

MARSH JLT SPECIALTY

INSIGHTS

JUNE 2019

# Transactional Risk Insurance Report

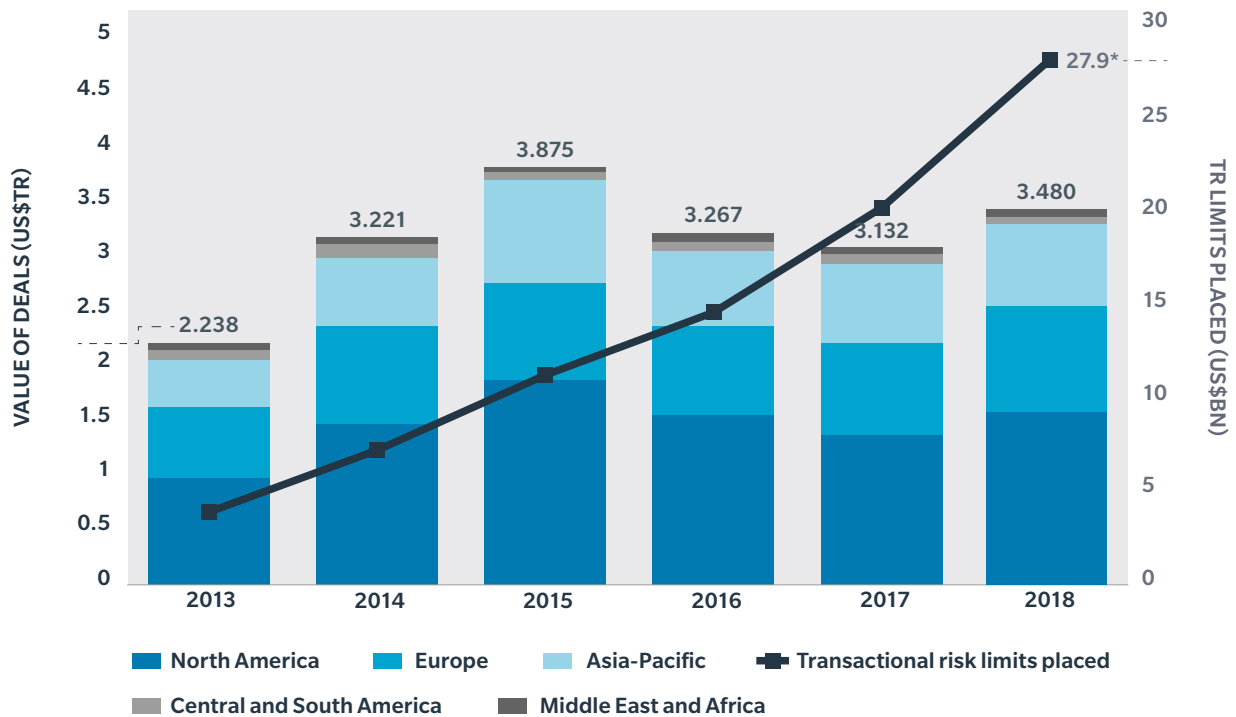
# Transactional Risk Insurance Report

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# Transactional Risk 2018: Year in Review

FIGURE 1 Total value of deals and limits placed.  
SOURCE: MARSH/JLT SPECIALTY



## M&A Snapshot

The value of global mergers and acquisitions (M&A) activity climbed 11.5% in 2018 to almost US\$3.5 trillion (see Figure 1), representing the fifth consecutive year of deal values in excess of US\$3 trillion, and the largest value since 2015. Overall deal count waned slightly, down roughly 4%, while private equity (PE) buyout activity reached the highest level in a decade, with 3,599 completed buyouts valued at US\$557 billion.<sup>1</sup>

Capital availability remained strong in 2018, augmented by uninvested funds from PE firms, responsive credit markets, and strategic acquirers with robust balance sheets all actively competing for assets.

The growth trajectory of transactional risk insurance continued in 2018, with substantial increases in both aggregate limits placed and the number of insured transactions (35% and 31% growth respectively). Widespread adoption by both PE and strategic investors is evidenced by the growth of transactional risk insurance placements outpacing global deal activity and growth.

\* US\$27.9 billion limits placed pre-acquisition of JLT and more than US\$36.5 billion limits placed from combined Marsh/JLT in 2018.

