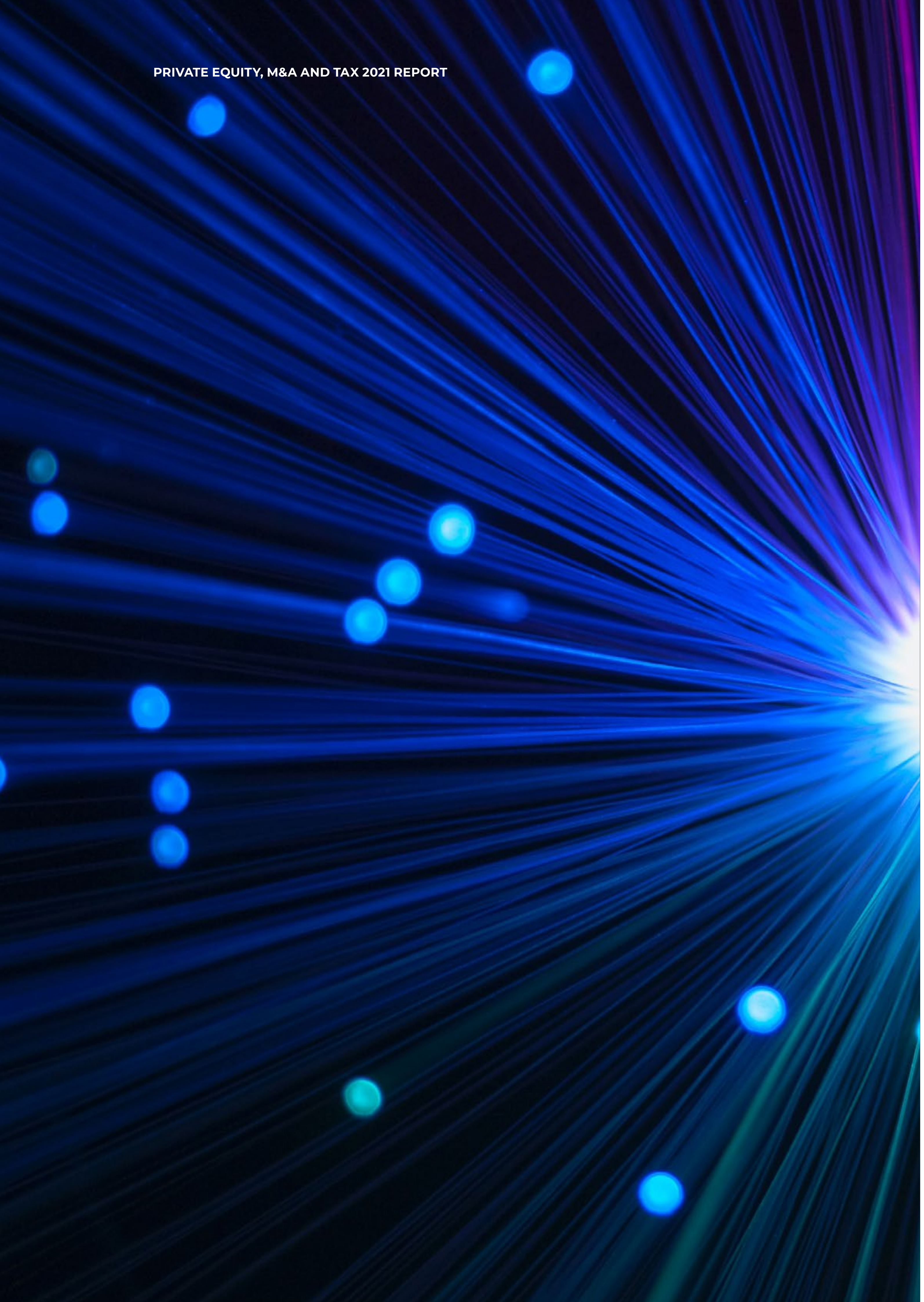
Private Equity, M&A and Tax 2021 Report

Redefining M&A Insurance for the 2020s



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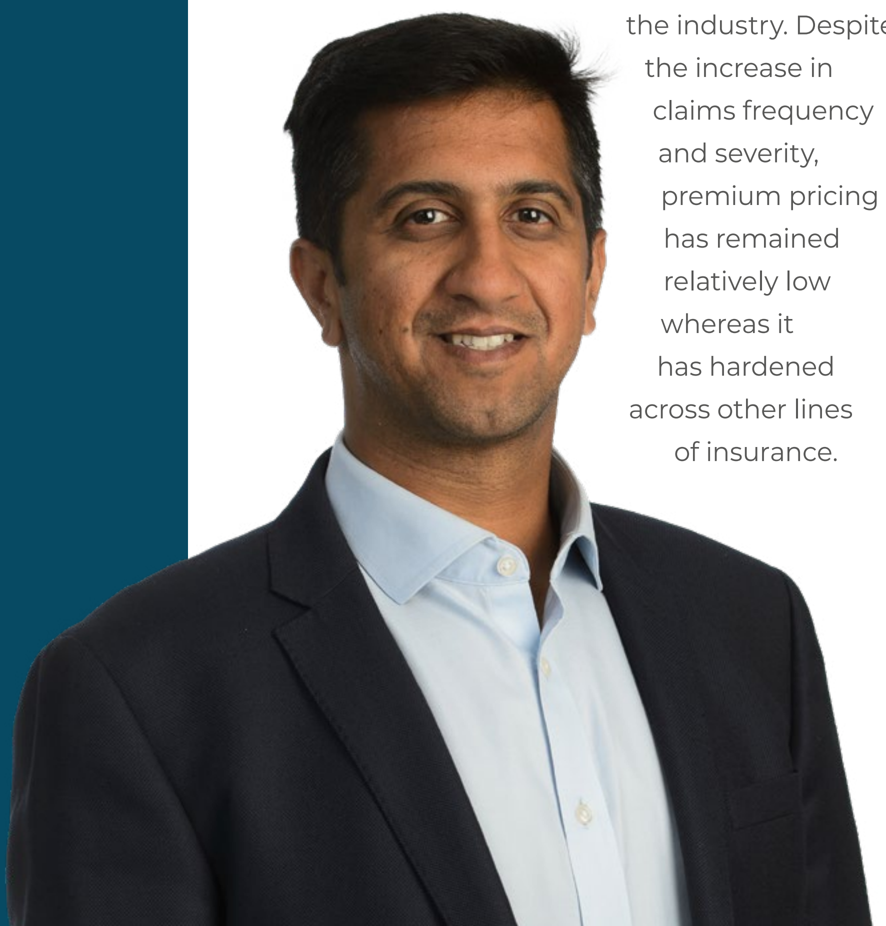
Welcome

to our inaugural report which provides a uniquely user-centric view on the way in which M&A insurance interacts with the wider transactions domain across the globe.

While a lot has been said and published about the benefits of M&A insurance, the customer's view as to its perceived value or merit has never been fully analysed – either through the buying process or when making a claim.

As a trusted insurance adviser, we felt it was vital that we understand those views in order to inform how we work with our clients, their advisers and insurers to create improved solutions and processes. This report reflects the views of individuals who are involved in M&A every day, and their perceptions on available insurance solutions.

This was a fascinating year in which to ask these questions as the M&A insurance market swung from the near paralysis engendered by the pandemic, to having arguably its busiest quarter on record in Q4 of 2020. However, it has also had to adapt and there remains a degree of caution within the industry. Despite the increase in claims frequency and severity, premium pricing has remained relatively low whereas it has hardened across other lines of insurance.



This has prompted some insurers to shift capacity where margins and returns are healthier and in 2020 we saw three major insurers withdraw capacity from the M&A line of insurance. Any further economic deterioration that impacts M&A volumes, sustained soft pricing and increasing claims may result in further correction in the M&A insurance market.

Notwithstanding this, we remain optimistic about the outlook for M&A insurance and expect it to continue to play a vital role in M&A, especially given how ingrained it has become in the deal process and the part it plays in unlocking both capital and negotiations which have reached an impasse on M&A transactions. M&A insurance claims handling matured with most carriers having dedicated M&A insurance claims specialists in their teams to resolve complex claims.

There is an ever increasing breadth of expertise joining the market from tax, litigation, environmental and IP backgrounds. Furthermore, with new capacity entering the insurance market in the last few months, we expect the number of insurers that provide M&A insurance to increase in the next 12-18 months.

This shifting landscape makes this the ideal time to understand what the buyers of insurance think and what the market can do to meet their needs. We do hope you find this report helpful and we hope to meet you all again in person as the world continues to recover.

Tan Pawar
Managing Director
Head of Private Equity, M&A and Tax, BMS Group

Executive summary

Our inaugural report provides a unique viewpoint from the users of M&A insurance on the way in which the product interacts with the wider M&A scene across the globe. On these pages we have summarised the key takeaways that have emerged from our research.

Overall how satisfied are you with the value and protection that W&I insurance currently provides?

4/5 of private equity transactions in North America use M&A insurance.

78% of respondents had worked on 6 or more transactions involving W&I insurance.

62% of transaction premiums are paid by the buyer.

46% said price is the most important factor when selecting an insurer.

51% said seller's financial statements was the biggest risk.

1/5 policies had claims notifications.

78% reported that their claim was accepted and paid.

32% scored their satisfaction levels with the claims handling at 8/10 or above.

1/7 enquiries related to tax matters under investigation or being litigated.

