Global M&A and
Transaction Solutions

Risk in Review 2020

Empower Results®

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Survey Methodology

Before the outbreak of the COVID-19 pandemic, Aon commissioned Acuris to interview 18 global insurers and managing general underwriters to learn their views about the risks and challenges they face in the current deal environment.

Introduction

In 2019, M&A defied a plethora of pessimistic predictions. Commentators announced that geopolitical uncertainty, trade tensions between the US and China and volatile capital markets would put the brakes on a decade-long run of dealmaking success. However, the market, once again, proved the doubters wrong.

As transactions grew, M&A insurance pursued the same upward trajectory. Demand from Aon's clients for deal-related solutions again showed year-on-year growth. The number of representations & warranties (R&W, also called warranty & indemnity, or W&I) policies Aon placed in 2019 increased by 18%. Expectations for 2020 were high – our survey revealed that respondents expected increases across all types of M&A insurance. And then COVID-19 hit. By early March, the pandemic was wreaking havoc across the globe, inflicting human tragedy and loss while also stalling deal markets as lockdowns took effect in all regions.

However, in the first half of 2020, despite a significant slowdown (Q1 saw a 25% fall in volume from the same period last year), deals continued to complete and, as countries and businesses begin to return from lockdown, the market could well pick up pace as we enter the second half of the year. "Buying opportunities still exist," said Matthew Heinz, Co-Practice Leader in Aon's Transaction Solutions Practice. "But a higher risk tolerance will be needed as buyers become less certain of valuations. With all the dry powder on hand, there nonetheless could be a feeding frenzy." The demand for M&A insurance should once again follow suit.

In our exclusive survey of global insurers and managing general underwriters, we found that 79% predict an increase in R&W insurance, 63% anticipate litigation and contingency to rise, and 88% feel that tax insurance will grow. While these figures emerged before the outbreak of COVID-19, M&A insurance has become such a staple of the industry that the percentage of penetration in the deal market should remain high even if the actual number of transactions stagnates.

The market in H2 2020 and into 2021 will likely be characterized by distressed deals – M&A insurance will become an increasingly powerful pillar in facilitating these deals. Meanwhile the surge in tax and litigation and contingency insurance on both distressed and "regular way" M&A deals is likely to continue, as these are not as inextricably linked to the broader M&A market and are increasingly recognized as strategic capital management tools that can solidify financials and unlock liquidity.

In this report, we take an in-depth look at how industry insiders see the market for transaction products developing in the next year. The coverage includes exclusive data exploring regional, deal size and sectoral variations as well as insights on claims, a potential hardening market and premiums, positions and policies. We are also delighted to have on-the-record interviews with five notable industry professionals who discuss a wide variety of subjects from the effect of COVID-19 to the impact of technology on the industry.

Continued Global Adoption and Growth

In line with the findings in this report about the broader market, Aon's Transaction Solutions global team's use of M&A insurance in 2019 resulted in:

1,195
transactions insured across all insurance lines

$45.6B
in limits placed

12%
increase in the number of policies closed in 2019

20,241
M&A deals announced in 2019, the second highest tally in the past 10 years

$3.4T
total value of M&A deals announced in 2019, the third largest sum in the past 10 years

3,980
deals with R&W insurance in 2019

Part 1: **Policies, positions and COVID-19**

The spread of coronavirus took its toll on global M&A in Q1 2020, as deal value and volume dropped by around 30% on Q4 2019 levels. Before the pandemic, however, M&A was on a decade-long roll.

Activity has doubled over the last 10 years. Global deal value climbed to US$3.4 trillion in 2019 from US$1.7 trillion in 2009. Volumes rose to 20,241 deals from 9,920 over the same period.

The uptake of M&A insurance has tracked this growth in the deal market and, according to our survey findings, the number of deals bound by surveyed insurance providers climbed across all categories in 2019.

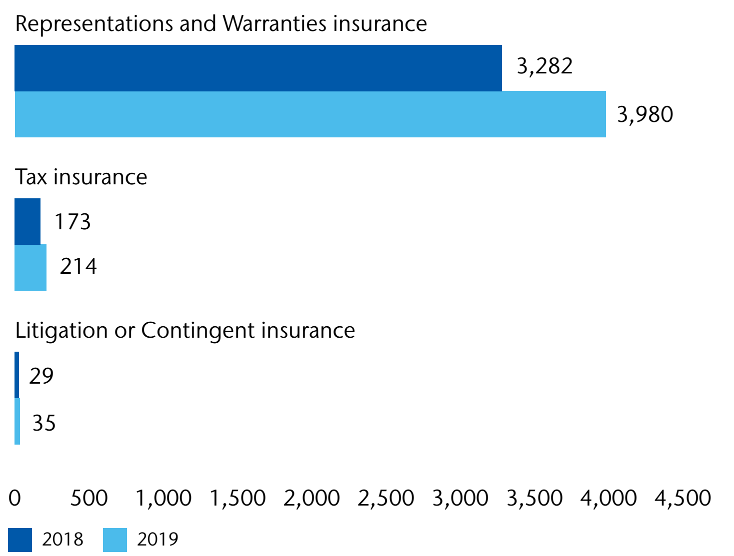
Survey respondents indicated that the number of deals with R&W insurance climbed to 3,980 in 2019 from 3,282 the previous year. Tax insuran on 2018 levels.

Figures from Aon draw similar conclusions, with the utilization of R&W insurance again showing year-on-year growth in 2019. The number of R&W policies Aon placed in 2019 increased by 18%, and although growth moderated in 2019 when compared to previous periods, the data show that R&W is still spreading across more M&A deals.

Most survey respondents expect this to continue in 2020 – 79% of those polled predict an increase in the use of R&W insurance, and 63% anticipate litigation and contingent policy uptake to rise. None sees a significant decrease in 2020.

However, the impact of COVID-19 on headline deal activity 2020 will have a direct influence on the number of R&W policies placed during the year. R&W numbers could decline on 2019 levels, although tax, litigation and contingent policies remain positioned for growth.

How many deals in total were bound by your firm globally in each of the following categories of insurance solution?



The evolution of underwriting

The proportion of deals that do proceed in the "new normal" of COVID-19 and make use of R&W could in fact increase. Vendors will be looking for ways to unshackle capital locked in escrow accounts, while also providing buyers with protection against breaches of R&W. Aon estimates that 48% of North American M&A deals (defined as private transactions in the US$25 million to US$10 billion range) utilized R&W insurance in 2019, up from 40% in 2018.

R&W underwriting is evolving rapidly in response to coronavirus uncertainty. R&W has become an increasingly important cog in the allocation of risk in M&A and, given its central role in dealmaking, insurers are obliged to tackle how COVID-19 risks manifest themselves in context of the policy coverage and which, if any, of those risks can be effectively underwritten.

Insurers' approaches to COVID-19 vary, ranging from broad exclusions of loss resulting from COVID-19 imposed on every deal to an effort to adjust the scope or need for an exclusion on a deal-by-deal basis. Insurers' positions on COVID-19 are fluid and subject to adjustment as the pandemic and its economic impact continue to develop.

"We are currently taking COVID-19 on a case-by-case basis, and our approach continues to evolve. Our view on any particular deal is influenced by a number of factors including, without limitation, the operations and jurisdictions of the target and breadth and scope of the representations related thereto," said a president at a US underwriter. "At this time, we do not have a requirement to utilize an exclusion on every single deal, however, where applicable, we will utilize an exclusion. At a minimum, we are adding COVID-19 as a heightened risk."

> "Federal Reserve models predict that COVID-19-linked bankruptcies could rise as high as one million this year, one-fifth higher than figures for 2019."