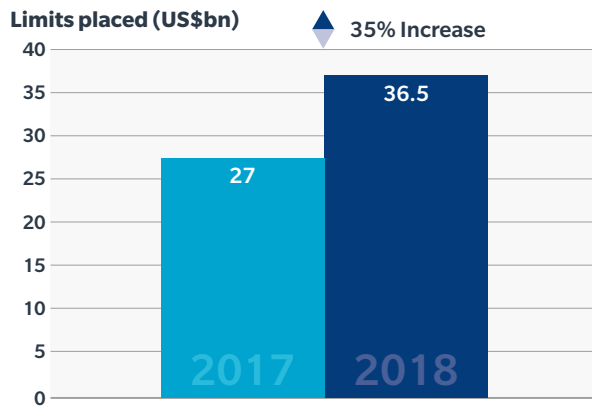
<sup>1</sup> Mergermarket, FY 2018 Monthly M&A Insider.

# Global Trends

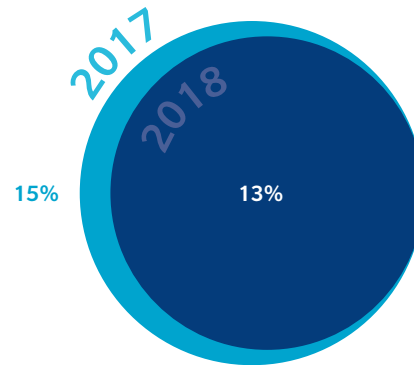
FIGURE  
2

Limits and number of deals increased by more than a third, while average enterprise value also increased.

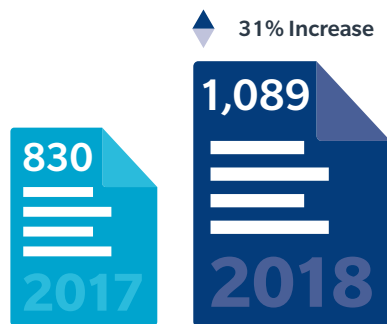
SOURCE: MARSH JLT SPECIALTY



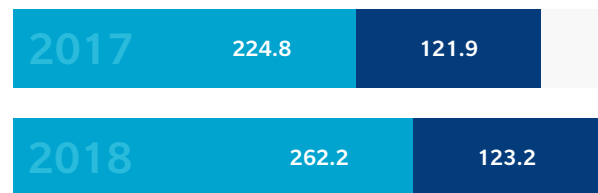
**Limits placed as a % of enterprise value**



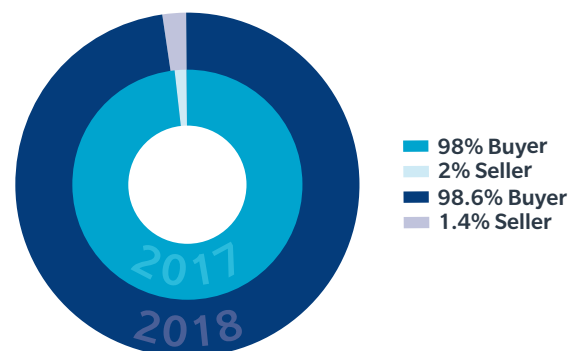
**Number of deals**



**Average/median enterprise value (US\$m)**



**Buyer-side/seller-side policies (as % of total policies)**



Transactional risk insurance includes policies that cover risks related to M&A, including representations and warranties (R&W) insurance, or warranty and indemnity (W&I) insurance, tax indemnity insurance, and contingent liability insurance. Transactional risk insurance limits placed globally by Marsh JLT Specialty increased in 2018 by 35% from 2017, to US\$36.5 billion (see Figure 2), with substantial increases in both average deal size (US\$262.2 million from US\$224.8 million) and the number of transactions in which insurance was used.

Global demand for both traditional and innovative transactional risk products increased in 2018. Marsh JLT Specialty placed transactional risk insurance on behalf of clients on 1,089 transactions, an increase of nearly 31% from 2017.

Transactional risk insurance capacity continued to expand in 2018 with more than 25 insurers currently offering primary terms for coverage. Overall capacity now supports limits of more than US\$1 billion on a single transaction.

# Regional Trends

# North America

Pricing reductions, larger transactions, and more corporate/strategic buyers spurred an increase in limits purchased and the number of deals closed.

