discernible link to COVID-19, especially because if that were the case then we would expect to have seen a similar uptick in our other regions as well (which we have not).

Figure 2:

**Notification count**




Data based on notifications received between January 1, 2018 and August 31, 2021

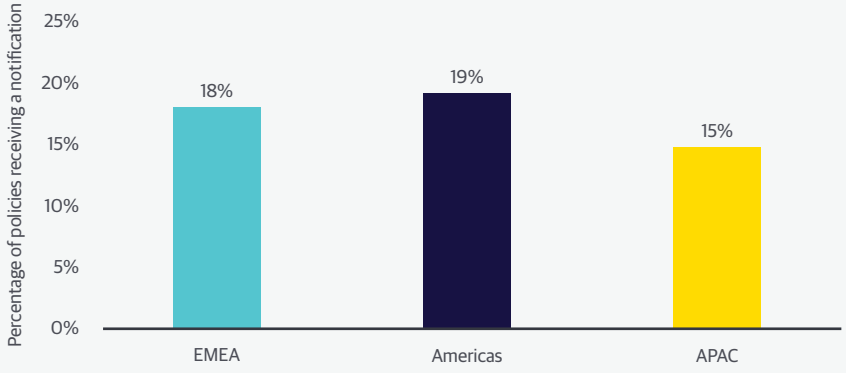
**There has been no major change in notification frequency with about 1 in 5 of our representations and warranties (R&W)[1] policies receiving a notification, although the figure is slightly higher in the Americas** (see Figure 3).

In last year's briefing, we reported that a notification had been made on approximately 19% of the risks that we bound in 2017, which was an increase from a historical average of approximately 14% between 2012 and 2015, and 15% in 2016. We have seen no real change in notification frequency over the course of the last 12 months, with approximately 18% of our 2018 risks (most of which are now "off-risk" for a claim in respect of the general warranties) having received a notification to date. The figures for our 2019 and 2020 risks are much lower, as these policies are still in their infancy (and, therefore, less useful as an indicator of notification frequency). The 18% figure is broadly consistent with the findings in other claims reports and suggests that the increase in notification frequency seen over the last few years has started to level off.

There is a slight divergence in notification frequency at a regional level. Our data suggests that the Americas region has a slightly higher propensity for notifications, with around 19% of the R&W risks that we bound between 2017 and 2019 receiving a notification to date. This compares to around 18% in EMEA and 15% in APAC. It is perhaps surprising that the gap is not larger, given that coverage in the Americas region is wider, meaning that one would expect fewer issues get filtered out at the notification stage as being something that is not covered under the terms of the policy. The reason for this is probably because the EMEA and APAC figures are inflated due to the large number of precautionary tax notifications that we receive in these regions (whereas we receive comparatively few of these types of notifications in the Americas region).

Figure 3:

**Notification frequency — regional view**




Data based on R&W risks bound in 2017, 2018 and 2019

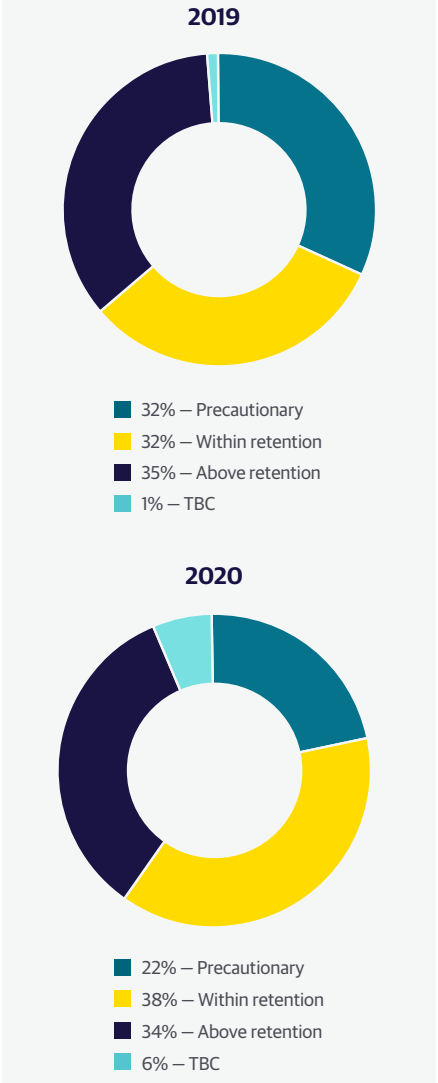
**We are seeing more notifications involving a loss or potential loss that falls within the retention, but no change in the number of notifications involving a loss or potential loss that exceeds the retention** (see Figure 4).

A significant number of our notifications are precautionary in nature and/or do not involve a loss or potential loss that either falls within or exceeds the retention. This would include, for example, notifications relating to the commencement of a routine tax audit. In 2020, 22% of the notifications that we received fell into this category, down from 32% in 2019.

Our data shows that there has been a slight increase in the proportion of notifications received involving a loss or potential loss that falls within the retention: in 2020 the figure was 38%, up from 32% in 2019 (see Figure 4). This increase is likely to reflect, in part, an increased willingness among insureds to submit a notification even if the quantum of the issue in question falls within the retention, although it may also be indicative of increased instances of low-level

Figure 4:

**Breakdown of loss — global view**




Data based on notifications received between January 1, 2018 and December 31, 2020

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

losses. This highlights the importance of having meaningful retentions from an insurer's perspective. These have been under pressure in recent years, but they represent an important buffer that absorbs a material proportion of low-level claims. Further downward pressure on retentions will just lead to narrower coverage as insurers look to respond to the increased risk of payouts that they wouldn't otherwise be exposed to.

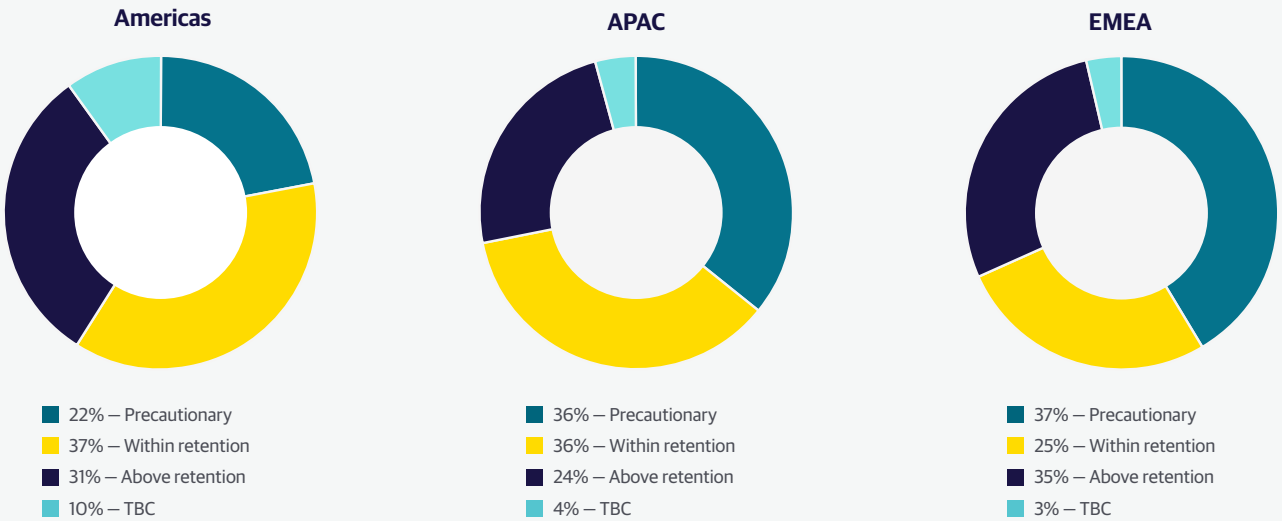
The proportion of notifications that we received involving a loss or potential loss that exceeds the retention remained steady between 2019 and 2020 at around 35%. However, not all of these notifications result in a claim being made under the policy and, overall, we haven't seen anything to suggest that there has been a material change to our view, expressed in last year's briefing, that no more than 25% of notifications will result in a request for a payment. It is common, for example, for some of the issues that are notified to be resolved via the completion accounts if they are discovered sufficiently early enough to be factored into the adjustment process. We also find that it is fairly common that a third-party claim that has been notified either isn't pursued or ends up being resolved for an amount within the retention.

**We receive more notifications involving a loss or a potential loss of some description in the Americas compared to other regions** (see Figure 5).

There are some interesting regional differences in our data. In the Americas, an analysis of all notifications received since 2019 shows that only a minority of these were precautionary in nature: the majority involved a loss or a potential loss of some description. This is probably due to the fact that, as discussed in Section 7, we see far fewer notifications relating to the commencement of a routine tax audit in this region. A further contributing factor is likely to be the nature of the cover in this region, where the measure of damages is often assessed on an indemnity basis, as opposed to requiring the insured to demonstrate a diminution in share value (which is not always possible in a claims scenario). However, the EMEA region saw a higher proportion of claims over the same period involving a loss or a potential loss that exceeded the retention. This is likely to be because retentions are generally lower in EMEA than they are in the Americas region. The APAC region saw the fewest such claims. This could be because tipping retentions are common in this region. The threshold at which a retention tips (often to nil) is set higher comparative to non-tipping retentions, with the net result that a larger loss is required before the policy will respond.

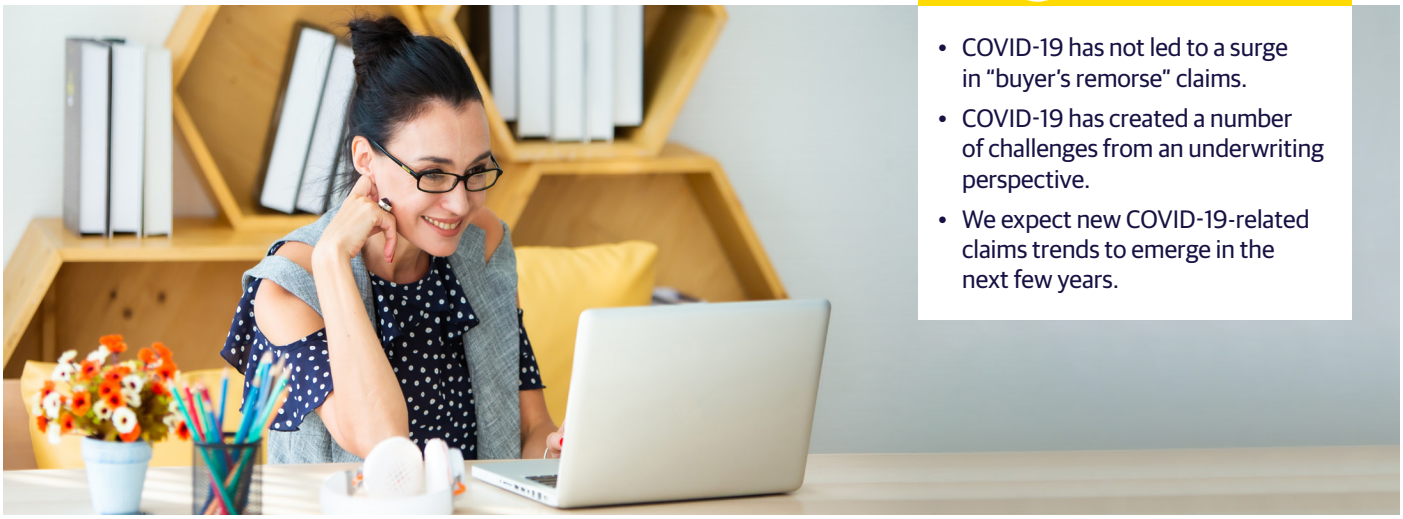
Figure 5:

**Breakdown of loss — regional view**




Data based on notifications received between January 1, 2019 and May 31, 2021

# Section 3:
# COVID-19



**Key insights**

- COVID-19 has not led to a surge in "buyer's remorse" claims.
- COVID-19 has created a number of challenges from an underwriting perspective.
- We expect new COVID-19-related claims trends to emerge in the next few years.

## COVID-19 has not led to a surge in "buyer's remorse" claims.

There was a concern, at the outset of the pandemic, that M&A insurers would see a flood of claims in respect of deals that signed in late 2019 and early 2020, but had yet to close when the full impact of COVID-19 became clear — especially if the buyer found itself in the position where it had overpaid for the business, with no opportunity to adjust the price (e.g., because it was struck on a locked box basis) or to walk away from the deal (e.g., because there was no Material Adverse Change clause in the agreement).

The perceived risk was that, faced with this scenario, a buyer would look to explore all opportunities to recover the lost value, including by claiming on the R&W policy. However, this risk has yet to materialize. This could be due in part to the widespread state support which was put in place from the outset by national governments in order to sustain businesses through the pandemic.

Undoubtedly, this has sheltered many businesses from the full impact of COVID-19, resulting in fewer instances of "buyer's remorse".

Of course, the reality is that any buyer looking to bring such a claim will still need to get over the usual hurdles i.e., to establish that there has been a breach of warranty and that a recoverable loss has flowed from this breach. It is important to remember, in this context, that — so far as pre-pandemic deals are concerned — the warranties on which a buyer relies are given at a certain point in time and will speak to events that existed as at that date or a historic point in time; they don't generally cover future events (and if they do, then insurers will not cover them). In that sense, our view is that COVID-19 is unlikely in itself to have an impact on whether an insured actually has a claim on a deal that was concluded before the pandemic.

**COVID-19 has created a number of challenges from an underwriting perspective.**

The greater risk from COVID-19, particularly during the early months of the pandemic, came from its ability to disrupt multiple parts of a business at a very fast rate. This created a more challenging underwriting environment: a due diligence report or seller disclosures could quickly become out of date, making it more difficult to rely on them to identify known issues. The ongoing lockdowns also made it more difficult to carry out due diligence in certain areas, particularly those that usually involve a physical inspection, e.g., stock and/or inventory checks, site inspections, etc. This was exacerbated by the fact that the time to complete due diligence was often compressed, sometimes by more than half, in the rush to get deals done in such a constantly changing environment.

