TRANSACTION LIABILITY

MARKET UPDATE 2024

THE AMERICAS

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THE RWI LANDSCAPE

While many prognosticators had anticipated a sharp increase in deal-making for 2024, such rebound was muted due to a challenging macroeconomic environment, as regulatory and geopolitical headwinds persisted. M&A volume remains well below the peaks of 2021, but we have seen green shoots of elevated activity and are cautiously optimistic this year's positive momentum will carry into 2025.

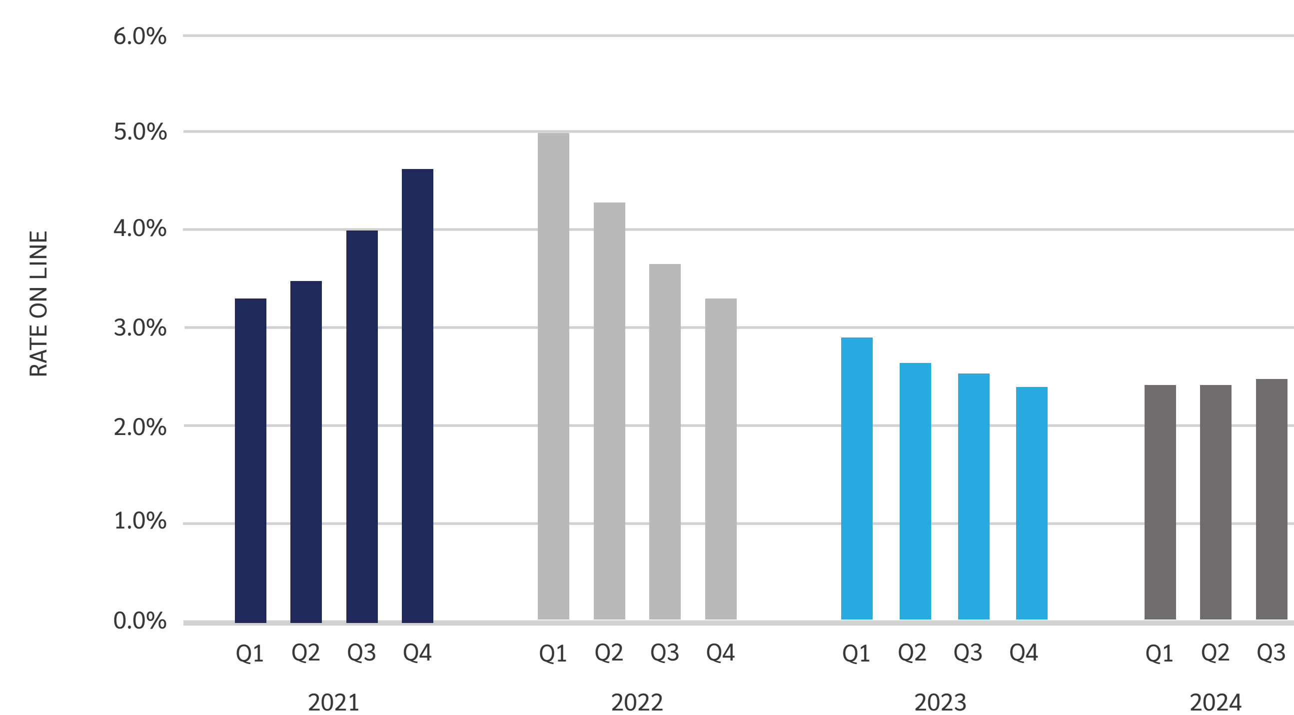
The slower M&A recovery, combined with significant representations & warranties insurance ("RWI") carrier resources and capacity, has led to some of the lowest rates in the history of the RWI market. While premiums continued to fall in the first half of 2024, an incremental uptick in M&A activity, coupled with increased carrier pressure on insurance pricing, seems to have caused the market to harden slightly, though still far from the highs of early 2022.

LOW, BUT INCREASING PREMIUMS

Given the competitive and crowded nature of the RWI landscape, other RWI terms continue to be insured-favorable, including lower initial and drop-down retentions, fewer deal-specific exclusions, and limited modifications to underlying representations and warranties in purchase agreements.

Current average premium rates range between 2.3% and 2.7% rate on line depending on size, sector, and transaction complexity. Notably, there appears to be an increasing spread between markets, with some carriers charging a higher premium while looking to differentiate on other terms, such as retentions, gross-up coverage, or extended policy periods, and highlighting essential soft factors, such as exceptional claims servicing. The chart below illustrates the latest trend in rates.

AVERAGE RATE ON LINE BY QUARTER (Q1 2021- Q3 2024)



THE RWI LANDSCAPE

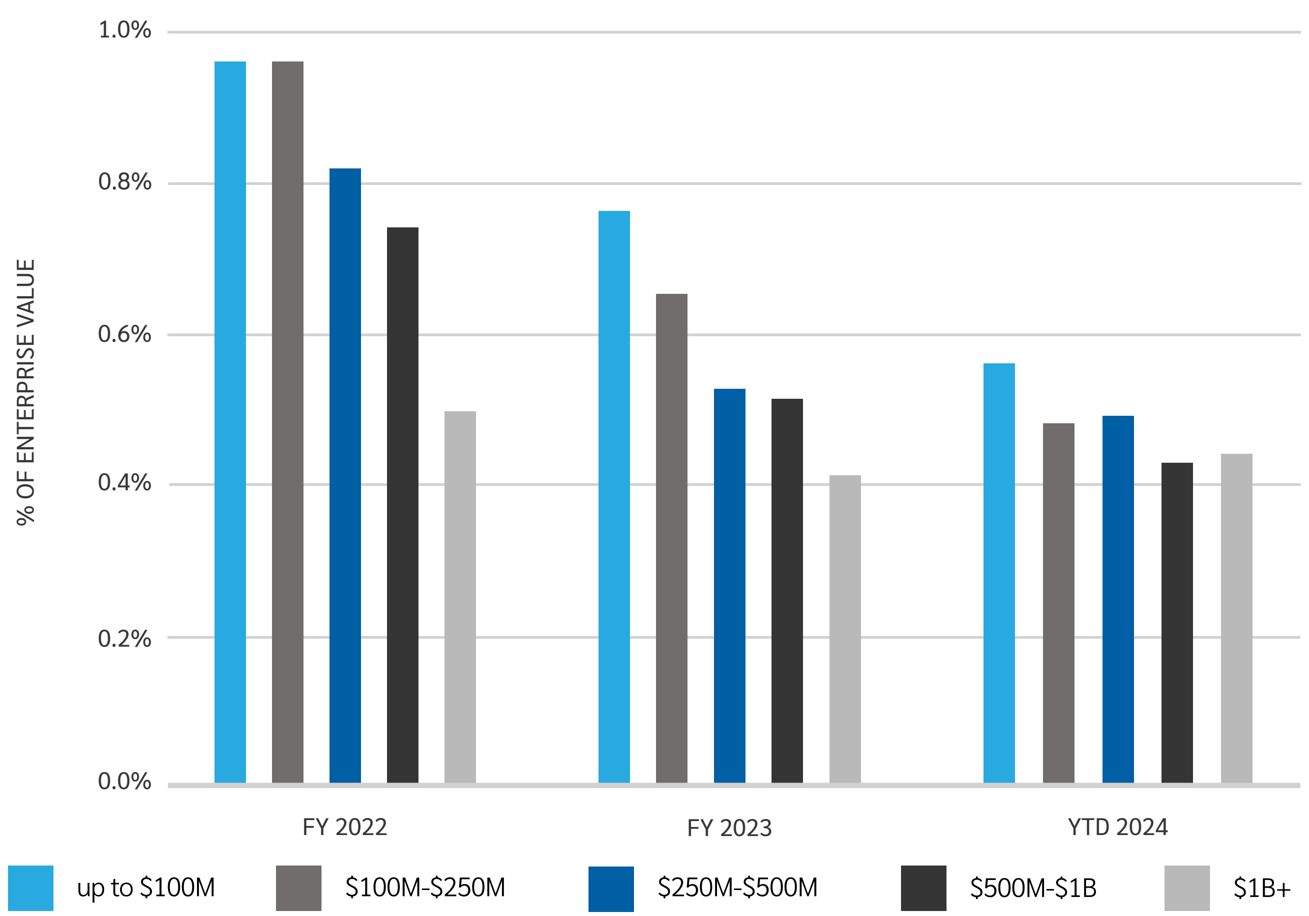
STABILIZED, LOWER RETENTIONS

While pricing appears to be modestly on the rise, retention levels seem to have stabilized across transactions, regardless of deal size (with limited exceptions). In last year's report, we highlighted that carriers were offering retentions below 1.0% of enterprise value ("EV") and becoming more aggressive with initial retentions approaching 0.60%-0.80% of EV. In 2024, initial retentions largely seem to have crystallized between 0.50%-0.75% of EV for the initial retention and 0.30%-0.45% of EV for the drop-down retention.

