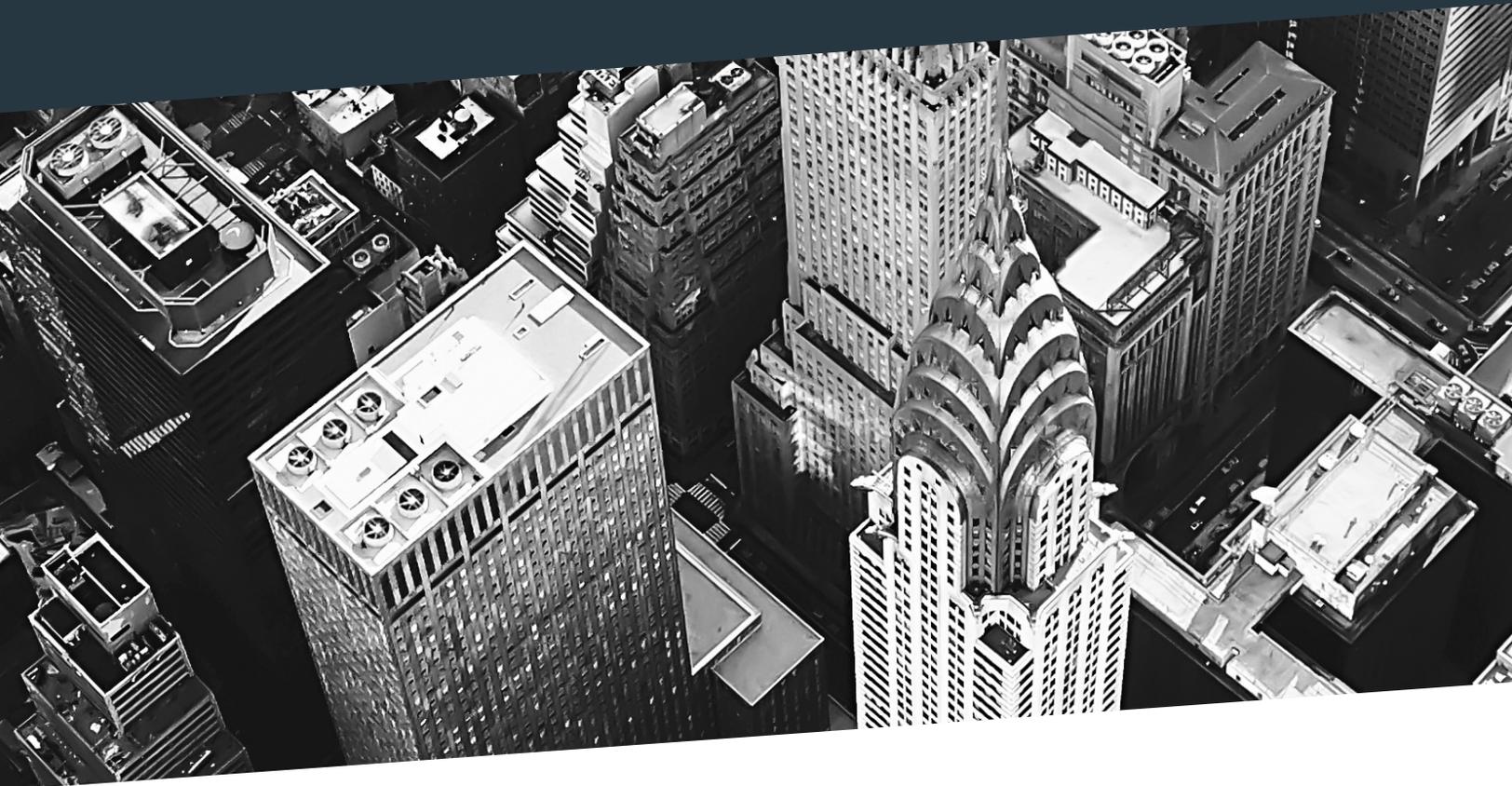




**REPRESENTATION & WARRANTY
INSURANCE MARKET UPDATE**

**QUARTER 2
2021**

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



The past year has been a roller coaster by any measure, and the Transactional Liability Insurance market was not immune to the COVID-19 pandemic's economic impacts. In short: after the bottom fell out, a record Q4 supported a strong finish – and the pace kept up through Q1 2021. Here, we review what we've learned and what we're watching for going forward.

RATES CLIMB HIGHER: BACK CLOSER TO HISTORICAL AVERAGES

Before mid-2020's extended slowdown in M&A, established insurers were citing a trend of more claims of greater severity to support pushing for higher rates. Then, when deals dried up for several months, rates briefly decreased as carriers scrambled for deals.

What no one saw coming was the sustained period of unprecedented demand that began toward the end of 2020 – and which largely continued through the first quarter of 2021. At the end of the year, rates dramatically increased, driven by historically high demand from a massive M&A rebound, and combined with relatively static supply. In Q1 2021, rates remained higher than a year ago as M&A charged full steam ahead, but rates on line (i.e., premium divided by limits) quoted for most mid-market transactions have settled back into the low-3% range (with exceptions depending on various factors).