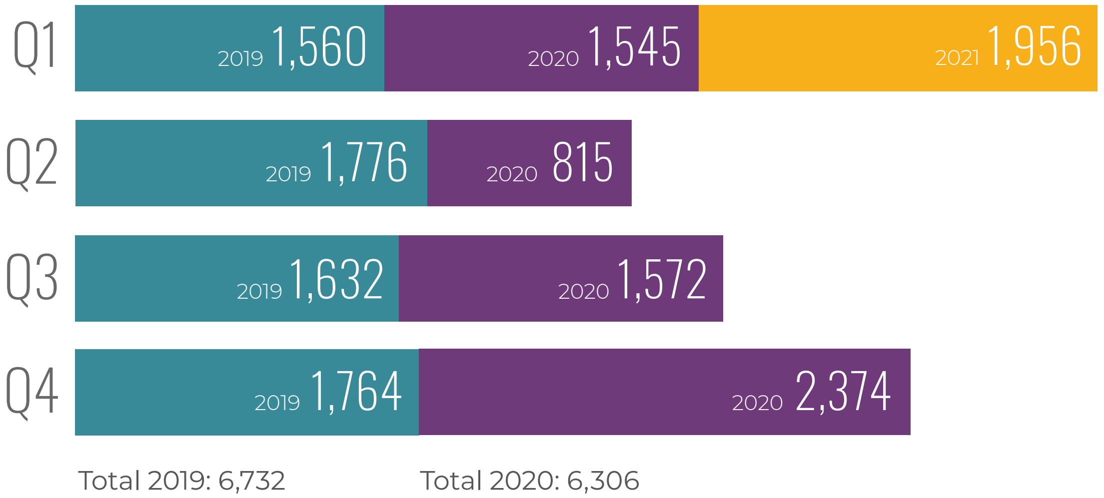
Breakdown of M&A insurance between financial sponsors & corporates in 2020

(% difference v 2019 in brackets)

M&A insurance
2020 snapshot

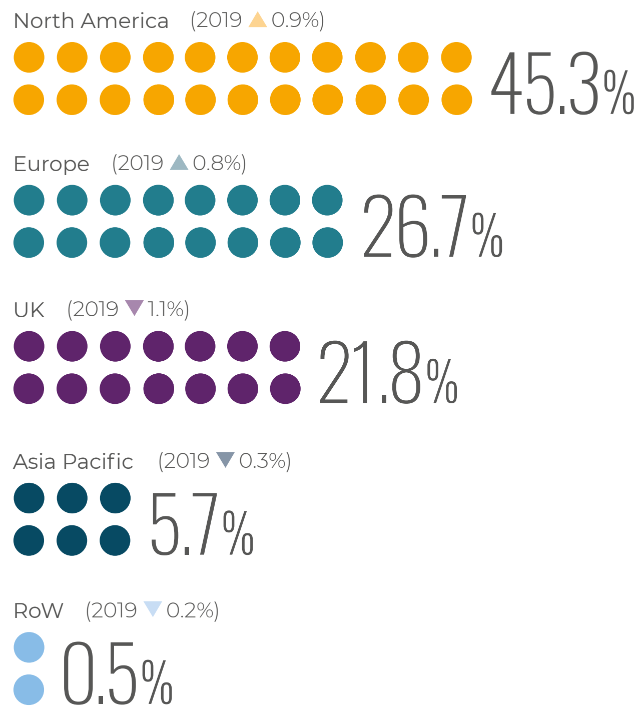
We've set out below our findings of the use of M&A insurance (W&I/R&W* insurance) in 2020:

Transactions using M&A insurance in 2020 v 2019 (quarter breakdowns including Q1 2021)



Q2 2020 saw a significant drop in policies being taken out given the impact that lockdowns across the world had on M&A activity. Somewhat ironically, the pandemic proved to be the main catalyst behind the recovery of activity as dealmakers finally found ways to transact whilst working from home in a virtual environment. As the initial challenges of operating amidst a lockdown were managed, deal volume rebounded strongly in Q3 and Q4 was the busiest quarter ever in the M&A insurance market. This trend carried over in to the first quarter of this year, spurred on by vast amounts of dry powder available, more varied transaction types being insured (de-SPACs and GP-led secondary transactions), and in the UK, anticipated CGT changes (which ultimately did not transpire) before the Spring Budget. As we go to press, early indications are that M&A activity has levelled up somewhat but nonetheless we expect 2021 to be a record year for M&A insurance.

Global distribution of M&A insurance in 2020



(% difference v 2019 in brackets)

North America continues to be the largest M&A market in the world, with more deals transacting there than in any other territory, so it is of little surprise that the majority of M&A insurance policies were issued there. Speaking to advisers and insurers the common consensus now is that 4 in every 5 private equity transactions in North America use M&A insurance. In Europe and the UK this is now firmly around 2 in every 3. In order to remain competitive when bidding for assets, corporates are increasingly utilising M&A insurance, further fuelling global growth.

In Asia Pacific, besides Australia and New Zealand, the use of M&A insurance is not as common as in Europe, UK and North America, which is reflected by the low percentage of the total policies placed there. Having said that, the general trend over the last few years has been upward and despite a small dip last year due to COVID-19, this confirms that M&A insurance has been gaining ground as a value adding tool in Asian M&A transactions over the past few years. It is expected that the use will see continued increase in uptake in 2021.

Four in 5

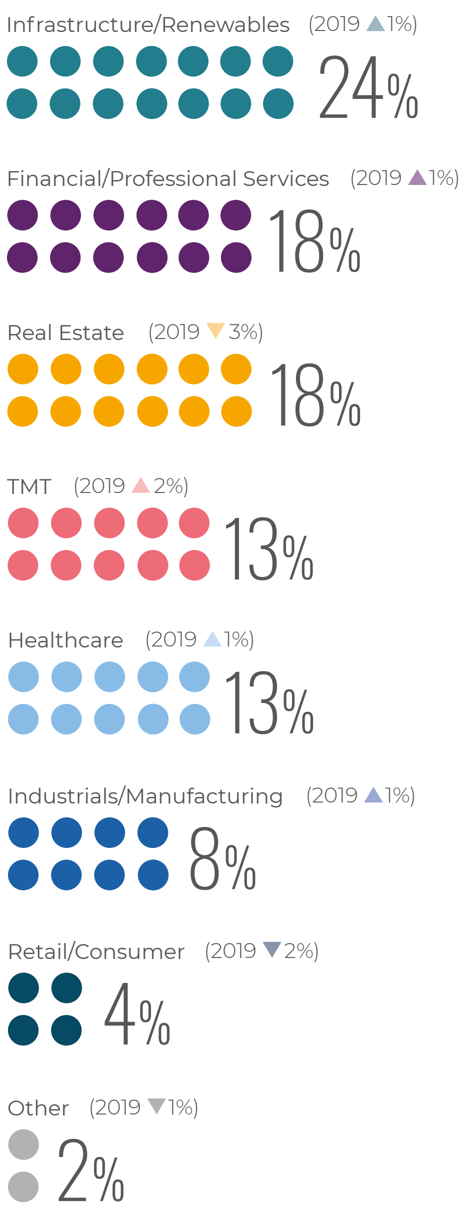
private equity transactions in North America use M&A insurance.

*Warranty & Indemnity (W&I) / Representations & Warranties (R&W)

Breakdown of M&A insurance between financial sponsors & corporates in 2020

(% difference v 2019 in brackets)

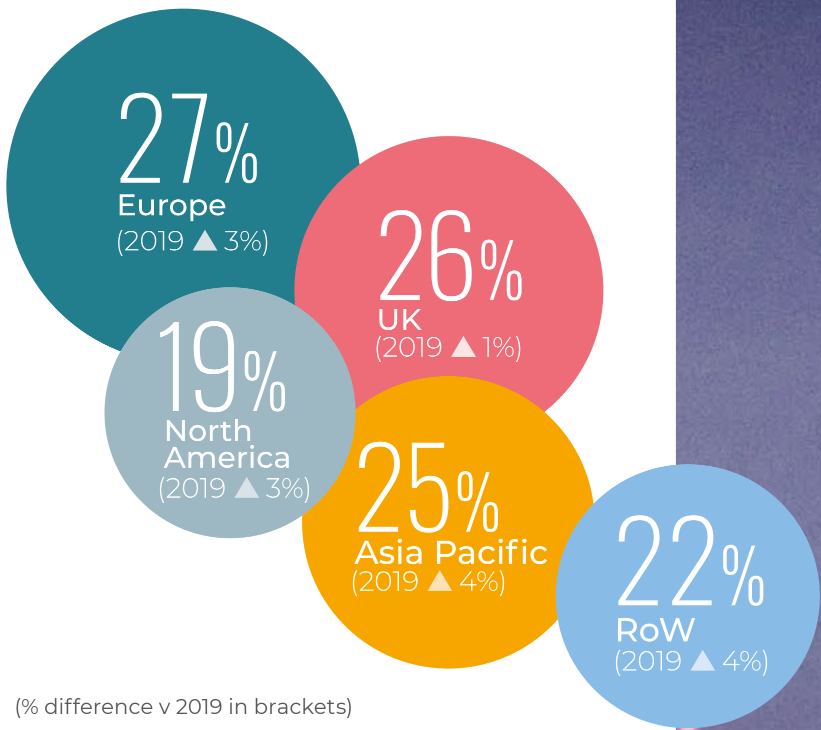
Sectors using M&A insurance in 2020



(% difference v 2019 in brackets)

M&A activity utilising M&A insurance remains particularly strong in the infrastructure, renewables and real estate sectors. The use of M&A insurance in the consumer and retail sector decreased as appetite in the sector waned amongst investors, given how badly affected it was by the pandemic. At the same time other sectors which appeared resilient to the pandemic experienced higher demand for M&A insurance particularly in the TMT sector where software, in particular SAAS businesses, continued to thrive. The healthcare sector was also an interesting one to watch as it came under extra scrutiny and we witnessed further activity in the financial and professional services industries.