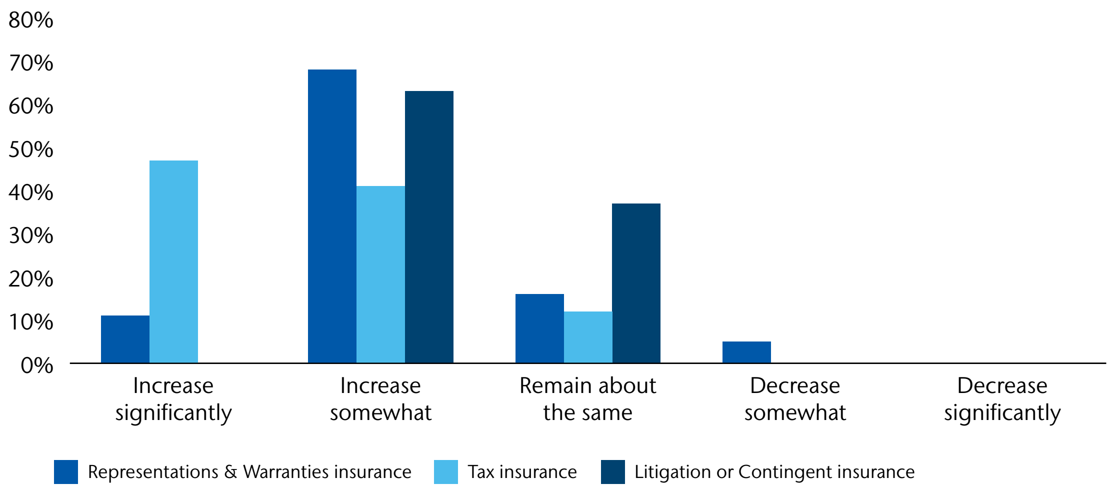
Opportunities in distress

M&A insurance could become increasingly important for facilitating distressed deals to address R&W, tax, and litigation risks. The forced closure of businesses in certain sectors and the impact of social distancing on consumer spending has pushed many companies into financial difficulty and might herald a surge in distressed deals. Insolvencies and personal bankruptcies are expected to climb. Federal Reserve models predict that COVID-19-linked bankruptcies could rise as high as one million this year, one-fifth higher than figures for 2019.

Investment or rescue through M&A is one lifeline available to businesses facing falling earnings and business failure. Cash-rich buyers, meanwhile, will be able to acquire assets at attractive valuations.

Investors are positioning themselves along these lines. According to data provider Preqin, 20 distressed funds raised just under US$20 billion in 2019. But market observers believe fundraising for distressed deal strategies could match the highs of around US$45 billion raised in 2008 during the global financial crisis. GSO, Oaktree Capital, Värde Partners, Bain Capital Credit and Marathon are just some of the special situations, credit and distressed investors who have recently raised or launched new funds.

What do you expect to happen in 2020 to the number of policies bound by your firm globally in each of these categories of insurance solution compared to the previous year?



If distressed deal flow accelerates as anticipated, M&A insurance solutions will be important tools to help maximize sale proceeds for the benefit of sellers looking to bolster operations or pay off debt and creditors. M&A insurance offers protections to buyers in these situations from misstatements in the R&W describing the target. Prior to the COVID-19-induced drop in deals, R&W cover was predominantly used by vendors in a seller-friendly market to limit transaction liability risk. Now that market dynamics have shifted, more buyers could start to employ the available cover as a way to support opportunistic M&A strategies in a distressed deal environment.

"Offsetting the slowdown on deal flow in the medium term could potentially be an increase in opportunistic M&A activity, with private equity (PE)funds and special situations investors making acquisitions of distressed companies," a practice group leader in the UK said. "These deals will likely be on buyer-friendly terms with valuations likely to be materially lower than what we have seen recently."

In addition to predicting an increase in the use of R&W cover in 2020, survey respondents see an even steeper uptake of tax insurance and litigation/contingent liability solutions. These solutions will see substantial interest in the context of distressed transactions as they are not inextricably tied to trends in the wider M&A market, uptake should prove more resilient in the face of a prolonged downswing in activity. Many customers are likely to continue using these solutions as part of their broader tax planning and risk mitigation strategies.

"Dealmakers recognize that doing deals with R&W insurance makes sense"

Jay Rittberg, Managing Principal of Euclid Transactional, tells us about the changing nature of deals, the mainstreaming of R&W and growth of tax insurance

Jay Rittberg
Managing Principle of Euclid Transactional

How will COVID-19 change the approach to policy terms and underwriting for M&A insurance in the coming 12 months?

Jay Rittberg: I believe the nature of deals will change over the next 12 months and our policies will likely change, but only to the extent necessary to accurately match up with how M&A is changing. We always need to examine the adequacy of buyer/seller diligence and disclosure process as we underwrite our insurance.

There might be some policy terms or structural aspects in the policy that could change to reflect any changes in how diligence is getting done. We may even have to postpone certain parts of coverage until diligence is completed. For instance, if there is an environmental issue at a factory and buyers are not able to go evaluate it, that's something we may not cover. Alternatively, we might say, "We'll cover it later if you can do the diligence later."

What are the main opportunities coming in the next 12 months?

We are seeing an initial period where capital is shifting to shoring up portfolio companies or maintaining existing businesses. Hopefully, once we hit a level of stability where portfolio companies and PE funds and other investors figure out that their existing investments will endure through the pandemic, people will look to invest again. For our industry, people will continue to use transactional insurance to do deals efficiently. Dealmakers recognize that doing deals with R&W insurance makes sense.

Is tax insurance part of your growth strategy and where does it fit into your future plans?

Tax insurance can give you a sense of security about the position you're taking. It adds value because buyers and sellers don't need to be taking that risk. There are lots of positions that are taken both in the context of M&A deals, but also non-M&A historical positions that people are taking with restructurings or corporate treatments of issues on their books. Companies want to ensure that their balance sheets are stable and avoid having timing issues with getting cash to pay significant taxes that taxing authorities can unexpectedly demand.

For contingent and liability insurance, what issues do you think will be most frequently insured, and why, in the coming months?

With litigation, there's not that steady, repeatable business, and the R&W market is used to seeing certain types of consistent opportunities. It's more analysis of one-off situations with specific facts for different cases with litigation buyout. It's more difficult to find clearly repeatable opportunities, though some are there and that can add a lot of value to deals. Contingent deals are key to servicing clients in circumstances where you might find something that has a low likelihood of going wrong but can really impact a deal. Whether it's fraudulent conveyance, issues of contractual interpretation or approval or successor liability, there are ways to address these sorts of situations that add a lot of value to clients. That will continue to be an important tool for us to stay relevant in the M&A world. We have to be able to solve problems where it's rational to do so, where we have the knowledge as an insurance market to take on a risk. We shouldn't shy away from it if we can get our minds around it and price it properly.

Part 2:
Regional view

North America emerged as the fastest growing M&A insurance market in 2019 and, COVID-19 notwithstanding, is expected to retain its position as the leading jurisdiction for R&W utilization.

Aon global data recorded 1,187 transactions in 2019, with limits coming in at US$32.6 billion. This represented volume growth of 12% on 2018 levels. North America was the largest market, accounting for more than two-thirds of deals (67%). The survey findings painted a similar picture. Almost four-fifths of respondents (78%) saw the greatest increase in the number of policies underwritten in 2019 compared to 2018 in North America, and 68% expected that market to show the greatest increase in 2020.