Astute observers acknowledge that while these rates may be high compared to 2019, they are merely back to where they were in the 2013-16 time frame. ***Very recent history's low-rate environment may turn out to be the outlier; we're now closer to average rates than to historically high rates.*** Moreover, the percentage increases in rates come in the context of – and have been supported by – a broader hard market in insurance and are small compared to (for example) recent increases in directors and officers, cyber, and property/casualty insurance rates.

INSURERS GATHER AND IMPLEMENT LESSONS FROM CLAIMS DATA AND EXPERIENCES

Insurance underwriters generally report that R&W insurance claims are significant, tough to correlate, and arise from a variety of types of breaches. Multiple large insurers say they have paid hundreds of millions of dollars in claims over one to two years. As this data builds, crunching it and applying the results will lead to more data-driven underwriting, compared to instinct-driven underwriting.

One takeaway is that claims are in large part industry-agnostic, with the possible exception of healthcare, an industry where some underwriters have experienced disproportionate claims (although not all underwriters agree that healthcare deals carry higher risk). Indeed, the market for R&W insurance coverage for healthcare transactions remains smaller than for most industries – but even then, rarely is there a healthcare deal where sound R&W insurance coverage is not available.

The data also show that **financial-statements representations continue to be the source of both the largest and the most contentious claims**. There are several reasons for this, including (a) financial-statements representations are made with respect to a wider window of time; (b) more people are involved with the analysis of financial-statement breaches, including accountants, forensic accountants, tax advisors, etc.; and (c) when a large multiple applies to a financial-statements breach, it can be especially challenging to make the buyer whole. To be sure, insurers are paying claims on financial-statements breaches, including claims based on multiples, but arriving at a fair valuation and damages amount can be tricky and requires significant work from all parties involved.

This same claims data, combined with insurers' growing underwriting experience, are starting to provide concrete grounds for underwriters to tailor their appetite in an effort to sustain long-term profitability. **More and more often, this takes the form of proposed "for policy purposes" edits to the covered representations and warranties**, which are becoming more nuanced.

As underwriters gain sophistication, so do insureds; **we're seeing a stronger focus from insurance buyers on coverage and policy language** – and on negotiating "for policy purposes" edits at the quoting stage – rather than selecting an underwriter based on small pricing differences.

INNOVATORS SEEK TO CHALLENGE THE STATUS QUO

Investment is flowing into the R&W insurance market. **New insurers and underwriters continue to launch and build teams, each with its own ideas on how to manage a book of business to profitability**. Broker and underwriter disruption at the corporate level (e.g., from M&A activity within the insurance industry) is dislodging professionals and kicking off a persistent game of musical chairs that threatens long-established players' status in the market. Transactional Liability underwriting groups are hiring from outside the industry, including specifically to supplement and diversify R&W insurance premium by expanding into tax and contingent risk.

In sum, as the industry evolves and matures, all participants in a R&W insurance placement – buyers/insureds, underwriters, lawyers, and brokers – are becoming more sophisticated and nuanced in negotiating coverage. This is flowing through to initial quotes and policy language, and will have a material impact on the next wave of claims. Further, in a market where supply trails far behind demand, relationships matter. Underwriters can say "no" to any deal for any reason, **and insureds and brokers who don't deal fairly and haven't built strong relationships with the 20+ R&W insurance underwriters are likely to be left in the cold**.

All of this points to an exciting 2021, with many changes ahead, and much that remains to be seen. We are watching closely these developments and how they impact our clients.

At CAC Specialty, we deliver technical expertise and deep market relationships with a white-glove level of service. We would welcome the opportunity to discuss any of these developments with you, and we appreciate your support!





ABOUT CAC SPECIALTY

CAC Specialty is the fastest growing U.S. insurance broker and the employer of choice for top industry talent drawn by the desire to serve clients from a client-centric platform. We benefit from having the ability to hand-select our team to build this business, and our team brings senior-level experience from law, investment banking, and insurance underwriting, as well as from large brokers – all of which is particularly important in current hard-market conditions.

We have earned the trust of sophisticated clients and companies across the Fortune 1000, other large corporations, SMEs, private equity, and other alternative fund managers.

Our philosophy of personal service and attention to individual needs, with our clients at the core, differentiates us in the marketplace. Throughout the entire process, we never lose sight of the fact that our clients come first. We believe each solution is as unique as the company for which it is provided.

ABOUT OUR REPRESENTATION & WARRANTY INSURANCE TEAM

Our TL team has experience practicing law at King & Spalding, Simpson Thacher, Willkie Farr, and in-house at Chevron; advising on tax M&A at PwC; clerking on two U.S. Courts of Appeal; and underwriting at Concord Specialty Risk (a leading transactional-insurance underwriter).

Where material “known” issues are identified in underwriting, our RWI, tax, and contingent risk specialists (as applicable) work hand in hand to propose risk-transfer solutions to take those issues off the table. Our approach to creatively addressing known risks when they arise has allowed parties to close deals that otherwise would have died.

When claims arise, we advocate for coverage. Our claims specialists have helped clients recover billions of dollars in financial-lines insurance claims, and we bring that experience and our market relationships to bear in helping achieve the best possible resolution of any claim.

Your deal is our first priority. As a boutique, specialist broker, we go farther and strive harder to add value for our clients. We integrate ourselves into deal teams, dig into documents, and seek to transfer the maximum amount of risk away from the deal parties, at the best possible cost.



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