2020 average policy limit as a % of enterprise value

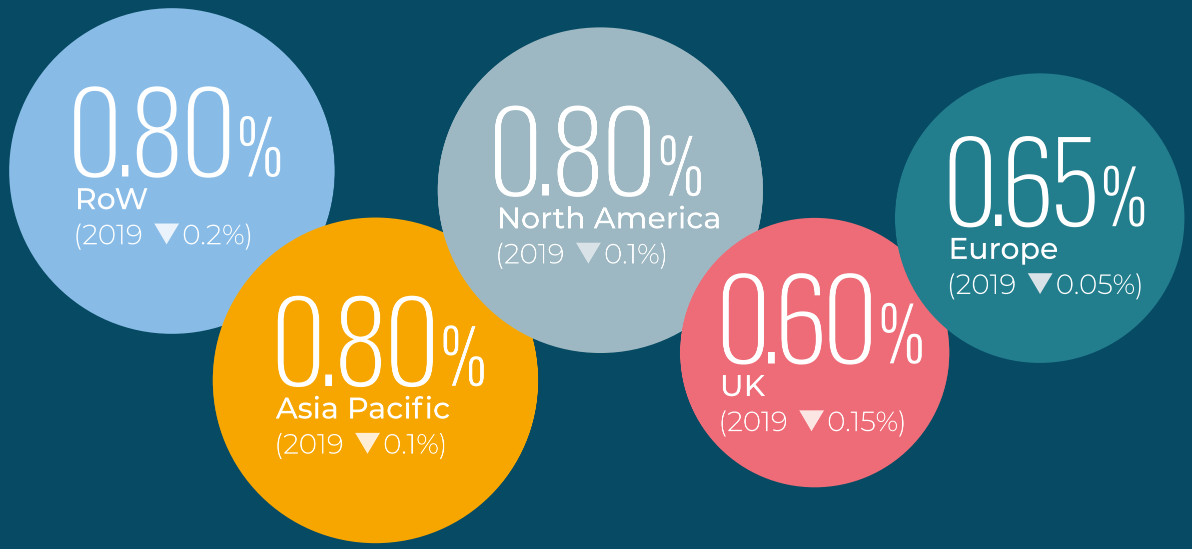


(% difference v 2019 in brackets)

The average limit being purchased has increased in all parts of the world year on year. Historically, in North America, the R&W product was used to minimise or replace escrows (typically 10-15% of deal value). Now however, clients are viewing the product not just as a deal facilitation tool but as a risk transfer solution, especially in a climate where valuation multiples across sectors continue to grow. What the above doesn't show is to what extent clients are buying "top-up" cover for fundamental warranties/reps (i.e. title to shares). Fundamental top-up insurance is often purchased for the full enterprise value on a transaction and is priced very competitively.

This is a dynamic we are seeing quite regularly in the UK and Europe and is a dynamic that is starting to be embraced in other parts of the world.

2020 global retention rates as a % of enterprise value



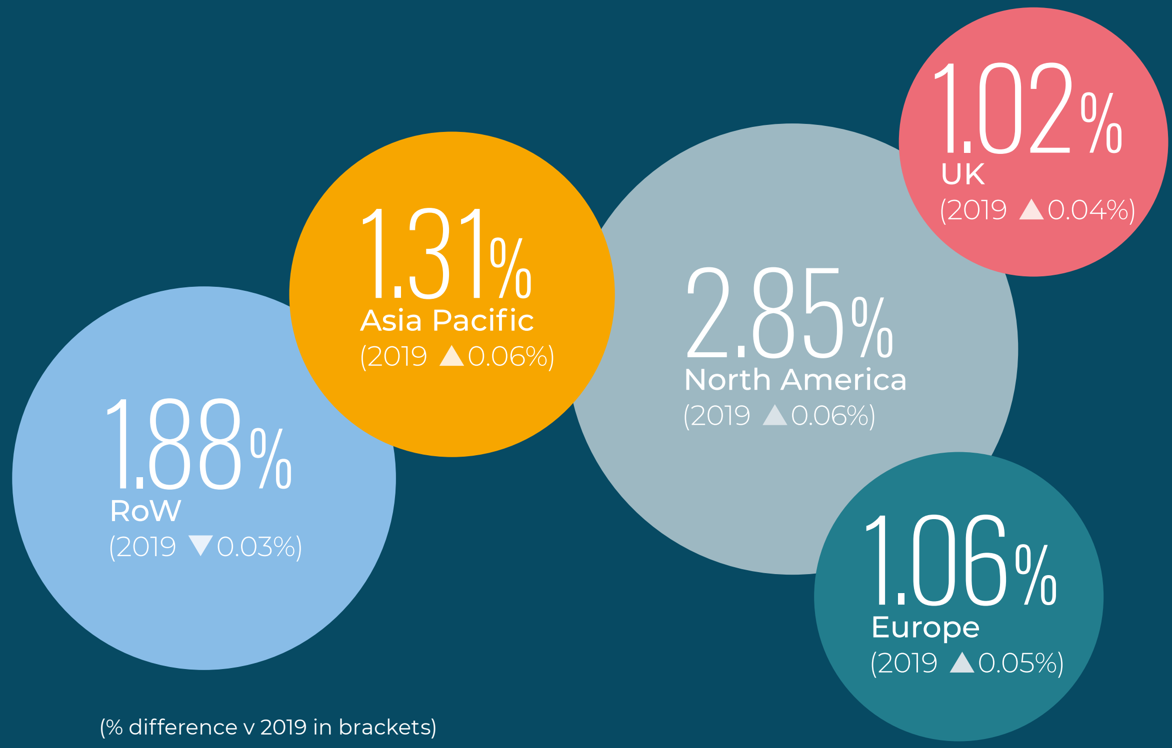
(% difference v 2019 in brackets)

While policy limits have been increasing, policy retentions across the world have been dropping, demonstrating the comprehensive cover that is being sought in a more cautious economic environment. In North America, 1% of EV has become the starting position for policy retentions with carriers prepared to drop after 18 months to 0.5% of EV and on larger transactions offer 0.5% of EV from the outset.

In the UK and Europe, 0.5% of EV has become the starting position across most sectors and increasingly some markets were prepared to offer 0.35% of EV, especially on midmarket PE transactions.

On real estate and renewables transactions a lot of markets were prepared to offer nil retentions which has become almost standard. In Asia, while 1% of EV remains the starting position, percentages are decreasing to 0.5% of EV or lower (even zero for real estate deals in more mature jurisdictions).

2020 global premium rates as a % of enterprise value



(% difference v 2019 in brackets)

Premium pricing is expressed as a percentage of the policy limit known as a rate-on-line ("ROL"). ROLs have stayed relatively stable and if anything have increased very slightly on the back of a heavy demand for M&A insurance across the globe in Q4 of 2020.

What the above doesn't demonstrate is that there is increasingly a divergence on premium pricing across sectors. For example, it is common to see infrastructure, renewables and real estate pricing in the UK and Europe around 0.6-0.9% ROL.

On the other side, on transatlantic transactions involving a US sponsor, we typically see a number of policy enhancements being taken out which can increase the overall cost of M&A insurance.

In Asia, pricing ranges between 0.6-2.5% ROL and is generally coming down due to the increasing number of insurers active in the market. There remain significant differences in pricing between matured markets (e.g. Singapore) and upcoming markets (e.g. Indonesia).

A view from Asia

M&A activity in 2020 was relatively strong across the board in Asia, with certain industries (e.g. technology, consumer business) and jurisdictions (e.g. Vietnam, China) taking the lead. It is widely projected that Asian economies will emerge strongly from the COVID-19 fuelled global recession. Forecasted Asian M&A activity in 2021 is promising, backed by a strong first quarter. A key driver behind this is the global PE funds' increased focus and fund allocation to Asia.

Even though the number of policies placed has increased over the last five years, M&A insurance has not seen the same enthusiastic uptick as in North America and Europe. M&A insurance is still in its infancy in a number of countries such as China and India, two of the largest markets in Asia, due to unfamiliarity with such risk transfer solutions. In contrast, Asian financial hubs such as Singapore, Hong Kong, Seoul and Tokyo, have witnessed an increasing level of regularity and sophistication in its usage.

We expect an increase in both demand for and insurers' appetite for Asian M&A transactions as deal parties seek to ringfence transactional liability. Insurers and brokers alike are already anticipating such increased demand by investing into additional resources in the region.

A view from North America

The M&A insurance market recalibrated in 2020 and North America experienced a resurgence of deal activity in Q3 & Q4. Growth in the North American market has carried over into 2021 partially due to increased geo-political certainty and particularly with the election of Joe Biden as US President. Considerable activity in the North American M&A market is expected for the balance of 2021, as many PE and similar funds have built up dry powder reserves over the course of the pandemic.

As 2021 progresses, M&A market participants along with brokers, insurance carriers and legal/financial advisers are optimistic about a full market recovery in light of widespread vaccinations and economic re-opening. M&A insurers have curtailed pandemic-related exclusions that were originally introduced at the start of the pandemic. Now, insurers are simply seeking information regarding the effects, if any, the pandemic has had on the target business (i.e. inventory or supply chain disruption).

Prices for M&A insurance have increased, however proportionately to the claims insurers are paying. To date, we have seen multiple nine figure pay-outs which included multiplied damages. As M&A insurance carriers continue to respond to valid claims, the market for M&A insurance in North America will continue to grow. Further, as the market matures, policy coverage and pricing are becoming increasingly uniform.

Your perspective

THE PARTICIPANTS AND THEIR VIEWS

Earlier this year, the BMS Private Equity M&A and Tax team sent a survey to individuals involved in M&A, asking them about their experience of using W&I insurance. These included senior executives at private equity funds, investment banks, corporate finance houses, financial & tax advisers and corporate & M&A lawyers.