Some insurers responded to this increased uncertainty by insisting on including a blanket COVID-19 exclusion in their policies from the outset. Our response was to try to underwrite around the risk depending on sectoral exposure and the buyer's approach to COVID-19-related due diligence. This ranged from rewriting or excluding specific warranties for the purposes of the policy, to excluding specific issues, to applying a broader COVID-19 exclusion if deemed appropriate based on the information reviewed during underwriting. This appears to have been the right approach, as we have seen very few claims to date that clearly involve COVID-19-related issues.

However, the pandemic is not over yet and it has undoubtedly stretched and tested businesses and their employees in ways never before experienced. Most have been quick to adapt, including by adopting new ways of working or making use of furlough programs to operate at reduced staffing levels. However, it is possible that steps such as these may have led to internal controls being compromised in some instances, either due to changes in individual responsibilities or to modifications to existing controls not happening at the same speed, or to new controls being implemented without sufficient testing of their design and/or effectiveness (in the context of a rapidly changing regulatory environment). The danger is that this could have resulted in issues falling through the gaps that have yet to be discovered. It will be a while, therefore, before the full effect of the pandemic has shaken out and we have a better picture of its impact on claims.

**We expect new COVID-19-related claims trends to emerge in the next few years.**

In last year's briefing, we identified claims relating to key customer insolvency as a possible new trend. While we have yet to see any such claims, this might be because it is only when the ongoing state support is withdrawn that we will see more businesses failing and this becoming an issue.

We have already started to see notifications being made in connection with the potential misuse of the various job retention and other support programs that were implemented by national governments in the wake of the pandemic. This is an emerging risk that we anticipate many insurers will become increasingly cautious about covering, particularly because of the high levels of reported fraudulent claims for support under these schemes. Additional concerns include that there remains some uncertainty around how the relevant rules will be interpreted and a risk that popular pressure will result in businesses that have benefited from taxpayers' money in this way being closely scrutinized for compliance.

We expect that the fallout from the pandemic will also lead to us receiving more tax claims in the coming years. This is because national governments will be looking to increase tax revenues significantly to fund their borrowing and expenditure in connection with COVID-19-related measures: this is likely to lead to more audits and more aggressive positions being taken by tax authorities.

We also predict an uptick in claims involving financial statement issues as a result of the challenges that the pandemic has created for auditors who found, almost overnight, that their ability to gather audit evidence via a variety of traditional methods (such as site inspections and face-to-face meetings to question and challenge company personnel and management) was compromised. Instead, many audits were (and still are) being carried out remotely and, while auditors have been quick to adjust, there is a risk that this new way of working could make it more difficult to pick up on certain issues, as evidenced by the fact that claims against auditors are expected to increase as a result of the pandemic. This may result in some auditors seeking to qualify their findings on certain areas. Careful review of the auditor's report is likely, therefore, to become an increasingly important part of the underwriting process with any qualifications scrutinized carefully from a coverage perspective.

# Section 4:
# Timing of notifications

There has been a noticeable increase in the speed with which we are receiving notifications in the last few years (see Figure 6).

In 2019, 49% of our notifications were received in the first 12 months of the policy period. This increased to 57% in 2020. The figure currently stands at 66% for notifications received in 2021 YTD.

The reasons for this are potentially varied, but the most likely explanation — given that the proportion of policies on which we receive notifications has not increased significantly over the same period — is that it is a by-product of both our increased policy count over the last few years and the fact that insureds are simply becoming better at identifying and notifying issues more quickly. However, it could also be indicative of the fact that some regular users of the product, assisted by their deal lawyers, are starting to carry out a post-closing review of the target business as a matter of course, which is in part informed by previous claims experience, with the specific objective of quickly identifying potential breaches in respect of which they can make a claim.

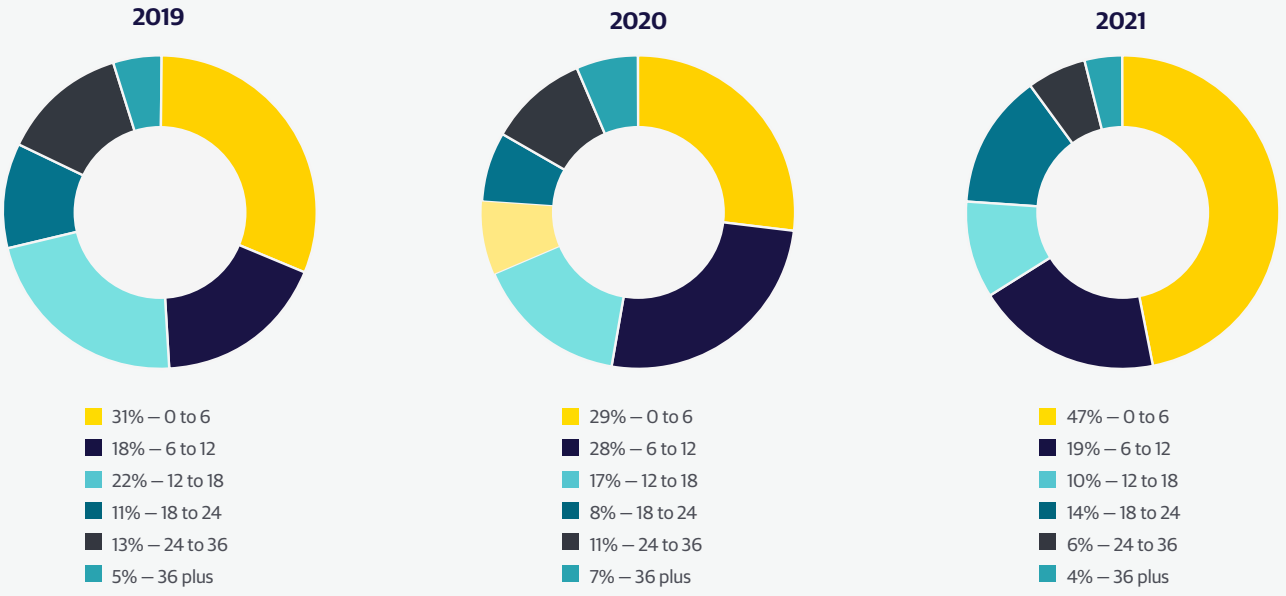
It remains common for us to receive a notification during the second year of the policy period, especially on larger deals involving businesses that are operating from multiple sites across numerous territories, as this can result in issues taking longer to be brought to the attention of senior management. However, the proportion of notifications that we receive during this window of the policy period has been shrinking and is down from 33% in 2019 to 25% in 2020. The figure currently stands at 24% for notifications received in 2021 YTD.

**Key insights**

- There has been a noticeable increase in the speed with which we are receiving notifications.
- Most paid claims are notified in the first year of the policy period, although significant issues can still come to light several years after completion.
- Large claims are being discovered and notified more quickly than in the past.
- An R&W policy might not have such a long tail as initially thought, with the vast majority of claims having been flushed out by the end of the third year of the policy period.

Figure 6:

**Gap (in months) between policy inception and notification — 2019 vs. 2020 vs. 2021 YTD**




Data based on notifications received between January 1, 2018 and May 31, 2021

Only 11% of our notifications received in 2020 were made in the third year of the policy period. This is down from 13% in 2019. The figure is currently running even lower at 6% in 2021 YTD. A significant proportion of these notifications involve tax-related issues.

**Most paid claims are notified in the first year of the policy period, although significant issues can still come to light several years after completion** (see Figure 7).

An analysis of our data from the last 10 years shows that 55% of our paid claims involve claims that were notified in the first year of the policy period. The number is appreciably smaller, at 33%, for claims that were notified in the second year of the policy period and smaller still, at 12%, for claims that were notified later than this. However, although rare, it is still possible for significant issues to come to light several years after the deal has completed. In the last 24 months, we have made two payments of $8.75m and $12m respectively in relation to claims that were notified in the third year of the policy period. This shows that insurers still need to price properly for extending cover beyond 24 months in respect of the general warranties.

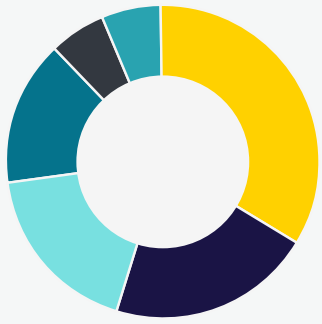
**Large claims are being discovered and notified more quickly than in the past** (see Figure 8).

An analysis of the "high" severity ($10m plus) claims that we received between 2015 and 2017 shows that only 8% were notified in the first six months of the policy period, with slightly more "high" severity claims being made during the second year of the policy period compared to the first year (42% vs. 41%). The reverse is true for the "high" severity claims that we received between 2018 and 2020. A significant portion of these claims (30%) were received in the first six months of the policy period, with fewer "high" severity claims being received during the second year of the policy period compared to the first year (35% vs. 52%). This indicates that claims which are notified after the first anniversary of the policy period are more likely to be for smaller amounts. This is logical: the more significant the issue, the more likely it is that it will be noticed sooner.

This — together with the fact that only a very small number of our notifications received between 2019 to 2021 YTD involved a deal that was more than 48 months old — goes some way to supporting the notion that a R&W policy might not have such a long tail as initially thought, with the vast majority of claims having been flushed out by the end of the third year of the policy period. This includes tax claims on the basis that most tax authorities will aim to commence a tax audit within two to three years of receiving the relevant tax return, with four years being the cutoff in many jurisdictions absent of any evidence of a careless or deliberate act or omission.

Figure 7:

**Gap (in months) between policy inception and notification — paid claims only**



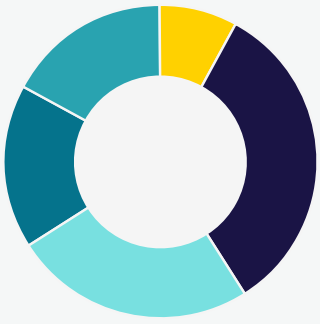
- 34% — 0 to 6
- 21% — 6 to 12
- 18% — 12 to 18
- 15% — 18 to 24
- 6% — 24 to 36
- 6% — 36 plus

Data based on all paid claims between 2010 and May 31, 2021

Figure 8:

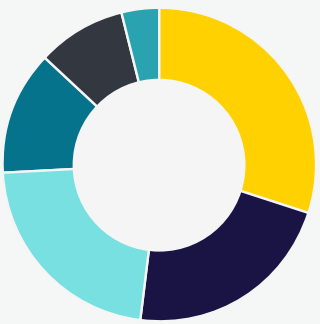
**Gap (in months) between policy inception and notification — "high" severity ($10m plus) claims notifications only**

**2015 to 2017**



- 8% — 0 to 6
- 33% — 6 to 12
- 25% — 12 to 18
- 17% — 18 to 24
- 17% — 36 plus

**2018 to 2020**



- 30% — 0 to 6
- 22% — 6 to 12
- 22% — 12 to 18
- 13% — 18 to 24
- 9% — 24 to 36
- 4% — 36 plus

Data based on notifications received between January 1, 2015 and December 31, 2020

# Section 5:
# Deal size trends

We are seeing more notifications involving larger deals because these now make up a much greater proportion of our insured risks (see Figure 9).

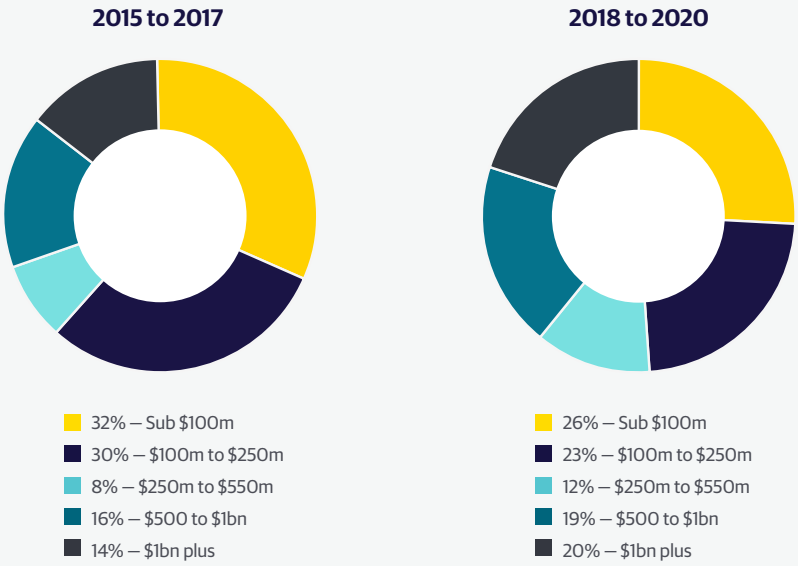
We have seen a steady fall in the number of notifications that we are receiving which relate to smaller (sub $250m) deals over the last three years: these accounted for 62% of our notifications between 2015 and 2017, whereas they account for 49% of our notifications since 2018. Conversely, we have seen a corresponding rise in the number of notifications which relate to larger ($500m plus) deals over the same period. This means that our notifications now break down fairly evenly by deal size, with no deal size bracket accounting for more than 26% of our notifications received between 2018 and 2020. The main driver behind these shifting numbers is the changing nature of our book of business, with larger deals now making up a much greater proportion of our insured risks, as opposed to smaller deals, where increased competition at this end of the market has driven down rates and led to broader coverage terms.

**Key insights**

- It remains the case that we are seeing a lower notification frequency on the largest deals compared to the smallest deals, but the divergence is relatively small.
- We have seen a number of claims for amounts that exceed the tower limit since we started writing this class of business in 2010, although they remain unusual. These have occurred across all deal size brackets, with 50% being in respect of deals with an EV of less than $250m.
- The majority of our paid claims from 2019 onwards have related to smaller deals with an EV of less than $250m. These types of deals accounted for around 65% of the dollars that we have paid out over this period.