In 2018, total transactional risk insurance limits placed by Marsh JLT Specialty in the US and Canada grew 53% over 2017 (to US\$16.56 billion). The number of transactions closed increased by 40% (see Figure 3). This level of growth far outpaced overall M&A activity in the region, which grew by 13.8%, and was valued at US\$1.6 trillion.<sup>2</sup>

There are multiple reasons for this large increase, including:

1. Pricing reductions.
2. Larger transactions.
3. More corporate/strategic buyers.

In 2018, the trend of meaningful pricing reductions on North American representations and warranties (R&W) placements continued, with primary layer rates declining 11% from 2017 (following a 13% decline from 2016). With more insurers entering the market in 2018, Marsh JLT Specialty anticipates that this trend will continue in 2019, albeit at a more modest pace.

A key driver of limits growth in 2018 was the use of R&W insurance on more large transactions, with a significant increase in the number of transactions with an enterprise value in excess of US\$1 billion. As a result, the average enterprise value for Marsh JLT Specialty insured transactions in this region increased by 29.2% in 2018 (to US\$402 million). Moreover, Marsh JLT Specialty placed the largest R&W insurance program in the North American marketplace in 2018, with limits in excess of US\$1 billion.

The trend of corporate/strategic buyers increasing their use of R&W transactions continued in 2018, with the number of transactions with a corporate/strategic insured increasing 21% over 2017. While private equity firms represented a slight majority of the transactions placed by Marsh JLT Specialty in 2018, new corporate clients are expected to use transactional risk insurance in 2019 and beyond.

Transactional risk insurance capacity continued to expand in 2018, with 20-plus insurers now able to offer primary terms for placements. Industry-wide increases in available capacity now allow placements of limits greater than US\$1 billion for a single transaction. Insurer competition and increased capacity is likely to result in a favorable rate environment for insureds in 2019 and beyond.

Deductibles for R&W placements settled at approximately 1% of enterprise value for most transactions, with a drop-down feature to 0.5% of enterprise value at the 12-month anniversary of closing, regardless of whether or not there is seller indemnity. (“No seller indemnity” deals represented approximately 30% of Marsh JLT Specialty’s transactions in 2018 — a slight increase from 2017.) However, on larger transactions (that is, where the enterprise value is in excess of US\$500 million), deductibles have been lowered to approximately 0.75% of enterprise value or less (with the same drop-down feature mentioned above).

*Marsh JLT Specialty placed the largest R&W insurance program in the North American marketplace in 2018, with limits in excess of US\$1bn.*

## Latin America

While the use of transactional risk insurance in Latin America is low compared to the rest of the world, there was an increase in investor interest. Marsh JLT Specialty has placed policies through its hubs in New York, Madrid and London for assets located in Brazil, Colombia, Mexico, Argentina, and Guatemala and received quotes for deals in Chile, Peru, and Costa Rica (figures included in this North America section).

More than ten insurers have demonstrated interest in providing capacity in the region. Insurer appetite is deal- and country-specific. Rates are significantly higher than in other geographies, at 3–5%, and underwriting costs are also higher (upwards of US\$40,000–50,000).

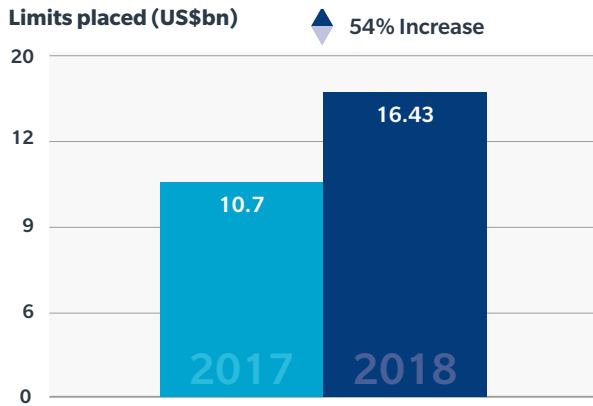
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<sup>2</sup> Mergermarket, FY 2018 Monthly M&A Insider

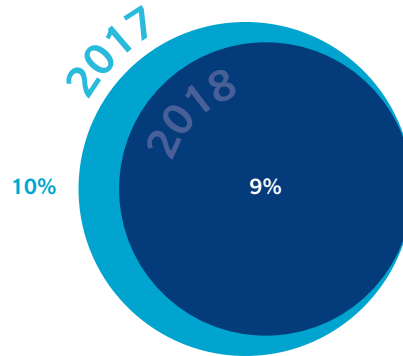
FIGURE  
3

Increased limits, number of deals, and average enterprise value.