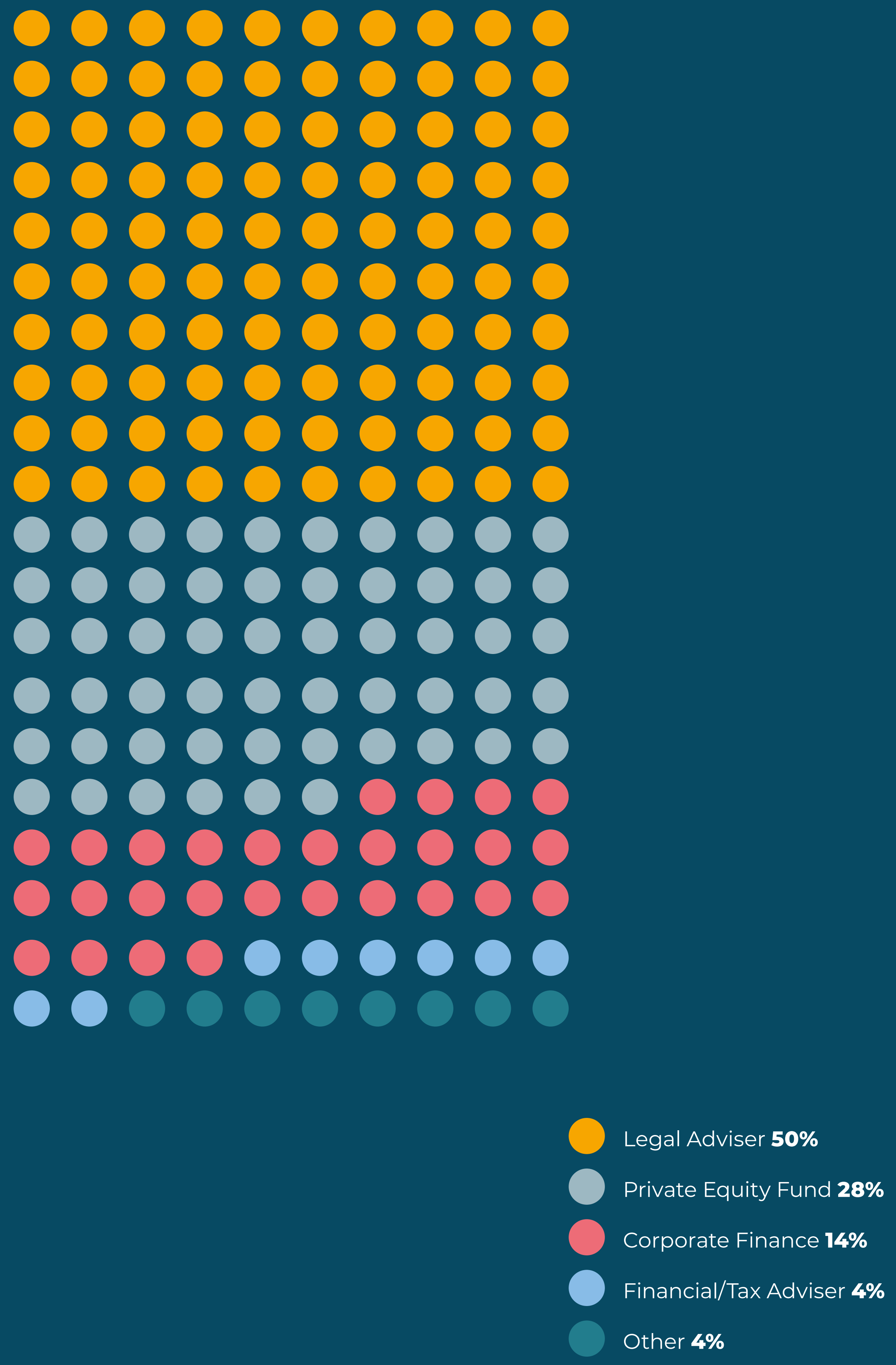
From the responses we received, 78 percent of respondents had worked on at least 6 transactions or more involving W&I insurance policies over the last 3 years.

In fact, 28% of respondents had used it in over 10 deals in the last 3 years (with 50% having used it in 6-10 deals). This clearly shows that the product is vital on most deals and, at the very least, is discussed by parties to a transaction even if it is not inevitably taken up. One respondent noted, *"Like any insurance, you don't tend to expect to make a claim when you take it out. The premiums for W&I seem expensive, but when you do suffer a loss and make a claim successfully, that premium is entirely justifiable. The hardest part is identifying the relevance of the claim against the warranties and indemnities covered, as the actual loss is typically against a warranty that is not immediately obvious. We now see these policies as near essential for acquisitions, as big risks really do lurk in deals."*

78%

of clients have used W&I cover on more than six deals in the last three years.

Survey respondents



USE OF W&I BY RESPONDENTS

The majority of respondents accept W&I insurance as being necessary in some cases and are ready to use it to see a deal completed. 34% of those on the buy-side describe themselves as 'comfortable and happy to use W&I insurance' when it is stapled on by a broker on the sell-side. Others are more neutral, with over half (52%) stating that they are 'indifferent' to sell-side brokers adding in W&I cover. Only 12% have any concerns about the use of W&I being initiated by the sell-side.

In many cases there is a recognition that a W&I policy is a valuable tool to facilitate deal execution, with one respondent commenting that *"the value arises from the fact that taking out the policy will often enable a buyer to get a transaction done"*. Interestingly, it can often be the case that this is the critical factor over and above the actual warranty protection the policy provides.

What has been your experience of using W&I insurance on transactions in the last 3 years?

HOW W&I IS INITIATED ON DEALS

In the majority of cases (56%), our survey found that usage was initiated by the sell-side and furthermore, in one-third of deals, the agreement to buy W&I cover was mutual.

How has W&I insurance generally been used on the deals you've worked on?

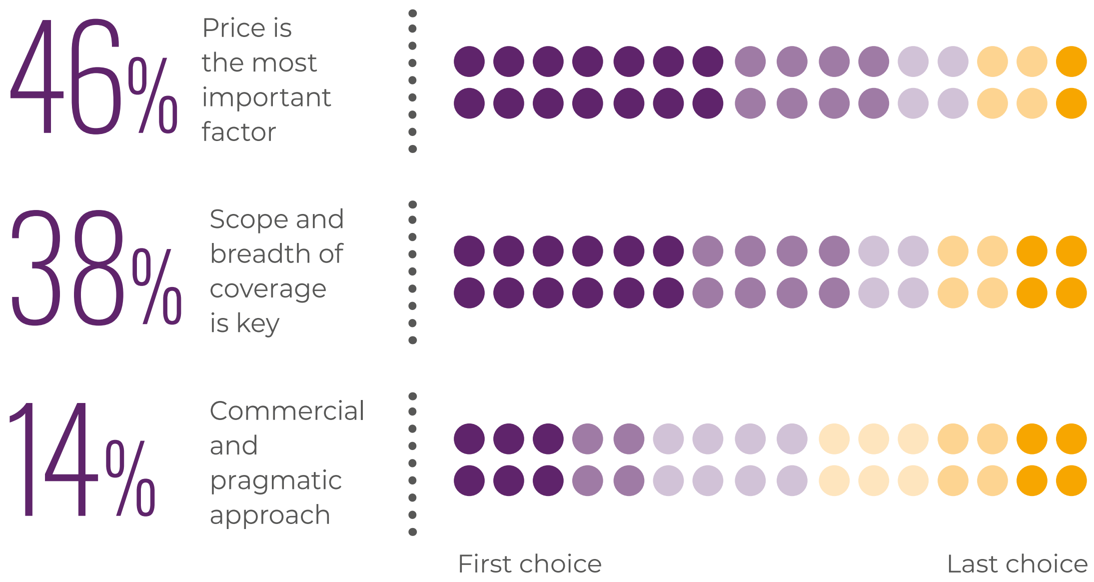
WHO PAYS THE PREMIUM?

Historically the sell-side would offer to make a contribution towards the premium but increasingly now the cost is being borne by the buyer. Our survey found that two-thirds of the time the premium is paid by the buyer (62% of cases). The seller paid for the policy in only 18% of cases (in the remaining 20% of cases, the costs are split).

From your experience, who ultimately pays the premium?

INSURERS MUST OFFER COMMERCIAL AND WIDE-RANGING COVER

When asked what is important when selecting an insurer, it is unsurprising that price remains the most salient of all factors. This, however, is closely followed by the scope and breadth of the coverage offered by the policy – this being the most important factor for over a third (38%) of respondents. In fact, there were a clear 'top three' decision-making factors for participants in the survey, as shown below:



Other factors, such as claims record and brand recognition, lagged further behind, with the three factors above being the most important for 98% of clients.

One observation made by a respondent was that underwriting speed was increasingly becoming a key factor with more expedited processes being run especially in competitive auctions.

While insurers were praised for their services overall, one buyer noted occasional gaps, stating that *"some insurers need to understand the process of a tax (and financial) due diligence process much better."* This is another area we are exploring with insurers and it will be critical to ensure that the most proficient underwriter is selected on each transaction to ensure they understand the nuances and have the expertise to provide the most comprehensive cover available. This is particularly applicable when new legislation is introduced in a given jurisdiction which can have a significant impact on the tax diligence process, for example, the new IR35 rules in England and Wales.