Although premium pricing can vary based on the ebb and flow of deal activity, retentions show signs of stabilizing at these lower levels. Certain carriers also have been offering nil retentions for "true" fundamental representations and warranties as a way of differentiating their terms from competitors, although interpretation of what constitutes a "true" fundamental representation varies from market to market.

The chart below reflects the steady drop in retention levels since 2022, with signs of leveling off in 2024.

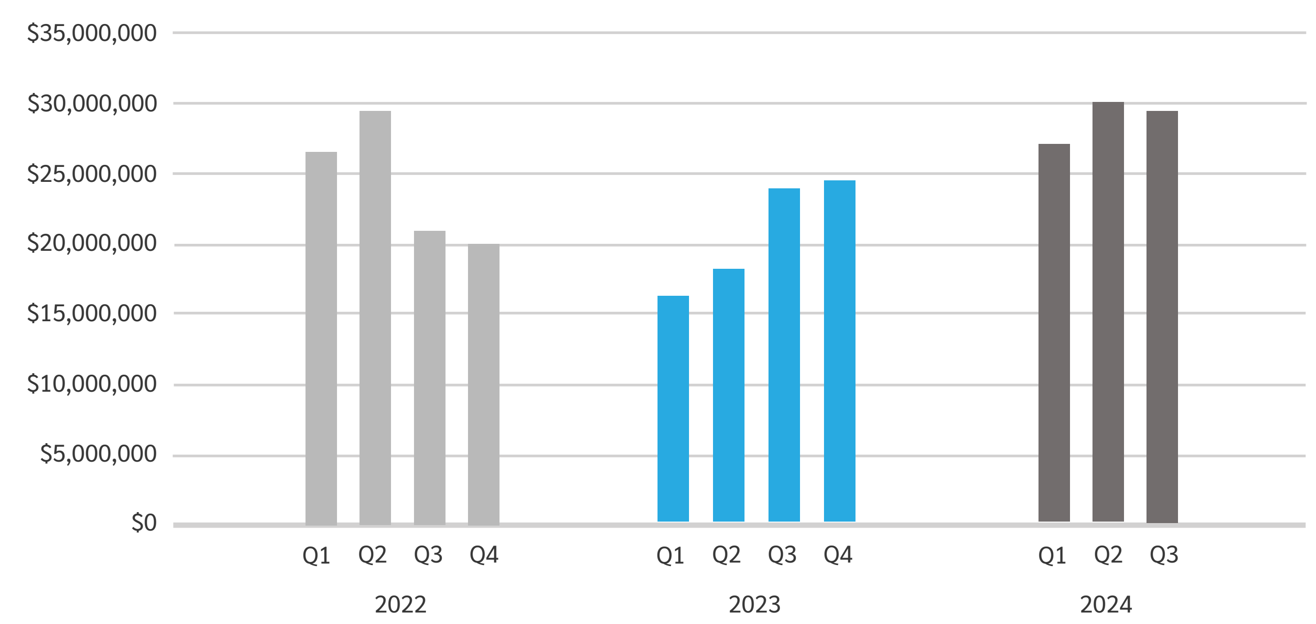
INITIAL RETENTION BY ENTERPRISE VALUE THROUGH YTD 2024



INCREASING DEAL SIZE & LIMITS PURCHASED

The aggregate deal value through Q3 2024 increased over the same period in the prior year, demonstrating an expanded buyer interest in larger deals. This trend has also carried over to RWI policies, with an increase in the average total limit placed as illustrated by the chart below. While private equity sponsors had shifted their focus to add-on acquisitions in a tightened debt financing environment, we are starting to see signs of an increased appetite for larger platform acquisitions, which is helping drive up deal size and a corresponding increase in limits purchased.

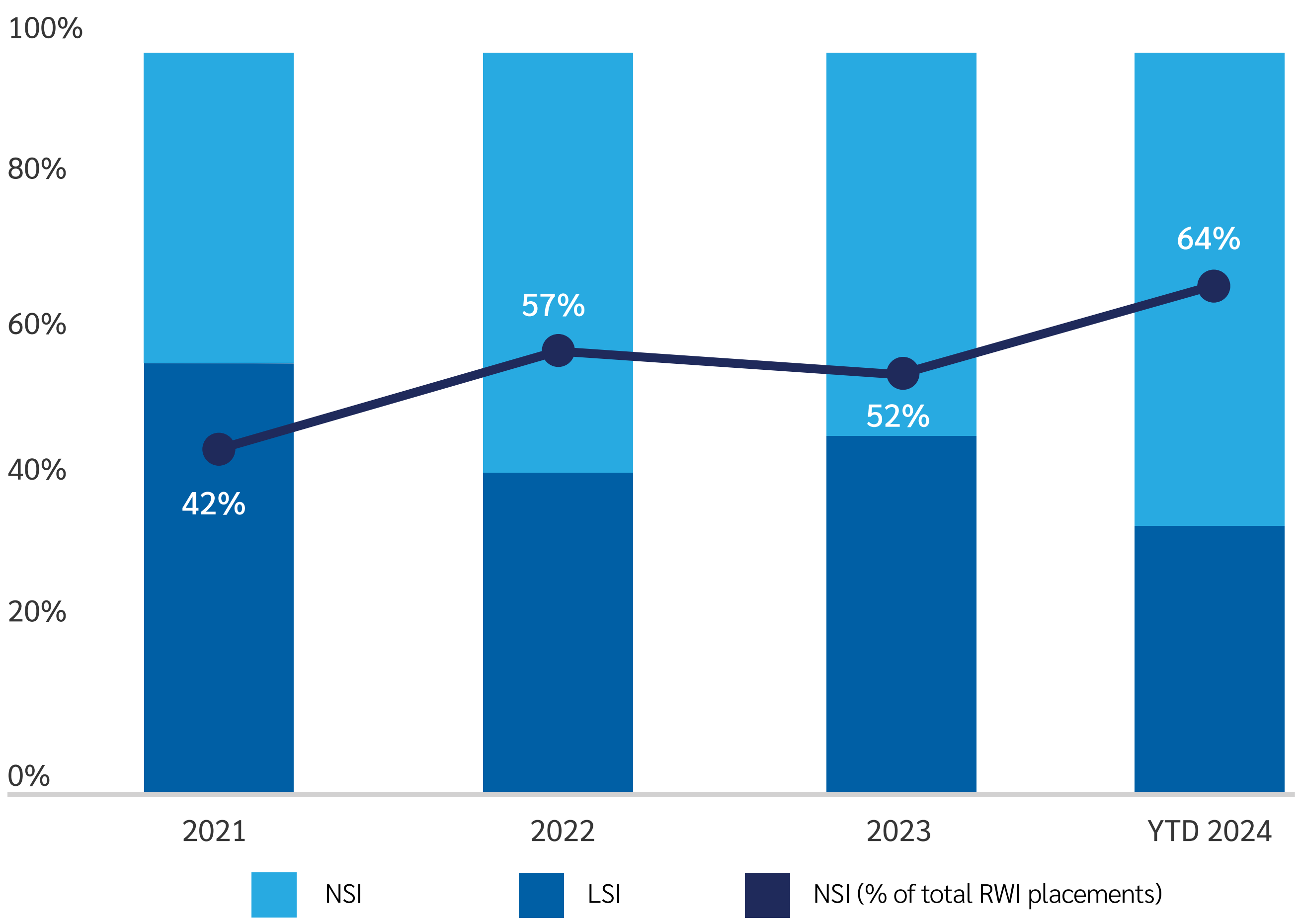
AVERAGE LIMIT SIZE BOUND BY QUARTER (Q1 2022- Q3 2024)



PUBLIC STYLE EXITS ARE AGAIN THE MARKET EXPECTATION

After a slight decrease last year in the use of public-style, "no seller indemnity" ("NSI") deal structures, whereby buyers have no recourse against sellers for breaches of general representations and warranties (except in the case of fraud), the use of NSI structures is increasing again as illustrated in the chart below.