The growth in M&A insurance underwriting in North America in 2019 tracked the strong dealmaking environment in the region. Deal value in North America climbed to US$1.71 trillion from US$1.64 trillion in 2018, and the region accounted for more than half of total global M&A value – its highest share of the global market for the last 10 years. Prior to the COVID-19 outbreak, a combination of low interest rates, steady economic growth, low unemployment and record dry powder provided a favorable backdrop. North America has also long been the most mature with respect to M&A insurance uptake and, in what was a sellers' market pre-coronavirus, pioneered the use of insurance policies as a tool to accelerate deal execution.

Global growth

Aon also recorded growth in M&A insurance in APAC and EMEA. M&A insurance volume in APAC was 40% higher in 2019 compared to 2018, with EMEA up 4%. 11% of survey respondents saw the most growth in APAC, with the same share selecting EMEA as their fastest growing market. More than a quarter (26%) also picked EMEA as the market most likely to grow the fastest in 2020.

Uptake increased despite a fall in dealmaking in these regions in 2019. Deal value in Western Europe fell to US$735.89 billion last year from US$917.9 billion in 2018, as prolonged Brexit uncertainty and European Parliament elections stymied deal flow. Asia also saw a dip, as escalating US-China trade tensions slowed activity. Deal value for APAC transactions slid to US$657.92 billion in 2019 from US$776.83 billion in 2018.

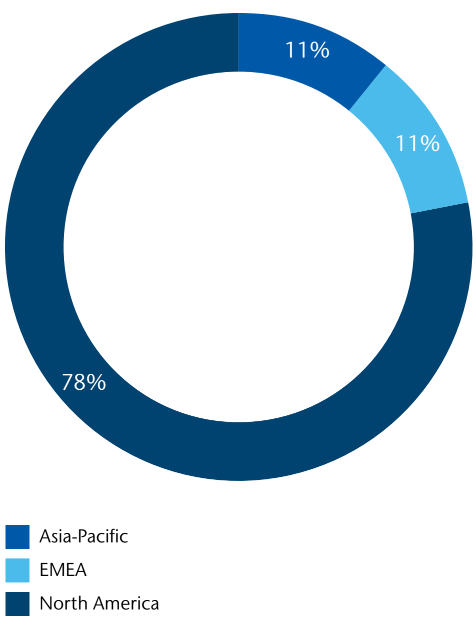
Despite the fall in headline deal numbers, the use of M&A insurance has continued to climb in both regions.

In EMEA, the influence of US investors and insurers on policy terms, as well as the rise in average limits per transaction, has supported sustained growth in M&A insurance. Market capacity in EMEA has increased materially in recent years and now averages around US$1.5 billion per transaction. The rise in transatlantic deals, meanwhile, has seen European W&I policies align more closely with the more flexible R&W deal structures. This has helped foster a better understanding of the wider applications of M&A insurance in the European deal community.

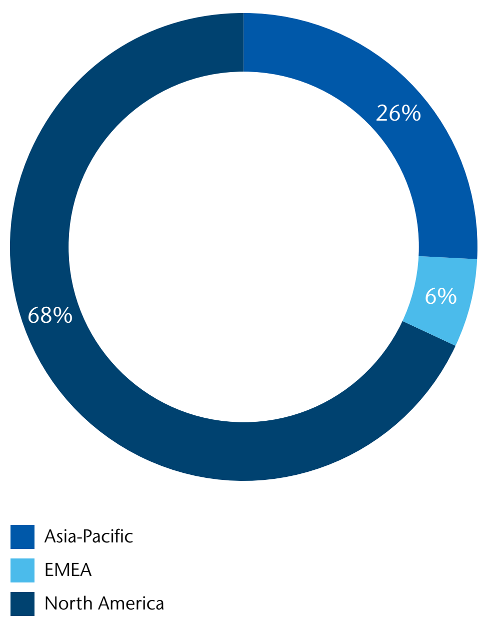
In APAC, M&A insurance has expanded in line with the growth of the region's economies and deal activity. During the last decade, APAC M&A deal value soared to US$657.92 billion in 2019 from US$362.67 billion in 2009. The number of providers serving the market has climbed to more than 20 from only four in 2014. Increased competition has encouraged more client-friendly policies, with insurers offering broader coverage and lower retentions at more attractive pricing. The rise in cross-border deals into APAC has also spurred R&W growth.

The impact of COVID-19 on deals is likely to cause a short-term shift in the market dynamics observed in 2019. But long-term trends point to continued growth in North America when dealmaking picks up again and ongoing uptake in other markets where understanding and use of deal insurance is maturing and growing rapidly.

In which region* have you seen the greatest increase in the number of policies which your firm underwrote in 2019 compared to the previous year? (Select one) *Defined by target company HQ location



In which region do you expect to see the greatest increase in the number of policies underwritten by your firm in 2020 compared to the previous year? (Select one)



Part 3: **Deal size**

In addition to growth in new jurisdictions, the use of M&A insurance in smaller transactions has also been on the rise. More than four-fifths of respondents (84%) expect to see the most growth in policy issuance in the lower mid-market (deals valued between US$5 million and US$99 million) and the upper mid-market (deals valued between US$100 million and US$999 million). Aon saw the most growth in 2019 in the sub-US$100 million range, a trend that looks set to continue.

Overall deal volume and value for deals worth US$1 billion or less has grown steadily since 2013. Volume for sub-US$1 billion transactions rose to 8,925 deals in 2019 from 7,741 in 2013, with a peak of 10,117 in 2018. On the value side, lower and upper mid-market deal value reached US$2.25 trillion in 2019 from US$1.61 trillion in 2013. For deals in the sub-US$100 million bracket, volume and value have climbed by 12% and 14% respectively over the same period.

Small (to medium) is beautiful

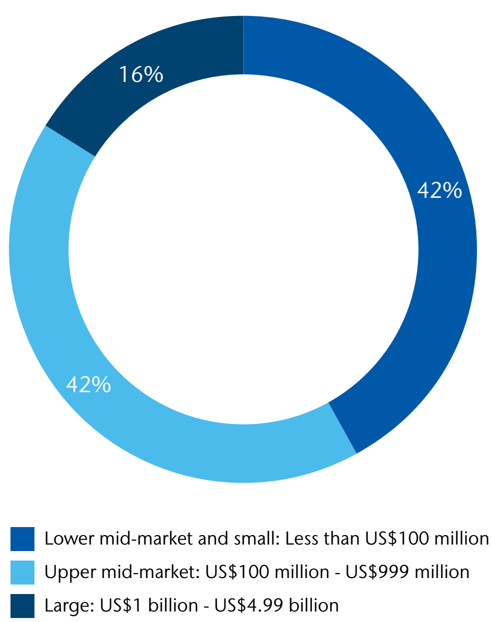
M&A insurance in this part of the market has followed a similar trajectory. Over the course of 2019, Aon's North America team witnessed a continued expansion of the use of R&W insurance for deals representing $100 million in enterprise value or less, noting a 46% increase in the number of R&W policies placed in this end of the market and a 21% decline in average deal size compared to 2018. The figures show the broadening appetite across the insurance market for smaller deals and indicate that favorable pricing and low retention amounts are encouraging dealmakers in the lower mid-market to make more use of R&W insurance to facilitate their deals.

COVID-19 could intensify this increased focus on the lower mid-market. Larger deals have relied on debt for financing, and with high-yield bond and leveraged loan markets effectively shut since the middle of February, megadeals have been delayed.

Corporates and PE firms have also paused amid the uncertainty before making big investments in new targets. The attention of corporates has shifted to executing smaller carve-outs that focus strategy on core business, while PE firms have prioritized portfolio management and smaller bolt-on deals to existing platforms.