FINANCIAL STATEMENTS ARE THE LEADING AREA OF PERCEIVED AND ACTUAL RISK

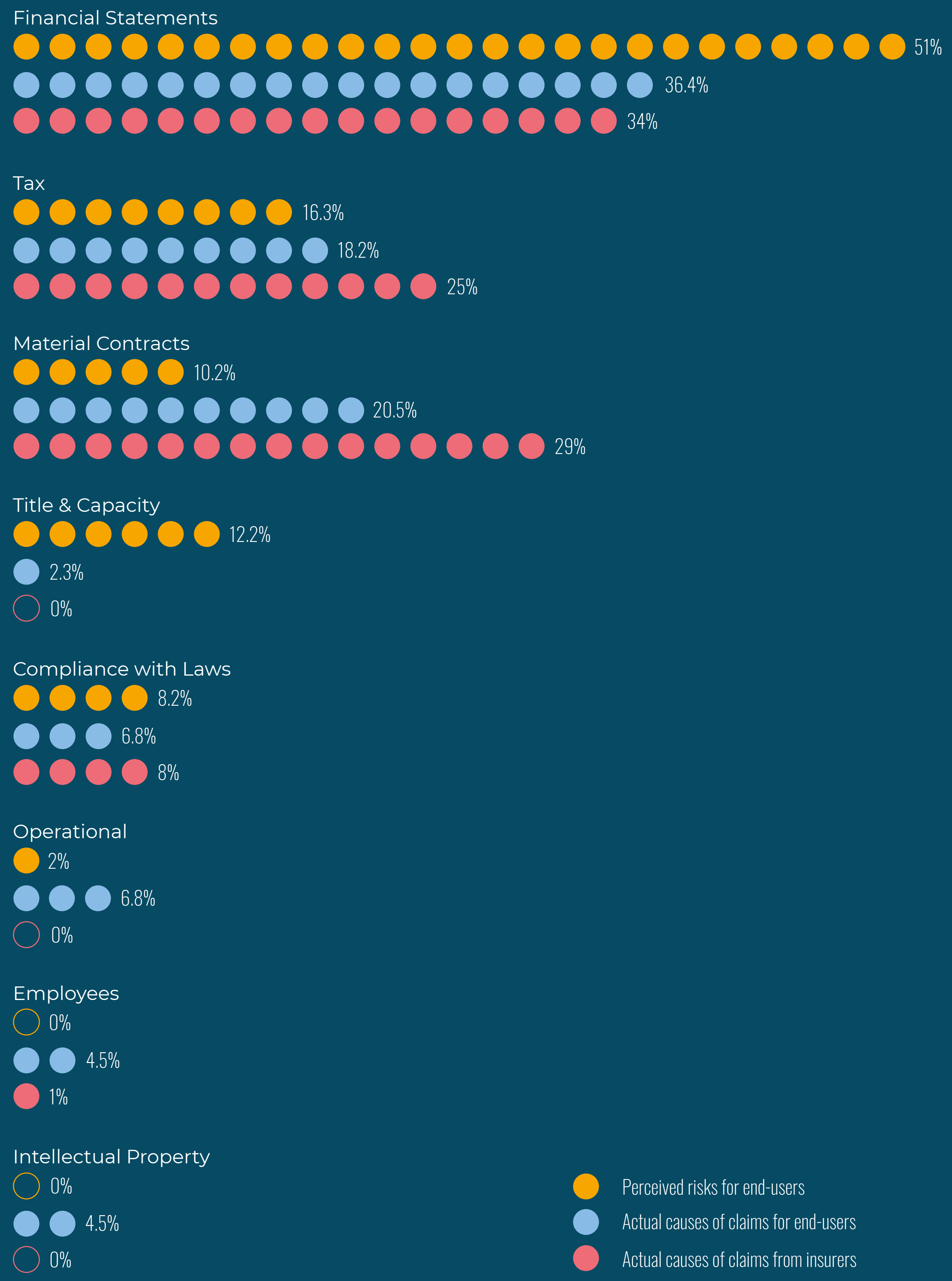
When looking at areas of risk that are coved by W&I policies, by far the greatest area of concern for clients are the seller's financial statements. Over half of clients (51%) state these as being the biggest risk, with the next major risk being tax. Risks around employees, operations and intellectual property were not a leading concern for most respondents, although some clients did see material contracts and compliance with laws also being high-risk.

This observation that financial statements are a key risk correlates with buyers' experiences of making W&I claims. Of the 48% of buyers responding to our survey who have been involved in bringing a W&I claim, the financial statements were the basis of the claim in 32% of cases.

However, most interestingly, the areas that clients believe are high risk do not entirely correlate with the reality of what causes claims. It is notable, for example, that the second biggest cause of claims reported by respondents to the survey is material contracts, which was rated as a leading risk by only 10% of clients – even though it was the cause of 20% of claims. The heads of loss where successful claims have arisen from remain consistent when asking both the end-users and the market.

With the impact of macro-economic matters such as COVID-19 and Brexit, we anticipate that there will be an increase in claims in the Material Contracts limb. This is due to issues arising whereby supply chains or key customer contracts fall through due to new restrictions and requirements in the post-pandemic world. In order for policyholders to avoid these issues, our message remains clear; that adequate due diligence is imperative when acquisitions are being made to ensure that insurers can get comfortable covering material contract warranties in the purchase agreement.

Comparison of perceived and actual claims risks.



M&A INSURANCE CLAIMS: SATISFACTION IS HIGH

Interestingly, while it appears that there has been some increase in the number of W&I claims globally, insurers do not talk in terms of a direct increase in claimants. Instead they explain the increase on the basis of:

- An increase in writing US policies where (based on our data) there are more claims
- They have increasingly been writing bigger books of policies, hence naturally more claims

More insurers also now engage specialised M&A claims teams in order to process claims in a way that effectively guards them from spurious or what should be invalid claims.

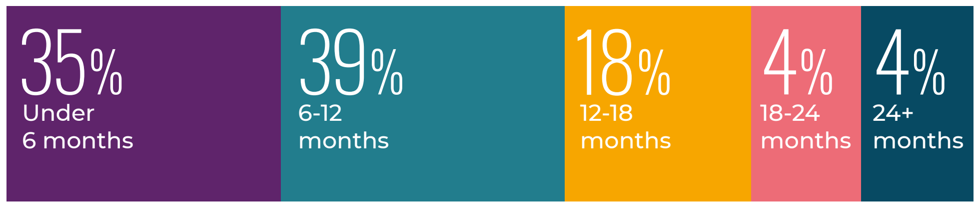
From the data collated from insurers, claim notifications as a percentage of primary policies placed is around 20%, which marries up with other evidence across the market that claims notifications are made on around 1 in 5 policies. Almost 50% of respondents questioned have been involved with bringing a claim under a W&I insurance policy, which demonstrates that more focus on claims may be required by policyholders and their advisers post transaction. This focus on looking to extract value from policies may not have been the case historically on the basis insurance was not used and warranty claims were few and far between.

Whilst end-users of W&I policies want to benefit from low premiums, broad coverage and more claims paid, it is unlikely that this can continue at the pace seen. For this reason many in the M&A insurance market predict that there may be a hardening of rates and/or a tightening of coverage terms due to a reduction in insurance capacity. Our research results from end-users of the product clearly show that pricing is still the most important component when selecting an insurer (with 46% of votes). Interestingly, the insurer's claims track record only scored 2% of the votes, suggesting that users either expect insurers to have decent claims processes and teams in place, or that the focus when in the midst of a transaction is the front end of the policy. The weighting of importance attributed to claims handling may well increase as end-users increasingly experience the financial and time costs involved in negotiating a claim.

> It is important to consider the adequacy of policy limits in light of the deal value; we have seen a number of full limits loss claims where the limit on the policy is substantially below the size of the claim.
>
> **Phillipa Hill**
> *Partner, Forensic and Investigation Services*
> *Grant Thornton UK LLP*

Most respondents have had good experiences with their W&I insurer when making a claim, with over three quarters (78%) reporting that their claim was accepted and paid. As is to be expected in such a complex policy, time periods for settling a claim varied. With that said, it was reported that almost three quarters of claims were paid in less than 12 months (74%), and only 8% took longer than 18 months. Around one-third of clients – the fastest group - saw their claims paid in less than six months.

If the claim was paid, then from the time the W&I insurance claim was submitted, how long did it take for the insurer to make payment on the claim?



In cases where a claim was denied, 50% of denied claims related to the insurer's view that the claim was not a breach of warranty under the policy, and therefore did not constitute an insured loss. In other cases, the cause was that the basis of the claim was excluded from the policy, or that the deal team already had actual knowledge of the item under dispute.

When asked if they were generally satisfied with the way in which their claim was handled, clients felt quite well served. The most common scores were above average at 7/10 and 8/10. 8/10 was the most common response, and just below one-third (or 32%) of clients scored their satisfaction levels with the claims handling they had experienced at 8/10 or above.

> Assisting the insured in understanding the scope of cover and the effect of the terms agreed in the policy at the placing stage is important to a smooth claims process. Having a broker with experience of the M&A market is therefore critical.
>
> **Geoff Tan**
> *Partner, Insurance & Reinsurance*
> *CMS Cameron McKenna*
> *Nabarro Olswang LLP*

It is hard not to conclude that claims management in this specialist sector is well-organised and that insurers have the trust of their clients on this point. Although claims are complex and clearly take time to settle, clients seem to understand that this is unavoidable – continuing to rate their claims experience highly, in spite of an average 6-12 month wait for a claim to be paid.

We expect that those who successfully claim under a policy are simply pleased that they took out the policy in the first place and that they can make good the financial hole in their business. This is not universal, of course, and there were one or two dissenting voices on this subject who wished for faster payment of claims, with a comment being made that the claims process *"needs to become more streamlined"*.

Were you generally satisfied in the way in which the claim was handled by the insurer?

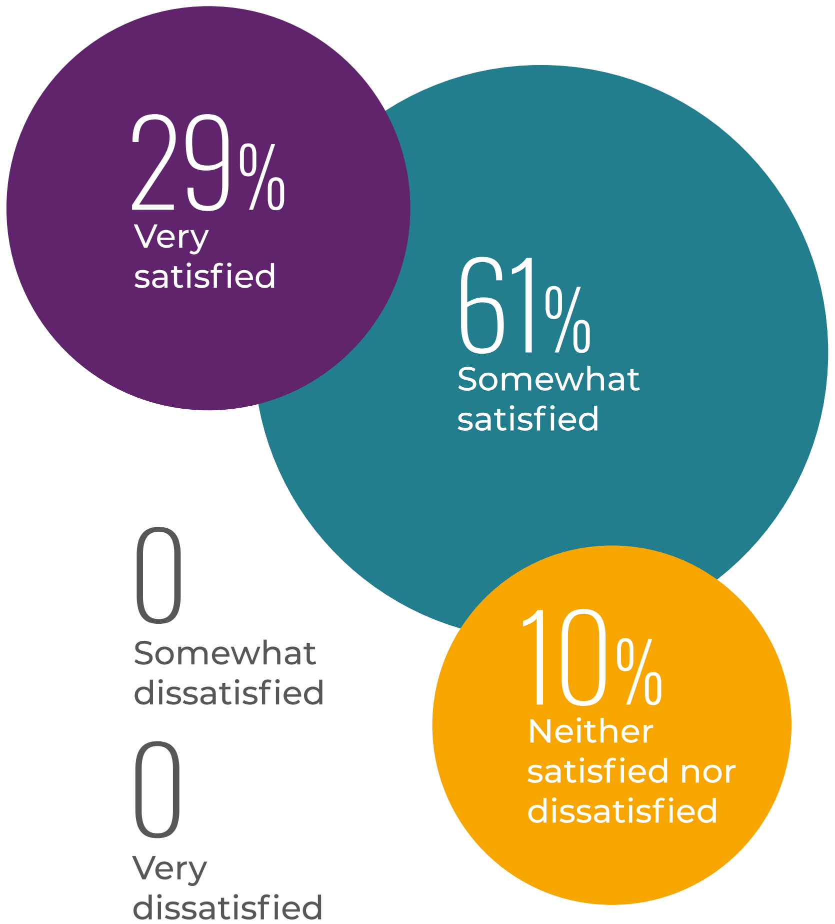
> Claims must be handled properly, but with a regard for timeliness. As brokers, we have a role to play, acting as advocates on behalf of our clients throughout the claims process to bring about a rapid resolution.