AVERAGE LIMIT SIZE BOUND THROUGH YTD 2024



An estimated 64% of our placements in 2024 reflected an NSI construct, which is meaningfully higher than historic levels. The frequent use of an NSI structure, even in a buyer-friendly environment, is likely attributable to the familiarity clients have with the RWI product and process, along with carriers' increasing comfort with underwriting to an NSI standard.

While carriers once attributed meaningful value to sellers retaining some exposure as demonstrated by a lower premium or retention for such structures, along with the maturation of the market, carriers are attributing less value to such "limited seller indemnity" ("LSI") deals, and in some cases, offering the same pricing regardless of whether or not the seller bears a portion of the retention.

LATIN AMERICAN EXPANSION

We continue to see healthy market appetite for transactions utilizing RWI in the Latin American market, as regional buyers and sellers have become more comfortable with the product, and carriers continue to expand their jurisdictional appetites. Common jurisdictions for target's operations include, but are not limited to, Brazil, Chile, Colombia, and Mexico. While the RWI market is typically willing to consider any transaction on a case-by-case basis, each carrier has its own defined appetite in a specified region, taking into account factors such as the jurisdiction of the named insured, governing law of the transaction agreement, deal size, and industry.

Recognizing the increased level of deal activity in the region, we recently expanded our M&A advisory capabilities in Latin America to include a dedicated Brazil-based team. This unit works in full coordination with our broader US team to provide our clients with additional ground support for RWI placements in Latin America, South America, and the Caribbean.

SECONDARIES

The first half of 2024 carried the momentum of the prior year, and saw record-breaking secondary market volume, surpassing the prior record set in the first half of 2022. In the fourth quarter of 2024, momentum slowed slightly heading into the United States presidential election, but activity has resumed for an active year-end. We continue to maintain approximately 60% of the market share on GP-led and other secondaries transactions, and we have structured and placed insurance on approximately 15-20% of the net asset value ("NAV")/new money that has traded hands in GP-led deals.

As the RWI market for GP-led secondaries continues to mature, so does the appetite of insurance carriers to participate in secondaries transactions. Many of the RWI insurance carriers who participate in buyout M&A RWI placements have made concerted efforts to understand the secondaries space, with a substantial majority of current market capacity now actively competing on GP-led deals. These carriers have honed their analysis of the risks associated with secondaries transactions to underwrite them effectively and, as a result, clients have benefited from a competitive marketplace with increasingly insured-friendly terms.

A notable evolution of the secondaries market over the course of 2024 is the myriad of transactions that are being categorized under the umbrella of a "secondary" transaction, and for which RWI may be placed. In addition to a typical single asset or multi-asset continuation vehicle ("CV"), we are seeing:

1. multi-asset deals from different flagship fund vintages being placed in a single CV;
2. public-to-private transactions, both SPAC and traditional public companies, in which there is an investor cash-out option;
3. LP transfer deals, including ECI and FIRPTA tax coverage in connection with these LP to LP trades;
4. asset(s) being placed in a CV early in a fund's term; and
5. credit fund, infrastructure and venture fund secondaries.

While there is some correlation between the secondaries market and the broader M&A market, we believe the secondaries market stands on its own as a resilient piece of the broader private markets landscape. Fifteen years ago, pundits predicted that the LP-LP secondaries market would fade as we recovered from the Global Financial Crisis, but were proven wrong—we believe the same to be true with respect to current cautionary whispers around a slowdown in GP-led secondaries when M&A activity returns with fervor.

The maturation of the secondaries market has shown GPs and investors that these strategies should remain a vital tool for managing capital and liquidity, and the aperture of the secondaries market will continue to expand.

CLAIMS ANALYSIS

To date, Lockton insureds have recovered more than half a billion dollars (approximately $560 million) to resolve RWI claims. Of that amount, more than $280 million was paid within the last two years. When accounting for retentions, RWI insurers have recognized loss to Lockton insureds to date in excess of $710 million.

SINCE WE BEGAN TRACKING RWI CLAIM METRICS:

30%
REMAIN ACTIVE

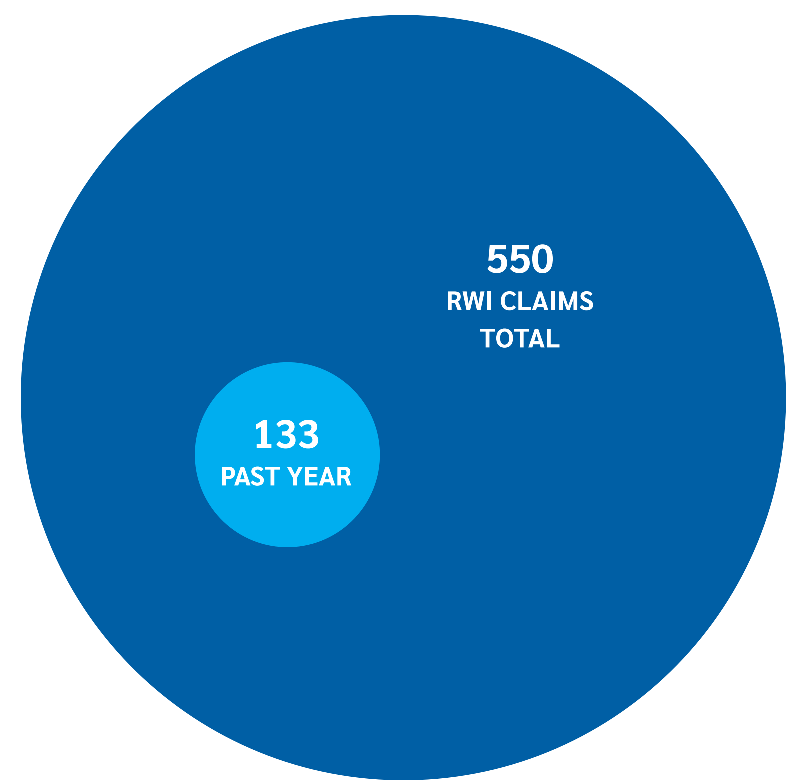
23%
HAVE RESULTED IN A PAYMENT IN EXCESS OF THE RETENTION

2%
WERE DENIED

22%
SETTLED WITHIN THE RETENTION OR WERE HELD IN ABEYANCE BY AGREEMENT OF THE PARTIES*

23%
WERE WITHDRAWN OR INACTIVE

*(OFTEN BECAUSE LOSS IS WELL WITHIN THE RETENTION) SUBJECT TO A MUTUAL RESERVATION OF RIGHTS



In total, our clients have submitted more than 550 RWI claims, including 133 within the past 12 months.