Figure 9:

**Notification breakdown by deal size**




Data based on notifications received between January 1, 2015 and December 31, 2020

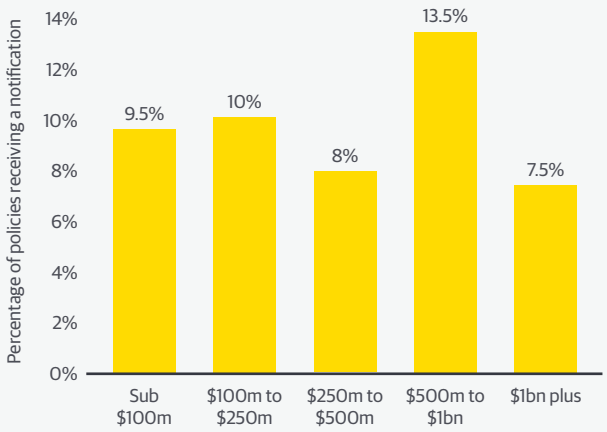
**There has been an evening-up in notification frequency across different deal sizes over the last few years** (see Figure 10).

In last year's briefing, we reported that our data from the last 10 years indicated that the largest ($1bn plus) deals are statistically less likely to result in a notification compared to the smallest (sub $250m) deals. We explored the possible reasons for this at the time, but concluded that part of the explanation might be that the lower attachment point on smaller deals makes it more likely that a policyholder will submit a notification even if the impact of the issue is relatively modest.

However, our data based on risks bound in 2019 and 2020 shows that there has been an evening-up in notification frequency. We have still seen a lower notification frequency on the largest deals compared to the smallest deals, but the divergence is relatively small. The possible reasons for this shift in our data include the fact that we are seeing more policyholders submitting notifications on larger deals where the matter is obviously within a large retention in circumstances where previously they may not have done so. We have seen the highest notification frequency on deals with an EV of between $500m and $1bn. However, because this is also one of our smallest data sets, it is difficult to draw any firm conclusions from this. Further, a significant portion of these notifications — around 82% — involve "low" severity issues, which is higher than the global average for all deal size buckets between 2018 and 2020 (see Section 6).

Figure 10:

**Notification frequency by deal size**



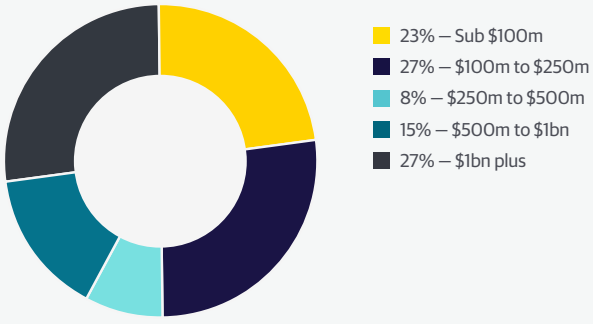

Data based on notifications received up to and including May 31, 2021 R&W risks bound in 2019 and 2020

**We have seen claims for the full tower limit across all deal size brackets** (see Figure 11).

We have seen a number of claims for amounts that exceed the tower limit since we started writing this class of business in 2010, although they remain unusual. These have occurred across all deal size brackets, with 50% being in respect of deals with an EV of less than $250m. We have found that these types of claims tend to involve either accounting and financial issues or material contract issues. In some of these cases, the relevant insured has been left with a significant uninsured loss which it has been unable to recover from the seller by virtue of the fact that its liability is capped under the share purchase agreement (SPA) (absent of fraud). There is evidence that insureds are buying more cover to guard against this risk, with it being increasingly common for insureds to seek a limit representing 20% to 30% of the deal value. Our experience is that a higher percentage would seldom be required: we have only seen an alleged loss which is in excess of 50% of the deal value on a very small number of occasions.

Figure 11:

**Breakdown of claims for full tower limit by deal size**




Data based on all claims for full limit received between 2010 and May 31, 2021

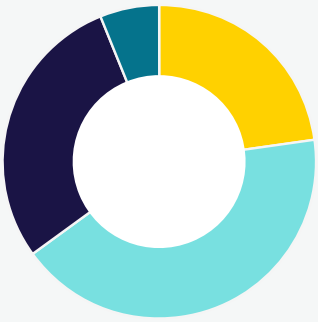
**We have paid out the most dollars on smaller deals over the past few years** (see Figure 12).

The majority of our paid claims from 2019 onwards have related to smaller deals with an EV of less than $250m. These types of deals accounted for around 65% of the dollars that we have paid out over this period. The data is somewhat distorted by one particularly large payment (of €50m), although — aside from this claim — we did make two other payments of more than $10m on deals falling within this deal size bracket and, since 2018, it has accounted for a very high proportion — around 72% — of our "medium" severity ($1m to $10m) claims.

We tend to see far fewer payments on deals with an EV of $500m or more (due to the higher retentions on these deals). Indeed, of the payments that we have made since 2019, only 18% involved deals falling within this deal size bracket. However, these payments, when made, can be sizeable as demonstrated by the fact that we have been involved in a number of large payments on deals with an EV of $500m or more in our capacity as an excess layer insurer in the last couple of years. This included a U.S. claim where our share of the payment was $27.5m. We expect to see a gradual evening-up in our paid claims deal size data in the next couple of years to reflect the fact that larger deals now make up a much greater proportion of our insured risks compared to a few years ago.

Figure 12:

**Breakdown of total dollars paid out by deal size**



- 23% — sub $100m
- 42% — $100m to $250m
- 29% — $500m to $1bn
- 6% — $1bn plus

Data based on claims paid between January 1, 2019 and May 31, 2021

# Section 6:
# Claims severity

Our data shows that there have not been any significant changes in how the notifications that we have received between 2018 and 2021 YTD break down in terms of severity (see Figure 13).

We continue to monitor the size (or severity as we refer to it here) of the claims that we are receiving. Of course, this is a slightly crude measure in the sense that some claims aren't pursued and, for those that are, the amount being claimed does not necessarily correlate to the amount which is actually recovered under the policy. However, it is still a useful yardstick that does offer up some interesting insights.

How we define severity:[2]

**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+.

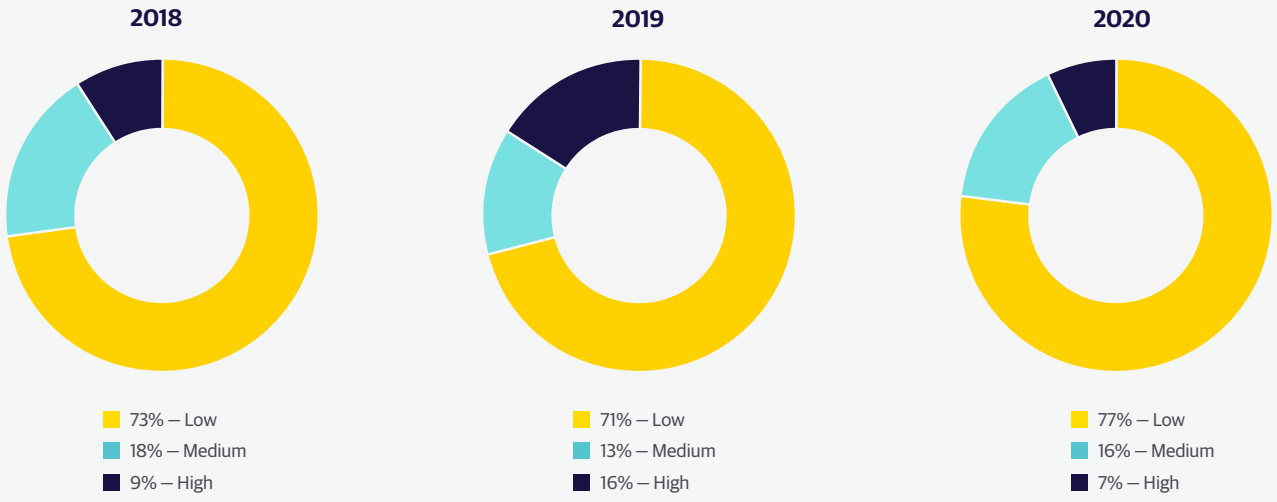
**Low severity:** We have seen a slight increase in the proportion of our notifications that fall into this category: up from 73% in 2018, to 77% in 2020. This reflects an increased willingness among insureds to err on the side of caution and submit a notification even where there has yet to be a loss or the quantum of the issue in question falls within the retention and is consistent with our observation, made in last year's briefing, that it is this type of notification which has driven increased notification frequency over the last few years.

**Medium severity:** The proportion of our notifications that fall into this category has fluctuated year-on-year, ranging between 13% and 18%. "Medium" severity claims were our fastest growing type of notification in 2020, with the number of claims falling into this category almost doubling compared to 2019.

**High severity:** We have seen a dropoff in the proportion of our notifications that fall into this category: down from 16% in 2019, to 7% in 2020. This is due, in part, to the increase in the number of "low" severity claims discussed above, although we did also see a small reduction in the overall number of such claims on a year-on-year basis. However, the claims that we did receive were for larger amounts compared to 2019 and included a number of claims for more than $150m, although each of these are in the context of multi-insurer towers.

Figure 13:

**Claims severity — global view**




Data based on notifications received in 2018, 2019 and 2020

2 The claimed amounts referenced are in excess of the primary layer retention.

**The Americas region sees a slightly high proportion of "high" and "medium" severity claims and more claims for the full tower limit** (see Figures 14 and 15).

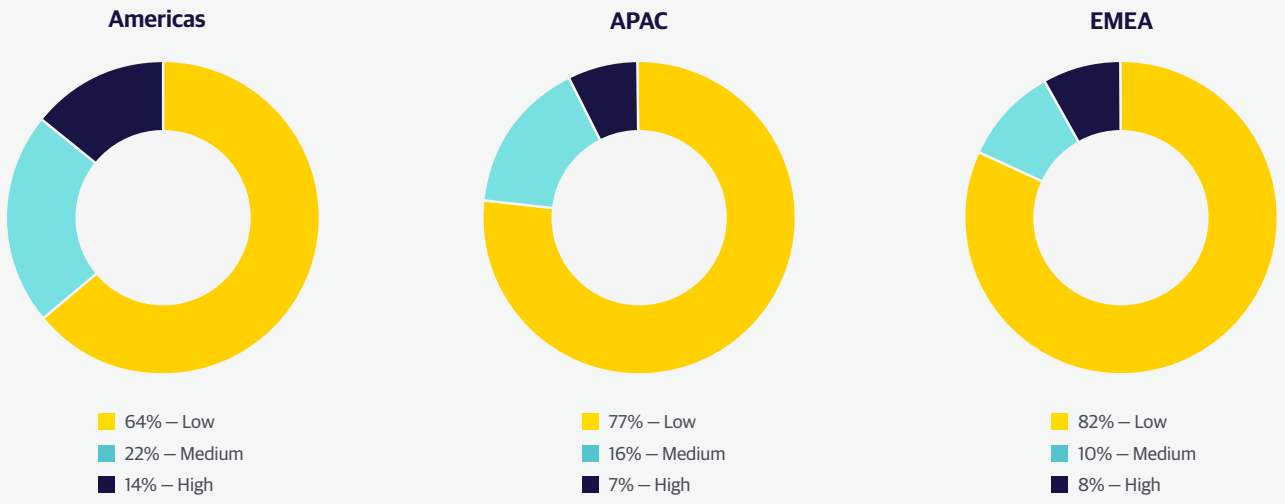
The Americas region saw a higher proportion of "high" severity claims over the last 36 months compared to the APAC and EMEA regions (14% vs. 7% vs. 8%). The same is true for "medium" severity claims (22% vs. 16% vs. 10%) (see Figure 14). The Americas region also saw more claims for the full tower limit compared to the EMEA and APAC regions over the same period (see Figure 15).

However, the start of 2021 has seen a flip in this trend, with EMEA seeing the most "high" and "medium" severity claims out of all of our regions and a reduction in severity in the Americas and APAC regions (see Figure 16). This is likely to add to the growing calls for rate increases in EMEA (which we have seen in the Americas market since Q3 2020), especially if this is part of a lasting pattern.

The increased frequency of higher value claims in the Americas is explained, in part, by the fact that we tend to see more notifications in this region that relate to either a breach of the financial statement warranties or the material contracts warranties and these types of claims tend to result in larger losses compared to other claims. In addition, more of the claims that we receive in the Americas involving a loss or potential loss that exceeds the retention are calculated by buyers on a "multiple-of-earnings before interest, taxes, depreciation, and amortization (EBITDA)" basis, which usually has the effect of driving up the overall number (sometimes significantly depending on the size of the multiple). We will always look very closely at whether it is justified to quantify a claim on this basis, usually with assistance from an expert. It can be one of the more contentious areas in a claim scenario, especially if the buyer is seeking to apply a multiple to what is a one-off, nonrecurring loss (such as a payment to settle a third-party claim).

Figure 14:

**Claims severity — regional view**

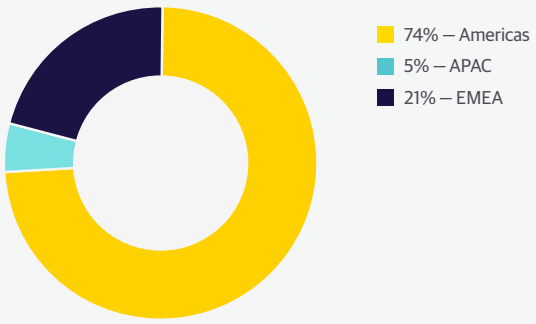



Data based on notifications received in 2018, 2019 and 2020

Of course, the risk of a larger claim is reflected, to a degree, in the price of the R&W product in the Americas, where rates are significantly higher compared to EMEA and APAC and have increased by up to 25% since Q3 last year, driven in part by increased claims activity. Furthermore, in the U.S. market, the tendency is to build a tower made up of a number of layers, each totaling between $20m and $30m. This means that insurers in this region tend to have less exposure to "high" severity claims that are for amounts in excess of these figures. In EMEA or APAC — where insureds are more open to a single policy approach (in part because dealing with a single insurer lends itself to a less complicated claims process) — it is much rarer to see a claim of this size.