Tan Pawar
Managing Director, Head of Private Equity, M&A and Tax, BMS Group

A HIGHLY RATED PRODUCT

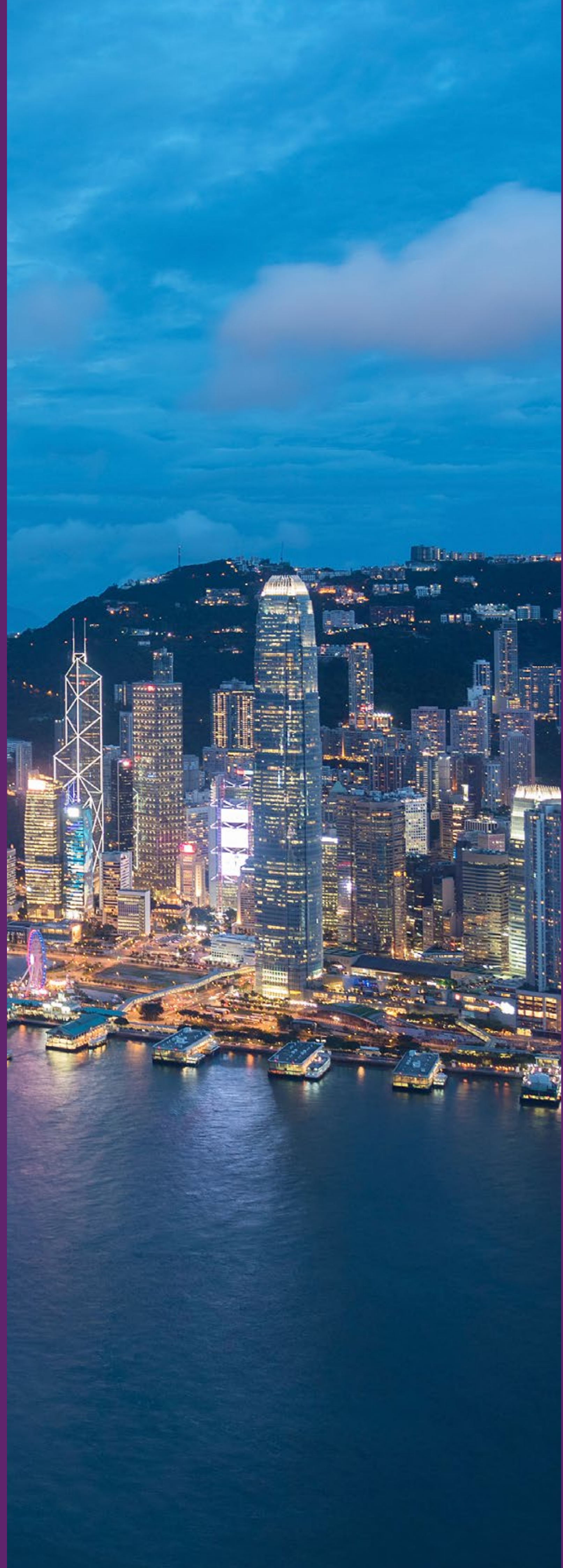
The high claims satisfaction rating translates through to an overall contentment with the W&I product. Eighty-eight percent of clients declared themselves 'somewhat' or 'very' satisfied with the value and protection the W&I insurances currently provide. There were few completely negative voices – no client declared themselves 'very' or even 'somewhat' dissatisfied – and the most negative user was neutral in viewpoint.

Overall how satisfied are you with the value and protection that W&I insurance currently provides?



Tax Liability insurance

Despite the challenges that 2020 brought, the rate of tax enquiries remained relatively consistent across the year when compared to fluctuating M&A activity, although there was an equal flurry of activity in Q4. The Tax Liability Insurance (TLI) market received approximately 700 enquiries in 2020 (up from approximately 600 in 2019) across 50 jurisdictions with approximately 400 policies placed.



One in 3

enquiries related to real estate acquisitions and acquisition structures.

> TLI is evolving from being overwhelmingly used as a deal facilitation tool, to a more traditional insurance product which allows businesses to transfer tax risk to the insurance market on an annual basis.

Dean Andrews
Head of Tax Liability Insurance
BMS Group

Despite 75% of enquiries emanating from transactions, the 25% of non-M&A related risks that sat alongside them shows a significant increase on the prior year, further evidence that TLI continues to evolve from its overwhelmingly M&A focused beginnings. For example in Europe, one in seven enquiries related to tax matters under investigation or being litigated demonstrating the expansion of appetite in this area, something we expect to continue to be a significant growth area as markets continue to invest in contingent litigation expertise.

Real estate continues to be the standout sector with one in three enquiries relating to real estate acquisitions and acquisition structures. Equally Northern Europe continues to be a strong region for enquires with Germany and Benelux standing out as key regions in terms of total enquiries, despite record growth from France.

Cross-border tax issues such as withholding tax, transfer pricing, substance and diverted profit taxes make up a relatively low number of policies placed, however, we consider this is an area that will continue to grow as advisers become aware of what is possible in these areas.

Currently, approximately 40% of tax policies placed relate to corporate tax adjustments which is unsurprising given the focus of the international tax community over the last 5 years.

IMPACT OF THE PANDEMIC

They key areas of tax risk that have been heightened due to the pandemic are corporate residence/permanent establishment and transfer pricing. Due to the almost complete cessation of global travel, directors have been unable to physically travel to attend board meetings. Under normal circumstances this could create a risk that a permanent establishment is created in the jurisdiction where the key decision makers are present, or at worst, corporate residence may shift to the relevant jurisdiction. Western governments were quick to offer guidance saying that they would allow a grace period in this regard.

> TLI could be the panacea for the modern tax world, where broad tax legislation, vague tax authority guidance and tax extraterritoriality have made uncertainty rife and tax risk present in even the most commercial of transactions.
>
> **Ben Jones**
> *Partner, Head of Tax (UK)*
> *Eversheds Sutherland*

However, what is not clear is how long this grace period will last. The OECD has also provided guidance, saying that tie breaker conditions under existing international treaties should mean that taxing rights of a second jurisdiction should not arise due to a temporary lack of travel. That said it will ultimately be down to the individual, cash-strapped, tax authorities to take a view as to how aggressively they review such interim measures. Corporate residence is something very frequently insured by the tax insurance market so it is well placed to assist businesses ring fence financial exposure to tax authority enquiries in this regard.

In relation to transfer pricing, it has also been noted that the pandemic has had an impact on intragroup arrangements for corporates across a wide variety of sectors, whether it be operational risk or financial risk, which should be supported by updated documentation and refreshed transfer pricing analysis. Again the OECD has provided helpful guidance in this regard, however interpretation and approach will be down to individual tax authorities.

Whether a business wants a tax liability insurance policy in relation to their filing position that they maintain their current intra-group arrangements, or in relation to their revised documentation and transfer pricing analysis, the tax liability insurance market has significant experience in this regard.

OUTLOOK

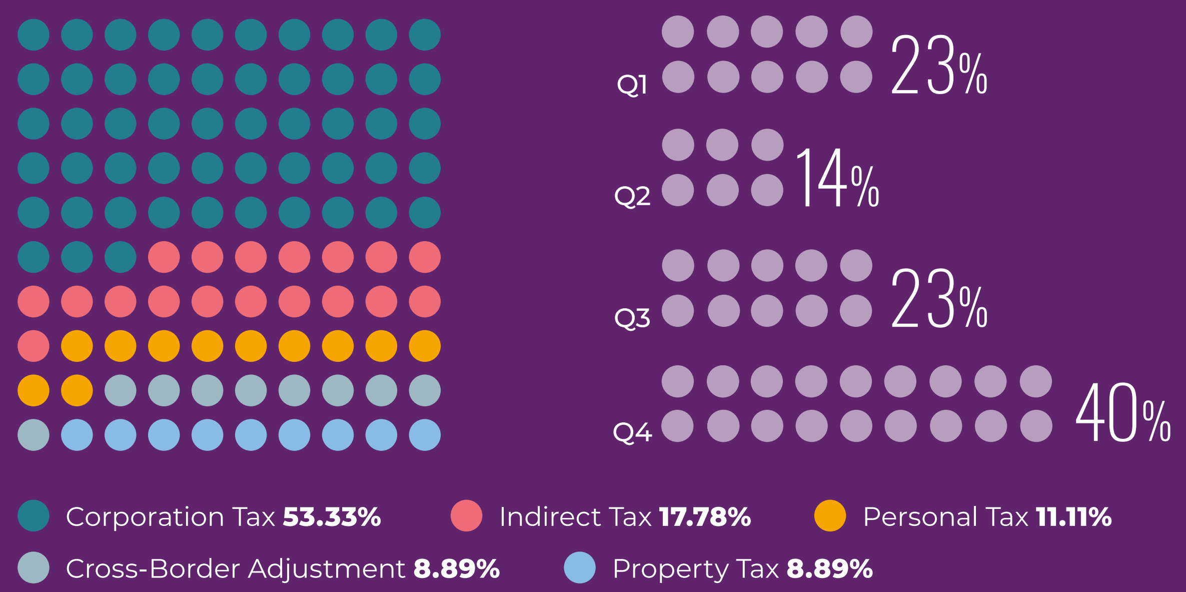
In terms of an outlook for 2021 and beyond, on the basis of a lack of a coordinated approach on the introduction of a 'Digital Service Tax' (DST), the UK has followed France and introduced its own. Each country generally agrees that a single applicable tax across the OECD nations would be the preferable route and would succeed their own state's DST to an agreed framework. Given the largest digital businesses in the world are in the US, it will be interesting to see whether they will agree to such a framework, or if it will remain EU led. Given Biden's election win, the prospect of US involvement is higher, but ultimately the focus of the DST is going to be European taxing rights of US entities so the expectation is that progress will be made whether the US is involved or not. This is part of a wider US led discussion regarding an OECD wide minimum tax rate, currently 21%. It is not yet clear if this will be adopted, or if it is, at what rate given there is significant dissent from jurisdictions such as Ireland and India, but any reorganisations that follow tax changes implemented by members of the OECD will typically create tax risk which may be insurable.

