

# M&A Insurance

The background features a light blue gradient with a complex network of thin, light blue lines and arrows pointing in various directions, suggesting a web of connections or data flow. On the right side, there are two prominent blue grid structures that appear to be architectural or technical in nature. A thick, solid red line runs diagonally from the bottom left towards the center, acting as a focal point or a path through the abstract design.

A Strategic Approach to Managing Deal Risk

March 2022

AON

# M&A and Transaction Solutions: Global Footprint

Securing Investments | Enhancing Returns



# M&A and Transaction Solutions



**696%**

Growth in the number of North American transaction liability insurance policies written from 2014-2021 by Aon



**\$65 billion**

Amount of transaction liability insurance limits placed globally in 2021 by Aon



**Global** litigation, tax & M&A solutions with strong coordination across regions

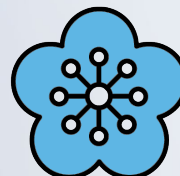


**100+** Dedicated Transaction

Solutions team members; **50+** former litigation, tax, and M&A lawyers



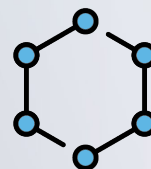
**#1** Tax insurance team by number of policies, limits placed and tax lawyers on staff



Unique **Service Model** designed for 24/7 support



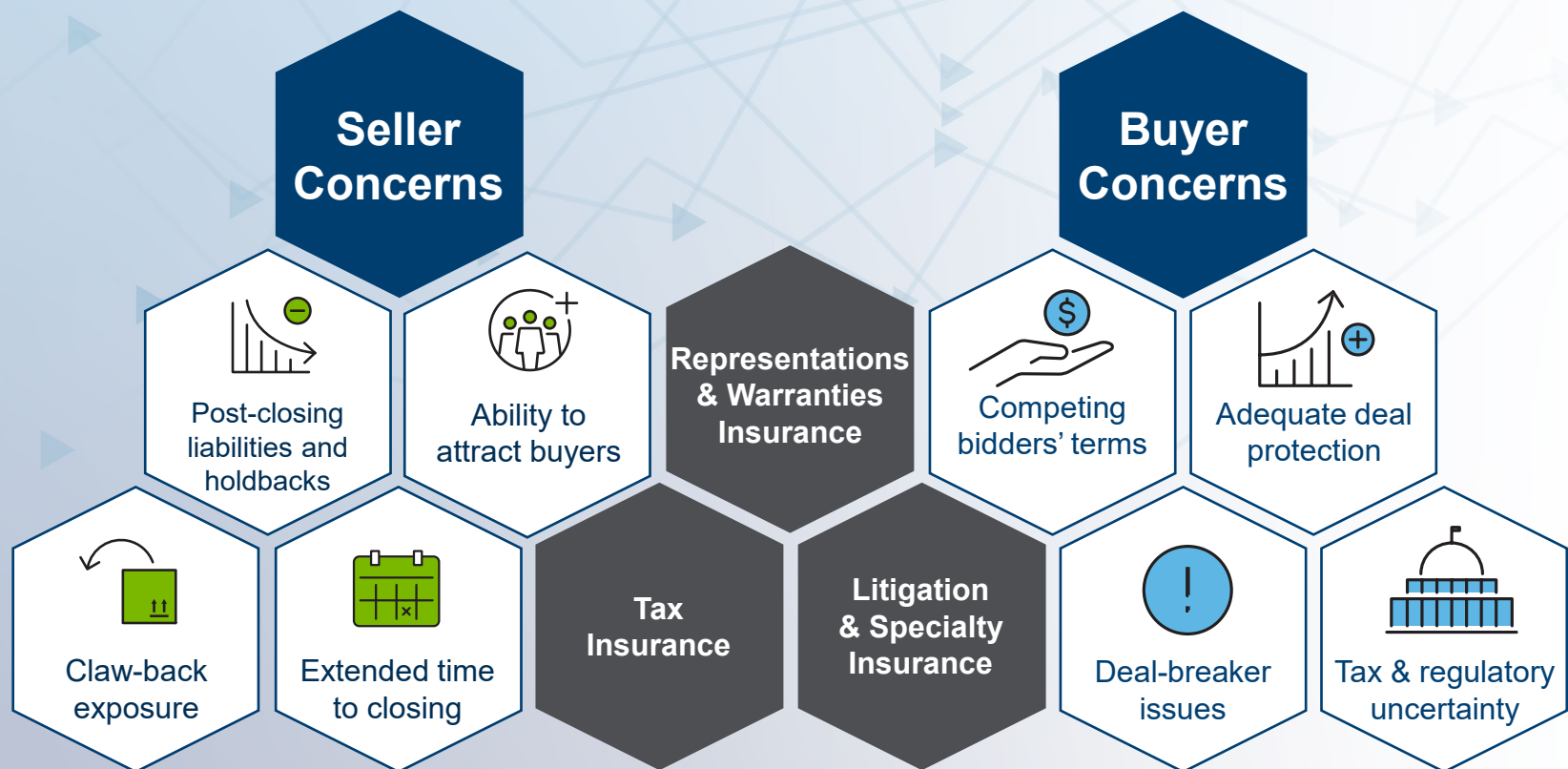
**Claims Advocacy**  
delivered by dedicated claims team



Access to **20+** A-rated or better insurance carriers collectively capable of providing per-risk limits of more than **\$1 billion**

# Deal Risk Challenges

## Meet Transaction Liability Insurance Solutions





# Deal Structures

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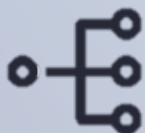
Standard  
M&A