Figure 15:

**Breakdown of claims for full tower limit by region**



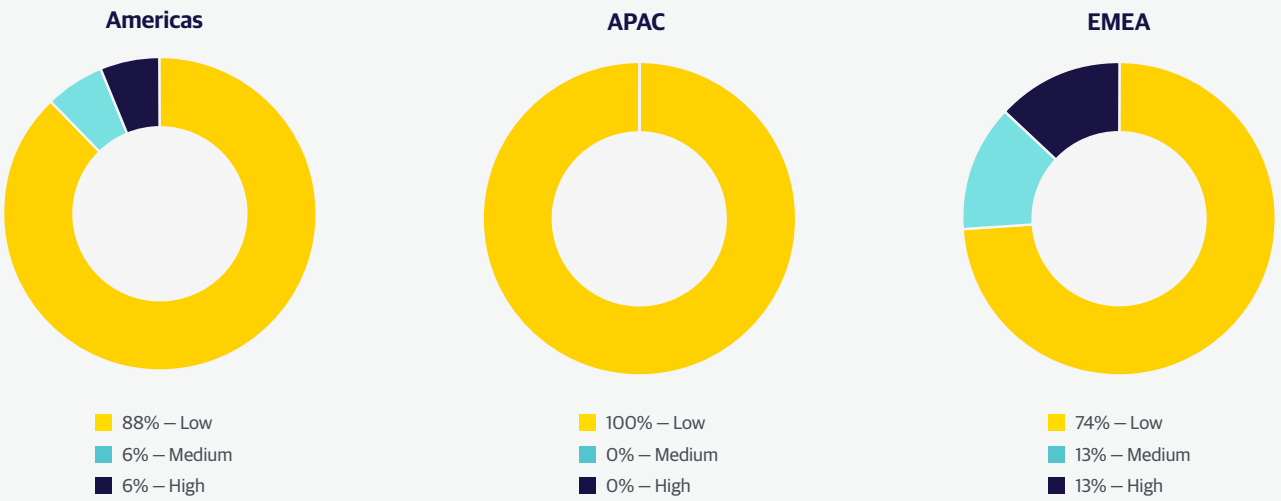

Data based on claims for full limit received between 1 January 2018 and May 31, 2021

## A number of our "high" severity claims have involved founder member deals.

There are few discernible trends in terms of the types of deals that are more susceptible to "high" severity claims. We have noticed, however, that a not insignificant number of our "high" severity claims have involved sales by founder shareholders. Some of these have involved suspected fraud by the founder(s). This may be because there is arguably a greater incentive for founder(s) to conceal issues deliberately, especially if they are exiting the business entirely and see the sale as a gateway to an early retirement. While these incentives are not unique to founder shareholder deals, these types of deals often involve smaller, less sophisticated businesses, which may not have the same robust controls or checks and balances that larger, institutionally-owned businesses typically have: this means that these types of situations can go either unnoticed or unchallenged, especially where the founder shareholder(s) exert significant control over the business. We are, therefore, approaching these types of deals with more caution.

Figure 16:

### Claims severity 2021 YTD




Data based on notifications received between January 1, 2021 and May 31, 2021

Section 7:

# Common breach types and emerging trends

There is a high degree of commonality in terms of the most frequent breach types that we are seeing across all of our regions (see Figure 17).

There are some regional variances in our data in terms of the most common breach types that we are seeing, although the most prominent globally involve tax, accounting and financial, material contract, employment and litigation issues. We take a closer look at each of these below.

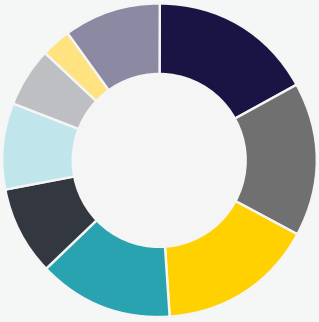
**Key insights**

- The most prominent breaches globally involve tax, accounting and financial, material contract, employment and litigation issues.
- We are seeing an increasing number of claims being made in respect of "Undisclosed Liabilities" and we continue to see a high number of claims relating to revenue recognition issues. We also have found material contract claims to be persistently costly.
- Wage-related disputes are on the rise.
- Cyber claims are an emerging area of risk.
- IT claims look set to continue to rise.

Figure 17:

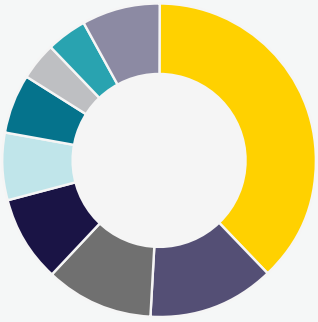
**Common breach types — regional view**

**Americas**



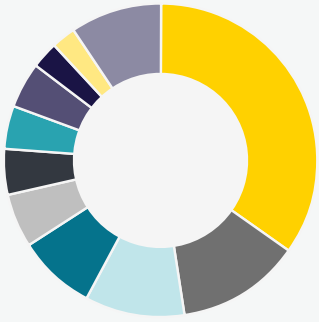
- 17% — Employee related
- 16% — Accounting and financial
- 16% — Tax
- 14% — Material contracts
- 9% — Compliance with laws
- 9% — Litigation
- 6% — IP
- 3% — Cyber
- 10% — Other

**APAC**



- 38% — Tax
- 13% — Real estate
- 11% — Accounting and financial
- 9% — Employee related
- 7% — Litigation
- 6% — Permits, licenses and consents
- 4% — IP
- 4% — Material contracts
- 8% — Other

**EMEA**



- 35% — Tax
- 13% — Accounting and financial
- 10% — Litigation
- 8% — Permits, licenses and consents
- 6% — Shares
- 5% — Compliance with laws
- 5% — Material contracts
- 5% — Real estate
- 3% — Employee related
- 3% — IT
- 10% — Other

Data based on notifications received between January 1, 2018 and May 31, 2021

**Large tax claims are rare, but "medium" severity claims are much more common** (see Figure 18).

In APAC and EMEA, tax-related notifications account for 38% and 35% of all notifications received in these regions since 2018. The number is significantly lower for the Americas region at around 16%.

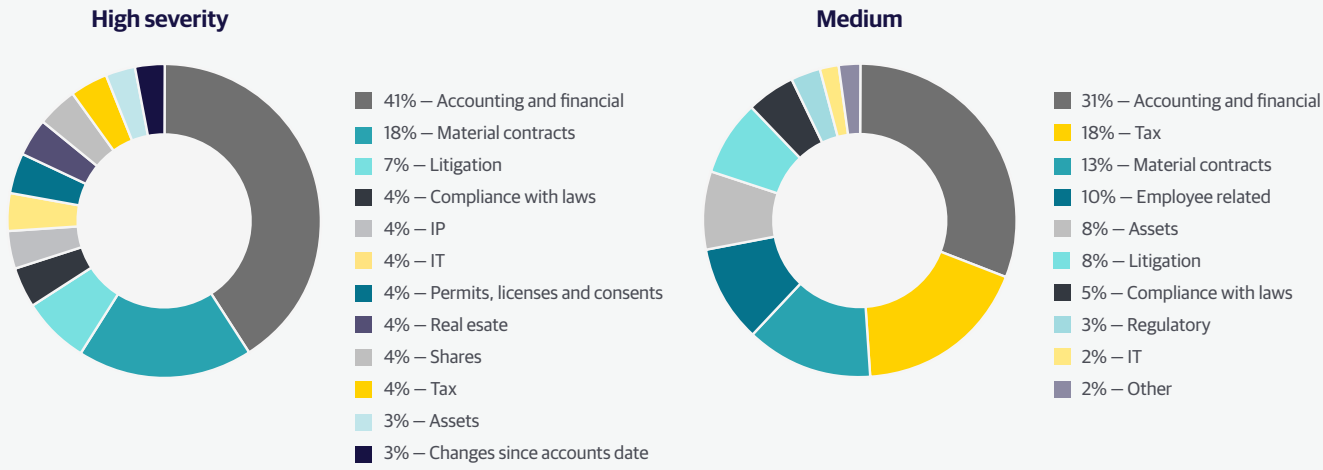
A closer look at these notifications reveals that 45% are precautionary in nature and involve the commencement of a routine tax audit. This is particularly the case in EMEA and APAC where audits of this nature are very common (sometimes taking place on a known mandatory cycle) in certain jurisdictions, which also helps to explain why we see a higher number of tax-related notifications in these regions compared to the Americas. In the majority of instances these audits are concluded without any finding that additional tax is payable.

In the last 12 months, we have seen a number of tax-related notifications where the amount in issue is material. This includes two "minded to" decisions in EMEA, each of which has the potential to result in additional tax payment of in excess of $15m. This is potentially indicative of the comment made in Section 3 that we can expect more aggressive positions to be taken by tax authorities as a result of COVID-19, resulting in more tax claims. Nevertheless, large tax losses of this nature remain rare and only make up a small number of our "high" severity claims over the last three years. This suggests that most of the key tax issues and potential liabilities are being successfully picked up at the due diligence stage.

However, our data shows that tax-related notifications made up a far greater portion of our "medium" severity claims between 2019 and 2021 YTD: about 18%. This was second only to accounting and financial issues. These attritional type losses typically involve either corporation tax or sales tax issues. However, we also are seeing an increasing number of claims involving import taxes and environmental taxes. The former is indicative of the increasingly complex global supply networks that many businesses rely on and could become a bigger issue going forward due to Brexit and in light of the recent moves by some national governments toward more protectionist trade policies. The latter is a by-product of attempts to encourage environmentally positive behavior and greener practices by large corporate entities via the tax system.

Figure 18:

**Common breach types — high and medium severity claims only**




Data based on notifications received between January 1, 2018 and May 31, 2021

**Accounting and financial issues are behind some of our largest claims** (see Figure 18).

We continue to find that accounting and financial issues are a significant driver behind many of our notifications, especially in the Americas, where they account for 16% of all notifications received since 2018. The number is slightly lower in EMEA and APAC, at 13% and 11% respectively. These notifications often involve large amounts, as evidenced by the fact that they account for 41% of our "high" severity claims and 31% of our "medium" severity claims over the same period.

As discussed in last year's briefing, many of these claims involve stock and inventory issues. These types of claims are not specific to any one region and can be very large, with several of the examples that we have seen over the last few years being for amounts in excess of $50m. This has led to us focusing much more on this issue at underwriting stage and carefully scrutinizing the level of due diligence that buyers have performed into this area.

We continue to see a high number of claims relating to revenue recognition issues. These claims have been responsible for some of our largest payments to date. In January 2021, we paid out $12m on a claim involving revenue recognition issues. This comes off the back of a similar claim, described in last year's briefing, that resulted in us making a €50m payment to FSN Capital in 2019. We have found that many of these claims involve the percentage of completion accounting (POC) methodology, where revenue is recognized over time based on the proportion of the contract fulfilled as calculated by comparing actual costs incurred vs. expected costs incurred. Our experience shows that this particular accounting methodology is ripe for manipulation. Examples of some of the improper and unjustified practices that we have seen include: the overestimation of expected revenue, the reallocation of costs between unrelated contracts, and the underestimation of expected costs — all with the intention of improving apparent margins on specific contracts and prematurely recognizing revenue.

We have also seen a number of instances over the last few years of management fabricating revenue to boost the bottom line by recording accounts receivable in respect of goods and/or services that had yet to be supplied (and, in some cases, before any contract had been signed). In one case, fake invoices were even issued to justify the entries. The real invoices were only issued once the goods and/or services were eventually delivered, with a credit note being issued at the same time in respect to the fake invoices (which had not been sent to the relevant customers).

These are by no means the only ways that financials can be manipulated by management. Others include delays in the recognition of impairments to certain assets (e.g., inventory or goodwill) or the understatement of allowances or the overstatement of accounts receivables. We are particularly mindful of the latter, as this issue accounted for one of our largest paid claims of the last few years.

The risk of such behavior has always existed due to the temptation of trying to make a business as attractive as possible with a sale on the horizon. However, there is a clear risk that it could become more common as the pressures and significant uncertainty associated with COVID-19 have placed increased pressure on management providing them with a greater incentive to cross the line in order to remain in business and avoid breaching financial covenants or future cash flow difficulties. This risk may be exacerbated if oversights and checks have become diluted due to remote working and reduced levels of staffing, giving fraudsters an opportunity to find new ways of overriding existing internal controls.

### We are seeing an increasing number of claims being made in respect of "Undisclosed Liabilities".

Another trend that we have seen recently is an increasing tendency for claims to be advanced under warranties citing an absence of any "Undisclosed Liabilities" as opposed to under the warranties that specifically address the accuracy of the financial statements. One reason for this is that — depending on the drafting — these warranties can be wider, making a claim easier to establish.

We are, therefore, looking at these types of warranties a lot more closely as part of the underwriting process and, in particular, the definition of "Liabilities". This is a particular issue in the U.S., where the definition has become very wide and is rarely restricted to liabilities that cross the reporting threshold for the purposes of generally accepted accounting principles (GAAP) or equivalent accounting standards (which is typically the case in EMEA and APAC), extending instead to "unknown", "undeterminable" and/or "contingent" liabilities in some cases. While it is common for warranties like this to be subject to a materiality qualifier, the policy will often scrape away this qualifier in the U.S., with the result that this type of warranty can end up capturing the smallest of issues. It is an area that we consider needs to be more robustly negotiated by the seller during the sales process in order to avoid a scenario where insurers are obliged to rewrite the warranty for the purposes of the policy, potentially leaving a buyer with a gap in cover that could disrupt the deal.

### We have found material contract claims to be persistently costly (see Figure 18).

In last year's briefing, we reported that claims involving material contract-related issues were on the rise, especially in the Americas. This trend has continued in 2020. Indeed, one of the largest claims that we were notified of last year related to a material contract issue reinforcing the point, made in last year's briefing, that these types of claims can be costly. This is further evidenced by the fact that, globally, material contract-related issues have accounted for 18% of our "high" severity claims and 13% of our "medium" severity claims since 2018.

The most common issues involve the failure to disclose information relating to a change in relationship with the contractual counterparty (e.g., receipt of a notice of an intention to reduce orders, terminate a contract or change the terms of doing business). We have also seen several large claims involving contracts that are said to be loss-making due to the costs of servicing the same being much higher than the target anticipated during the bidding process.