History indicates that mid-market deal volumes show more resilience in downturns. Following the global financial crisis, volumes for US$1 billion+ megadeals fell by 60% between the peak of 2007 and 2009. Meanwhile, lower mid-market deals worth US$100 million were down by just over 50%, indicating that smaller deals are easier to close against a difficult backdrop.

In which of the following deal size categories do you expect to see the most growth globally in your firm's policy writing in 2020 compared to the previous year? (Select one)



"Opportunities are arising from internal restructuring transactions of companies"

Robert Underhill, SVP of Transactional Insurance at Berkshire Hathaway Specialty Insurance, discusses dealmaking, distress and diversification

Robert Underhill
SVP of Transactional Insurance at Berkshire Hathaway Specialty Insurance

How do you feel the coronavirus crisis is going to affect transactional insurance?

With the reduced M&A activity, we have obviously seen a significant decrease in the opportunities for R&W insurance. We're seeing a lot more distressed M&A, which raises some new challenges for us. With distressed deals, we are generally focused on the causes of distress and whether it affected conduct and internal controls, as well as the level of diligence being performed by a buyer. In some ways, targets distressed by the pandemic often have better controls as a result of the short period of distress.

Where are the opportunities for the industry in the next 12 months?

We see a lot of opportunities in the next 12 months in areas that are not strictly tied to M&A. Both tax and contingent liability have held up very well and we expect those areas to continue to grow. In the R&W insurance area, we're hopeful that there will be more visibility on the future outlook to drive more M&A, but we are still seeing some strong opportunities now. There are plenty of companies with strong business models that have suffered from the coronavirus. It's a matter of the industry shifting their underwriting and gauging what type of diligence is needed to get comfortable with underwriting in the current environment.

How do you see the contingent and litigation market moving?

Our business has continued strongly in the contingent liability area, which has primarily been driven by litigation-related risks. We're still seeing people who are trying to wall off litigation that could affect future financings and acquisitions. We are seeing a wide variety of litigation. One of the things we're seeing more frequently is customers that have judgments in lower courts and who need the money now because of the COVID-19 situation. Those people are selling their judgments to litigation funders who want insurance to protect the downside of their investments.

How do you see tax insurance fitting into your overall growth strategy in the coming 12 months?

Pre-COVID-19, we were seeing incredible growth in our tax insurance group. We expect that growth to continue throughout the year, but at somewhat reduced levels. COVID-19 hasn't significantly affected the tax credit insurance area and we expect that to continue. The legal opinion side has historically been more M&A driven, so it has slowed down. However, we are seeing new opportunities arising from internal restructuring transactions of companies, especially with distressed companies. We expect to grow this area in the next year.

What way do you see premiums going in transaction insurance in the next year or so?

Uncertainty and resulting risk have generally increased, and claims activity was trending upward even before the pandemic, so premiums should be increasing. However, we have seen several of our competitors, particularly among MGAs, taking greater risks for less premium. We expect this to catch up with these folks in the next year or so and result in a significant withdrawal of capital from this market. Longer term, we expect to see modest increases that will reset the market from the artificially low rates that resulted from so many people entering the market so quickly.

Part 4: **Claims**

Most respondents (83%) received claims that impacted their deal selection and underwriting approach. Restriction of deal selection was chosen by 47% as the most important consequence following a received claim. This was the top choice, followed by 43% opting for narrowing policy terms for some risks.

This high share has intensified the focus on how policies respond to claims, as well as insurer claims behavior. This has become particularly pertinent as M&A insurance has grown in popularity and dealmakers have come to rely on it, rather than a traditional escrow or indemnity, to manage transactional risk.

Claims have increased in line with the growth in the number of policies placed. Insurers and reinsurers have also been monitoring claims outcomes, the number of claims and an upward trend in the size of claims.

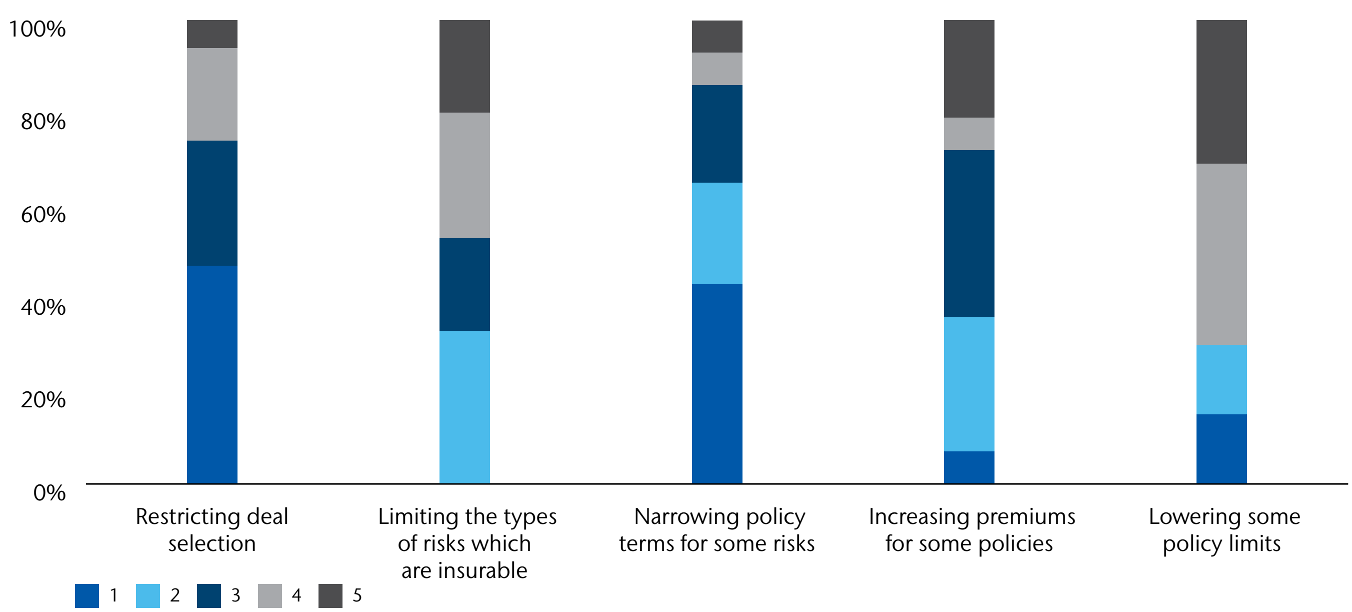
83% of respondents report that the claims they have received are impacting their deal selection and underwriting approaches.

Managing exposure

The survey findings suggest, somewhat surprisingly, that rather than raising premiums in response to the increase in claim volumes, insurers are adjusting their appetite for certain deals or scope of coverage as the preferred method for managing exposure. Only 7% of those surveyed picked increasing premiums as the best way to respond to the uptick in the number of claims.

The head of M&A insurance for a US institution said, "We have implemented a corrective action plan to modify certain reps that, as stated, are not able to be properly vetted."

How are claims received changing your deal selection or underwriting approach? (Please rank all that apply where 1=most important)



Part 5: **Technology**

Technology is playing an increasingly important role in the M&A process, from digitalizing data rooms to automating due diligence. R&W insurance is following suit.

Technological advancements have facilitated seamless document sharing and instant access to large data banks including historic rates, exclusions and premiums. Technology also gives all team members on the insurer side full visibility of the workstream on each deal.

Despite the technology's power as an enabler for R&W provision, only 37% of respondents think their firms are using technology effectively and just under a third (32%) believe their organizations are not using technology effectively.

The large share of insurers that are not maximizing technology's potential is concerning, especially given that the role of technology in M&A is already prominent and likely to become more influential following the enforced coronavirus-related lockdowns.