Public  
company



Secondaries



Spinoffs



SPACs



# Trends

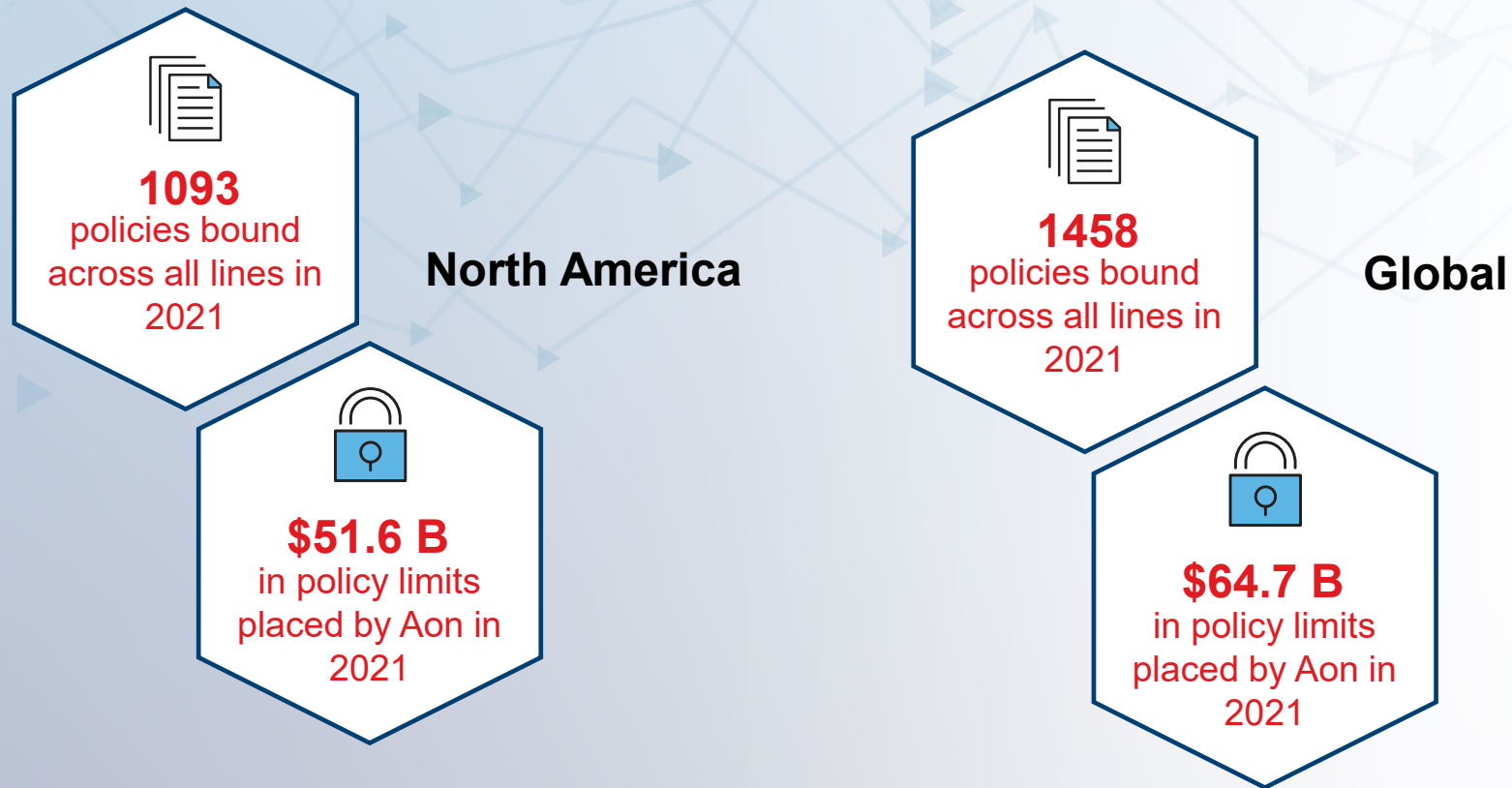


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# M&A Insurance

## Changing the Global Landscape

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# M&A Insurance

## Demonstrable Impact

### Aon estimates

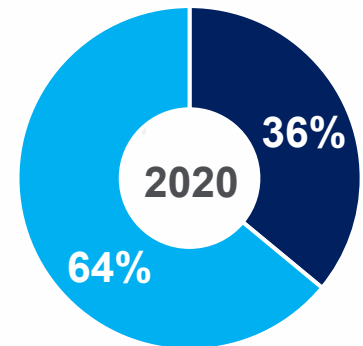
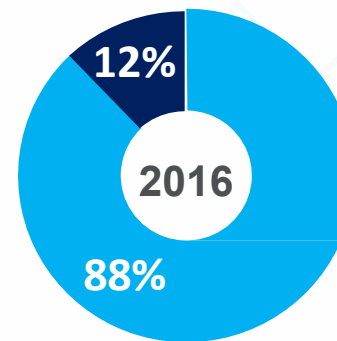
**48%**

of North American private deals used representations & warranties

More than **75%** of private equity/financial sponsor deals utilized R&W insurance

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

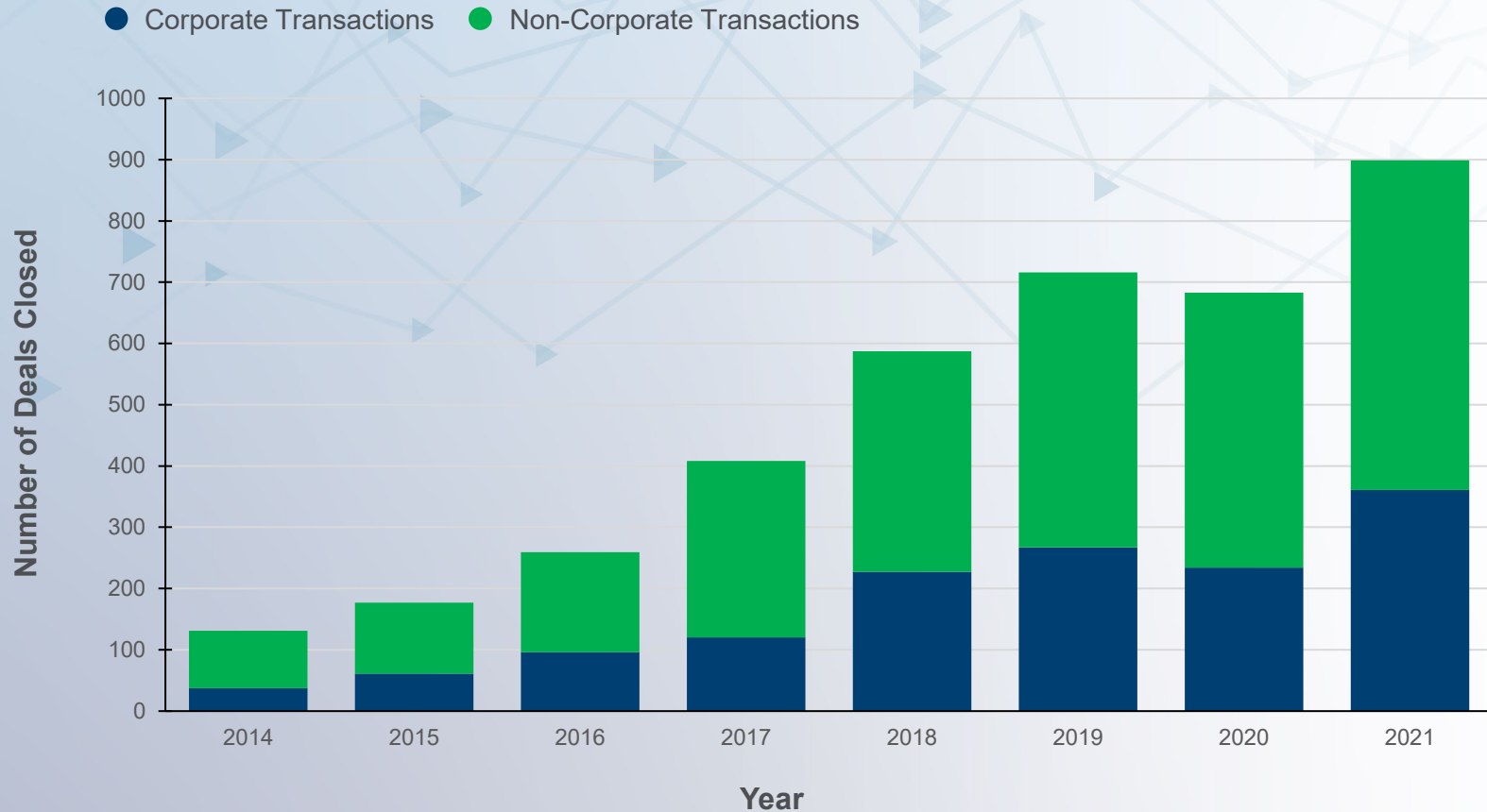
● No Seller Indemnity    ● Limited Seller Indemnity