The largest of these claims have involved deals where a single customer makes up a large part of the target's revenue or where the target is reliant on a small number of long-term contracts. We are increasingly sensitive to these scenarios and are looking to check as part of our underwriting that enhanced due diligence has been carried out on these customers and related contracts. This includes enquiring as to whether the buyer has asked and been allowed to speak with the key customer(s). This is because one of the recurring themes that we have found with these types of claims is that, in some cases, the seller has (arguably) held information back deliberately. This could be because it knows that any adverse information relating to a key customer has the potential to have a significant impact on value depending on the nature of that information. In a number of these cases, had the buyer spoken to the key customer(s) concerned, the issue(s) would most likely have been discovered prior to signing.

### Wage-related disputes are on the rise.

There has been a notable increase in claims involving employment-related issues in the last few years, especially in the Americas and APAC regions. These claims tend to be at the less severe end of the spectrum in terms of the amount in issue and, in many cases, they are picked up by the target's "business as usual" insurance. However, wage-related disputes are a notable exception. These types of claims have become particularly prevalent in Australia and in the U.S., where they are often brought by way of a class action and involve allegations that employees have not been fully compensated for working through mandatory rest periods or for working overtime or paid in accordance with minimum wage legislation. They can be surprisingly expensive claims, in part because they can result in additional employee-related tax liabilities as well as an increased wage bill. For example, a recent claim was quantified at around $1.5m even though it involved fewer than 200 employees. These types of claims are a growing risk area for insurers, not only because employee rights and pay is becoming an increasingly litigious issue, but also because they carry an added "social inflation" exposure, especially in the U.S., due to the fact that they are susceptible to plaintiff-friendly jury awards.

### We have observed an increase in the costs of dealing with third-party claims.

We continue to see a significant number of notifications alleging that there has been a breach of the "No Litigation" warranties. These notifications typically involve an actual or potential dispute that was ongoing at the time of the acquisition and are often triggered by the receipt of a third-party claim by the target company. This breach type has accounted for slightly less than 10% of the notifications that we have received globally since 2018 and tends to be more common in the Americas and EMEA than it is in APAC. However, it is worth noting that, for purposes of this briefing, we have elected to classify some third-party claims separately (such as employee-related class action lawsuits, which fall within the "employee-related" category, and intellectual property (IP) infringement cases, which fall within our "IP" category). Therefore, third-party claims actually make up an even more significant portion of claims notifications than many market participants appreciate. What is more, the number has been steadily increasing: around 39% of our notifications so far this year have involved a third-party claim (which is up from around 21% in 2020).

Historically, this breach type has proven to be relatively benign from a claims severity standpoint. Indeed, our data shows that, since 2018, it has made up just 7% of our "high" severity claims and 8% of our "medium" severity claims. Additionally, a reasonable proportion of the notifications that fall within this category don't turn into a claim under the policy (often because another insurance policy is in play or because the associated third-party claim is settled within the retention). However, the costs of dealing with a third-party claim can still be significant, even if it has very little merit, and we are seeing more and more instances of these costs eroding the entire R&W policy retention or a significant portion of it, especially on smaller deals with a low attachment point. This is particularly the case with government investigations, which can involve a significant amount of document production and often spawn related, follow-on litigation. We expect this to become an increasingly common issue going forward as the economic fallout caused by COVID-19 is likely to lead to a rise in the number and types of disputes as attitudes harden and litigation is used as a means of raising revenue. If this holds true, then this may necessitate an increase in retentions, particularly on smaller deals, in order to counter-balance the risk derived from this heightened exposure.

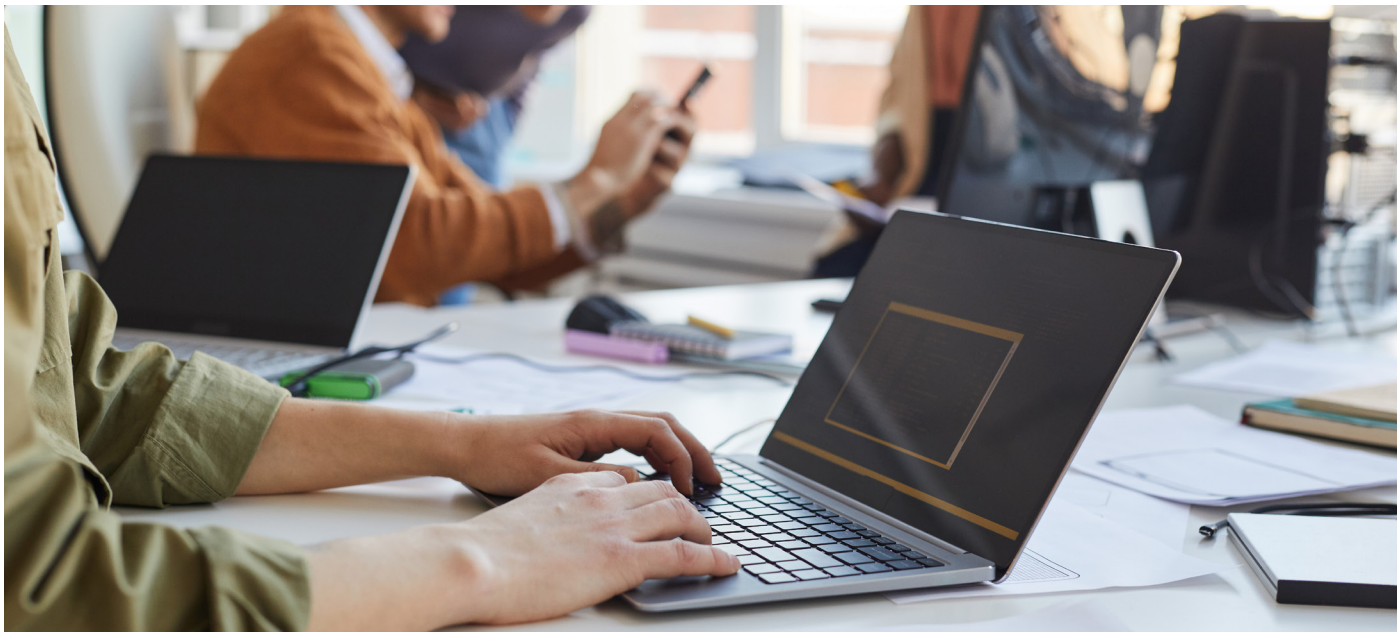
### We are seeing more instances of significant claims being made for the costs of investigating and pursuing a claim for a proven breach.

This is particularly the case in the Americas where cover for such prosecution costs is now increasingly standard. However, our experience suggests that this cover is becoming an increasingly expensive add-on for insurers. For example, we paid out $550,000 on a recent claim, but only 50% of this amount related to underlying loss — the remainder consisted of costs. We are also finding that the cover is capable of changing behaviors. For example, we have seen evidence that insureds are becoming increasingly inclined to pursue a claim against the warrantor(s) on the basis that they don't have to fund all of the costs of doing so, meaning that they have little to lose. There is also the risk of perverse outcomes. For example, an insurer can quite easily find itself in a situation where it remains exposed to a claim that exceeds the retention even after it has paid its share of the underlying loss simply because the warrantor(s) is still refusing to pay its (much smaller) share. The effect of this is that we are now taking a much more cautious approach to this cover in other regions.

## Cyber claims are an emerging area of risk.

We have received several notifications in the last 12 months involving cyber-attacks that have targeted personal data held by the target or shut down critical systems belonging to the target. This follows a number of similar, high-profile attacks in 2020 and 2021, with victims across most sectors and including financial institutions, healthcare companies, education establishments and infrastructure assets. The consequences of a cyber breach are numerous and can include both first- and third-party losses. Additionally, regulatory bodies throughout the globe are beginning to concentrate investigatory and regulatory efforts on preventing the unauthorized release of data, as well as imposing penalties for noncompliance with these heightening standards. These attacks have, therefore, cast a spotlight on both the scale of risk involved and the breadth of industry sectors that can be targeted.

This poses a problem for M&A insurers who see this as a risk that businesses ought to be managing by purchasing a bespoke cyber policy with suitable cover and adequate limits. We are increasingly focused, therefore, on managing cyber risk, in many cases by excluding cover for cyber-related issues altogether and, in other cases, limiting it by only covering specific cyber-related warranties that we are satisfied have been properly diligenced (including technical testing of the adequacy of the target's cyber security systems) and sublimiting our liability. This is helping to provide all parties with much more clarity in terms of where they stand in respect of a cyber-related loss, although the expectation remains that these types of issues will be picked up by the target's underlying cyber policy in the vast majority of cases.



## IT claims look set to continue to rise.

We are seeing more IT-related claims as businesses become more digitally enabled and increasingly reliant on technology for all aspects of their operations.

We identified claims involving software licensing shortfalls as an emerging trend in last year's briefing and this continues to be an issue that we are paying close attention to, given the rise in the number of audits that are being carried out by or on behalf of software vendors.

We are also finding that major IT projects which were part way through being rolled out at the time of the sale are becoming an increasingly common source of claims. These claims typically relate to missed milestones, or higher-than-expected costs or the failure of the project to achieve its stated aims. They can be for significant amounts, especially if the IT project was supposed to be transformative for the business and the projected benefits had been taken into account by the buyer in its purchase price for the target. Of course, major IT projects are especially susceptible to these kind of issues because they do not always run smoothly. However, there is often a significant difference between the position at the time that the deal was concluded and the position post-closing when the project is concluded. This is an important distinction because an M&A insurer is not underwriting the successful rollout of an IT project, which represents a future business risk. These claims need, therefore, to be assessed carefully without the benefit of hindsight.

# Section 8:
# Jurisdictional trends

In this year's briefing we have chosen to focus on loss location to reflect the fact that 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. This section focuses on the EMEA and APAC regions only. This is because the Americas region is dominated by notifications with a U.S. nexus making our data of limited value.

**The EMEA region has accounted for about 39% of loss locations since 2018** (see Figure 19)**, with the top five territories being the U.K., Germany, Italy, France and the Netherlands** (see Figure 20).

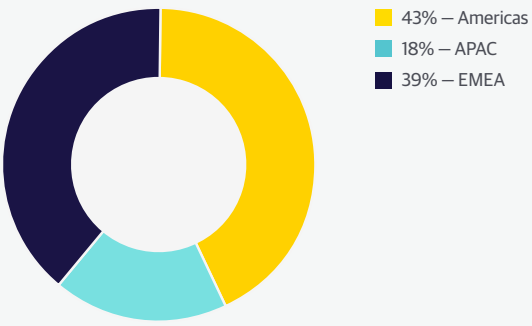
These findings reflect, in part, the fact that we have insured a significant number of deals involving businesses that operate either predominantly or exclusively in these five territories. They are also influenced by certain local factors. For example, in Germany, the tax authorities tend to conduct a routine audit of large corporations every three to four years, making 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. Indeed, 23% of our notifications with a German nexus over this period fall into this category. Therefore, a high notification count involving a particular territory is not necessarily a sign in itself that deals with significant operations in that territory are inherently riskier to insure.

**The Nordics region has seen relatively few notifications, but has accounted for our largest paid claim** (see Figure 20).

Only 9% of the notifications that we have received since 2018 have had a nexus with the Nordics region. This could be in part because Nordic insureds are long-time users of the product, so they tend to be more familiar with what needs to be notified and what does not. In other territories, where the product has only taken hold relatively recently, there is perhaps more uncertainty over this point, meaning that we often see clients notifying matters that don't need to be or aren't caught by the policy. However, our largest paid claim to date involved a Nordic deal and so it doesn't necessarily follow that a territory with a low notification count is low risk.

Figure 19:

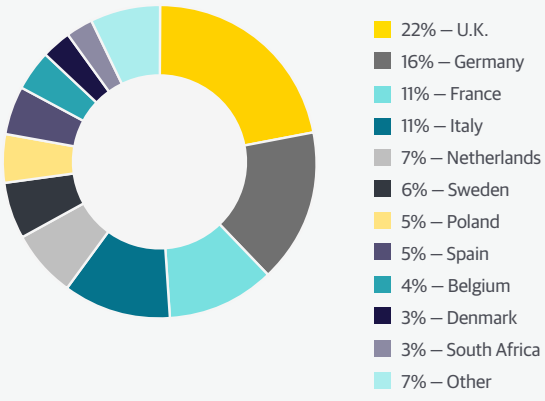
**Loss location by region**




Data based on notifications received between January 1, 2018 and May 31, 2021

Figure 20:

**Breakdown of EMEA loss locations**




Data based on notifications received between January 1, 2018 and May 31, 2021

**We have seen several large claims with a Belgian nexus in the last few years** (see Figure 21).

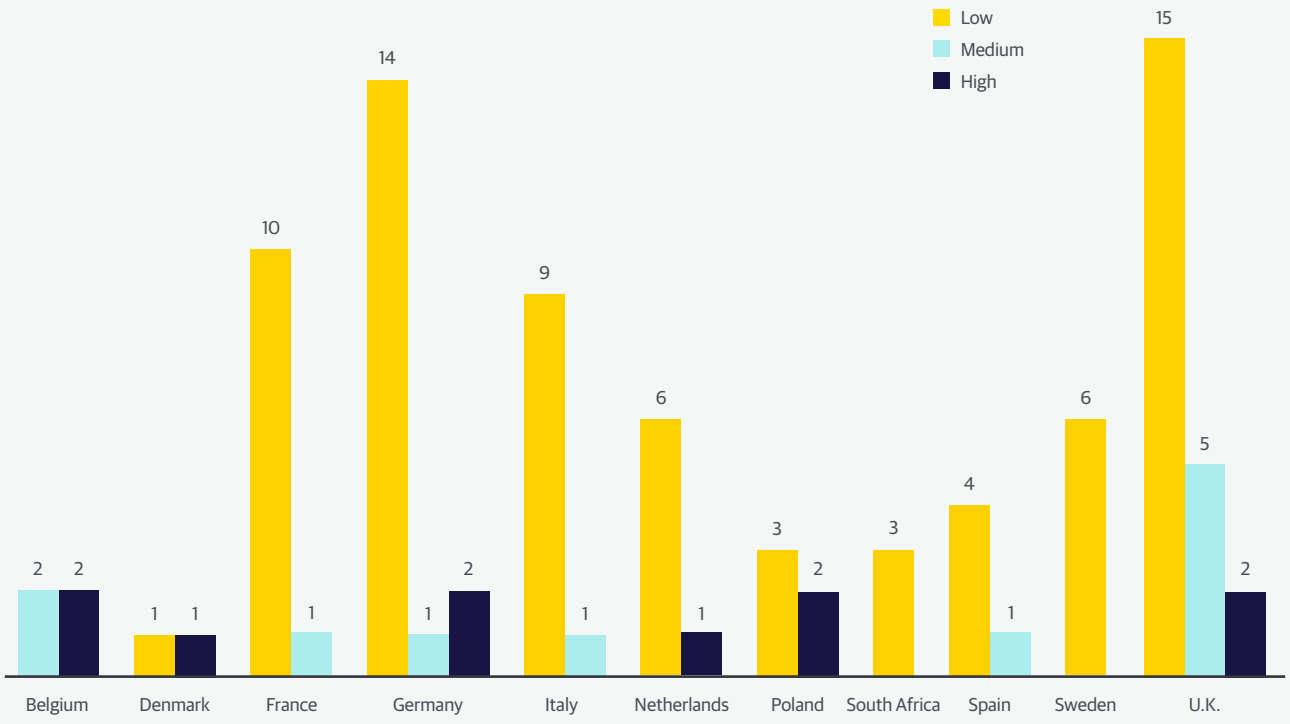
A breakdown of our top 10 EMEA loss locations by severity contains some interesting insights. It shows that the U.K., Germany, Belgium and Poland have accounted for the highest number of our "high" severity claims. A number of these territories have also generated several "medium" severity claims.
The results for Belgium and Poland are perhaps surprising given the relatively small number of deals that we have insured with significant operations in these territories. There is no obvious reason for this, but it is something that continues to inform both our underwriting approach, coverage and pricing.

**The majority of our notifications with a Southern European nexus have involved "low" severity issues** (see Figure 21).

At the other end of the spectrum, despite Southern European deals having a slightly higher rate of notifications relative to number of policies issued, we haven't seen any "high" severity claims emanating from this region in the last few years. Most of the notifications have been either precautionary in nature or at the lower end of the severity spectrum. This dispels some of the myths around Southern European deals being riskier than Northern European deals, although we continue to be selective about the risks that we insure in this region and more restrictive around certain aspects of cover (e.g., tax).

Figure 21:

**Breakdown of top 11 EMEA loss locations by severity**



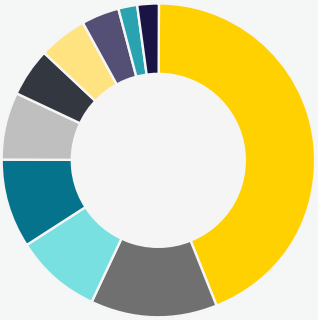

Data based on notifications received between January 1, 2018 and May 31, 2021

**The APAC region has accounted for about 18% of loss locations since 2018** (see Figure 19)**, with the top five territories being Australia, Malaysia, Singapore, India and China** (see Figure 22).

It is little surprise that Australia is the most common loss location by some distance, given that many of the APAC deals that we insure involve a business that operates either exclusively or predominantly in this territory. However, we are also starting to see notifications coming out of territories that have only started to use the product relatively recently (e.g., India and Indonesia). We have seen a small number of claims with a Chinese nexus, but none of these have involved significant issues and we write very little Chinese business, so don't expect to see any notable increase in claims emanating from this territory. Japan is a notable absentee from the list. This is because all of the Japanese deals that we have received notifications on over this period involved outwards-bound investment, meaning that the actual loss location is abroad. One of these involves a claim for an amount which is in excess of $50m.

Figure 22:

**Breakdown of APAC loss locations**



- 44% — Australia
- 13% — Malaysia
- 9% — India
- 9% — Singapore
- 7% — China
- 5% — Indonesia
- 5% — New Zealand
- 4% — Philippines
- 2% — Thailand
- 2% — Korea

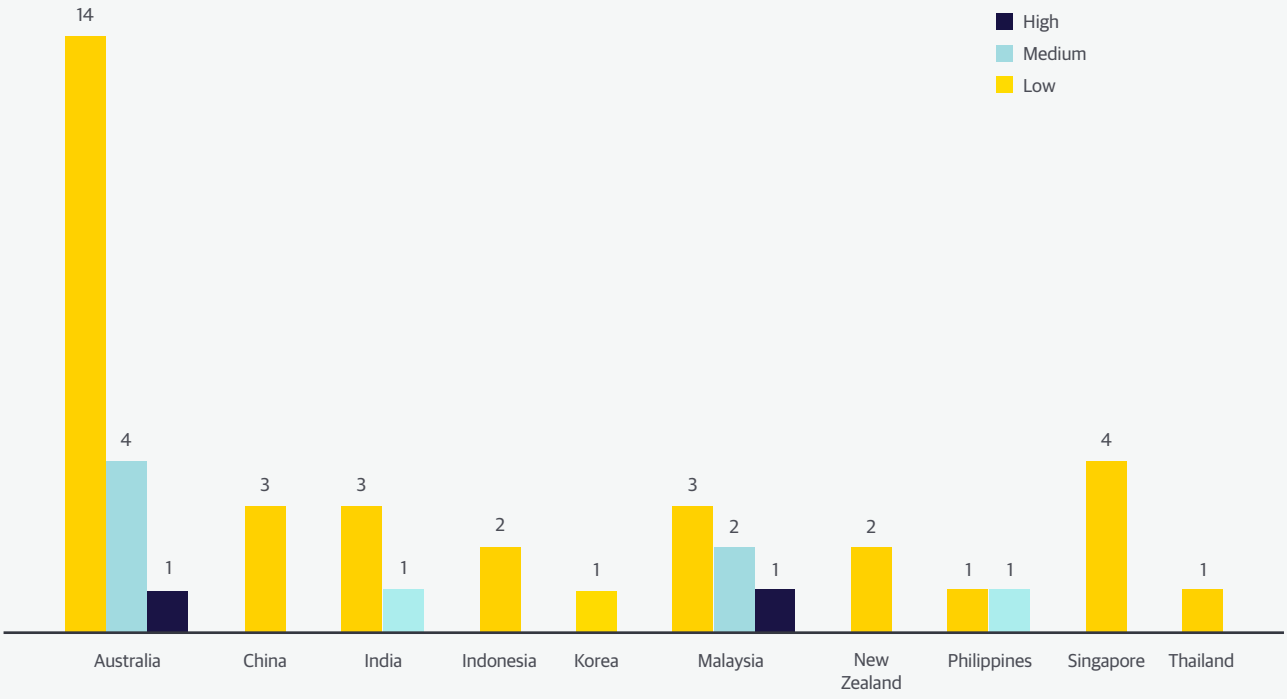
Data based on notifications received between January 1, 2018 and May 31, 2021

**Our largest claims in the APAC region have been limited mostly to Australia and Malaysia** (see Figure 23).

We have received relatively few "high" severity claims that have a nexus to the APAC region over the last few years. However, the ones that we have received have been for substantial amounts. This includes one claim for in excess of AUD $100m. These "high" severity claims have been, together with most of our "medium" severity claims, limited to Australia and Malaysia, although there have been other APAC territories that have generated large claims in the past (most notably Singapore and New Zealand). The fact that most other territories in this region have generated low severity claims only over this period indicates that our increased appetite for deals involving businesses that operate either exclusively or predominantly in APAC countries with emerging economies has not come at the expense of increased risk.

Figure 23:

**Breakdown of top 10 APAC loss locations by severity**




Data based on notifications received between January 1, 2018 and May 31, 2021

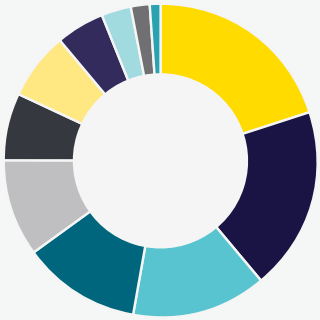
# Section 9:
# Sector trends

## Most notifications stem from deals in the Industrials sector, yet all sectors are represented (see Figure 24).

The Industrials sector has been behind about 20% of our notifications over the last few years based on a breakdown according to the Global Industry Classification System (developed by Standard & Poor's). This is followed by the Healthcare sector (at 19%), the Consumer Discretionary sector (at 14%), the IT sector (at 12%), and the Real Estate sector (at 10%). We take a closer look at some of these sectors (and other sectors) below.

Figure 24:

**Breakdown of notifications by industry**



- 20% — Industrials
- 19% — Healthcare
- 14% — Consumer discretionary
- 12% — Information technology
- 10% — Real estate
- 7% — Materials
- 7% — Consumer staples
- 5% — Utilities
- 3% — Financials
- 2% — Energy
- 1% — Communication services

Data based on claims paid between January 1, 2018 and May 31, 2021

### Focus on Industrials sector

This broadly defined sector encompasses industry groups such as manufacturers of capital goods, providers of commercial and professional services, and transportation. It captures many of the deals that we underwrite, which explains in part why it features so highly in terms of the number of notifications that we receive.

This sector has accounted for a relatively high proportion of our "high" severity claims comparative to other sectors, with most of these falling within the manufacturers of capital goods industry group. A closer look at this industry group shows that we have seen several large claims involving businesses involved in the aerospace and defense industry, mostly relating to material customer contracts. These types of businesses will often be dependent on a small number of contracts for a large amount of their revenue. In theory, it ought to be a more straightforward task to perform a fulsome diligence exercise in this situation. However, if an issue related to one or more of these contracts slips through the net, there is clearly the potential for a large claim. In addition, because these contracts are often project based, there is a greater risk of the sort of revenue recognition issues discussed in Section 7.

The commercial and professional services industry group has accounted for several "medium" severity claims (but no "high" severity claims) over this period. A significant proportion of the issues that we see are either material contract related or employee related. The latter includes the misclassification of employees as contractors and issues around the failure to comply with minimum wage legislation.

We have only received a relatively small number of notifications involving deals falling within the transportation industry group, with most involving operational businesses (such as rail, trucking, logistics companies) as opposed to more infrastructure-based businesses (such as highways).

## Focus on Healthcare sector

The Healthcare sector has been generating an increasing number of notifications in the last few years. This is largely driven by notifications submitted on policies underwritten in the Americas region. While that in part may be explained by the very active market for healthcare M&A that the U.S. has experienced over the past few years (and the fact that Liberty GTS has historically held a broad appetite for several types of healthcare transactions, subject to careful underwriting and appropriate diligence), it also may reinforce a commonly held belief that healthcare transactions must be examined under a heightened risk standard. This is supported by our severity data, which indicates this sector sees more severe claims as a proportion of all notifications received compared to other sectors.

A large number of the notifications that we receive relate to deals involving businesses that operate healthcare facilities or provide other forms of patient healthcare. The notifications often relate to billing or coding issues that have been triggered by audits or a whistle-blower report. These can result in large claims depending on how endemic the issue is and whether it is part of a concerted scheme or a genuine error. We have also seen this type of issue trigger a government investigation where Medicare and Medicaid are involved, which can be time-consuming and expensive to deal with.

A number of our more recent notifications have involved cyber-related issues. This is indicative of the fact that businesses operating in this sector, particularly those that hold a large amount of personal information, are seen by cyberattackers as a prime target. The sharp increase in the number of such attacks reported this year means that we are now taking steps to limit our exposure to this increasing risk area, such as requiring deal teams to ensure that the underlying business has adequate cyber cover in place as part of their due diligence.

We have also received a number of notifications involving production-related issues. These have mainly involved businesses operating in the pharmaceutical, biotechnology and medical devices space. One reason for this is that these types of businesses are frequently engaged in bringing new products to market. Each new product will often require a bespoke, and usually complex, production process. A new or untested process is particularly susceptible to problems during the early stages of production, potentially leading to delays and setbacks. These notifications have accounted for some of our largest claims in this sector.

Interestingly, we have seen very few notifications involving IP issues, which is usually one of the most significant areas of focus and concern during the due diligence process on deals in this sector.

## Focus on the Consumer Discretionary sector

The Consumer Discretionary Sector encompasses those businesses that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, leisure equipment and textiles and apparel. The services segment includes hotels, restaurants and other leisure facilities, education services, and consumer retailing and services.

This sector has probably been affected the most by COVID-19 and it will be interesting to see whether this has any impact on future claims activity. However, for the time being, we haven't noticed an uptick in claims involving this sector.

We have received a number of claims involving deals falling within the education services sub-sector (such as private universities or schools). These have involved a range of issues, including the lack of appropriate permits, unpaid tax, noncompliance with health and safety laws, and irregular enrollment practices. This suggests that this sub-sector may involve more risk than traditionally thought.

The automobile sub-sector has also generated a number of claims. A number of these have involved stock-related issues, which is unsurprising given that automobile businesses tend to be very stock orientated. We have also seen a large claim involving an automobile manufacturer which was caused by production delays (because its contracts with key customers included a provision stating that liquidated damages were payable in the event of a missed delivery date). The risk of this type of issue arising is particularly acute for production line-orientated businesses like automobile manufacturers because there is often little slack in the production timetable to cushion against a delay. This means that a relatively minor issue can cause delays in respect of assets already in production and delays in respect of assets that have not yet entered production, but where there is still a hard delivery date that needs to be hit (because it is difficult to find space in the production timetable to claw back the time). We are, therefore, increasingly focused on checking whether planned production targets are being hit on deals like this because, if they aren't, then there is a risk that delivery dates have been or will be missed.