Insurers that do embrace technology to deliver services are positioned to gain a competitive edge both in terms of deal execution and internal efficiencies and visibility.

"Our underwriting platform provides underwriting efficiencies, internal controls and reporting and analytics," one US underwriter said.

Harnessing technology's potential in an R&W context, however, does require extensive investment and planning, as the bespoke character of deal underwriting does not lend itself as readily to automation as other insurance disciplines.

"This underwriting is highly customized, so technology is not as effective as in many other areas of insurance," a second US insurer acknowledged.

Is your firm currently using technology effectively to maximize efficiencies in M&A insurance underwriting?

31%
No opinion

32%
No, it is not

37%
Yes, it is

M&A Insurer Perspectives

"R&W insurance should remain a significant feature in M&A deals"

Mary Duffy, Global Head of M&A Insurance at AIG, talks falling M&A, rising premiums and stable R&W growth

Mary Duffy
Global Head of M&A Insurance at AIG

What will be the main opportunities and challenges in the next 12 months?

Buyers' ability to do deals may be impacted by the practical challenges in the current deal environment. Eventually, strategic buyers, PE funds and others will begin to implement their medium-term deal objectives and take advantage of both distressed and non-distressed opportunities.

Do you expect the take-up of R&W insurance to increase over the next 12 months?

R&W insurance should remain a significant feature in M&A deals regardless of whether we remain in a sellers' market or swing towards a buyers' market. The use of R&W insurance has become so entrenched in the way people do deals, and many of its advantages are now well understood by both buyers and sellers. R&W has an important role to play in helping buyers and sellers manage risk in a general climate of uncertainty. It can be particularly useful in distressed transactions.

> "The use of R&W insurance has become so entrenched in the way people do deals, and many of its advantages are now well understood by both buyers and sellers."

How do you expect premiums to move in the next 12 months?

In the last few years the industry has seen a significant increase in both the frequency of claims and the severity of claims payouts. A push for increased rate is appropriate to reflect the value of the insurance as a solution and is also necessary to help ensure the long-term sustainability of the R&W insurance market. Our clients have come to rely on R&W insurance to help them do deals and it's important that insurance premiums are aligned with any potential claims that may need to be paid in the long run.

What focus do you have on tax insurance and do you see it as part of your growth strategy?

To date we're seeing a lot of tax credit risks and M&A related tax issues. Distressed deals, restructuring and bankruptcy situations could also generate tax opportunities. For example, tax insurance can be an incredibly useful tool in helping to respond to contingent tax issues to help avoid the need for an escrow for insolvency trustees.

Part 6: **Hard market**

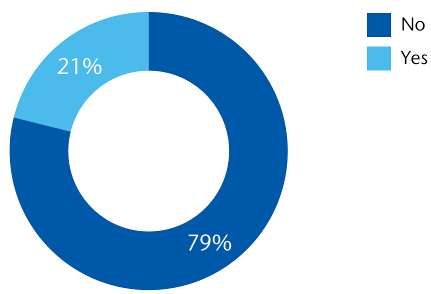
Although other parts of the insurance market have shown signs of hardening – particularly pronounced with the advent of COVID-19 – the survey findings show that M&A insurance has been relatively insulated so far.

Almost four-in-five respondents (79%) claim the hardening insurance market has not impacted their approach to underwriting. 89% report that they do not feel pressure to change their underwriting approach in 2020 based on pressure from their management in light of the broader hard market, and 82% do not feel pressure from their reinsurers. More than three-quarters (78%) claim their approach to pricing is guided by their own underwriting results and loss experience.

"Our approach to underwriting is a constantly evolving process, rather than being impacted solely by macro or external market forces. It is coincidental that the market may be seemingly hardening, as with increased sophistication in our team due to more deals bound and more claims received, naturally brings with it increased sophistication in our underwriting approach," a transaction liability team leader in the UK said. "Claims frequency has an impact in terms of lessons learnt and re-underwriting considerations, again, which is a natural progression as we see more deals and more claims in our portfolio. We aren't being strong armed into changing our terms directly as a result of a 'hard market'."

The wider insurance market, however, was already hardening before the COVID-19 pandemic. Competition and low interest rates had pushed the viability of some insurance lines to breaking point. This has seen some providers consolidate the risks they will cover, reduce capacity in certain areas and push for higher pricing.

Has the broader insurance "hard market" (i.e., increase in rate and tightening of terms in the P&C insurance market generally) impacted your approach to underwriting?



Although the survey suggests providers of M&A insurance have been sheltered from the hardening market, all providers do operate within the broader insurance market and its cycles of expansion and contraction in pricing and coverage subject to broader loss trends.

Coronavirus cover?

The survey indicates that underwriting trends in M&A insurance are determined by performance of M&A books of business, but the COVID-19 impact could see the market harden in response to wider macro trends.

As the pandemic unfolds, it will be interesting to note how M&A insurance providers, particularly large balance sheet insurers, respond if the coronavirus develops into a large-scale insurance event.

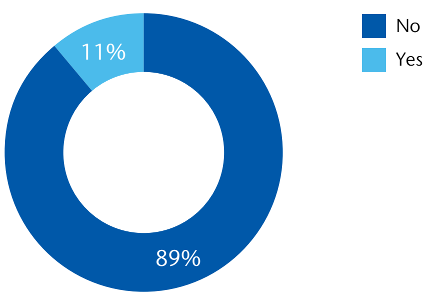
At this stage, it is unclear whether COVID-19 will cause losses resulting in covered claims, but the market will be observing if policyholders decide to look into whether coverage is found under business interruption, event cancellation, pollution liability or other policies.

Pre-coronavirus, it appears that reinsurers were yet to apply pressure on underwriting standards, even though there were whispers throughout the industry that claims trends could be affecting how reinsurers viewed M&A insurance.

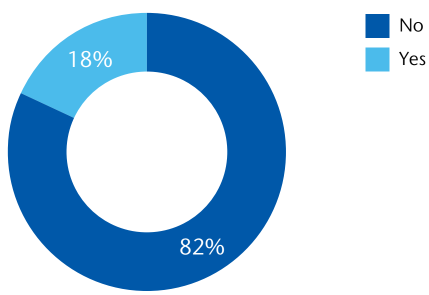
If the market for M&A insurance does harden because of COVID-19, the growth in claims or the wider hardening across other lines of cover, dealmakers could be in for a surprise – 89% of respondents believe the average M&A practitioner/insurance buyer is not aware of the broader hard market.

The perception of such lack of awareness among dealmakers is unsurprising, since many M&A professionals are not as versed in the broader insurance market as their insurance and risk management colleagues. This observation, however, underscores the perception and reality that M&A insurance solutions are viewed less as traditional insurance but as another deal facilitation tool available to buyers, sellers and their advisors.

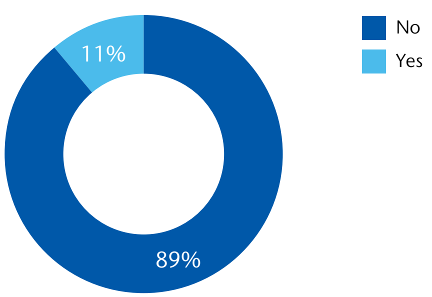
Do you feel pressure to change your underwriting approach in 2020 based on pressure from your management in light of the broader hard market?