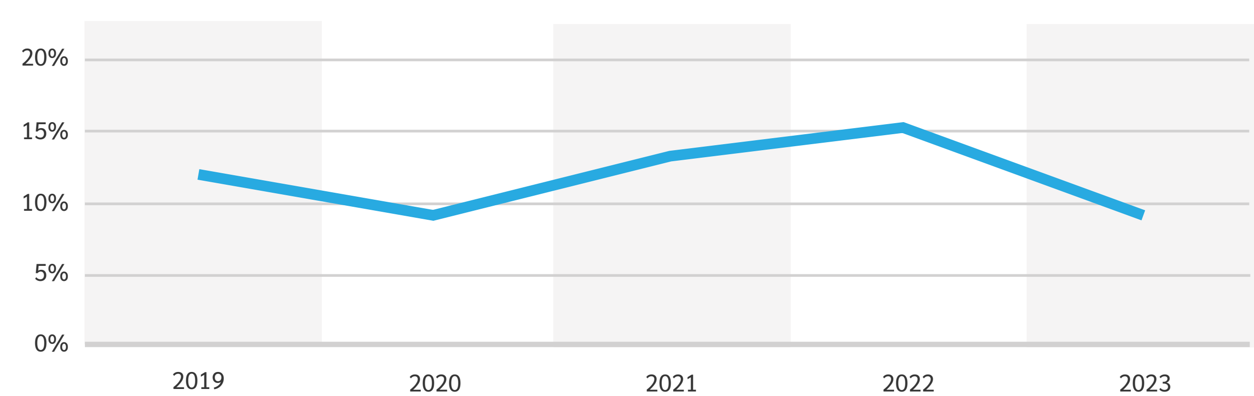
While denials of RWI claims remain exceedingly rare, the approximate 2% denial rate is actually artificially high.

In particular, some acquisition agreements require the buyer to make a good faith effort to seek recovery for loss incurred by a breach under the RWI policy before being entitled to alternative relief, even if a claim fits squarely within a policy exclusion. Accordingly, RWI claims will occasionally be submitted as an administrative exercise, with the full expectation that a denial will be forthcoming. Most of the denials to date fall within this bucket, making contested denials exceptionally rare.

CLAIM FREQUENCY ON THE RISE

The chart below illustrates the percentage of policies placed each year from 2019 through 2023 for which at least one claim notice was submitted. For policies placed in 2019 and 2020, coverage for the general representations (typically three years) has expired, and we therefore assume that most of the claims that will be made on those policies have been submitted. However, data for policies placed since 2021 is less mature, as there is still time for additional claims to be submitted; accordingly, percentages of claims for those years will inevitably increase.

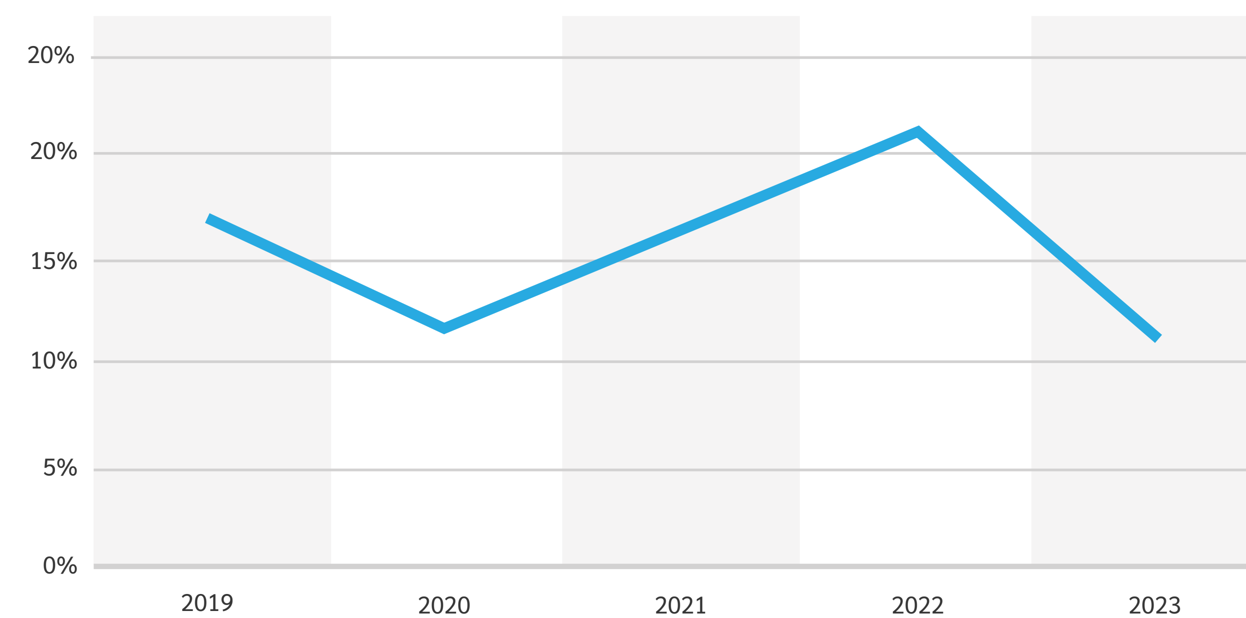
CLAIM FREQUENCY -- AT LEAST ONE CLAIM SUBMITTED PER POLICY



As noted, the foregoing figures reflect percentages of policies where at least one claim was submitted. In other words, there is no differentiation between a policy under which one claim is submitted and one in which two or more claims are submitted.

Obviously, figures increase when we look at true frequency, which is measured by taking the total number of claims submitted arising out of policies issued in a given calendar year and dividing that figure by the total number of policies issued in that year, as illustrated in the chart below.

CLAIM FREQUENCY -- TOTAL CLAIMS SUBMITTED DIVIDED BY POLICIES PLACED



Claim frequency is unquestionably on the rise, as approximately 15% of policies placed by us in 2022 have already received at least one claim, and true frequency for that policy year is already slightly over 20%. Because there is still at least one year left for insureds to bring claims for breaches of general representations under those policies, the figures we are currently reporting for those 2022 vintage policies will inevitably increase.

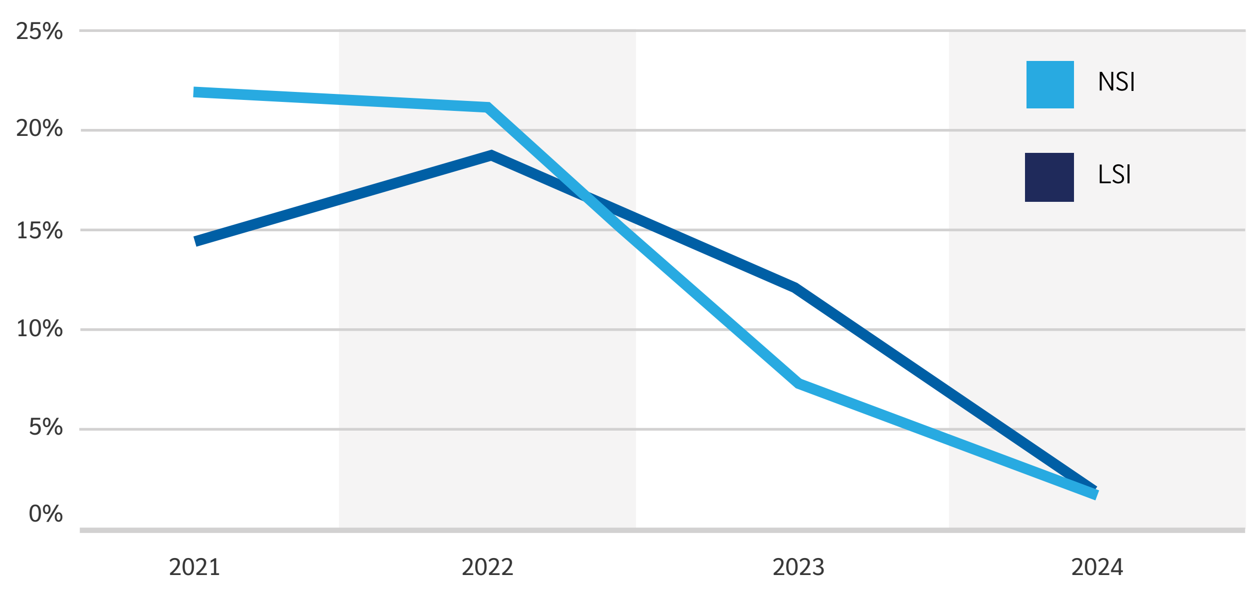
CLAIMS ANALYSIS

As noted above, deals with NSI structures are progressively increasing in popularity, accounting for 64% of deals placed in 2024, up from 42% in 2021. Carriers are attributing less value to sellers having "skin in the game," likely driven by analysis of claims data, which reflects negligible variance in risk between LSI and NSI structures.

