

TRANSACTIONAL LIABILITY INSURANCE ALERT

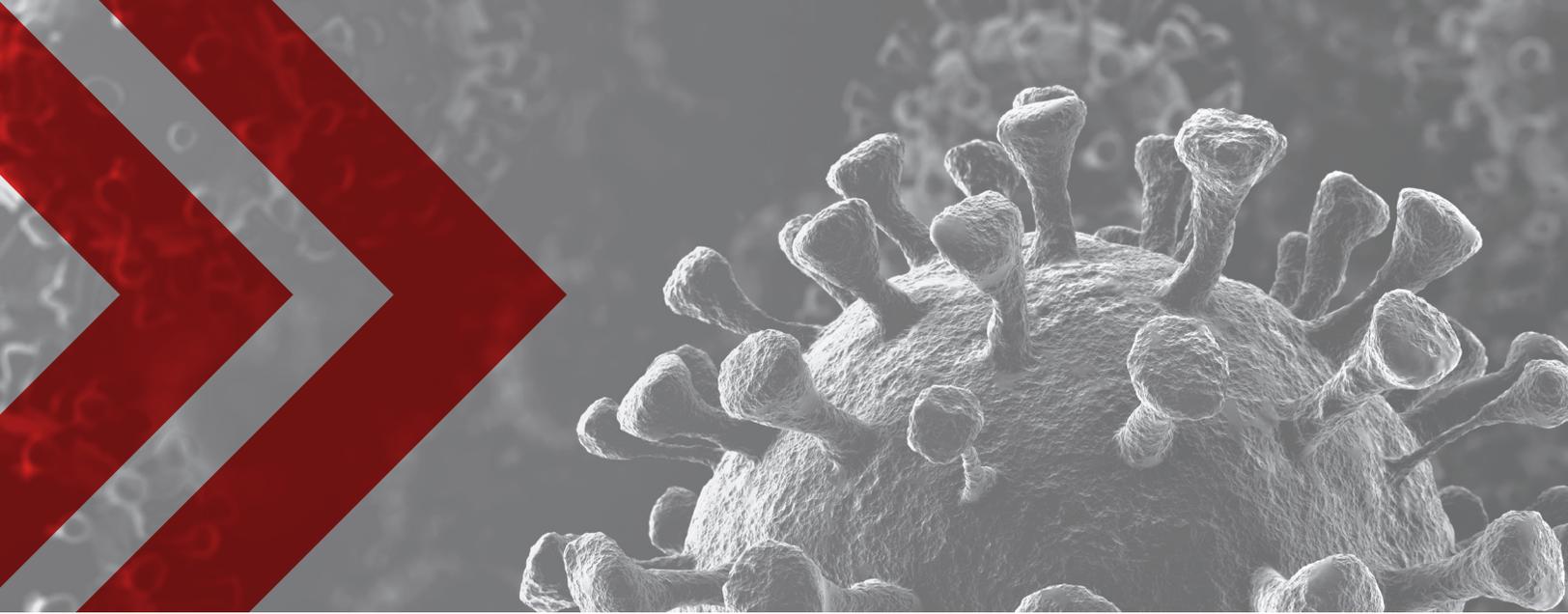
COVID-19



COVID-19 PANDEMIC CONSIDERATIONS FOR TRANSACTIONAL LIABILITY INSURANCE

The impacts of the pandemic resulting from the coronavirus disease (COVID-19) have created unprecedented uncertainty and turbulence across the globe. Our highest priority – as a society, an industry, a company, and individuals – should be doing our part to stop the virus’s spread. But within the context of our work as Transactional Liability Insurance brokers at CAC Specialty, we will also continue to secure and execute the best possible risk-transfer solutions for our clients.

In this regard, the coronavirus is already a factor in the underwriting of representation & warranty insurance (“RWI”) and other M&A-related policies, and it’s important to understand the pandemic’s implications. Although we don’t yet know the end or even the middle of this story, we are writing now with some initial thoughts and observations, particularly with respect to the R&W insurance market.



INSURERS ARE ALREADY SEEKING TO EXCLUDE LOSSES ARISING FROM THE CORONAVIRUS PANDEMIC IN R&W POLICIES THAT ARE NOT YET BOUND.

R&W insurers have moved quickly to limit their exposure to coronavirus-related losses by proposing exclusionary language in initial quotes and final policies. For example, we are starting to see attempts to exclude all losses arising out of or resulting from the coronavirus and any resulting COVID-19 sickness, or any pandemic or epidemic disease outbreak relating to it. Some underwriters also propose specifically excluding supply-chain disruptions and business interruption. A few are approaching it with a more nuanced approach, just noting in their initial quotes that they need to better understand the impact of the coronavirus on the target business. We are generally advising clients to expect proposed exclusions if underwriting identifies particular coronavirus-related risks.