# M&A Insurance: A Mainstay of the M&A Industry

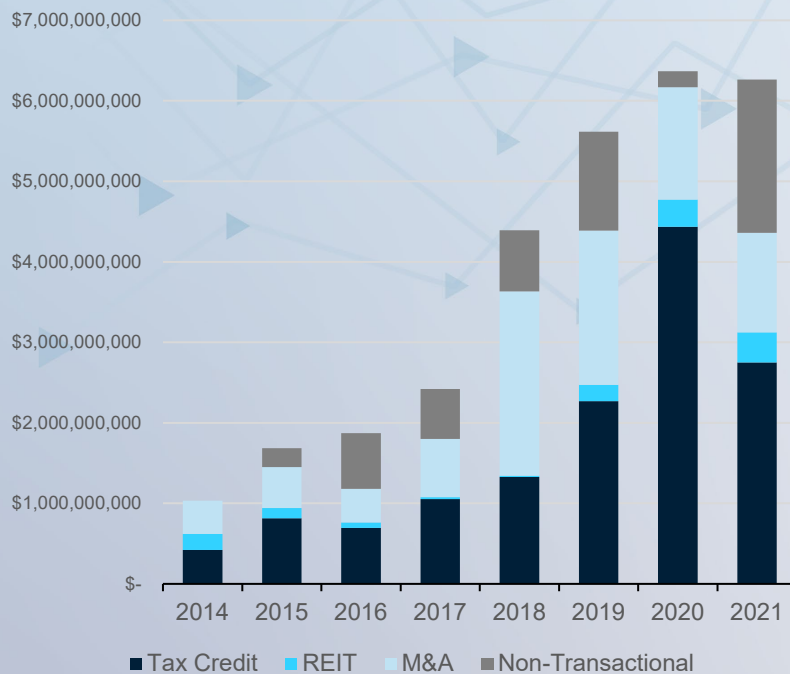
## Number of Deals Closed | Total Representation & Warranties



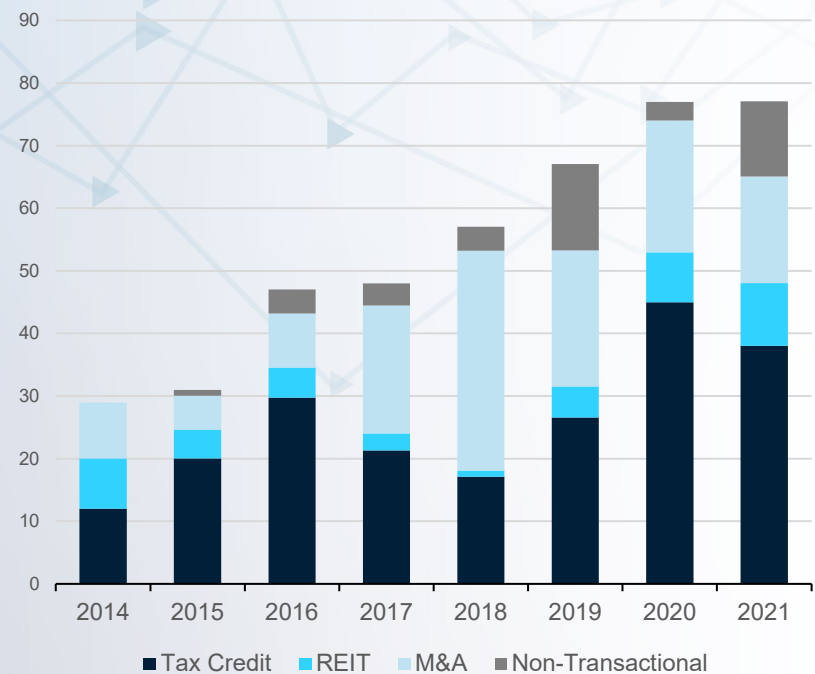
# Tax Insurance

## Growth by Product (2014-2021)

### Limit of Liability Placed



### Number of Deals Closed



# M&A Insurance: Market Snapshot

## CAPACITY



\$1.3 billion capacity available for both public and private M&A, with new markets DUAL coming on line in mid-late 2020 and Mosaic and RP Underwriting in late 2021

## COVERAGE



Coverage remains broad with fewer broad exclusions and more industry sectors (e.g. healthcare, FI). Carriers are commenting more often on wording of the representations and warranties.

## PRICING



Rates at the start of 2021 had stabilized but rose over the course of Q3 and Q4 as the market hardened in light of a precipitous spike in deal activity.

## RETENTION



Retentions decreasing for both limited seller and no seller indemnity deals

## PROCESS



Pronounced deal activity has challenged insurers' bandwidth contributing to increased selectivity in considering deals and limited ability to accommodate compressed timeframes in the near term

## CLAIMS & LOSSES



Increase in number of claims being submitted and losses being paid

# Representations and Warranties Insurance

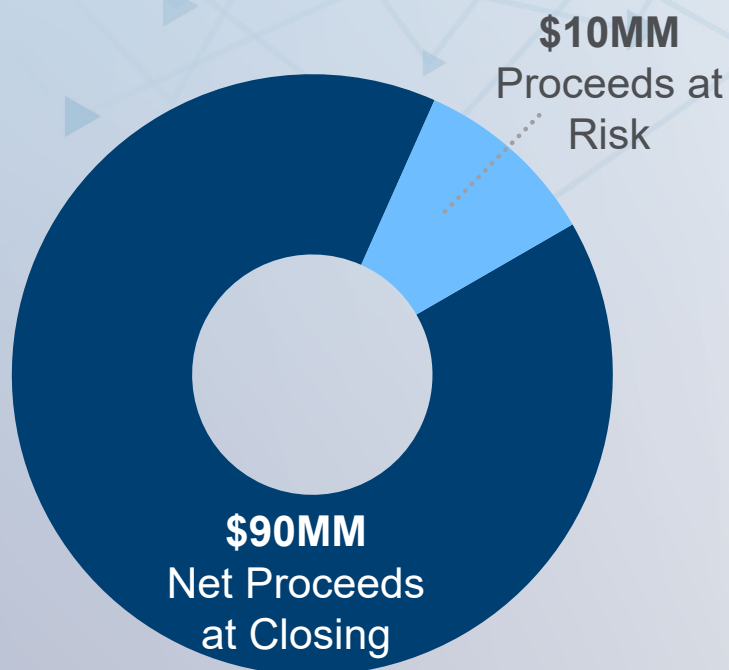


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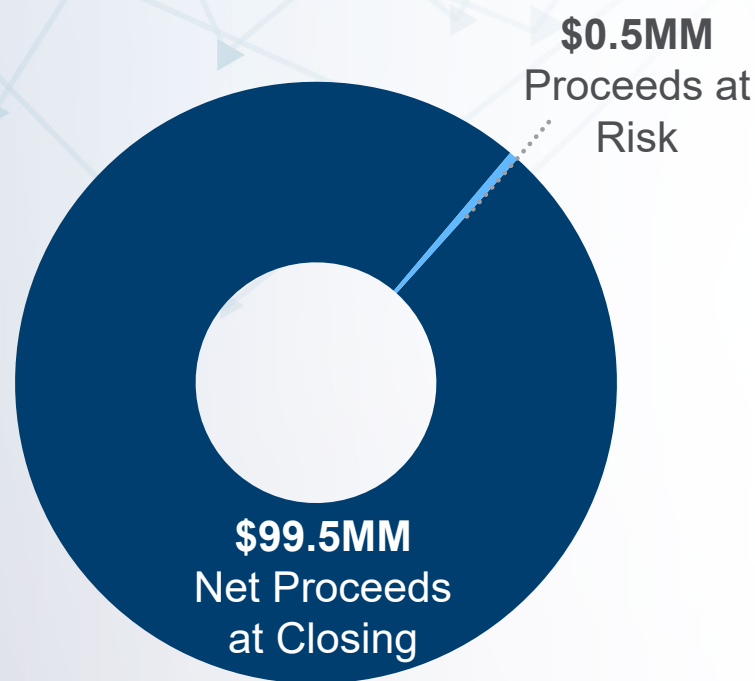
# Representations and Warranties Insurance