Our data paints a similar picture; the chart below compares the percentage of policies placed with LSI structures versus NSI structures each year from 2019 through 2023 for which at least one claim notice was submitted.

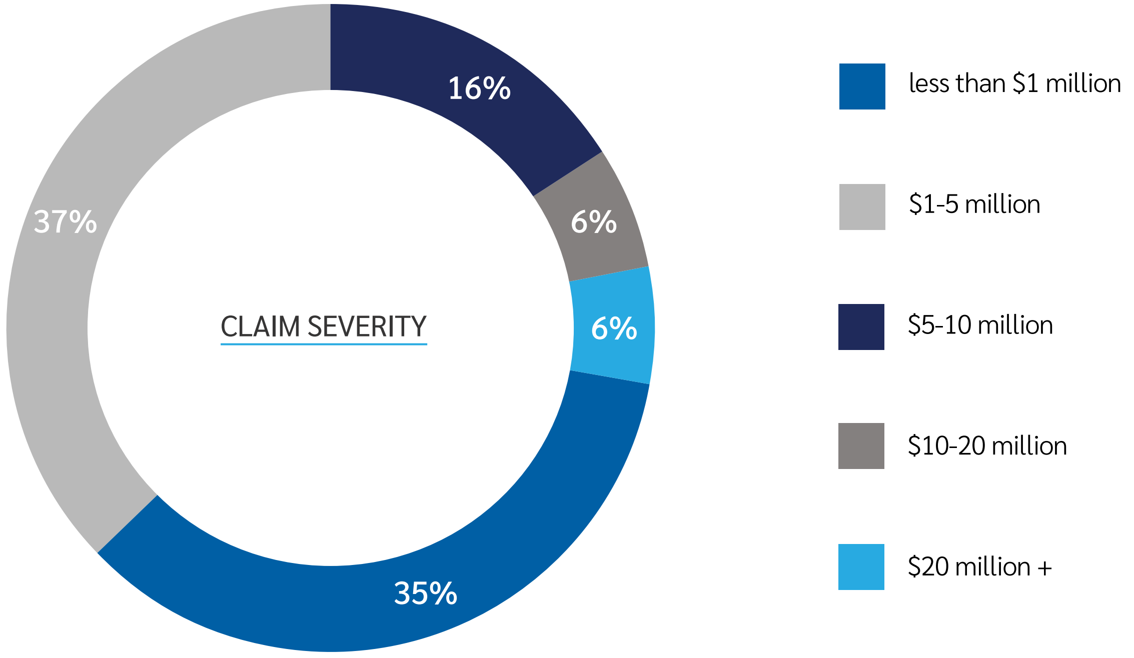
As shown below, while claim frequency figures for NSI were slightly higher than those for LSI deals in 2021 and 2022, the graph actually flipped in 2023, with higher frequency for LSI deals than for NSI deals. Though immature, data for 2024 shows a statistically identical frequency for LSI vs. NSI deals.

NSI V. LSI CLAIM FREQUENCY



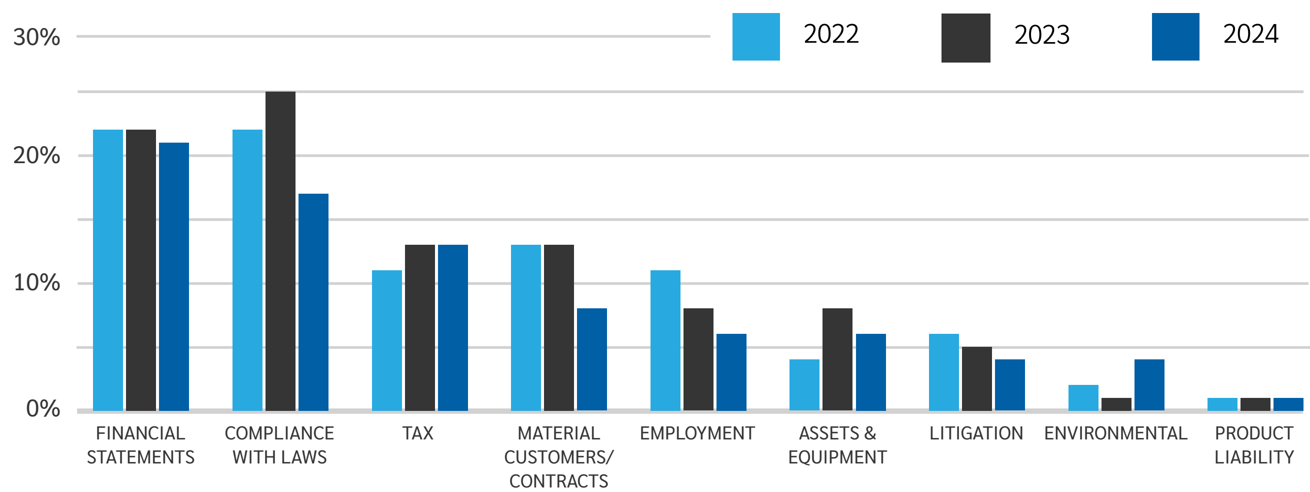
CLAIM SEVERITY ON THE RISE

With respect to severity, small and medium-sized payments represent the majority of the number of claim payments, with payments of less than $5 million representing more than 70% of the total number of payments made. However, we continue to see very large payments as well, with 12% of the total number of claim payments exceeding $10 million. We're also seeing a trend of increasing severity; whereas that 12% figure reflects claim payments made to our clients since we began collecting data, 18% of the number of claim payments made in 2023 exceeded $10 million.



TYPES OF BREACHES

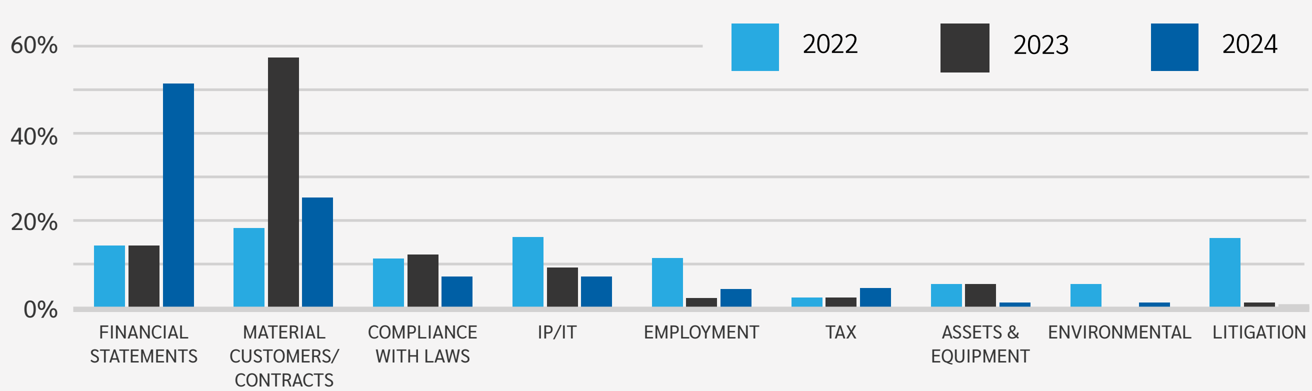
PERCENTAGE OF CLAIMS FILED BY BREACH TYPE (2022 THROUGH Q3 2024)