## Focus on IT sector

We have seen a noticeable uptick in the number of notifications that we are receiving in connection with deals in the IT sector, reflecting the increasing number of deals that we are seeing in this space. This has thrown a spotlight on the high valuation multiples in this sector, which can sometimes exceed 20x EBITDA on deals involving relatively young, but fast-growing tech businesses. A high valuation multiple like this can obviously result in a large claim where the loss is calculated on a "multiple-of-EBITDA" basis, including in situations where the underlying issue is not particularly significant in itself.

The use of such a high multiple in a claims scenario in the early-stage tech sector doesn't make much sense conceptually because the reality is that the past performance of the business usually carries much less significance on these types of deals: the value is wrapped up in the future growth prospects of the business and in many cases this may be largely unaffected by the underlying issue, even if it is recurring in nature. A further problem is that it is not unusual for deal advisors to ignore items below a certain value for the purposes of their due diligence on the basis that the buyer does not consider these to be material to its decision to transact. However, these items can suddenly take on a new significance in a claims scenario where a high multiple is involved. We are, therefore, scrutinizing how purchase prices have been calculated on these types of deals much more carefully and we predict that the market may increasingly look to cap the size of the multiple or even exclude the use of a transaction multiple altogether on a case-by-case basis.

## Focus on Real Estate sector

The fact that the Real Estate sector features highly is not surprising given that these types of deals tend to involve a low attachment point and, in many cases, there is no retention at all. This makes it more likely that an insured will notify us of an issue, even if it is relatively minor in nature. However, while frequent, the notifications that we have received have tended to be at the lower end of the severity spectrum and it is one of the few sectors where we have not received any "high" severity notifications over the last few years. This can be explained by the fact that these types of businesses feature fewer moving parts than, say, a manufacturing deal, meaning there is less scope for things to go wrong.

A high proportion of the notifications that we receive involving this sector are tax related. We also see a lot of notifications involving lease- and tenancy-related issues, especially on multi-tenant deals. This tends to mean in practice that deals involving retail sites generate more claims than deals involving office buildings. Other common issues include unpaid utility bills and disputes between landlord and tenants around fit-out costs.

Notifications involving issues with the construction and the condition of the building(s) are still surprisingly common despite the fact that most insurers exclude these issues as a matter of course. To the extent that a claim is rejected on this basis then we rarely find that it is challenged.

We are also seeing an increasing number of claims relating to health and safety issues, including around noncompliance with fire regulations. These types of issues are coming under heightened scrutiny from local authorities and can necessitate a significant capital outlay depending on the nature and scale of remedial action required.

## Focus on Consumer Staples sector

The Consumer Staples Sector comprises companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food and beverages and producers of nondurable household goods and personal products. It also includes food and drug retailing companies as well as hypermarkets and consumer supercenters.

Our notifications involving this sector mostly relate to the Food and Beverage industry group. A significant proportion of these notifications involve APAC deals and two of the notifications that we have received in the last 24 months involve claims for more than $50m. The reason for the heightened claims activity is partly down to the fact that many companies operating in the Food and Beverage industry have complicated supply and distribution agreements. They are also susceptible to stock and inventory issues, particularly around obsolescence and spoilage. Indeed, this has been the primary driver behind a number of the claims that we have received and we are, therefore, particularly focused on these types of issues as part of our underwriting process. We have also seen a number of wage-related disputes involving this industry group which is perhaps indicative of the fact that, compared to many other industries, it is more heavily reliant on a low-cost, shift-based workforce. The balance of our notifications mainly involve real estate-related issues, although these have tended to be at the lower end of the severity spectrum. This can be attributed to the real estate footprints, including storage centers and warehouses, that are the hallmark of many of these types of business. We have also noticed an increase in the number of notifications that we are receiving which involve consumer actions against food and beverage companies based on allegations of deceptive advertising.

# Section 10:
# Claims handling

In this section, we focus on the claims handling process and leverage our substantial experience in this space to offer some of our tips for practitioners in the M&A insurance area: insurers, advisors, brokers, and dealmakers alike.

### When should an insured notify?

We would always suggest that it is prudent for an insured to put insurers on notice of an issue as soon as possible, even if details are sketchy or investigations are still at an early stage. This gives insurers an opportunity to ask initial questions, make any initial requests for further information at an early stage and can save time down the line. An insured can always provide a supplemental, more detailed, claim notice as further facts emerge and as its investigation progresses. It is particularly important that third-party claims are notified as soon as possible. This is because third-party claims can move quite quickly and a failure to involve insurers at the outset could mean that an insured is in breach of its policy terms.

### What should a claim notice include?

A well drafted, well thought-out claim notice sets the claim off on the right foot. It aids the insurer's understanding of the issues and helps sharpen the focus of the insurer's response and follow-up enquiries. A claim notice should:

Give full details of the irregularity and how and when it was discovered — The more information that can be provided the better.

Address seller knowledge (where applicable) — If the warranties that are alleged to have been breached are qualified by seller knowledge then evidence should be adduced to demonstrate that the seller possessed the requisite level of knowledge.

Provide evidence to support the loss being claimed — Where the loss has been calculated on a "multiple-of-EBITDA" basis then the insured should be prepared to justify this approach, and the size of the multiple being applied. It should also expect insurers to ask to see a copy of the valuation model used and any investment committee papers relating to the deal. Focusing on this issue at the outset maximizes the chances of a swift resolution.

Identify the warranties/indemnities that may have been breached (after checking whether any of these were rewritten or excluded from cover) and explain the basis for this — An insurer cannot assess whether there has been a breach of an insured warranty without this information.

Enclose key documents — It is important to include as much relevant documentation in support of the claim as possible, including any correspondence or evidence referred to in the claim notice itself, as this helps to reduce the number of follow-up questions.

Attempt to value the claim (ideally with a clear explanation of how that number has been arrived at) — This doesn't need to be the final number, but an indication of the possible quantum of the claim will help to guide the insurer's response.

## The investigation stage

The claim investigation phase should be a collaborative process and a continuation of the partnership already in place between the insurer and its insured. The length of an investigation can depend on a number 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. Here are a few dynamics that permeate our most efficient processes following receipt of the claim notice:

- Quick action by Liberty in acknowledging the notification and instructing advisors where necessary.
- Direct communication from the outset between Liberty and individuals on the insured's deal team or within the target company's operations that have firsthand knowledge of the claim. This helps promote ongoing dialogue between the parties and reduce the information gap that is inherently present at the beginning of a claims process.
- A thoughtful, systematic initial information and document request from Liberty (while additional follow-up is common, we will always tailor our questions and work with our insureds to find a way to get answers to our questions without being overly burdensome and to avoid a drawn-out process).
- A fulsome document production from the insured. If certain responsive documents are unattainable or particularly sensitive, we will usually press for a discussion and explanation so that we can work together to find a work-around such that the insured can sufficiently support its claim.
- An early meeting of technical experts (where these have been appointed) can also help to bridge any information gaps and narrow the scope of any further enquires that might be required in order for insurers to make a determination on the validity of the claim.

## Engaging advisors

While our M&A claims team has significant experience in reviewing and paying claims in-house, it is common, especially in the case of complex claims, for insurers to retain legal counsel and/or other experts to assist in the claims process.

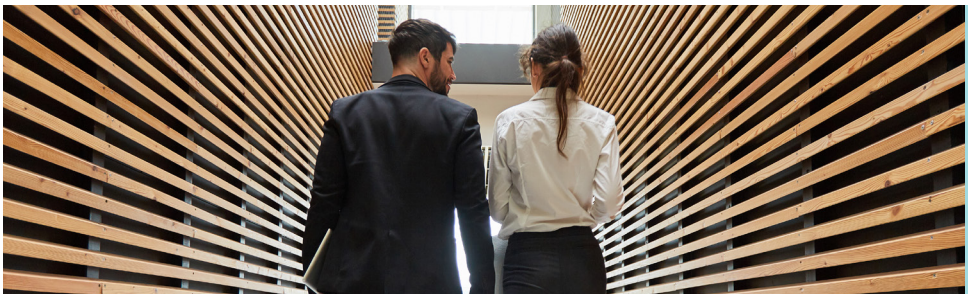
It is essential that insurers communicate the meaning of these engagements to their broker and insured partners from the outset. Specifically, it is important to confirm that our insureds understand that retention of counsel or other industry-specific experts should not be taken as an indication that a dispute is forthcoming; rather, engagement of these professionals is simply to ensure that we are asking the correct questions from the beginning and that the process moves smoothly. Ultimately, Liberty views engagement of advisors as a tool to make the process more streamlined and less cumbersome for our insureds given the complexity of transactions and the level of scrutiny sometimes required to confirm coverage.

In terms of selection, we hand-select advisors, specific to our business, which have both the proper expertise and outlook towards the process that will promote an efficient and collaborative experience. At Liberty, our claims mindset is never dispute-oriented — our sole job is to ensure that valid claims are paid promptly based on our partnership with our insured, and we believe that the advisors we select to assist in the claims process are an extension of that approach.

## Collaboration with brokers

A vital aspect of our claims process is our relationship with our broker partners, many of which have dedicated M&A claims handling counterparts with whom we work daily.

While brokers play an important role in the policy placement process, their role is heightened in the claims process. In fact, we find that our most collaborative processes are often ones in which the broker plays an active role. First, the broker is in a prime position to understand the needs of both parties and to help set expectations in terms of the need for collaboration and timing. The broker can communicate to an insurer where resolution of a particular claim is especially urgent or crucial to a business and can similarly communicate to an insured why certain documents need to be produced in order to substantiate a claim. Second, because we place numerous policies with a variety of brokers each year, we likewise work through several claims simultaneously with those brokers. This builds trust into the claims ecosystem and promotes candid conversations that can flow through the broker to each party. Strong partnerships like these prevent the breakdown of communication and limit the likelihood of disputes arising, which works to everyone's benefit. For these reasons, we greatly value the experience and insights that our broker partners can bring to the table in the claims process.



## Third-party claims

Third-party claims (as are typically defined in a R&W policy) can be delicate in the M&A claims world because they often produce a scenario in which the insured and insurer alike necessarily must wait for a determination as to the merits of certain alleged underlying issues.

The most common mistake in this process is for the communication flow between insured and insurer to cease following the initial notification, only for the conversation to pick back up just when an insured is nearing a settlement. Assuming the insurer's consent is required (as is typically the case, depending on the amount of a settlement), this can put both parties in a difficult position if an active dialogue about the status of the third-party claim has not been maintained.

Additionally, insureds often place too little emphasis on requirements contained in the policy such as obtaining consent to hire certain advisors that are not preapproved and consent to incur fees past certain thresholds. We always recommend, therefore, that insureds err on the side of disclosure and provide insurers with frequent updates as to the status of any claims, the amount of fees incurred, and the potential for resolution at a minimum.

# Section 11:
# Claims outcomes

## Claims are being paid, helping our insureds to recover, and then move forward quickly (see Figure 25).

An analysis of our notifications received between 2010 and 2019 involving a loss or potential loss that exceeds the retention reveals that approximately 43% of these have ended with us making a payment. A further 31% involve claims that are still ongoing or are currently dormant, but could still result in a payment. About 12% involve claims that were not ultimately pursued by the insured. The reasons for this are varied, but include where the issue was resolved via the completion accounts process or where the claim involved a third-party claim that ended up being unsuccessful or where the insured simply dropped the claim (perhaps because the amount in issue was relatively small). Only 14% of claims were not paid after being declined. The most common reason for declining a claim was due to the application of a policy exclusion.

**We made payments totaling in excess of $45m during the course of 2020.**

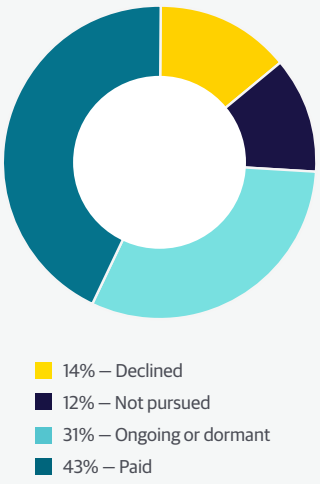
This was slightly down on 2019 due to the absence of any payments similar in size to the €50m payment that was made to FSN Capital by a Liberty-led insurance consortium during the course of that year. The majority of our paid claims in 2020 were in respect of U.S. claims (which is a reversal from 2019 when most of our paid claims were in respect of EMEA and APAC claims). This included three claims that we paid in our capacity as an excess layer insurer. Our attachment point on each of these claims was in excess of $30m. This is indicative of the increased claims activity that has been seen in the U.S. over the last few years and provides some context to the rate increases of approximately 25% in this region between 2019 and 2020.

### Key insights

- Most of our paid claims from 2019 onwards have involved financial and accounting or material contract-related issues.
- Our most significant payments come in the Industrials and Healthcare sectors.
- We paid out more than $45m for claims in 2020.
- Revenue recognition issues account for our largest paid claims by value.

Figure 25:

**Summary of claim outcomes**




Data based on notifications received between January 1, 2010 and December 31, 2019

**Most of our paid claims from 2019 onwards have involved financial and accounting or material contract-related issues** (see Figure 26).

An analysis of our paid claims from 2019 onwards shows that 32% of these involved financial and accounting-related issues. This is in line with our historical data which has consistently shown that these types of issues are responsible for most of our paid claims.

A further 21% of our paid claims over this period involved material contract issues. This is higher than the historic average: between January 2010 and April 2020 the material contract issues accounted for only 11% of our paid claims.[3] This is indicative of the rise of this type of issue in the last few years.

The remainder of our paid claims over this period were made up of a variety of more discrete issues including IT, real estate, compliance with laws and employment-related issues.

It is important to note that the above analysis only represents a snapshot of our data from the last few years. Historically, as discussed in last year's briefing, we have paid claims relating to many other issues, including, for example, tax-related issues and undisclosed litigation (and we have a number of ongoing claims involving these issues too).

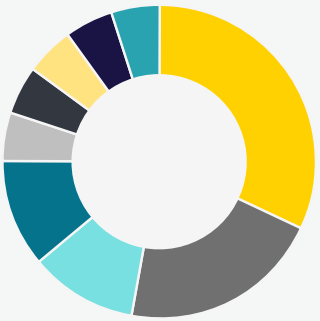
**A number of these paid claims involved the same underlying cause, with revenue recognition issues accounting for our largest paid claims by value** (see Figure 27).