Representations and Warranties insurance allows sellers to close a deal with limited or no indemnity and can make a buyer's bid more attractive.

## Traditional Deal Structure



## Representations & Warranties Policy

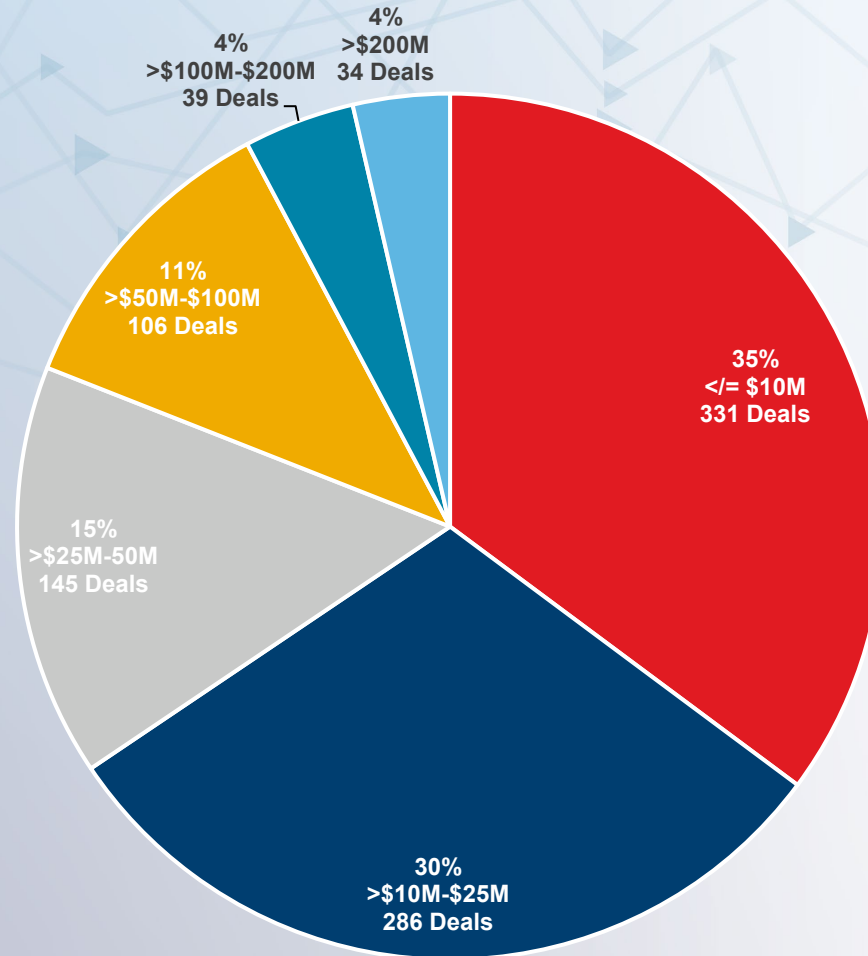


\*Seller may cover a share of policy premium

# 2021 Range of Limits for Representations and Warranties Insurance

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Percentage of Deals by Limit (\$mm)





# Representations and Warranties Insurance Enhanced Indemnity

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A buyer-side representation & warranties insurance policy may enhance a buyer's potential for recovery rather than simply replace the typical seller's indemnity.