This will likely be a significant source of interest for the global TLI market in the following years. We also expect to see funds utilising tax insurance to mitigate potential tax risks inherent in their cross-border structures. In particular, the complex and rapidly shifting tax environment means that asset managers face significant challenges when seeking to ensure that:

- changes in legislation do not adversely affect existing fund structures and investments; and
- new fund and transaction structures appropriately address substance, permanent establishment and hybrid risks.

Underlying tax for policies placed in 2020

When tax policies were placed in 2020



Outlook
& conclusion

After such a turbulent year, making an attempt at a reliable prediction for 2021 and the year ahead is undoubtedly challenging. There are however certain trends that we saw emerge in 2020 and at the start of this year that we expect to continue.

FOCUS ON ESG IN M&A

Increased focus from investors, shareholders and other stakeholders on greater transparency and accountability from companies on environmental, social and governance (ESG) factors and ESG-related synergies in M&A transactions will now be an important consideration for all M&A practitioners. The increasing rise of ESG will inevitably create more responsible business opportunities such as clean energy projects, sustainable transport and digitalisation while at the same time introducing a new range of risks highlighted by investors obtaining indications of a company's exposures to ESG risks from specialist ratings companies or certain stock exchanges demanding better transparency.

Buyers on M&A transactions will also need to demonstrate that their approach to due diligence has factored in ESG considerations on issues such as employment, tax and environmental matters. This is an area insurers are going to start asking a lot more questions around. We understand that there has been a significant increase in the amount of ESG related litigation, we therefore expect to see a rise in the number of contingent litigation policies being taken out in this regard.

> If, through diligence or disclosure, a risk is uncovered, for example, threatened litigation, then the M&A insurance market may be able to insure against it with a contingent litigation policy, therefore providing the buyer with financial certainty.
>
> **Sophie Wallace**
> *Divisional Director, Private Equity, M&A and Tax*
> *BMS Group*

NSI BILL IN THE UK WILL IMPACT M&A

Like CFIUS and the EU's FDI Regulations, the National Security and Investment Bill (NSI) which was published in November 2020, will impose a new filing and clearance process for certain investments (especially those with national security concerns) for targets with a nexus to the UK.

All overseas acquirers will need to consider whether their current, intended and historical M&A transactions involving targets with UK activities could be subject to the new legislation once adopted. These potentially far-reaching measures will add a new level of administrative burden and potentially prevent certain transactions from closing – insurance may be able to play a role in providing certainty, especially in relation to transaction costs.

PUBLIC TO PRIVATE (P2P) M&A ACTIVITY

2020 also saw some Public to Private (P2P) M&A activity. The takeover of the AA by two private equity firms demonstrated private equity investors' appetite to deploy unused capital and to take advantage of the COVID-induced dislocation in the capital markets. P2P has already proved an attractive value proposition for private equity and we expect to see this continue into 2021, despite capital markets recovering.

We are aware of a listed target that was purchased by a private equity buyer under a Scheme of Arrangement earlier this year that used M&A insurance. While the deal was subject to the Takeover Code, the shareholders entered into a standard transaction warranty deed and undertook a standard disclosure process. The key to the ability to utilise the standard warranty deed was the Scheme of Arrangement (it wouldn't have been permitted by the panel in an Offer process) and the requirement to get sufficient irrevocable undertakings; if the right number of irrevocable undertakings were not achieved, the warranty deed would have been void.

This demonstrates that the M&A insurance market is prepared to consider a breadth of transaction dynamics beyond the traditional buyouts, disposals and carve-outs. Insurers are prepared to offer solutions for more complex deals and coverage for public to private deals is an example of this evolution.

SPAC MANIA MAY COME TO THIS SIDE OF THE ATLANTIC

Special Purpose Acquisition Company (SPAC) activity has been thriving in North America, with record SPACs listings on the NYSE and NASDAQ. In the UK however, SPAC activity has been relatively subdued. The main reason for this has been that in the US, shareholders vote on whether to approve a SPAC's acquisition target and can get their investment back if it isn't approved.

In the UK however, under current rules, shareholders typically do not vote nor have a redemption right if they do not approve of the target. However, Lord Hill's recent review called for a range of deregulatory measures that would relax these rules and that would aim to "ensure the UK remains one of the most attractive places to grow and list successful companies", thereby encouraging SPACs to list on the LSE.

The insurance market is already experiencing heavy demand for scarce D&O coverage in a hard market for SPACs. We expect that this will extend to M&A insurance in circumstances where a SPAC has identified a target and will enter into a de-SPAC process to acquire the shares in that target. Working with the insurance market from the outset is therefore vital that those contemplating SPAC structures together with the bankers and lawyers engage with insurance specialists early on in the process, to ensure they obtain the appropriate insurance protection they seek.

> Having recently advised on a number of SPAC IPOs and de-SPACs/reverse takeovers on both sides of the Atlantic, we don't view the regulatory conditions as being quite ripe to warrant a slew of these vehicles listing in the UK; should they become so, however, there is much to learn from US practice – not least, as regards M&A insurance coverage.
>
> **Ed Dyson**
> *Partner, Public and Pre-IPO Private Companies*
> *Orrick*

SECONDARIES MARKET CONTINUES TO FLOURISH

GP-led restructurings or secondaries transactions have also attracted considerable interest in recent years and 2020 saw a large increase in these transactions, particularly in the M&A insurance market. Given the market dislocation caused by the pandemic, many funds decided it was prudent from a portfolio management perspective to extend the duration of their fund structure for specific assets and raise additional capital during the current pandemic by capitalising continuation funds, thereby providing liquidity to investors and capturing this next leg of growth once economies recover.

The continuation fund is managed by the same general partner (GP), albeit in a new fund vehicle, whilst the limited partners (LPs) of the selling and buying funds are typically different, although some of the existing LPs may roll over their interests to the new fund. These transactions can involve either a single asset or a portfolio of companies.

Whilst a lot of comfort can be taken from the fact that GPs know the asset or portfolio and are aligned economically, there may be a need for the GP to stand behind certain business warranties as the new LP may seek broader representations and warranties. This means that whilst the GP may be required to provide these warranties as the seller, it wouldn't want to bring a claim on behalf of the new LPs for a warranty breach.

BMS have worked on four transactions in the last six months, working closely with the lawyers and the insurance market to craft solutions to support these GP-led restructurings and using M&A insurance and fundamental "top-up" insurance to help facilitate the transactions.

"The volume and complexity of GP-led secondaries transactions continues to progress and this sector has been strengthened by the effects of COVID-19 which has clearly pushed out the exit horizon for many portfolio companies.

We are seeing more GP-led deals relating to concentrated pools of assets and it is natural therefore that buyers are seeking a greater degree of contractual protection. Organising a 'clean break' on behalf of exiting investors is a key concern for sponsors; they want to avoid any prospect of distributions being recalled and various insurance policies are a key part of this risk management exercise.

Gabriel Boghossian
Partner, Corporate (Secondaries), Stephenson Harwood

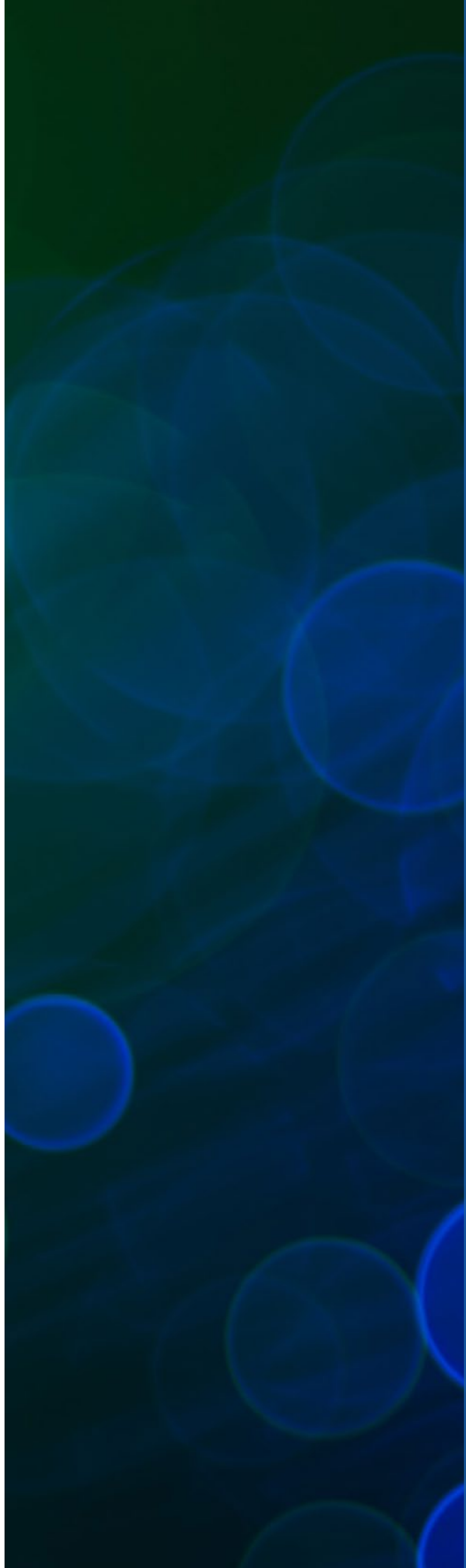
COVID-19 STILL AT THE FOREFRONT OF M&A ACROSS THE WORLD

Almost all of the above is fuelled by the dislocation caused by the current pandemic which continues to present opportunities for M&A. Many commentators felt that there would also be a spate of distressed transactions in 2020 but this hasn't transpired, or not at least at the volume one was expecting. This has largely been due to the fact that government support schemes have been extended but the concern remains that these distressed opportunities could come to fruition once these support schemes come to an end. Whilst there is optimism that the vaccine roll out could bring some degree of normality to the world, it may well be that the death knell rings for some businesses at the same time and synthetic M&A insurance may play a pivotal role in aiding these distressed transactions, in particular sales from administration.