SOURCE: MARSH JLT SPECIALTY



**Limits placed as a % of enterprise value**

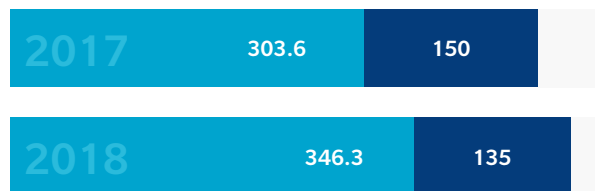


**Number of deals**

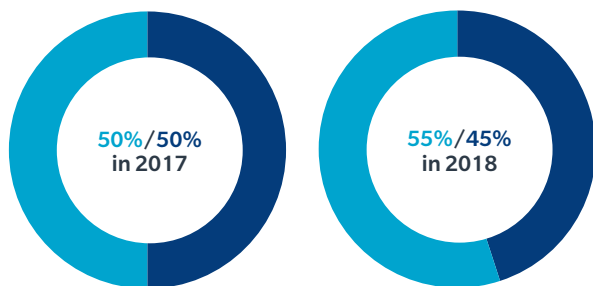
▲ 40% Increase



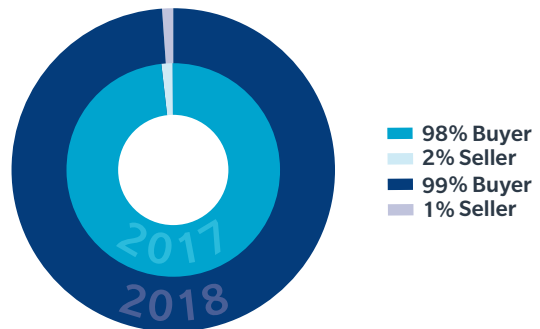
**Average/median enterprise value (US\$m)**



**% Private equity/corporate**



**Buyer-side/seller-side policies (as % of total policies)**



# EMEA

In 2018 the region saw increased take-up of policy enhancements, a synthetic warranty and indemnity policy, and increased insurer appetite for different sectors and regions.

In EMEA, Marsh JLT Specialty placed transactional risk insurance on 479 transactions in 2018 — an increase of 31% over 2017 (see Figure 4).

Average premium rates increased from 0.99% to 1.19%, despite a significant increase of new capacity. This can be attributed to two main factors: (1) an increase in deal size and complexity, and (2) increased warranty and indemnity (W&I) insurance policy enhancements, and their associated additional premiums, such as: i) knowledge scrapes; ii) synthetic (created in the insurance policy) tax covenants; and iii) non-disclosure of due diligence reports. The increase in average premium rates also reflects the growing appetite for not just W&I insurance, but also tax insurance, and contingent liability insurance, which typically attract higher rates than W&I.

The average limit purchased as a proportion of enterprise value decreased to 17%, from 20% in 2017. This is largely due to the increase in deal size (average and median enterprise value) and proportionally lower limits typically purchased for larger transactions. Additionally, there were fewer transactions in the real estate sector, where clients normally purchase higher limits to cover title and tax exposures, and increasing use of the products in transactions contemplating operating businesses.

There are now few geographic or sector restrictions of the target businesses: Marsh JLT Specialty placed deals across 21 sectors and saw a doubling of deals in the financial/professional services, and technology, media, and telecommunications (TMT) sectors. There were also more deals in the power and utility sector. Meanwhile, the proportion of real estate deals halved, reflecting underlying M&A activity.

The largest growth in deals placed by Marsh JLT Specialty in EMEA (by %) occurred in Spain (approximately 100% increase); Italy (100%); Germany (100%); and France (50%). There was also increased activity and innovation in the Middle East. Notably, insurers are offering fully Sharia-compliant policy structures, with Marsh JLT Specialty seeing an increase in such placements made in Saudi Arabia. During 2018, Marsh JLT Specialty also saw increased insurer appetite for deals in several African jurisdictions, including Burkina Faso, Ethiopia, Kenya, and Niger.

Appetite for specific tax policies continued to grow in various European jurisdictions among both insurers and potential customers. For example, in 2018 Marsh JLT Specialty structured a tax program with an aggregate limit in excess of US\$400 million.

Specific tax policies have increased as insurers have allocated increased capital to this area (and hired and upskilled their teams accordingly), because of the potentially higher premium rates compared with other products.