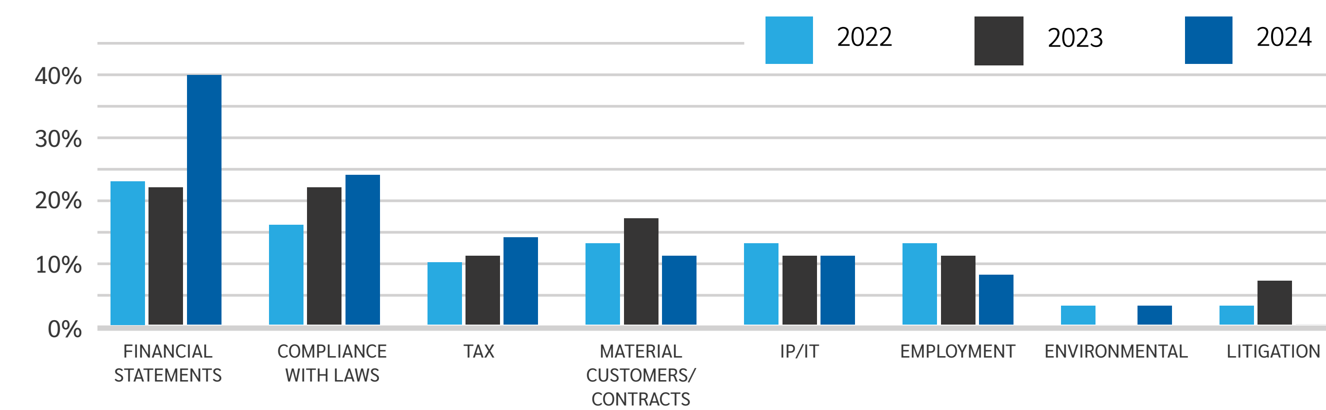
The chart above illustrates the percentage of claims filed by breach type broken down by the calendar year in which the claims were filed. As a general matter, the percentage of claims filed by breach type has remained relatively consistent over the past three years. Breaches of the financial statements representation are the most frequently reported claims, accounting for more than 20% of all 2024 notifications. Additionally, breaches of the compliance with laws and tax representations continue to rank among the top three in terms of frequency.

Of course, the 2024 percentages are subject to change as Q4 numbers are accounted for, but there are also a couple different trends to note at this juncture. Specifically, breaches of the material customer and/or material contract representations declined this past year; such breaches accounted for 13% of all claims filed in 2022 and 2023 but are currently down to 8% of submissions in 2024. Also, there has been a slight uptick in claims asserting a breach of the environmental representations, up from 1% in 2023 to 4% in 2024.

PERCENTAGE OF AMOUNTS PAID (NET OF RETENTION) BY BREACH TYPE (2022 THROUGH Q3 2024)



PERCENTAGE OF NUMBER OF CLAIMS PAID (BY NUMBER) (2022 THROUGH Q3 2024)



The chart above illustrates the percentage of number of claims paid by breach type, net of retention, broken down by the calendar year in which the claims were filed. The percentages of claims paid by breach type generally track the frequency of claims filed by breach type, though there are a few notable exceptions.

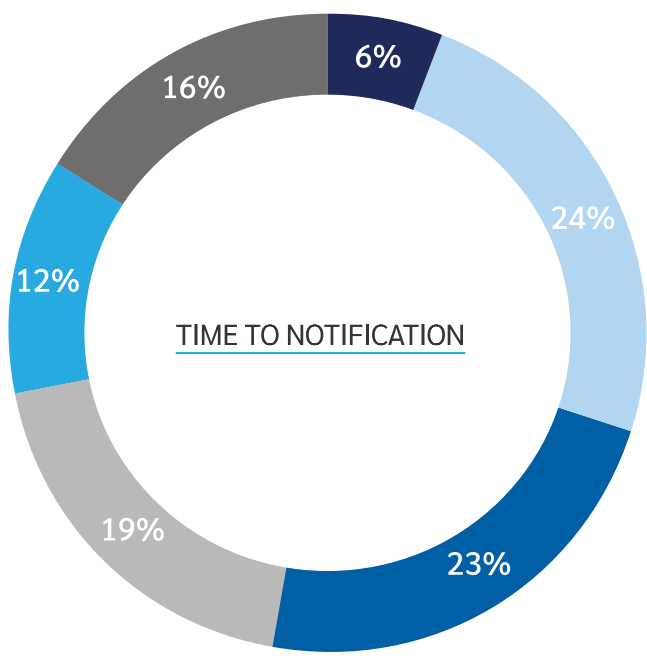
As in past years, the most frequently paid claim by breach type is the financial statements representation, accounting for 40% of the number of claims paid by breach type, despite hovering around 20% of claims notified in the past three years. Claims alleging breach of the compliance with laws and tax representations also represent significant percentages of the overall number of payments made by breach type, with the top three categories constituting over 75% of all payments made.

The chart to the left illustrates the percentage of amounts paid by breach type, net of retention, broken down by the calendar year in which the claims were filed. Consistent with prior years, alleged breaches of the financial statements representation account for the largest amount of claims paid as well, representing more than 50% of the claim payments made through Q3 2024. Although there was a slight decline in the frequency of material customer/contracts claims being made, breaches of that representation still account for a sizable percentage of overall claim payments as well, at about 25% of the total payments made in 2024.

Also worth noting, although claims alleging a breach of the tax representation account for 12-13% of claims filed and paid, they make up just 4% of the amount of claims paid. Indeed, the biggest payment on a single tax claim in 2024 was $1.9 million, whereas there were several payments above $25 million made in connection with breaches of the financial statements and material customer/contract representations.

TIMING CONSIDERATIONS

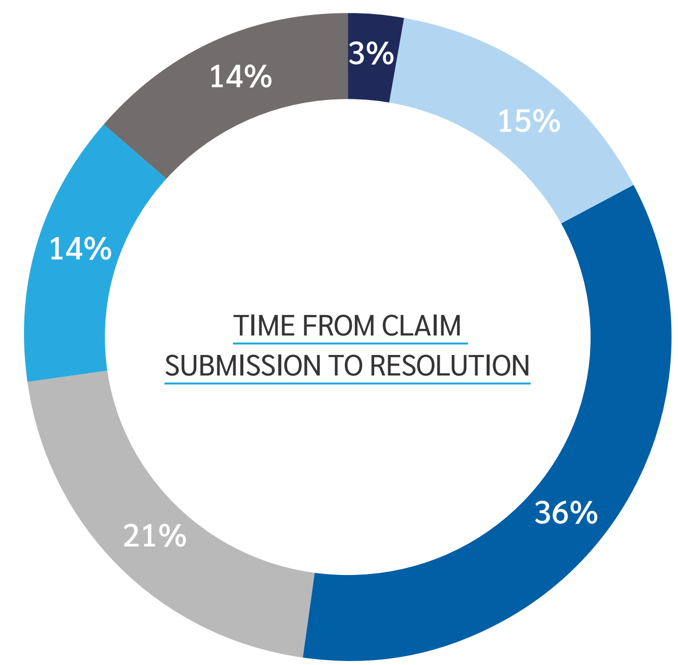
The chart below shows the time between policy inception and claim notification for all claims that have been noticed arising out of policies issued prior to September 30, 2021 (that is, policies for which the general representations period has expired).



Consistent with industry averages and expectations, nearly half of claims are notified within 12 months of policy inception, and nearly 75% of claims are submitted within the first two years of policy issuance. Although 6% of claims are notified after 36 months, most of those claims involved deals with a split signing and closing, such that the general representation extended beyond three years of the inception of the policy. Notifications of claims pertaining to the coverage following the expiration of the general representations coverage period continue to be exceptionally rare.

CLAIM RESOLUTIONS

The chart below illustrates the time from claim notification to resolution with respect to all claim payments made to date. We intentionally have not included closed claims with no payment because, as noted above, nearly 45% of closed claims were closed following a period of inactivity or deferral. Disregarding inactive and deferred claims thus yields a more useful analysis. The figures below do, however, include third-party claims, but we note that third-party claims, which typically cannot be resolved until the underlying matter is settled or concluded, often take longer to resolve than first-party claims.