**Survival  
Period**

**Materiality  
Scrape**

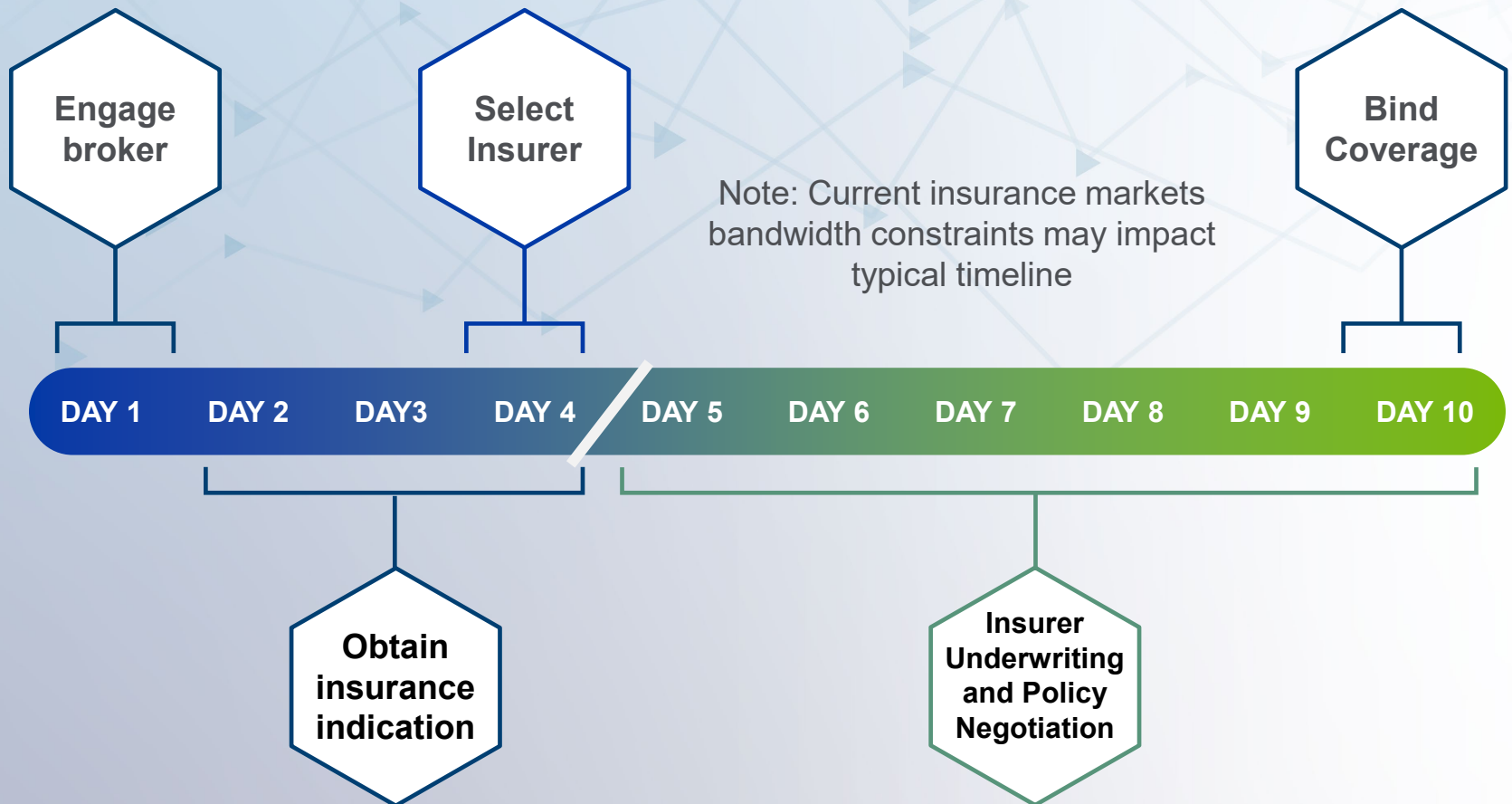
**Definition of  
Loss**

**Policy  
Limits**

# Representations and Warranties Insurance

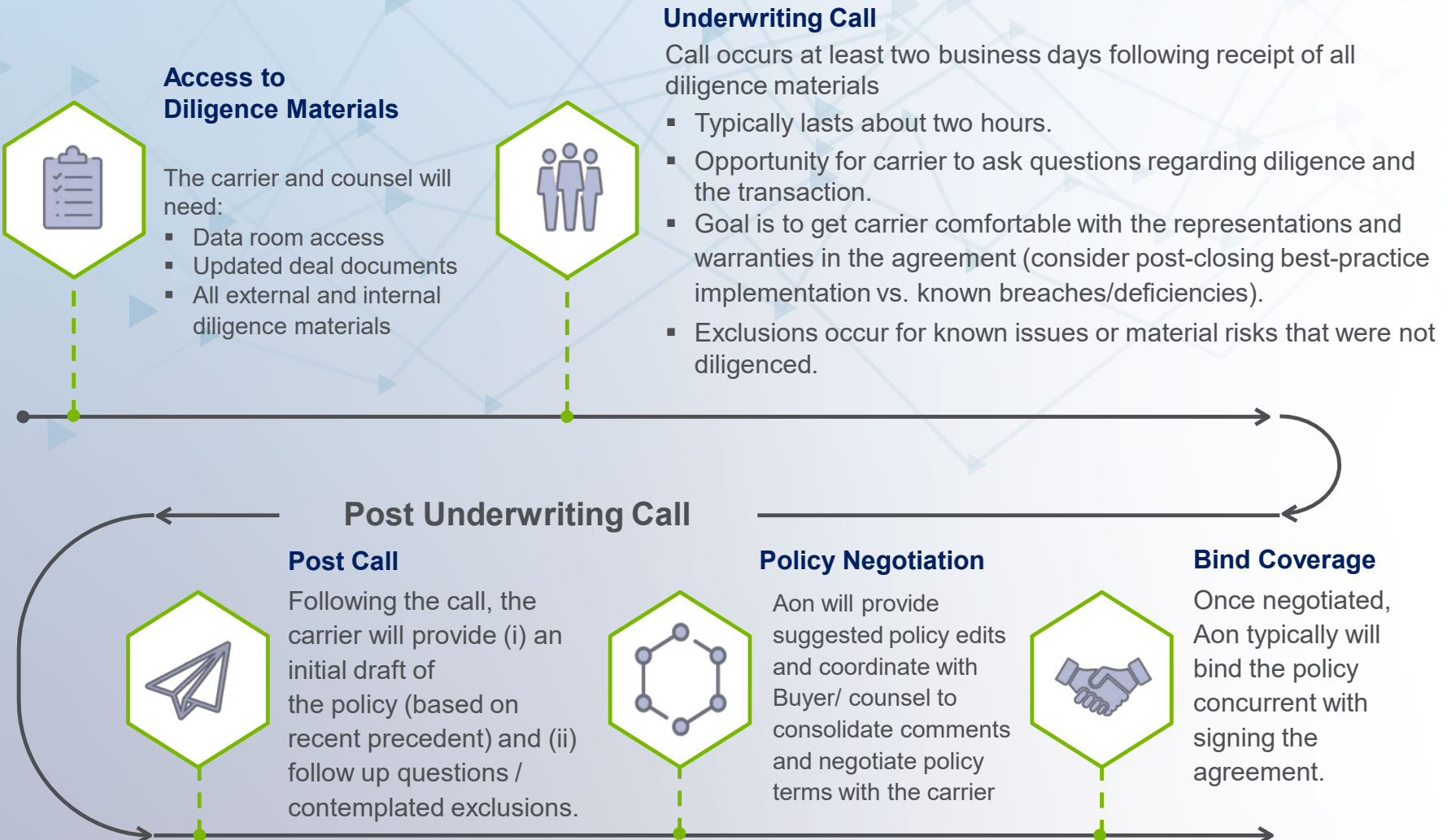
## Process and Timing

Partnering with a team that deeply understands the sensitivity and timing of a deal is paramount to your success.



# Representations and Warranties Insurance

## Underwriting & Diligence Process and Timing



# Representations and Warranties Insurance

## Coverage Highlights

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R&W insurance is used in mergers and acquisitions to protect against covered losses arising due to the seller's breach of certain of its representations and warranties in the acquisition agreement.

<b>Duration of Policy</b>	Three years for general reps; Six years for fundamental and tax reps
<b>Coverage Limits</b>	Typically 10% of enterprise value / purchase price (up to 100% potentially available)
<b>Retention/ Deductible</b>	Typically 1% of enterprise value, dropping down to 0.5% at 12 months
<b>Definition of Loss</b>	Policy silent with respect to consequential damages (additional losses incurred as a consequence of a direct loss) and multiplied damages (losses based on an EBITDA multiple)

# Representations and Warranties Insurance

## Coverage Exclusions

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### Standard Exclusions

- Actual Knowledge of Breach
- Purchase Price/Working Capital Adjustment
- NOLs
- Pension Underfunding / Withdrawal Liability
- Forward looking statements
- Asbestos, PCBs and CFCs
- Interim Breaches\*
- Transfer Pricing\*
- COVID

### Deal Specific Exclusions

- Material known issues discovered in diligence likely to result in a breach
  - Language tailored to specific identified issue (no catchall)
  - Materiality viewed as respects policy retention

# Representations and Warranties Insurance

## Coverage Exclusions (Cont'd)

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### Sample Deal Specific Exclusions

- Arises out of or results from any failure of the Target to pay sales or use taxes or file sales or use tax returns in Arkansas, Arizona, Minnesota or South Carolina
- Arises out of or results from any failure of the Target to pay income and/or franchise taxes or file income and/or franchise tax returns in Virginia
- Arising from or related to the failure to pay, remit or otherwise satisfy any non-US Tax liability or obligation, including any interests or penalties thereon
- Arising out of or resulting from the Target Group's failure to obtain prior express written consent from patients for automated text messaging
- Arising out of or resulting from the misclassification of Nick XXX as an exempt employee and of Sharon XXX, Jack XXX, Michele XXX, and individuals retained pursuant to the Target Group's agreement with XXX as independent contractors



# Tax Insurance



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# The Insurance Version of a Private Letter Ruling

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Tax Liability or Tax Opinion Insurance protects buyers against a successful challenge by the IRS or other foreign, state or local tax authority.