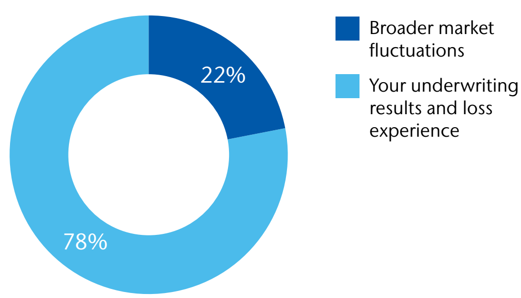
Do you feel pressure from your reinsurers to change your underwriting approach in 2020 in light of the broader hard market?



Do you think the average M&A practitioner/ insurance buyer is aware of the hard market?



Is your approach to pricing more guided by…?



Part 7: **R&W: Sector and business focus**

The survey findings identify PE firms as the largest group of R&W buyers. Respondents said that 62% of the R&W policies bound in 2019 involved a PE buyer, versus 38% with corporate buyers.

The survey results parallel trends on Aon's book of business in 2019, where 37% of closed R&W deals were placed for corporate buyers. Although PE still represents most of the market, the findings reveal that R&W insurance's status as an alternative to traditional indemnities and escrows continues to be embraced by an ever-increasing number of corporate buyers. Aon figures show that, in 2019, there were policies placed on behalf of 223 different strategic acquirers

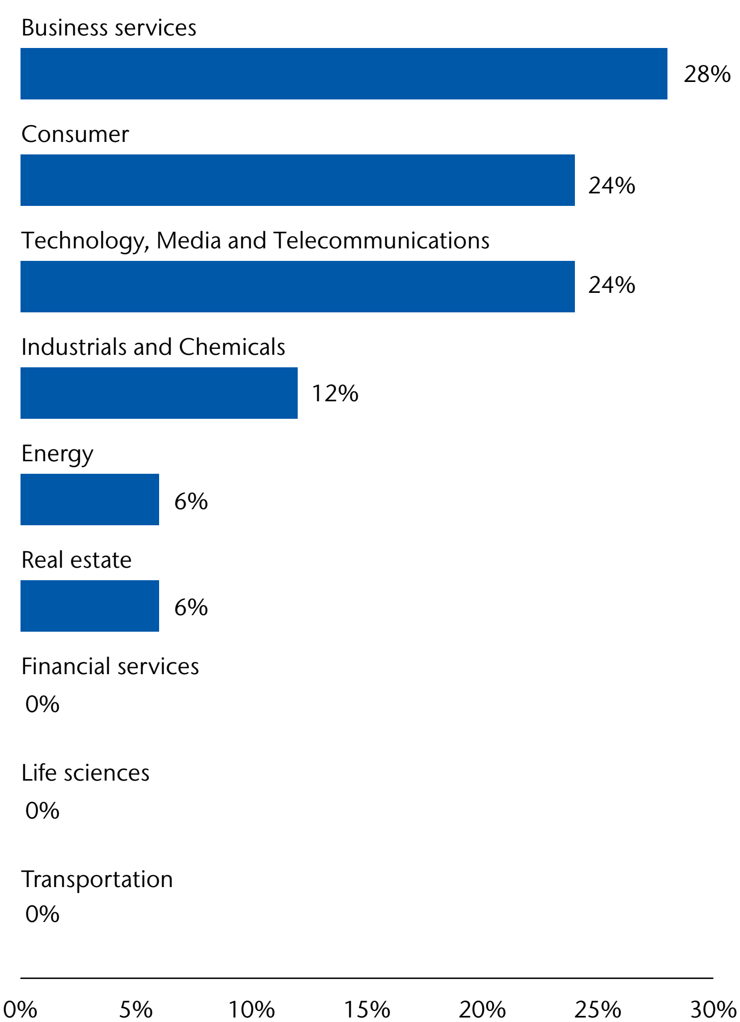
With respect to the top industries for R&W uptake in 2019, business services led the way, selected by 28% of survey participants, followed by consumer (24%) and technology, media and telecommunications (TMT) (24%). Aon's book across 2018 and 2019, meanwhile, when segmented by sector, showed a concentration of deals in the professional/financial/technology services space, as well as data analytics and software (19% and 13% respectively). R&W cover provided by Aon was used broadly across a number of other sectors too, including distribution, warehousing, logistics, healthcare, construction and infrastructure.

The COVID effect

COVID-19 has taken a toll on several industries. Lockdowns and falling demand have engendered steep declines in deal activity in the leisure, travel, energy and consumer markets. Healthcare, a priority in the pandemic, and TMT, which has seen sustained demand thanks to home-working arrangements, are expected to experience softer landings and smaller drops in M&A. Headline deal figures, however, are likely to continue trending down. Volume and value numbers for global M&A took a 30% hit in Q1, and Q2 is expected to see even weaker activity as the full impact of lockdowns on deal appetite becomes clearer.

Prior to the pandemic, more than half of respondents (56%) said they expected R&W premiums to increase in 2020, while 39% anticipated no change. The downturn in M&A as a result of the impact of COVID-19 on the global economy may, however, counteract the trend toward increased premium rates as insurers compete for a smaller number of deals.

For R&W insurance policies which your firm bound in 2019, what were the top industries represented by those deals (as defined by target company sector)? (Select top two)



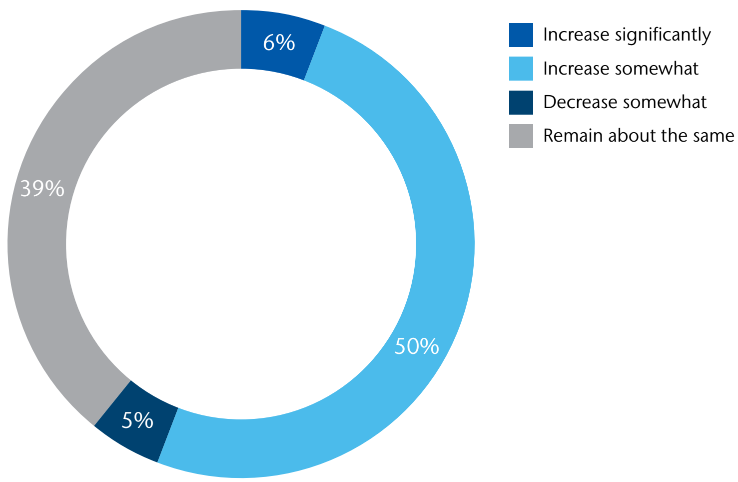
When deals do transact, however, R&W cover will be required to manage risk and uncertainty.

"COVID-19 is a known issue creating rapidly changing risks and uncertainties. Buyers and sellers proceeding with transactions while the impact of COVID-19 on a target's employees, facilities, vendors and customers remains highly uncertain will need to install appropriate risk allocation mechanisms," the president of a US insurer said.

A UK head of M&A said the range of coverage sought would help to balance competition from new entrants and keep premiums in line with previous years.

"Given the large number of new entrants, we expect additional competitive pressure, but this should be counterbalanced by claims experience and the broad coverage being sought," the executive said.

Over the next 12 months, do you expect average premiums for R&W insurance as a percentage of policy limits to...?



"Transactional insurance products have even more value in an economic downturn"

Tim Kennedy, Chief Underwriting Officer for the Ambridge Group, talks opportunities in uncertainty, the future for R&W and the growth of contingency and tax insurance

Tim Kennedy
Chief Underwriting Officer for the Ambridge Group

Given the crisis, do you see any opportunities in the market?

In an economic downturn, parties to a transaction are even more sensitive to risk allocation in a deal. Due to an increase in the number of financially distressed entities, we anticipate an increase in opportunities where sellers are unwilling or unable to provide any meaningful indemnity. In addition, with increased volatility and uncertainty about the economic outlook, acquirers are even more concerned about protecting potential downside. As a result, transactional insurance products have even more value in an economic downturn.

What challenges will the industry face in the next 12 months?