Alongside the more commonly insured real estate tax risks, examples of tax liabilities that have been placed by Marsh JLT Specialty include substantial shareholder exemptions, enterprise investment scheme, and VAT. These are most commonly used to provide bidders with recourse where they are unable to negotiate a more typical contractual indemnity from a seller, due to the competitiveness of a sales process.

In 2018 there was the first placement of a fully synthetic W&I policy, which provided recourse through a set of warranties written only in the policy and not in the sale and purchase agreement, including non-disclosure against those warranties. Although insurer appetite for such structures remains limited, it is indicative of future growth trends and potential innovations.

*Marsh JLT Specialty placed deals across 21 sectors and saw a doubling of deals in the professional services and TMT sectors.*

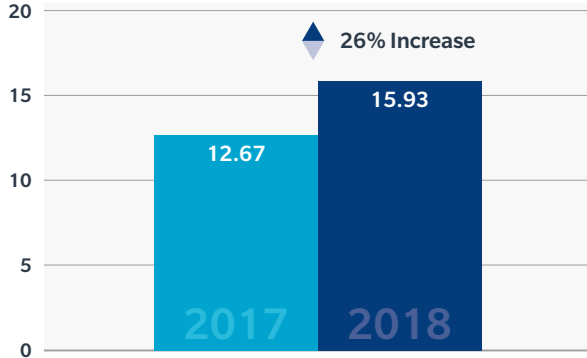


FIGURE  
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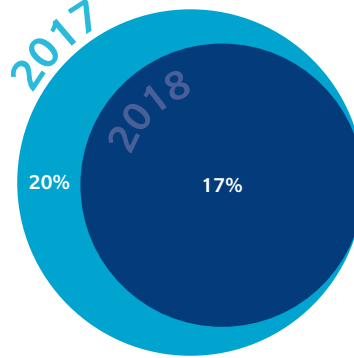
Increased limits, number of deals, and average premium rate.

SOURCE: MARSH JLT SPECIALTY

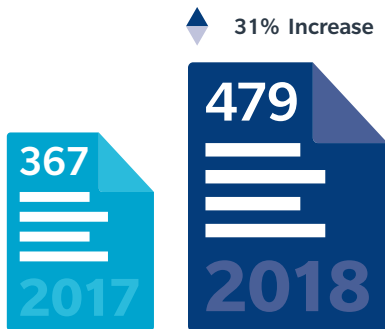
Limits placed (US\$bn)



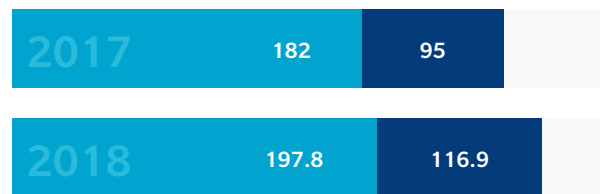
Limits placed as a % of enterprise value



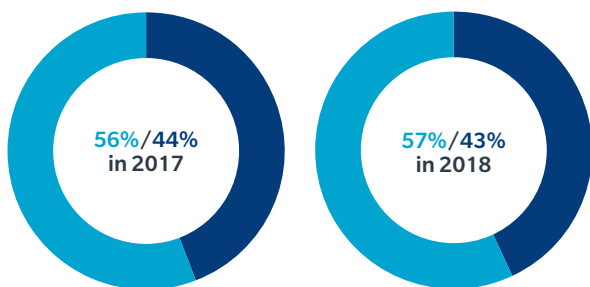
Number of deals



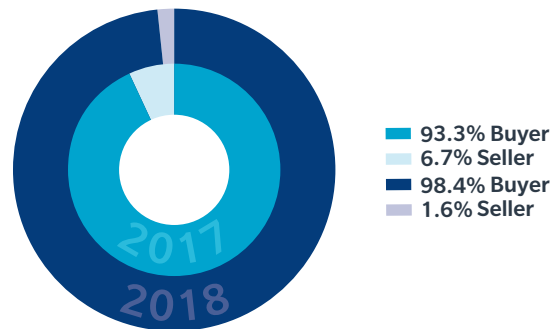
Average/median enterprise value (US\$m)



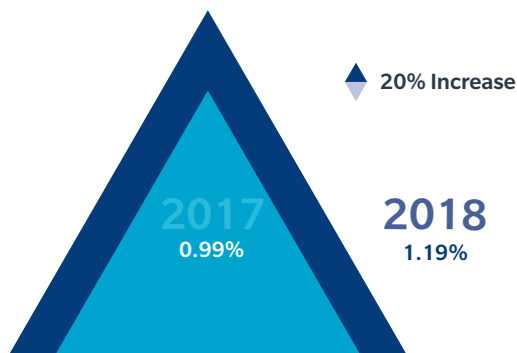
% Private equity/corporate



Buyer-side/seller-side policies (as % of total policies)



Average premium rate



# Asia

In 2018 the region saw notable growth in South Korea and Greater China, and a surge in use of warranty and indemnity and tax policies in real estate transactions.