- Policy pays tax, interest, penalties, contest costs and gross up.



# State of the Tax Risk Landscape

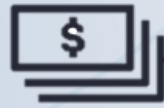
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Uncertainty is inherent in transaction and business tax planning and tax equity investing. Tax insurance addresses a range of tax planning and investing issues to help bring certainty to improve outcomes.



## Mergers & Acquisitions

- Complex deal tax planning
- Transfer pricing
- REITs



## Tax Planning

- Cash flow and liquidity management
- Balance sheet risk
- Family office and estate planning
- Transfer pricing



## Tax Equity Investing

- Section 45Q Carbon Sequestration
- Hybrid tax and representations and warranties

# Tax Insurance: M&A

## Risks

### Unknown

#### Representations & Warranties Insurance

- Breaches of tax representations and pre-closing tax indemnity

### Known

#### Tax Insurance

- Coverage for identified exposures in tax diligence or disclosure schedules
- Reasonable and defensible positions subject to specific underwriting
- Exclusions from R&W policies

### Uninsurable

- Unpaid amounts subject only to detection risk
- Tax shelters, abusive transactions

## Representative Issues

- S corporations (pre-Closing taxes, lost asset basis step up, inadvertent termination)
- Reorganizations (tax-free and taxable)
- REITs / real estate acquisition / sales
- NOL carryforwards and carrybacks
- Partnership Issues
- Employee Benefits Plan Qualification
- Transfer Pricing
- Debt / Equity
- Cross-border transactions and non-U.S. exposures

## Key Benefits

- Achieves economic certainty
- Eliminate the need for escrow / indemnity
- Streamline negotiations by eliminating deal-breaking issues
- Reduces uncertainty in cross-border deals
- Not tied to deal timing - **can be placed pre- or post-Closing**

# Tax Insurance: Tax Planning

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## Representative Issues

- Uncertain Tax Positions
- Tax Treaty Qualification
- Executive Compensation
- NOL Carryforwards and Carrybacks
- Transfer Pricing
- Valuations and Basis Studies
- Internal Reorganizations & Restructurings
- BEAT / GILTI
- Section 355 Spin Offs
- Employee Benefit Plan Restrictions
- Family Business Estate Restructuring

## Key Benefits

- Achieve economic certainty and general corporate risk management
- Protect anticipated tax benefits and tax positions from future challenges
- Alternative to Private Letter Rulings
- Tax risk transfer from balance sheet to insurers - offsetting entries on existing reserves and positive P&L impact

# Tax Insurance: Tax Credits

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## Representative Issues

- Renewable Energy (Solar, Wind, Carbon Sequestration, etc.)
  - Investment Tax Credit and Production Tax Credit
- Low Income Housing Tax Credit
- Historic Tax Credit
- New Market Tax Credit
- Opportunity Zones
- Federal and State Tax Incentives

## Key Benefits

- Achieves economic certainty
- Eliminates the need for escrow or guaranty / indemnity
- Manages counterparty exposure
- Achieve stronger ratings from ratings agencies with securitizations
- Bring new tax equity investors to the table



# Tax Insurance: Important Considerations



# Litigation and Specialty Insurance



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# Managing Litigation Risk to Drive Growth

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Litigation Risk Insurance protects businesses from adverse judgments and preserves the benefits of favorable judgments to facilitate balance sheet optimization and successful M&A and other material transactions.

## Adverse Judgment Insurance

The potential for significant damages from litigation can hinder business operations or complicate M&A and other material transactions that weigh on your stock price or force you to reserve funds that could be better used to grow your business.

## Judgment Preservation Insurance

When a party has won a significant judgment in court or in arbitration, judgment preservation insurance protects against the risk that the judgment will be partially or completely reversed on appeal, or that the quantum of awarded damages will be reduced. Such appellate risk can impact business operations, M&A deals, and other material transactions.

# Adverse Judgment Insurance

Enables defendants to ring fence litigation-related risks to proceed with M&A deals, financings, or other transactions, and operate unimpeded by a potential future judgment.

## Business and Balance Sheet Risk

- Protects companies from catastrophic loss from an adverse judgment
- Reduces uncertainty for shareholders and fixed income investors
- Transfers risks that require cash or credit reserves to strengthen corporate balance sheets

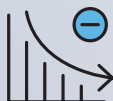
## M&A Deals

- De-risks M&A transactions to reduce or eliminate deal-breaking exposures
- Helps sellers avoid substantial escrow requirements
- Allows buyers to ring fence the cost of damages from an adverse judgment
- Addresses concerns of financing sources arising from material litigation risks

## When to consider Adverse Judgment Insurance



Pending, threatened, or potential future litigation with possibility of catastrophic outcome



Significant delta between damages sought and likely damage award



Pending litigation is preventing a deal or another material transaction from closing



Litigation requires reserves, hampers operational plans, or suppresses stock price

# Judgment Preservation Insurance

Enables plaintiffs to lock in some or all of a damage award pending appeal to retain the immediate benefits of judgments that might otherwise take years to become final and which may ultimately be fully or partially reversed.

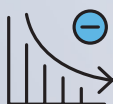
## Business and Balance Sheet Risk

- Allows companies to recognize some or all of a damage award on their balance sheet while appellate proceedings work their way through the courts
- Avoids the need to settle cases on disadvantageous terms in order to avoid the possibility of reversal on appeal
- Favorable economics as compared to traditional judgment monetization deals

## When to consider Judgment Preservation Insurance



Plaintiff has obtained substantial monetary judgment



Judgment is being, or is anticipated to be, appealed



Appellate risk impacting business operations or preventing recognition of damage award on balance sheet