We anticipate increased bankruptcies, liquidations, restructurings, and other workouts. This may lead to trustees or other specialists selling assets. Such individuals may not have as strong a working knowledge of the target as a founder, PE firm or other sellers. With reduced seller knowledge, the disclosure process will be impacted, increasing potential risk as to whether the R&W are accurate.

In terms of contingent and litigation insurance, what issues do you think will be most frequently insured, and why, in the next 12 months?

Contingency insurance is primed for growth, but is still currently behind R&W. While further education about the product is required, the current awareness and success of R&W insurance will help to accelerate contingency insurance's growth as parties and advisors to a transaction are already familiar and comfortable with the manner in which transactional insurance can enhance or facilitate transactions.

From a litigation insurance standpoint, the biggest challenge is being able to underwrite to the key facts. While not every instance, we've found that the instances in which insurers are most likely to be able to offer coverage terms are with respect to litigation situations which are on appeal or have at least completed discovery.

How does tax insurance fit into your overall work strategy over the next 12 months?

Tax is a perfect example of a contingency-type risk, particularly in instances when an entity has an identified tax risk that may or may not have yet crystallized. Tax insurance has and will continue to be a great transactional insurance solution because it can be utilized to cover issues that neither buyer nor seller want to retain. Inherently, tax risks are long tail in nature, potentially large in quantum (especially in relation to the purchase price), and therefore difficult for the parties to agree to the value and/or allocation of such risk in a transaction.

So, for a premium, tax insurance allows the risk to be taken off the table. In the last few years we've really seen a dramatic increase in the use of tax insurance, and the insurance markets underwriting it. We see more brokers focusing on it as well. This will continue.

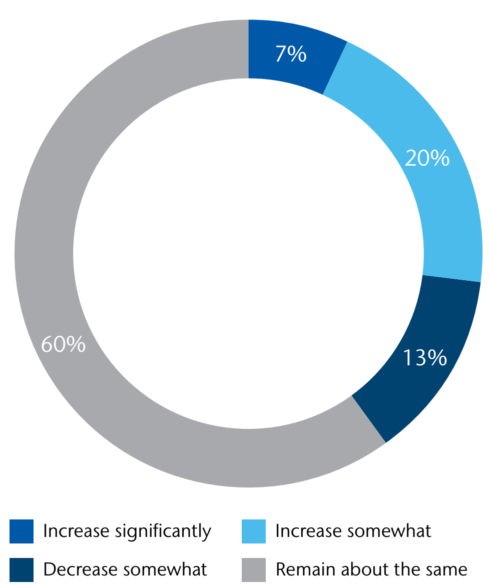
Part 8: **Tax insurance policies**

The most frequent tax issues insured in 2019 were acquisitions of S corps and 338(h)(10) elections (37%) and reorganizations and spinoffs (26%).

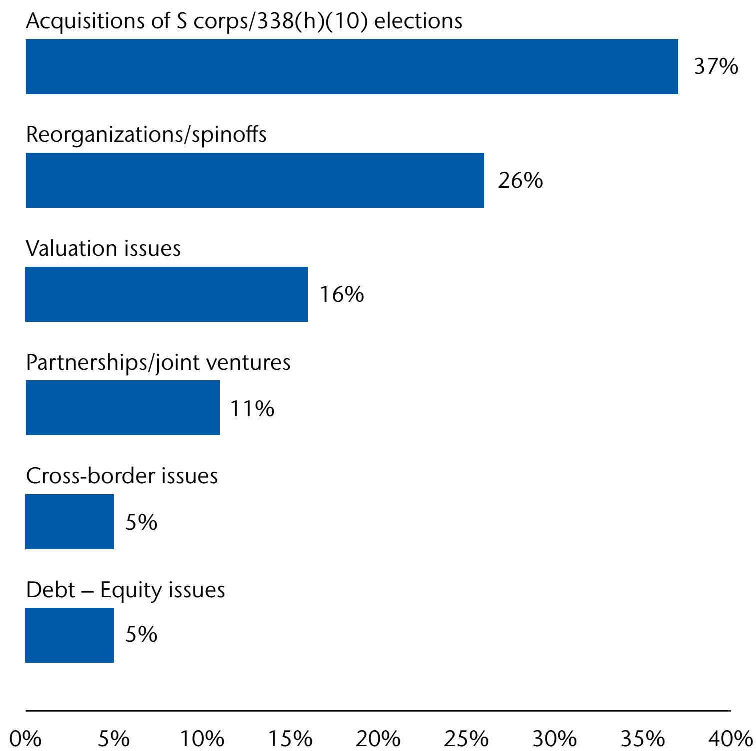
More than half of respondents (53%) said they had experienced claims notices from tax policies, but almost all of those polled (93%) expected an across-the-board increase in tax capacity, policy terms and geographic appetite. It is worth noting, of course, that a notice of claim will not necessarily precede loss.

> "Providers are differentiating solutions beyond their core R&W offering, with tax cover emerging as a growth vertical."

Over the next 12 months, do you expect average premiums for tax insurance as a percentage of the coverage limit to…?



For M&A tax insurance policies bound in 2019, what were the most frequent tax issues insured?(Select top two)



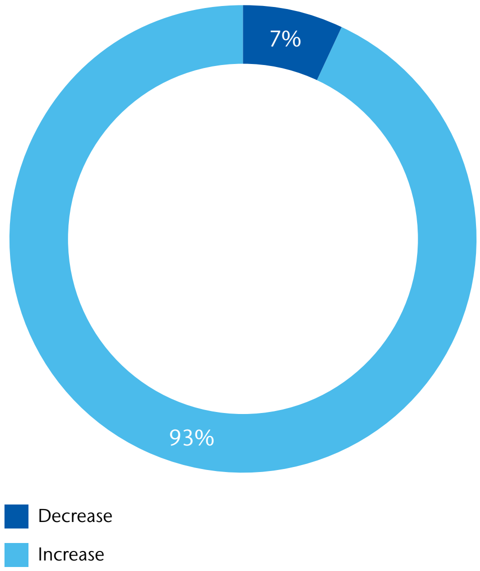
Other areas that Aon sees as frequent tax issues that can be addressed with insurance include NOLs, Ordinary vs. capital characterization, Secondary tax liabilities, Transfer pricing arrangements, Transfer taxes.

60% of those polled expected average premiums for tax insurance as a percentage of the coverage limit to remain about the same.

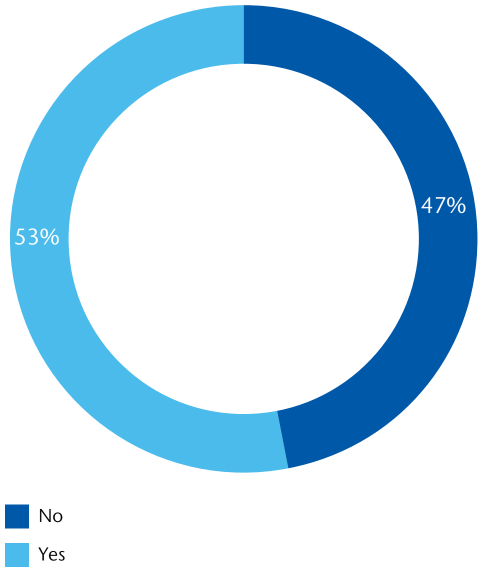
“Tax is a growth area and we continue to see investment in the space by brokers. R&W growth appears to have slowed a little, and deal flow in the early part of 2020 has been lumpy,” a North America and UK M&A manager for a US-based firm said.