The region's overall deal count growth (21.7%) reflects increased penetration of warranty and indemnity (W&I) insurance, while the reduction in limits placed (39%) reflects a decrease in the average deal size from US\$273 million to US\$231 million.

The average limit purchased (as a percentage of enterprise value) remained relatively unchanged from 2017, hovering at approximately 20%.

There were more Asia-based inbound and domestic deals, as outbound deals proved challenging due to macro forces, such as complex international trade dynamics and capital controls in China.

Adoption of transactional risk insurance continues in all countries in the region, and burgeoning markets such as South Korea and Greater China showed notable growth in deal activity and, correspondingly, the use of transactional risk solutions. Deals closed with W&I placed across Greater China (as a percentage of the total Marsh JLT Specialty Asia book) increased from 5% to 13%, while in South Korea it increased from 3% to 11%. In 2019, deal flow and the use of transactional risk solutions in these two regions is likely to continue to grow, particularly in South Korean domestic and outbound transactions, Chinese domestic transactions, and in Taiwan, with Marsh JLT Specialty having placed the first W&I policy for a Taiwanese deal in 2018.

Markets such as India, ASEAN, and Japan continued to exhibit a steady flow of deals throughout 2018, although deal sizes across ASEAN decreased from the prior year.

There was a surge in the use of W&I and tax policies in real estate transactions, a sector that consistently represents approximately 13% of Marsh JLT Specialty's total Asia deal count.

Average premiums across Asia increased slightly from 2% to 2.1% of the rate on line, a minor increase that is not attributable to any particular market trend, and is likely a reflection of the types of deals closed in 2018.

More insurers are entering the Asia market. In the past, only two insurers (Ironshore — now known as Liberty GTS — and AIG) were considered to have Asia-wide underwriting appetite. Today, new entrants such as HCC Tokio Marine, Chubb, and Berkshire Hathaway all have Asia-based underwriters. More markets are likely to enter Asia in the coming years.

While more insurers are looking to break into the Asian market in 2019, significant reductions in premium across the region appear unlikely, in light of the surge in the number of claims notified on policies placed in the last two to three years.

Premium rates have been consistent across Asia. Premium rates in lower-risk jurisdictions, such as Singapore and Hong Kong, appear to have reached rock bottom, while rates in India and Greater China stabilized in 2018, with some small decreases due to them being high-margin geographies

In 2018, average retention for policies placed across Asia fell below 1% of transaction value, indicating that insurers have become more comfortable with the region.

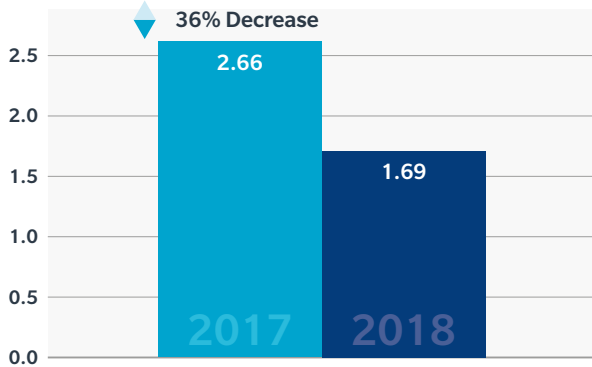
*There was a surge in the use of W&I and tax policies in real estate transactions.*

FIGURE  
**5**

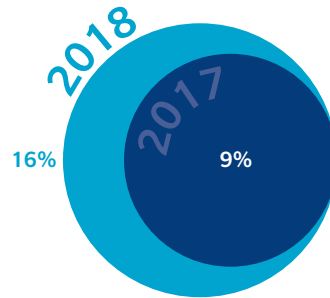
Increased number of deals, and more private equity and buyer-side transactions.