Desire to lock in some or all of damage award pending appeal

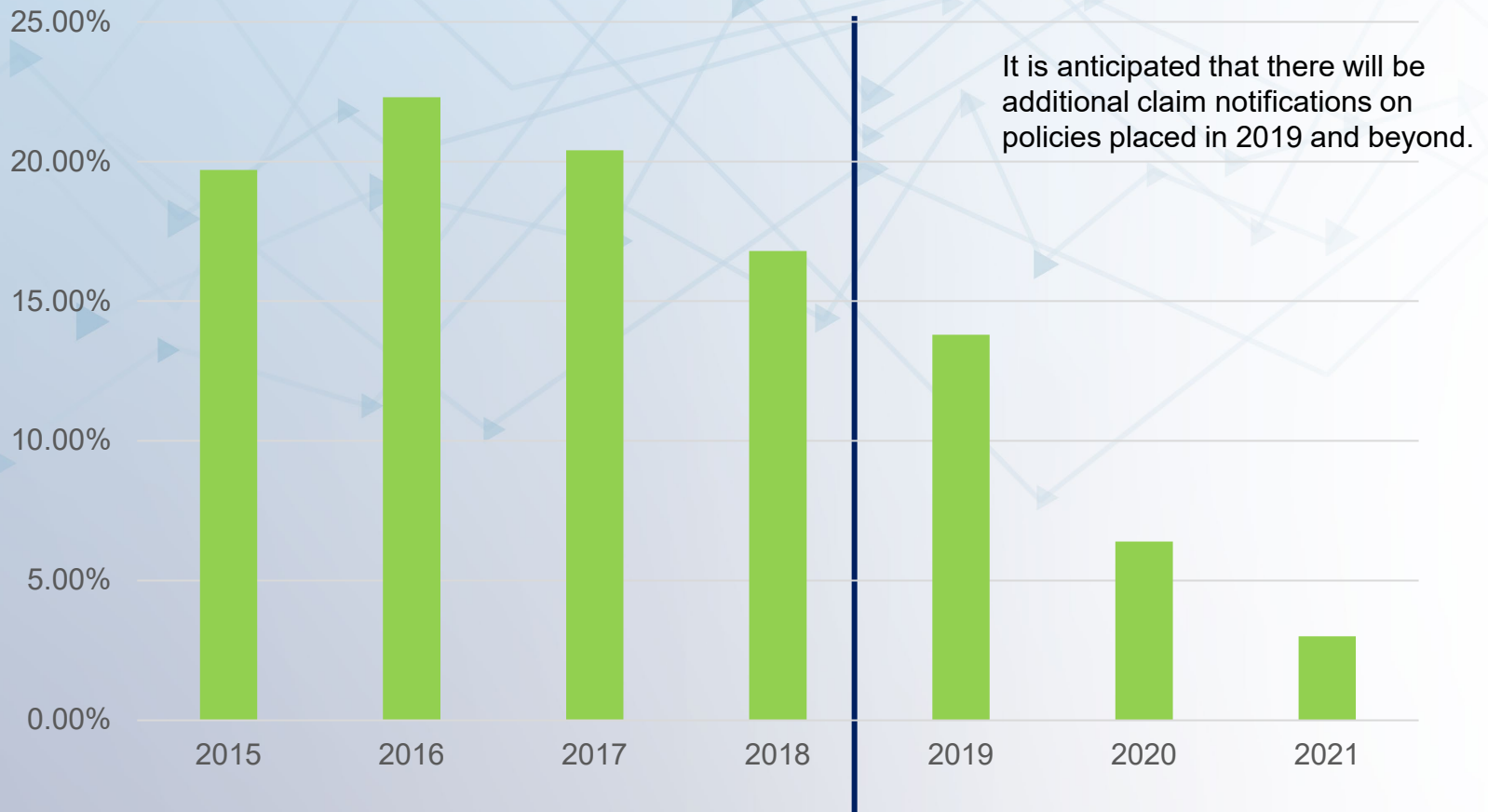
# Transaction Solutions Claims



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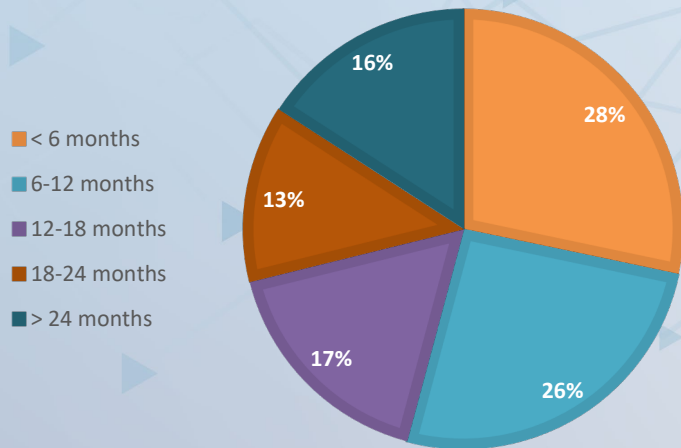
# R&W Claim Frequency 2015-2021



**This chart illustrates the frequency with which R&W insurance policies are notified of a claim each year when taking into account situations in which multiple claims are made on one policy.**