That said, we are working with underwriters to avoid such exclusions if at all possible and, when an exclusion is unavoidable, tailor it narrowly. The last thing we want is for a too-broadly worded exclusion to prevent coverage for losses that would have occurred, and been covered, in the absence of the pandemic.

COVID-19 AND SIMILAR PANDEMICS ARE LIKELY TO BECOME AN IMPORTANT PART OF R&W INSURERS' UNDERWRITING.

If there is no exclusion proposed at the outset, deal teams should be ready to answer questions in underwriting about diligence regarding the impact of this particular pandemic and similar future events. For example, insureds and their advisors should plan to conduct focused diligence in the following areas:

- ***Employee Safety.*** How is the target ensuring the safety and health of its employees? What is the target's policy regarding paying sick employees and encouraging sick employees to stay home? How is the target maintaining sanitary work conditions?
- ***Potential Future Business Interruptions / Closures.*** What diligence has been done to assess the likelihood and the economic impact of a pandemic related shutdown of the target? Is there a strong, tested business continuity plan? Can business continue with employees working remotely?
- ***Key Supplier and Customer Contract Breaches.*** How is the pandemic affecting any vital business supply chains? Could a supply chain disruption result the breach of a key customer contract? How strong are contracts with suppliers?
- ***Accounts Receivable Collectability.*** Has diligence been conducted to understand the risk to accounts receivable posed by a macroeconomic event such as a global pandemic that could impact a wide range of counterparties' ability to pay?

These are just examples and will vary by industry. Underwriters will be particularly cautious about risks in transactions involving public transportation, entertainment, healthcare and medical, retail, hospitality, education, and businesses heavily dependent on global supply chains. We are advising our clients through the underwriting process to limit or avoid exclusions resulting from these types of matters.



SOME TRANSACTION TIMELINES **WILL BE IMPACTED.**

Not surprisingly, some deal parties – especially those sensitive to negative market behavior – are pushing pause even on deals under LOI.

That said, many existing transactions are proceeding as normal. Physical diligence may be disrupted due to travel restrictions, but so much diligence is done electronically these days that, for many acquisitions, this just doesn't have a big impact. Slow-downs and logistical challenges will arise, however, and we expect extensions of exclusivity periods. We also expect underwriters to work with parties to facilitate these extensions, as well as new working arrangements and routines.

COMPETITION FOR FEWER DEALS COULD BENEFIT **INSUREDS IN THE SHORT TERM.**

Based on our conversations with a range of underwriters, submissions are still coming in, but at a slower pace; some buyers are taking a wait-and-see approach. Perhaps perceiving there are fewer deals to go around, some underwriters have recently offered aggressive terms in hopes of keeping the pipeline full as the dust continues to settle.

As a result, while we recently reported that rates were beginning to tick up slightly at the end of Q4 in 2019, some underwriters may offer lower pricing as the demand for R&W insurance decreases during this period of uncertainty. We predict this to be a short-term phenomenon.

THE PANDEMIC MAY REVEAL OTHER COVERED LOSSES **UNDER EXISTING R&W POLICIES.**

R&W insurance policies are designed to cover historical issues that were unknown by buyers and nonetheless result in breach of a rep and loss to the insured. In this sense, they generally are not intended to cover post-closing events (like a global pandemic) that might threaten a supply chain or a customer contract. CAC Specialty has published other materials analyzing the potential coverage insureds might find in, for example, a pollution legal liability policy.

But as Warren Buffet famously said, “Only when the tide goes out do you discover who's been swimming naked.” That same concept might apply to claims under R&W insurance policies. As the coronavirus pandemic creates a challenging business environment for companies recently acquired (i.e., the tide goes out), we imagine insureds will identify other problems with those companies that arise from breaches of reps and warranties and are thus covered by R&W insurance (i.e., the swimming-naked pieces of the business).

This could increase the already growing number of R&W insurance claims in the coming months, and will only increase pressure on both underwriting and premium costs. This makes it important to place risk with reliable insurers – and to work with a broker with the expertise to navigate claims.

We wish everyone health and safety as we navigate this unique time in market – and world – history. As M&A activity continues, we are happy to discuss these issues and work with you to secure leading R&W insurance coverage.

**Expanding what's possible for solving
risk challenges – from the simple
to the previously unsolvable.**

ABOUT CAC SPECIALTY

CAC Specialty is a risk solutions company of seasoned and proactive senior industry leaders, operating as a nimble and collaborative partner who puts you and your business first. With a knowledge-driven approach informed by data and decades of honed instinct, CAC Specialty brings an innovative vision to insurance broking and structured solutions to solve your risk challenges – from the simple to the previously unsolvable.

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