The Asian outlook is strong and considerable activity in the market is expected for the remainder of 2021 too, as many PE funds have been increasing their investment allocation to Asia in search for yields exceeding those in the US and Europe. Although there is much activity across the board, there is particularly strong activity in technology and real estate.

The North American outlook continues to be strong and focused. From our perspective, there will be a continued focus on technology related businesses that can offer services traditionally overlooked before the pandemic. In addition, real estate assets are currently in high demand in North America. This is due primarily to technology firms looking to warehouse products for sale electronically. With decreased business valuations due to COVID-19 and the pent up dry powder held by PE and similar funds, there will be increasing opportunities for the M&A insurance market.

With the release of multiple COVID-19 vaccines rolling out across the world, M&A activity will continue to grow in 2021, as we saw in Q3 & Q4 of 2020 and Q1 of this year. M&A activity is expected to be particularly strong in infrastructure, renewables, technology, and traditional safe havens such as education and healthcare, generally sectors that have remained resilient during this current crisis. In other sectors most affected by the pandemic i.e. retail, leisure and travel, consolidation will continue. However, as the world continues to heal, both PE (with high amounts of dry powder) and corporates will look to ramp up M&A activity as certainty returns to the economy. With this passage of time, M&A insurance – already clearly embedded in the M&A landscape – will continue to play a pivotal role and bring certainty to the economically essential M&A process.



Methodology & acknowledgments

While a lot has been said and published about the benefits of W&I Insurance, to date there has been limited studies of how M&A insurance interacts with the wider M&A sphere and furthermore the customer's view as to its value or merit has never been explored (whether that be the buying process or making a claim). That's why we wanted to get your views to build a collective view and then work with the W&I insurers to create and implement improved and meaningful solutions for you. So in January this year, the BMS Private Equity, M&A and Tax team sent a survey to individuals involved in M&A, asking them about their experience of using W&I insurance. These included senior executives at private equity funds, investment banks, corporate finance houses, financial & tax advisers and corporate & M&A lawyers. At the same time, and to give a more holistic view of M&A insurance, we overlaid the survey results with a separate set of interviews and questions we posed to the M&A insurance market to better analyse and understand the key trends emerging and to identify challenges and issues that have arisen along the way.

Please note that in some instances, we have extrapolated some of the responses and data as each carrier provided data in different ways and so reasonable assumptions had to be made to reconcile any inconsistencies in how the data was reported. In some cases, results total more than 100 percent because of rounding and/or because respondents were asked to select multiple options that applied.

We would like to extend our gratitude to the below carriers who worked with the BMS Private Equity, M&A and Tax team for their valuable feedback that has helped shape together this comprehensive report which we hope you will find useful.

AIG
Aviva GCS
ANV Global Services
Ambridge Europe
Acquinex
Ascent Underwriting
Arch Insurance
AXA XL
Beazley Group
Berkshire Hathaway
Brockwell Capital
Certa Insurance
CFC Underwriting
Chubb
DUAL Asset
Ethos Specialty
Euclid Transactional
Nexus Underwriting
Tokio Marine HCC
Icen Risk
Liberty GTS
Riskpoint A/S
RSG Transactional Risks Europe
Themis Underwriting
Transact Risk Partners
Vale Insurance Partners

About our team

Every M&A transaction is different and we pride ourselves on being able to structure tailored M&A insurance solutions with the broadest coverage in a clear and concise manner.

Our team is a group of multi-disciplined professionals with backgrounds in M&A, Insurance, Law, Tax, Finance & Accounting and Litigation.

With in-depth global experience, we have extensive expertise in well over 1,000 cross-border M&A transactions.

We partner with our clients and their advisers to help them navigate efficiently through the course of a transaction. This entails an in depth understanding of the transaction dynamic, our client's commercial goals and identifying potential obstacles as early as possible. This process allows us to provide innovative insurance solutions which facilitate transactions regardless of the complexity, size and sector, all within your transaction timetable.

Please visit our website to see historical transactions that the Private Equity, M&A and Tax team have worked on - https://www.bmsgroup.com/pemat-transactions

A selection of transactions BMS worked on recently

Sector: Infra, TMT
Type: Buy-side W&I

Acting for one of the world's largest digital infrastructure companies on its acquisition of data centers in India.

EV: $161m — Q3 2020

Sector: Secondaries
Type: Buy-side W&I

Acted for a UK Private Equity fund on a GP-led secondary transaction of a single asset.

EV: £300m — Q3 2020

Sector: TMT
Type: Buy-side W&I

A listed multinational internet services holding company purchasing a Polish digital advertising company.

EV: £36m — Q4 2020

Sector: Secondaries
Type: Buy-side R&W

A subsidiary of a leading PE firm on its acquisition of a portfolio of healthcare assets.

EV: $700m — Q4 2020

Sector: Secondaries
Type: Buy-side R&W

Three leading secondaries investors on a process that allowed a leading PE fund to move a portfolio of assets from a vintage fund into a continuation vehicle.

EV: $1.7bn — Q4 2020

Sector: Healthcare / TMT
Type: Buy-side W&I

Acted for a food safety developer on the acquisition of an analytical reagents solutions company.

EV: $46m — Q4 2020

Sector: Financial Services
Type: Buy-side W&I

A UK PE firm buying a Wealth management tech enabled platform business.

EV: £102m — Q1 2021

Sector: TMT
Type: Buy-side R&W

A leading global venture capital and private equity firm investing in high-growth technology and software ScaleUp companies on its acquisition of an Israeli software development company.

EV: $210m — Q1 2021

Sector: TMT
Type: Buy-side W&I

A global IT and software development company on its acquisition of a UK multi cloud digital transformation company.

EV: $32m — Q1 2021

Sector: TMT
Type: Buy-side W&I

A leading technology-focused private equity firm on its major investment of a leading provider of cloud-based services the UK.

EV: £108m — Q1 2021

Sector: TMT
Type: Buy-side W&I

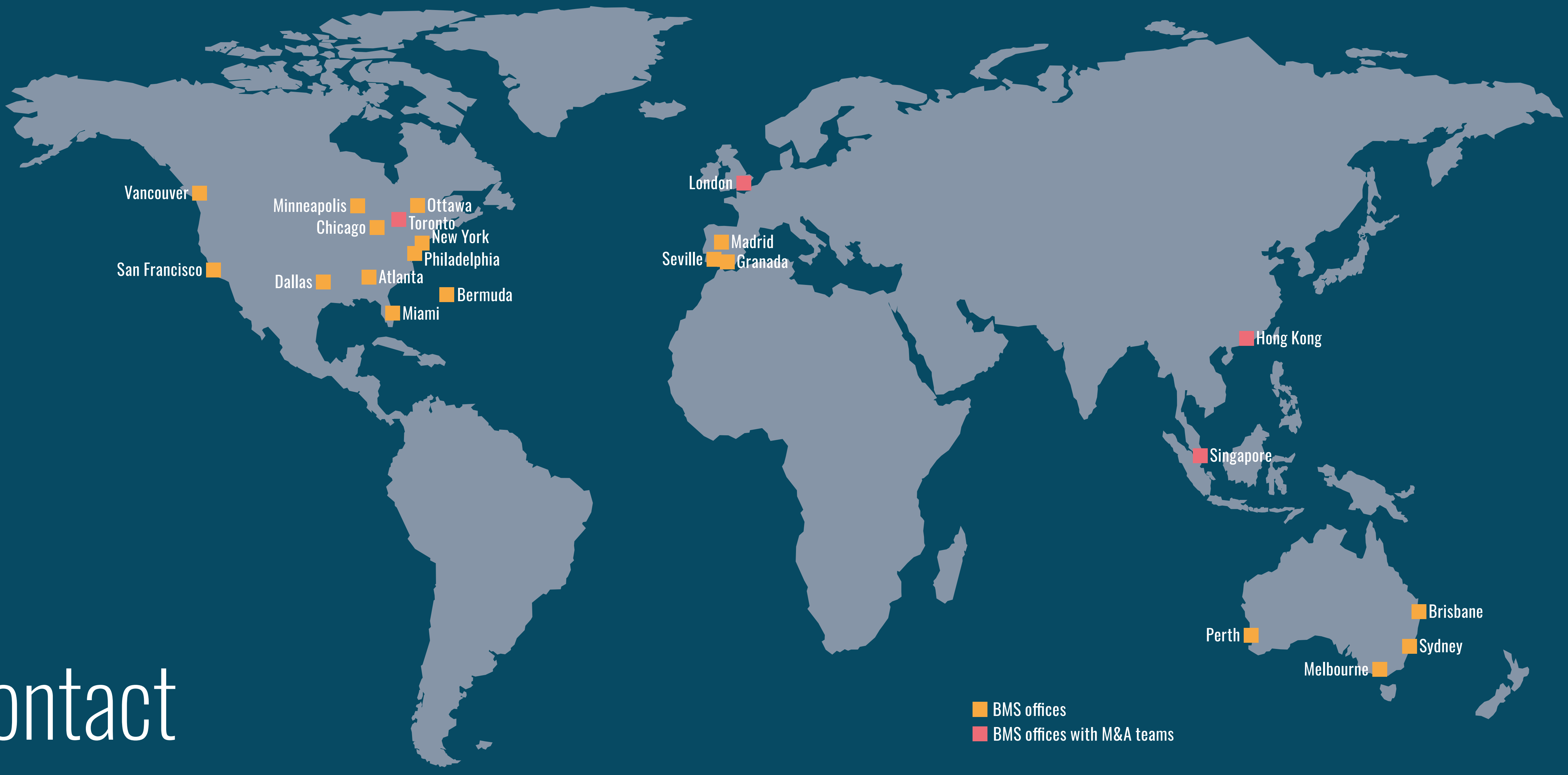
A US casino giant on the acquisition of an Irish gaming software business.

EV: €40m — Q1 2021

Sector: Financial Services
Type: Buy-side R&W

A Canadian insurance services company on its acquisition of a Canadian insurance broker.

EV: CAD 130m — Q1 2021



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