A deeper dive into the underlying causes of these paid claims reveals that a number involved the same issues. The most commonly occurring issue involved the failure to disclose an intention to reduce order volume or to terminate a contract (at 16%). This was followed by claims involving revenue recognition issues, software under-licensing issues, and failure to disclose a material adverse change since the accounts dates (each at 11%). We also paid a number of paid claims relating to health and safety issues, wage-related disputes and an undisclosed liability (each at 5%).

Our costliest claims involved revenue recognition issues. These accounted for 28% of the dollars that we paid out from 2019 onwards. We also saw several significant payments in connection with accounts receivable and material contract-related issues. We flagged some of these issues in last year's briefing as areas where we were seeing a number of large claims and this helps to explain why we are now so focused on them at the underwriting stage.

Figure 26:

**Breakdown of our paid claims by breach type**

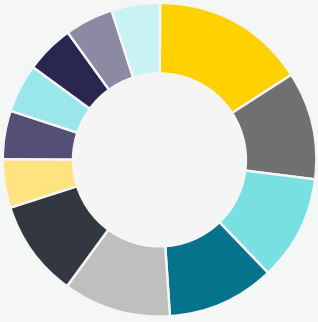


- 32% — Accounting and financial
- 21% — Material contracts
- 11% — Changes since accounts date
- 11% — IT
- 5% — Compliance with laws
- 5% — Employee related
- 5% — Other
- 5% — Real estate
- 5% — Assets

Data based on claims paid between January 1, 2019 and May 31, 2021

Figure 27:

**Breakdown of our paid claims by underlying cause of loss**



- 16% — Notification of intent to reduce volume or terminate material contract
- 11% — Material adverse change since accounts date
- 11% — Noncompliance with accounting standard
- 11% — Revenue recognition
- 11% — Software licensing
- 10% — Condition of asset
- 5% — Undisclosed change in material contract terms
- 5% — Undisclosed liability
- 5% — Wage-related dispute
- 5% — Other
- 5% — Provisions for debts or liabilities
- 5% — Health and safety

Data based on claims paid between January 1, 2019 and May 31, 2021

3 Liberty GTS 2020 claims briefing

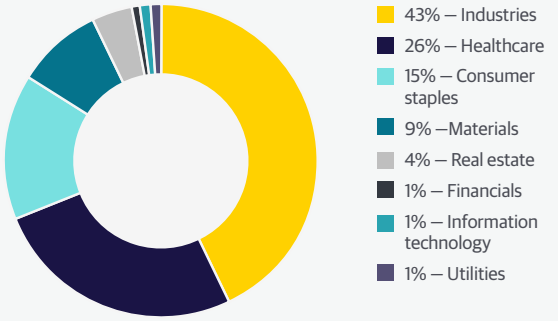
**Our paid claims were spread over a number of different industry sectors, with our most significant payments coming in the Industrials and Healthcare sectors** (see Figure 28).

We have paid claims across a variety of different industry sectors over the last few years. The largest of these payments have involved deals in the Industrials and the Healthcare sectors, which helps to explain why these two sectors account for a significant percentage of the total dollars that we have paid out over this period. This is also consistent with the fact that these sectors have accounted for the highest volume of our notifications and a relatively high proportion of our "high" severity claims comparative to other sectors (see Section 9). The Real Estate sector only accounted for 4% of our paid claims by value over this period. This is partly because the claims that we paid in this sector were not calculated on a "multiple of EBITDA" basis, meaning that they involved smaller amounts.

The IT sector and the Utilities sector generated only a small percentage of our paid claims, but we expect this to change going forward based on the ongoing claims that we are handling.

Figure 28:

**Breakdown of total dollars paid out by industry sector**




Data based on claims paid between January 1, 2019 and May 31, 2021

# Section 12:
# Subrogation

Subrogation is a valuable, but seldom used, right.

An insurer's potential right of subrogation is an important tool at its disposal in the event that it makes a payment under the policy. However, it is usual for a R&W policy to provide that the insurer may only exercise its subrogation rights against the seller where it has been fraudulent, deliberately deceitful or engaged in willful concealment. This means that is a seldom used right. Fraud is not easy to prove. It is a serious allegation and not something that can be pled casually. Another problem is recovery. Often, by the time the issue is discovered, the proceeds of sale may have been paid away and it could be that the seller, to the extent that it is a corporate entity, has since been wound up or is just a shell company. This adds an additional layer of complication and expense to subrogated claims.

**We have seen examples of the buyer successfully circumventing the seller's liability cap under the SPA by claiming fraud.**

Fortunately, fraud is not an issue in the vast majority of R&W claims and, to date, we have yet to pursue a subrogated claim against a seller (although there are a handful of claims where this is under consideration). However, we have seen a number of instances where fraud has been pled against the seller by the buyer. These have tended to involve accounting-related claims and can happen where the buyer has suffered a loss in excess of the policy limit and is seeking, in an effort to recover the full loss, to circumvent the seller's liability cap under the SPA by claiming fraud. There was a recently reported case in EMEA where such an action was successful.

**Insureds need to be careful not to unintentionally waive the insurer's subrogation rights when entering into a settlement with the seller.**

We have seen several instances recently where an insured has unintentionally waived our subrogation rights, either in respect of a particular issue or more generally. This can happen where the buyer opts to pursue a claim against the seller (up to the limit of its liability cap under the SPA) and any resulting settlement between the parties is concluded on a "full and final" basis, with no carve-out for fraud. A settlement on this basis will effectively extinguish any subrogation rights that an insurer has obtained or may obtain against the seller in due course because, when bringing a subrogated claim, it stands in the shoes of the insured and is not entitled to exercise rights that are not available to it or have been waived. In this scenario, the

only remedy that an insurer may be left with is a possible claim against the buyer for having prejudiced its position in the event that evidence of seller fraud later emerges.

The best course of action is for a buyer to try to avoid such a situation arising in the first place by carving out fraud from any settlement that it concludes with the seller or, alternatively, engaging with an insurer at an early stage in the process in order to get them on board with the terms of the settlement to the extent that these might impact existing or future rights.

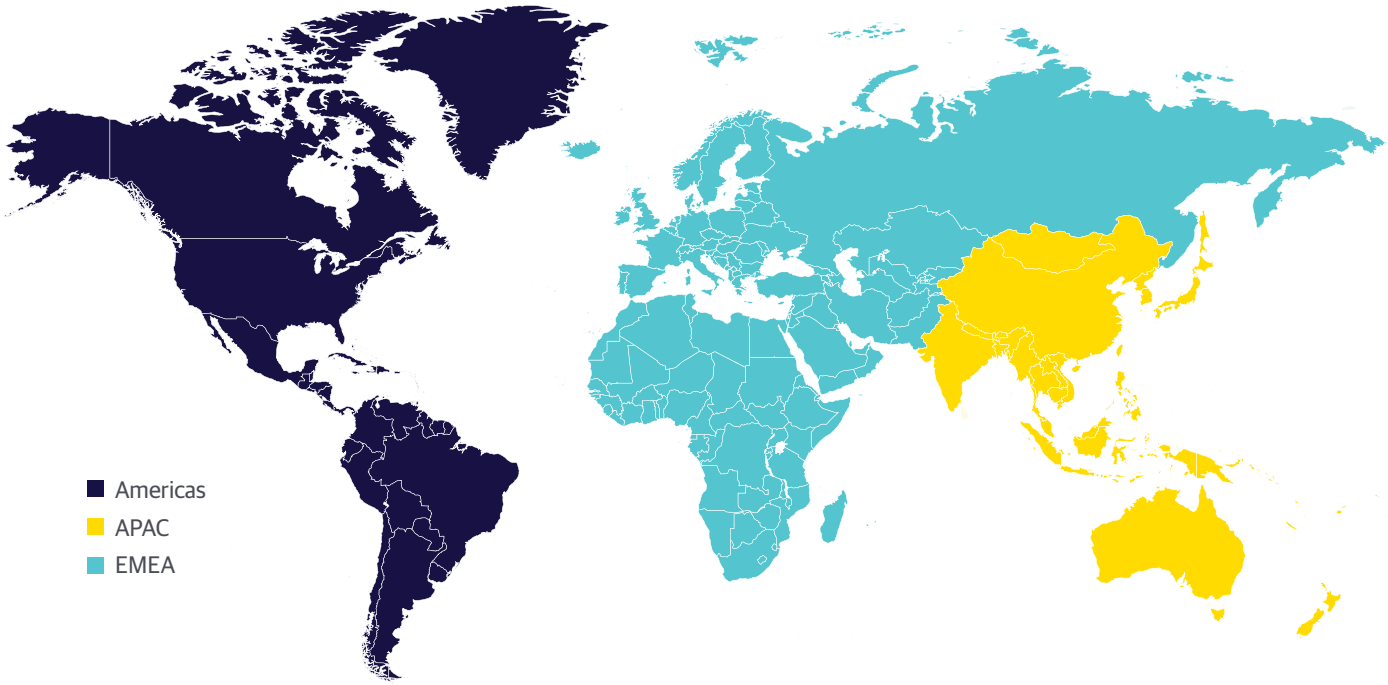
This issue is, of course, less of a problem on nil recourse deals, as in this scenario the insured is unable to pursue the seller for any loss (absent of fraud).

**Insureds also need to take steps to ensure that a settlement with the seller does not curtail their ability to bring a claim under the policy in respect of the same issue.**

An additional, unrelated issue, that a buyer needs to consider when concluding a settlement with the seller is how this might impact any claim that it might have under the policy. In particular, it should take steps to agree with insurers that any language in the settlement agreement that curtails its ability to make a claim under the SPA against the seller in respect of a particular issue is a limitation that is disregarded for the purposes of the policy. Otherwise, the buyer runs the risk of unintentionally compromising its ability to bring a claim under the policy in respect of that issue because the link to an actionable claim against the seller under the SPA has been broken.

Section 13:

# Claims briefing insights




## Global insights

Global notification count was **up 40%** in 2020 vs 2019, mainly driven by increased policy count.

**57%** of notifications were received within 12 months of the policy incepting in 2020 (up from 49% in 2019).

About **33%** of notifications involve a loss that exceeds the retention.

There was a fall in the number of **"high" severity claims** in 2020, but those that we did receive were for higher amounts.

We paid out in excess of **$45m** in 2020.

Revenue recognition issues account for our **largest paid claims** by value.

## Americas insights

- Americas notification count up 40% in 2020 vs. 2019.
- Region with the highest claims severity, including several $150m plus claims.
- Region with the highest number of limit losses.
- There has been a drop-off in claims severity in the Americas in 2021 vs. 2020.
- We have seen increased claims activity involving businesses operating in the healthcare sector.
- We have paid three claims in our capacity as an excess layer insurer in the last 24 months.



## APAC insights

- APAC notification count up 90% in 2020 vs. 2019.
- Region with the smallest proportion of notifications involving a loss that exceeds the retention (at 24%).
- Region with the lowest claims severity, although we have received several notifications in the last 24 months involving claims for more than $50m.
- Tax issues are still behind a high proportion of our APAC notifications.
- Wage-related disputes are becoming increasingly common in this region.
- We have seen increased claims activity involving businesses operating in the food and beverage sector.

## EMEA insights

- EMEA notification count up 17% in 2020 vs. 2019.
- Region with highest proportion of notifications involving a loss that exceeds the retention (at 35%).
- There has been an increase in claims severity in EMEA in 2021 vs. 2020.
- The top five EMEA territories for notifications are U.K., Germany, Italy, France and the Netherlands.
- Tax issues are still behind a high proportion of our EMEA notifications.
- We have seen increased claims activity involving businesses operating in the pharmaceutical, biotechnology and medical devices space.

# Section 14:
# Conclusion

The recent boom in M&A activity has fueled an unprecedented demand for M&A insurance in the short term. However, in the long term, this is likely to result in a significant increase in claims activity which is likely to shape the M&A insurance market in a number of different ways over the next few years.

First, it will bring how insurers are set up to handle M&A claims into much sharper focus fueled by an expectation among insureds that their claims will be dealt with by an experienced and specialist in-house claims team that has full control over their processes and decisions. This is only to be expected: M&A insurers compete on price, they compete on coverage, they compete on deal execution, but they should also compete on the quality of their claims function too.

Second, it could result in the appetite of some insurers for this class of business starting to wane, leading to significant structural changes in the M&A insurance market. In particular, it is likely that some of the mono-line Managing General Agents (MGAs) that operate in this space will see reductions in their capacity as the insurers that back them seek to reassess how to deploy their capital. This is important because it is usually these insurers (as opposed to the MGA) who will control any significant decisions in a claims scenario, and if they no longer have any interest in the M&A insurance market or the MGA that wrote the risk, then this could potentially result in a more protracted and unpredictable claims process.

Third, it is likely to result in a more data-driven approach to underwriting as new claims trends emerge. This data will undoubtedly shape future underwriting decisions, leading to changes in appetite for some deals and some jurisdictions. It may also lead to shifts in both pricing and coverage. It is important that deal teams adapt accordingly and focus more attention on the areas where M&A insurers are seeing claims or else assume more of the risk themselves.

Fourth, and related to the above point, there is an opportunity for M&A insurers, like Liberty GTS, who have sufficient data and an effective claims feedback loop to provide more tailored coverage to their insureds taking into account the issues and areas where they are not seeing claims, both at a sectorial and regional level.

"At Liberty GTS 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. We are, therefore, well-placed to deal with the challenges that flow from an increase in claims activity and to use our extensive claims experiences and knowledge to tailor our underwriting approach appropriately. The work that we do around our annual claims briefing is a key part of this and we hope that the insights it contains can encourage wider discussion about claims and their importance to the continued success of this product."

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Special thanks for the development of this briefing are attributed to the Claims Client Relationship team within Liberty Specialty Markets, led by Andrew Pedler, and to Hannah Wood, Head of Marketing for Liberty GTS.