SOURCE: MARSH JLT SPECIALTY

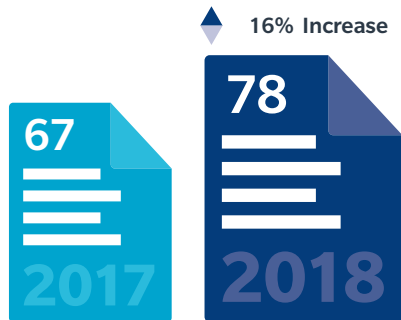
**Limits placed (US\$bn)**



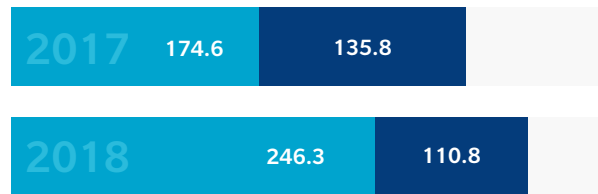
**Limits placed as a % of enterprise value**



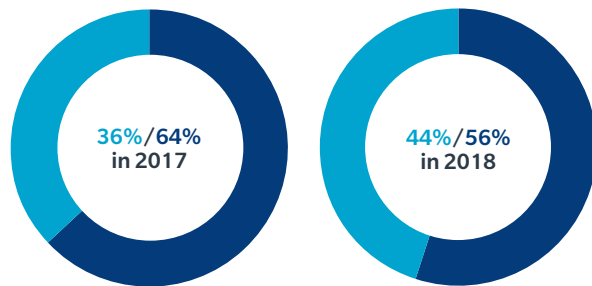
**Number of deals**



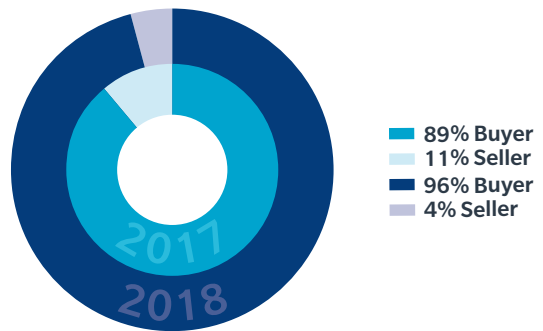
**Average/median enterprise value (US\$m)**



**% Private equity/corporate**



**Buyer-side/seller-side policies (as % of total policies)**



# Pacific

In 2018 the region saw significant increases in deal values insured, the advent of public-to-private warranty and indemnity insurance, and a sharp increase in market capacity.

In 2018 there was a significant increase in limits placed (183%) among Marsh JLT Specialty clients, reflecting a strong growth in deal count (36.4%) and an increase in the number of billion-plus dollar deals using transactional risk insurance (see Figure 6).

Similarly, there were increases in average enterprise value (US\$244 million, up from US\$103 million in 2017); and median enterprise value (US\$86 million, up from US\$37 million in 2017), again reflecting the number of large deals compared with the previous year, and more general M&A activity in the region.

The split between private equity (PE) and corporate insureds in 2018 was relatively similar to 2017. There has been a general increase in regional corporates' knowledge and use of warranty and indemnity (W&I) insurance, though PE is still a very strong user of the product.

Insurers have increasing appetite for public-to-private transactions, with buyers looking to expand the set of warranties included in scheme of implementation agreements. Until recently, W&I insurance had not been considered an option when a public company was acquired, due to the fact that the suite of warranties were generally limited and given by the target. This is no longer the case, with a number of public market deals in Australia having employed W&I insurance to cover a broad set of warranties and as a risk allocator and deal facilitator.

Available capacity continued to expand for both W&I insurance and tax insurance in the Pacific region. Overall capacity has grown by more than AU\$200 million, with existing insurers increasing lines, along with new market entrants.

Insurers have been looking for increases in the policy de minimis, notably where there is a large gap between the materiality threshold and the de minimis.

More generally, all policies placed were general W&I policies that covered title, business and tax warranties, and the tax indemnity. In the Pacific, no tax-specific policies were placed by Marsh JLT Specialty; though brokers and insurers are keen to push tax-specific policies, there is still limited adoption in the region.