With respect to claims for which payments have been made, more than 50% have been resolved and paid within 12 months of notification, and the large majority --around 70%-- have been resolved and paid within 18 months of notification. The most significant variables impacting the timeline to claim resolution remain claim complexity and responsiveness of the Insured to insurer information requests.

Carriers typically appreciate the importance of efficient claims resolutions and are staffed with attorneys willing to work with insureds to minimize burden and intrusion, but the claim process nevertheless can be time-consuming, particularly on claims that may require a forensic accounting analysis.

To maximize the chances of a smooth and efficient process, we encourage our clients to partner with insurers early in the claim process and to promptly provide reasonably requested information, so insurers are properly equipped to make coverage determinations.

2024 SUCCESS STORIES

01
FINANCIAL STATEMENT MISREPRESENTATION

- Post-Closing, the Insured discovered that the Company had failed to credit certain prepaid expenses to the balance sheet and to record those expenses on the income statement as final goods were delivered to customers. As a result, over time, the prepaid expense balance became inflated, and the expenses on the income statement were significantly understated.
- Following productions of relevant information to the RWI carrier and its advisors, the carrier validated the full amount of the Loss, which was based on a multiple of EBITDA, and made a $22.6 million payment less than 12 months after the claim was submitted.

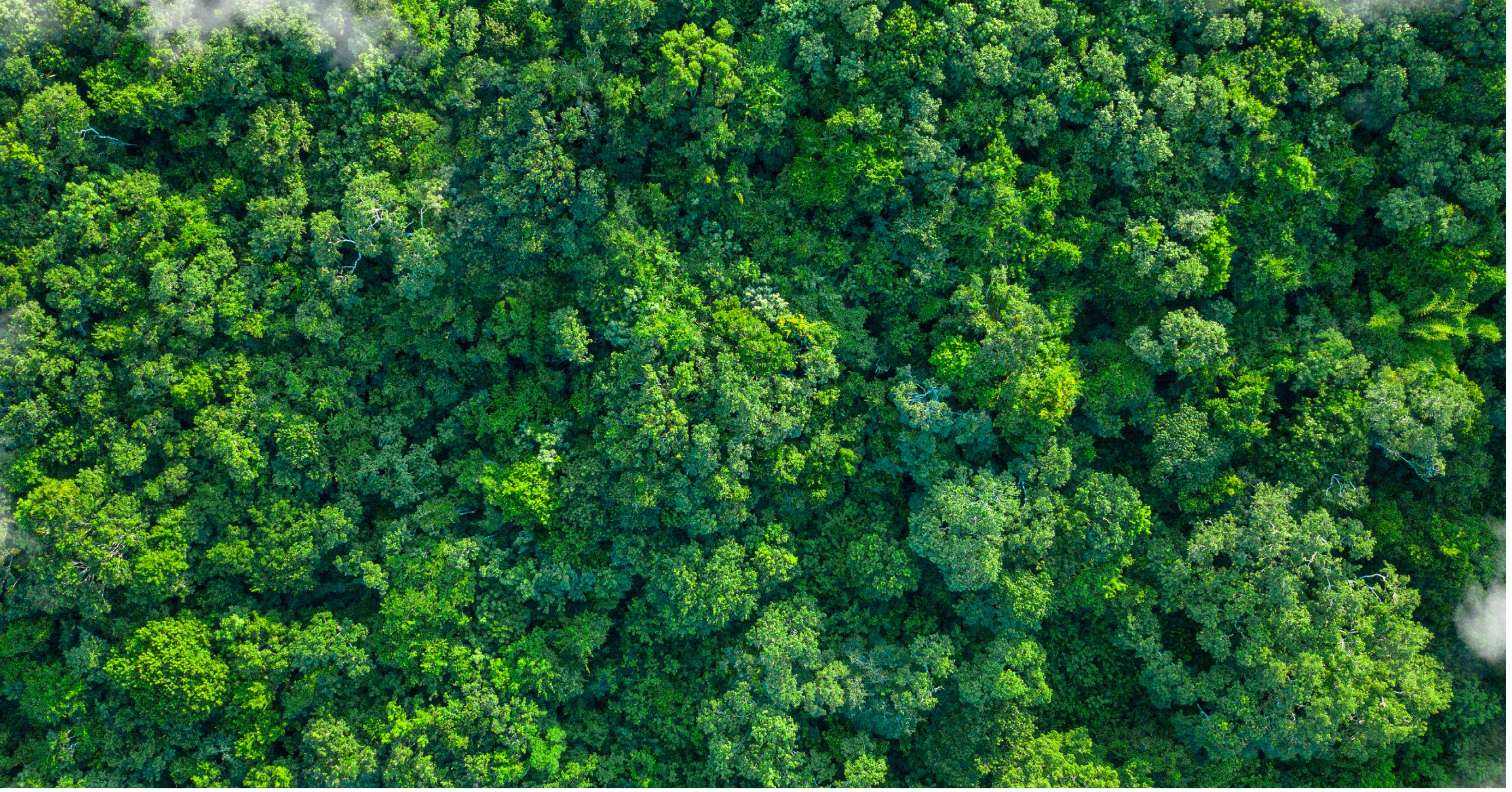
02
TAX MISREPRESENTATION

- Post-Closing, the IRS assessed the Company a penalty for failing to have an ACA compliant healthcare plan.
- The claim was validated and paid by the RWI carrier less than six weeks after it was submitted.

03
THIRD-PARTY CLAIM / IT

- A pre-Closing data breach resulted in several post-Closing lawsuits filed against the Company arising out of the disclosure of personal identifiable information. The lawsuits were consolidated and litigated for several years.
- The Company's cyber insurer initially indicated that its policy would respond, but back-tracked midway through the underlying lawsuit. The RWI insurer maintained that its policy should sit excess over the cyber policy, but, working collaboratively with Lockton and the insured, agreed to make a significant contribution to the $7 million settlement amount reached with the third-party plaintiff.

CLAIMS ANALYSIS



OVERVIEW OF THE TAX INSURANCE MARKET

Tax insurance addresses identified tax risks whereby the insurance markets provide a financial guarantee of a particular tax result in return for a fixed upfront premium payment. It has been most often used to protect against tax risks identified in the context of M&A transactions and renewable energy tax credits. More recently, tax insurance has expanded to address a broad array of tax risks, including internal transactions, transfer pricing and valuations. Tax insurance policies have been secured by publicly traded and private companies, private equity firms and their portfolio companies, estate planners, and individual taxpayers.

RENEWABLE ENERGY CREDITS DOMINATE THE TAX INSURANCE MARKET

According to the data we collected in connection with our inaugural renewable energy tax credit survey (the "Survey"), published in October 2024, the number of renewable energy credit tax insurance policies bound in the first half of 2024 exceeded the number of similar policies bound in all of 2023 by more than 30%. There has been a significant increase in full scope insurance coverage for the acquisition of renewable energy tax credits, as well as an increase in "hybrid" policies, which are bound by tax equity investors or developers who intend to utilize a portion of the credits generated and transfer others. The survey can be found here.

The investment tax credit ("ITC") market continues to dominate the transferable tax credit market, but there have been several large transfers of production tax credits ("PTCs") as well. Several pieces of new guidance have been released to help taxpayers and their advisors better understand and implement renewable energy tax credit transactions, which has served as a catalyst for such deal activity. For example, in May 2024, Treasury released Notice 2024-41, which provided the option to use a safe harbor table that provides percentages for different components that can be utilized for purposes of calculating the domestic content. This provided an additional path for projects to qualify for the domestic content bonus and has led to an increase in tax insurance policies that include domestic content coverage.

We also continue to see innovation and expansion of tax insurance outside of the M&A context. For example, in the past year, policies have been designed to address transactions involving real estate, transfer pricing, treaty qualifications, and qualified small business stock. In particular, the use of tax insurance in real estate transactions has increased dramatically in the last six months and has led to a meaningful growth in the number of REIT policies as sellers require buyers to purchase a REIT entity (rather than the real estate directly). Buyers have turned to RWI and tax insurance policies to obtain certainty that the REIT status will be respected (and for any other potential breaches of the seller's representations).