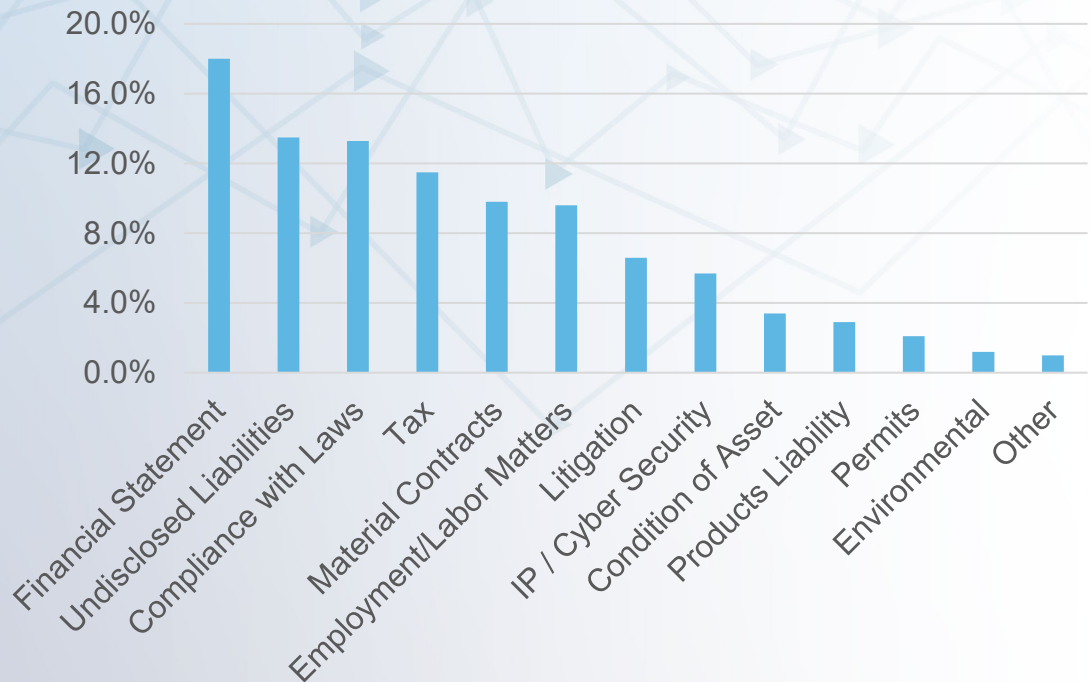
# Trends in Claims

## Months Between Closing and Claim Notice



**Median:** 11.75 months  
**Mean:** 13 months  
**Range:** 3 days - 61 months  
**Claims before closing:** 18

## Type of Breaches Most Commonly Cited

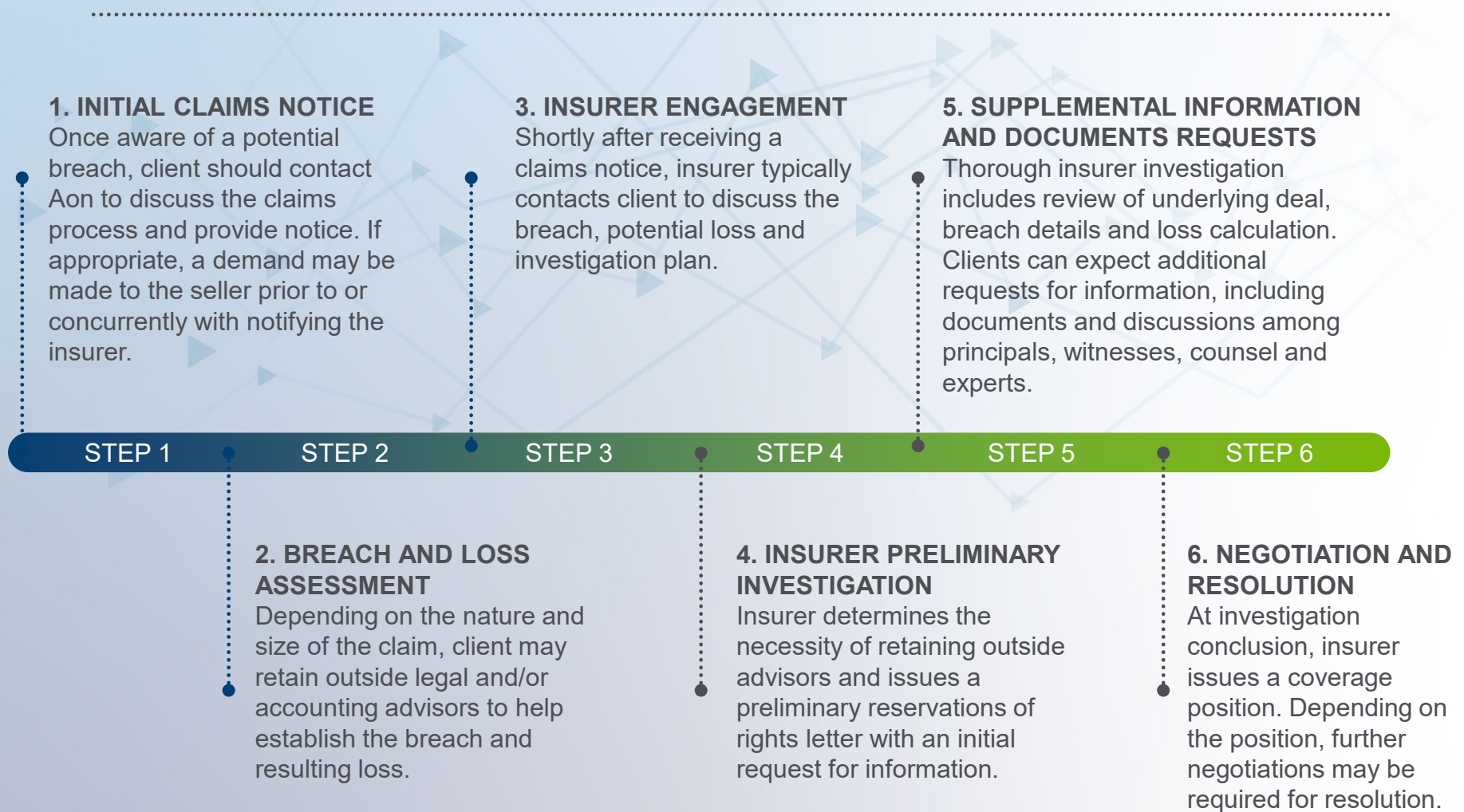


### Examples of "Other"

- Healthcare: 6
- Property Related: 4
- Subsequent (Non) Events: 3

# Timeline of a Claim

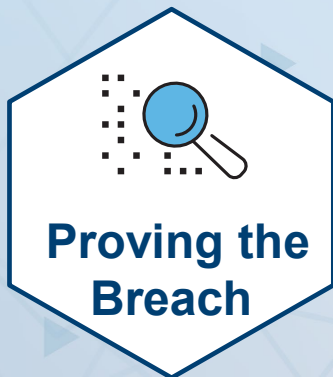
## Buyer-Side Policy



# Claims Takeaways

## What are Insurers Evaluating?

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- Is there a breach of a representation in the transaction agreement?
  - What is the specific language of the representation at issue?
  - Is there a knowledge qualifier?
- Are there applicable exclusions?
- Did the relevant deal team members have actual conscious knowledge of the breach prior to the close of the deal?
- Specific to a financial statements breach:
  - Is there a violation of GAAP (where required by the rep)?
  - Is the alleged breach based on accounting procedures that were in place pre-close?



- How is loss calculated?
  - How can the insurer validate the amount of loss?
- If a multiple is sought, can the policyholder demonstrate that the breach would have had an impact on the purchase price had it been known?
  - Was the transaction value determined using a multiple?
  - Were there changes to the financials during the negotiation process that resulted in a corresponding change to the purchase price?
- Can the loss be mitigated or is there an offset?
- Do the actions giving rise to the breach straddle a pre- and post-close period?

# Claim Resolution Highlights

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- Aon has seen more than 600 claims made by clients on R&W policies placed in North America since 2013
- As of November 2021, R&W insurers have paid more than \$550M above the policy retention to Aon clients in North America since 2013, and more than \$825M in total loss has been recognized (when factoring in erosion of policy retentions)
- To date, 12% of claims have resulted in a payment, 20.5% of claims have settled below the retention, 3.5% have been denied, 50% remain active and 14% are inactive (have had no correspondence for more than a year)
- Approximately 25% of our clients' claims since 2013 have been resolved within six months of filing the claim notice and 58% have been resolved within 12 months of providing notice
- To date, ten claims have utilized mediation, five have begun arbitration (with two settled before the hearing and the other three active) and three have resulted in litigation being initiated by insureds

# Due Diligence Solutions



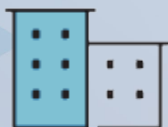
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# Due Diligence: A Unique Suite of Services

The M&A risk landscape is broader and more complex than ever. Ensure you approach your diligence with the same broad view of risk to improve deal outcomes.

## Traditional Risk Diligence



Risk & Insurance



Human Capital

## Enhanced Risk Diligence



Cyber Security



Source Code



Intellectual  
Property Liability

# Risk and Insurance Due Diligence

## Secure investments to drive value



### Cost

Compare total cost of risk including impact on quality of earnings

- Pre-close insurance expense versus proforma budget
- Recommended coverage enhancements
- Self-funded losses
- One-time costs:
  - D&O & run-off coverage
  - M&A insurance (Representations & Warranties, Tax, Litigation, Environmental)
  - Unmodeled insurance related CAPEX



### Balance Sheet

Assess accruals for retained losses and collateral requirements

- Retained versus assumed liability
- Letters of credit & bonding
- Claims modelling and accruals for current & future self-funded losses
- Captive valuation & exit costs
- Uninsured losses
- Working capital impact of risk management strategy



### Transaction

Match insurance assets with assumed liabilities

- Portability of coverage & change of control provisions
- Insurer ratings
- SPA review including completeness of insurance representations & warranties
- Treatment of historical insurance-related liabilities.



### Risk

Evaluate past and future risk transfer and risk retention strategies

- Peer benchmarking of insurance protection versus sector norms
- Qualitative & quantitative analysis of sector & asset specific risks
- Contractual requirements
- Coverage gap analysis and other red flags
- Bespoke solutions
- Identify products & services to enhance or ensure investment return.

- Real time, financially focused diligence
- Detailed reporting with concise executive summary
- Review and commentary of the transaction documents

- Industry specialists to unlock potential insurance solutions
- Day-one insurance readiness and go-forward strategy