Competition is one of the growth drivers in the tax insurance space. Providers have moved to differentiate solutions beyond their core R&W offering, with tax cover emerging as a growth vertical. Buyers have been using tax insurance not only in an M&A context, but also as a general tax planning tool. This has helped sustain double-digit year-on-year growth rates in tax insurance.

Over the next 12 months, do you expect to increase/decrease your tax capacity, policy term and geographic appetite?



Have you experienced claims from tax policies (as opposed to breaches of tax representations under R&W policies)?



Part 9: **Litigation and contingency insurance**

The most frequent issues for litigation or contingent insurance policies insured in 2019 were existing litigation, including appeals (61%), followed by successor liability (22%).

Over half of respondents (55%) expect existing litigation to see the highest growth over the next 12 months, followed by successor liability (23%).

The expectations of an increase in litigation insurance are underpinned by similar drivers to those behind anticipated growth in tax insurance. The use of insurance as a risk mitigation tool for active litigation, rather than only for cover, is set to rise. Insurers also have growing appetite to offer litigation and contingent liability insurance policies as they look for new ways to expand their book beyond core R&W insurance offerings.

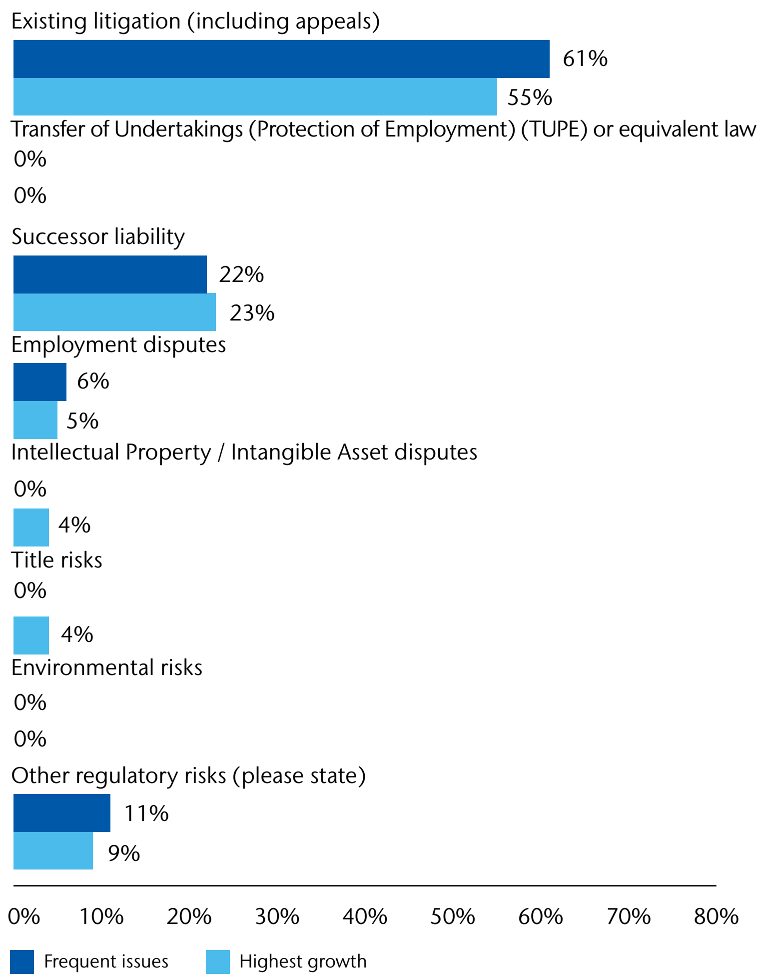
Declining global economic growth in Q1 2020 could see more companies buy litigation insurance as a way to manage cash flow through the downturn. Insurance could be used to mitigate losses from lawsuits or protect favorable rulings on appeal.

Law firm Norton Rose Fulbright was already forecasting an increase in litigation this year in its Litigation Trends Survey. Close to a fifth of corporates surveyed by the firm said they expected their in-house litigation teams to expand, with only 2% expecting a decrease. More than a third (35%) expected the volume of disputes to rise, with less than 10% anticipating a decrease.

The financial distress caused by COVID-19, and the risk of class action suits brought against employers on health and safety grounds, are just two factors that could amplify litigation volumes through 2020. Litigation risk will be front of mind for all businesses.

Meanwhile, a rise in distressed deals could generate an increase in uptake of contingent liability insurance. This cover protects buyers who acquire assets in financial distress or insolvency and then face claims from creditors for liabilities not accounted for as part of a transaction.

For litigation or contingent insurance policies bound in 2019, what were the most frequent issues insured? Where do you expect to see the highest growth over the next 12 months?(Select top two)



"We're getting creative with how we approach diligence during the underwriting process"

Toria Lessman, SVP and Underwriting Leader at QBE America, discusses COVID-19, creativity and customer satisfaction

Toria Lessman
SVP and Underwriting Leader at QBE America

How do you think the COVID-19 pandemic is going to affect policy terms, underwriting and the industry as a whole?

At the moment, as we go through underwriting, we're asking additional questions to examine the impact of COVID-19 on businesses – are they seeing a decrease in revenue, a change with respect to their customers, or interruptions in their supply chain?

What are the main opportunities for the industry in the next 12 months?

The main opportunities are an increase in some of the smaller deals and strategics using the insurance. We're trying to get creative and see how we can make the insurance more attractive in those instances.

Where do you see the major challenges coming from?

In the coming months one of the challenges we'll see due to the pandemic is the type of diligence that gets done if people can't do site visits. Certain types of diligence may have to be put on hold for a couple of months if people can't travel. It's about getting creative with how we approach that during the underwriting process and, again, still making the insurance attractive to buyers.

How is the industry optimizing technology for M&A and insurance underwriting?

We can always find ways to use technology to help us throughout our underwriting process. Technology is a major focus for QBE and we're constantly analyzing different platforms that can help us grow and create better solutions for our customers.

"Certain types of diligence may have to be put on hold for a couple of months if people can't travel."

Conclusion

The M&A insurance market has come through a strong period of growth in the last decade.

The expansion of dealmaking during this period has supported increasing uptake of R&W cover, and providers have seized the opportunity to expand limits and move into new jurisdictions. Even as other lines of insurance hardened in 2019, M&A insurers reported little initial impact on their books, with neither their organizations nor reinsurers pushing for tighter underwriting and higher pricing.

The COVID-19 pandemic has upended these dynamics, causing a steep decline in headline deal activity that will be felt in the M&A insurance industry.

During the growth in dealmaking over the last decade, however, R&W cover has demonstrated its value not only in risk mitigation, but as a tool to facilitate more efficient deal execution and cash management than escrow accounts can deliver. Although M&A activity will fall this year, demand for R&W cover for deals that do close should be sustained.

Insurers, meanwhile, have moved to diversify their offerings with tax and litigation cover, both of which are expected to see strong demand as companies look for ways to protect cash and shield themselves against the risk of lawsuits.

As ever, insurers remain innovative and open to new ways to cover clients in these uncertain times.

"R&W cover has demonstrated its value not only in risk mitigation, but as a tool to facilitate more efficient deal execution."

About Mergermarket

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Aon thanks the insurers who contributed their data and valuable insights and who work with us to create solutions that secure investments and enhance returns for our clients.

About Aon

Aon's Transaction Solutions team has been leading the creation and advancement of Transaction Liability Insurance since the market's inception. Comprised of former senior M&A and tax attorneys and other senior M&A leaders, we bring a depth of knowledge and passion for developing tailored solutions to your complex deal risks. We know first-hand that the timing and sensitivity of a deal is paramount to its success and work closely with your deal team and our insurance providers to advise and execute solutions that improve your deal outcomes.

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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