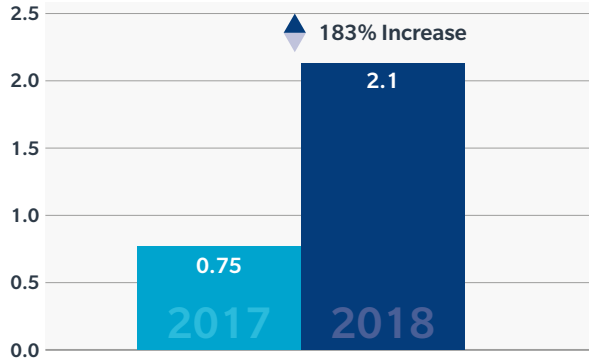
*Insurers have increasing appetite for public-to-private transactions, with buyers looking to expand the set of warranties included in scheme of implementation agreements.*

FIGURE  
**6**

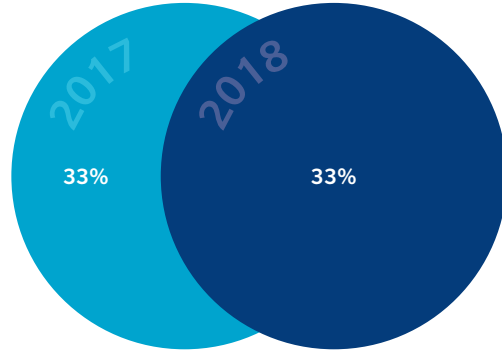
Significantly increased limits and average enterprise value, and reduced average premium rates.

SOURCE: MARSH JLT SPECIALTY

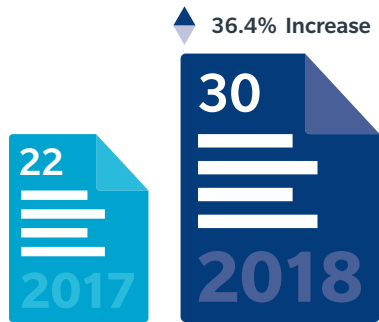
**Limits placed (US\$bn)**



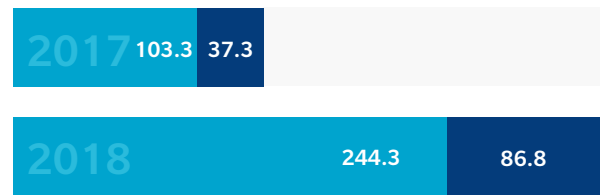
**Limits placed as a % of enterprise value**



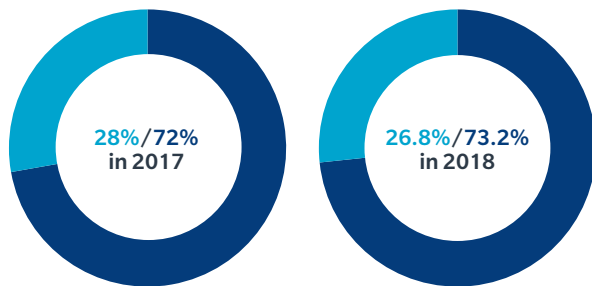
**Number of deals**



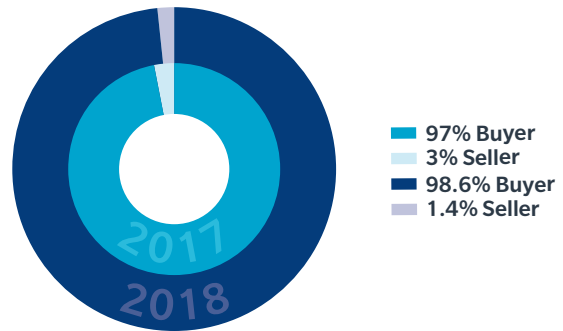
**Average/median enterprise value (US\$m)**



**% Private equity/corporate**



**Buyer-side/seller-side policies (as % of total policies)**



# Conclusion

Transactional risk insurance is a deal solution firmly established in the M&A marketplace, as evidenced by the global adoption across PE firms, strategic buyers, deal practitioners, and the insurance markets. Market capacity has evolved to a point where limits in excess of US\$1 billion are available, making it a viable solution in almost any transaction where practical to do so. Underwriting processes around transactional risk insurance have become highly refined and move at typical deal cadence, or can be accelerated as necessary based on deal timing. Overall capacity expansion is likely in 2019, along with modest pressure for rate reductions and continued policy innovation. Trends to follow include increased use of synthetic warranties, broadening of policy forms across geographies, increased use of tax insurance, and parity between PE and strategic investors.

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