Our presence in the tax insurance market has grown significantly. In the first ten months of 2024, We have sent well over 50% more tax submissions than in all of 2023. Similarly, we have bound well over 50% more tax policies in the first ten months of 2024 over full year 2023.

With the election providing Republicans with control of the White House and the Senate, many taxpayers are contemplating the possibility of material changes to the tax laws and a shift in regulatory approach to tax enforcement. While the renewable energy tax incentives in the Inflation Reduction Act have attracted the most attention, the same uncertainty exists for a wider range of tax issues. Such uncertainty creates risks for existing tax positions and poses significant challenges for future transactions and tax planning. Accordingly, we expect tax insurance to continue growing as taxpayers increasingly turn to such insurance to protect against the potential downside of material tax exposures.

INTANGIBLE ASSET AND CONTINGENT RISK MARKET

In the past year, the litigation insurance and intellectual property insurance markets have hardened considerably. This hardening has been largely driven by losses under judgment preservation insurance ("JPI") and intellectual property collateral protection insurance ("IP CPI") policies. Nevertheless, despite these headwinds, innovative markets continue to underwrite opportunities in both areas and develop new products designed to help insureds recognize the value of their intangible assets or ring-fence their contingent liabilities.

LITIGATION INSURANCE

In the litigation insurance space, there has been a notable shift away from single-case JPI. While carriers are still willing to quote and underwrite single case JPIs, appetite has subdued, and accordingly, the amount of capacity has drastically reduced and premium rates have significantly increased.

Instead, carriers have shown an increased interest in underwriting and quoting portfolio risks, adverse judgment policies, and non-litigation contingent risks. For example, we have seen a dramatic increase in submissions from law firms for law firm Work-in-Progress wraps, which these firms use to backstop the law firm's hourly and legal expense investment in a portfolio of affirmative complex commercial disputes. Also, we have noticed more companies exploring defensive specific contingency policies as M&A transaction volume has increased. These policies are designed to remove a contingent liability stemming from a particular litigation matter that is impeding an M&A transaction (and would otherwise be excluded from RWI) and can also be procured outside of the M&A context. Finally, the markets have begun to emphasize known "non-litigation" risks, such as whether a corporation has been in compliance with certain regulations. This product has been popular in the M&A context where the buyer may be unfamiliar with the regulatory scheme governing the target.

INTELLECTUAL PROPERTY COLLATERAL PROTECTION INSURANCE

Markets have cautiously started to venture back into IP CPI placements. However, this newer version of the product has two main themes: (i) higher retentions and/or coinsurance and (ii) insureds/borrowers with higher revenue. While carrier appetite remains very limited for these placements, we have seen that companies with stronger credit and proven technology can generate interest with the limited markets currently willing to write this product.

INTANGIBLE ASSET AND CONTINGENT RISK TEAM

OTHER IACR PLACEMENTS

Our IACR team continues to innovate and develop new products to meet the needs of our ever-evolving client base, and we have collaborated with our clients to find novel ways to use insurance to achieve better financial results for a particular investment.

For instance, we have worked with fund managers to design insurance solutions that mitigate the credit risk associated with the loans they make to small to medium-sized businesses. We have also helped clients insure some of their harder to quantify assets—like contingent legal assets—to raise more cost-efficient financing. Finally, we have worked with project developers to structure and place highly bespoke technology insurance programs to mitigate the technology start-up risk associated with bringing new pieces of technology online.

LOOKING AHEAD

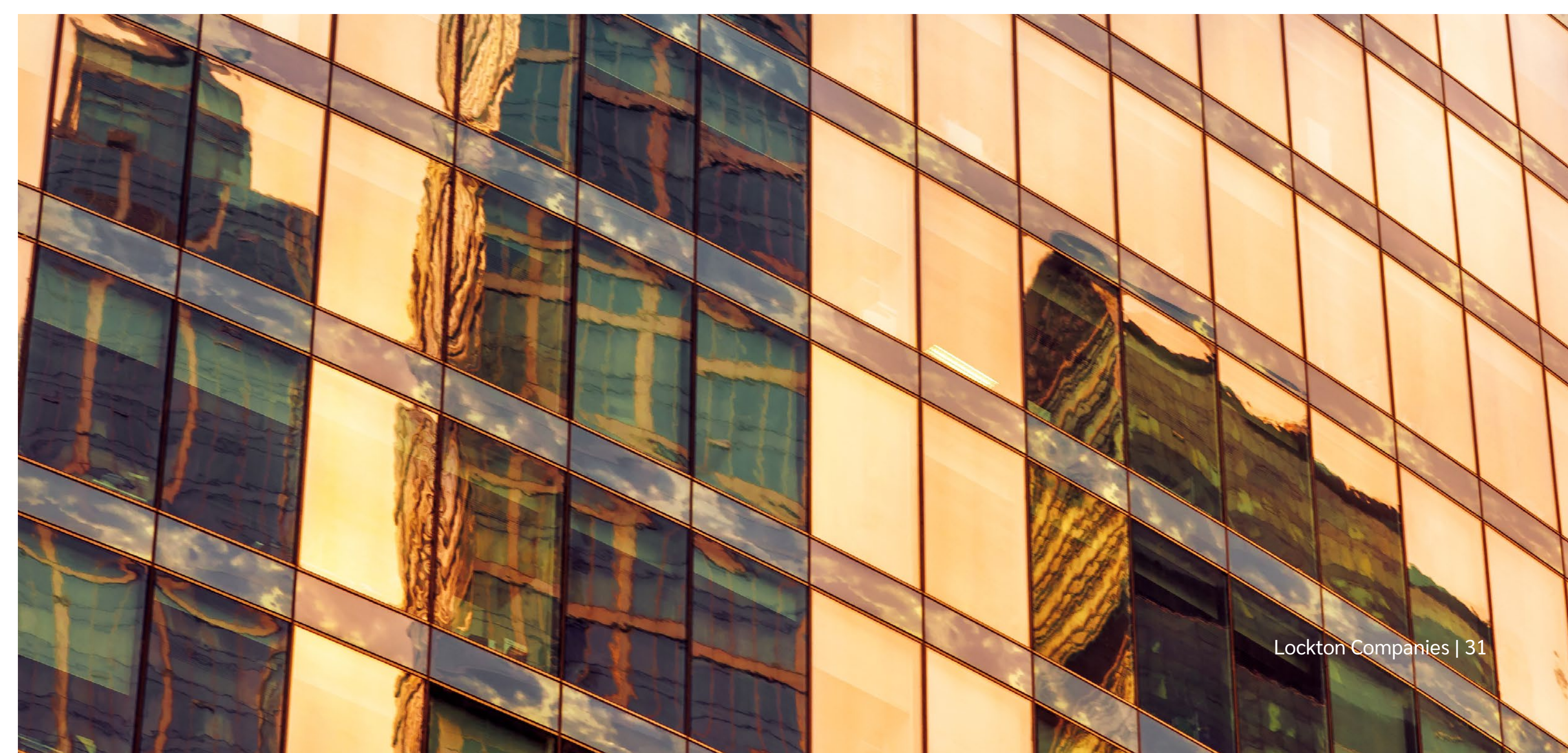
As we enter the final month of 2024, we are cautiously optimistic we will see a stronger rebound in deal-making activity in 2025. A tempered inflationary outlook, along with further anticipated interest rate cuts, should foster an environment conducive to M&A. However, the administration change in the United States will invariably invite some uncertainty. On the one hand, protectionist policies could potentially spark additional inflationary concerns and curb the momentum of incremental rate cuts; on the other hand, a more relaxed regulatory environment could help spur M&A activity.

To the extent 2025 welcomes a significant rebound in M&A activity, our Lockton team is well equipped to service each transaction with the same level of attention, detail, and care that our clients have come to expect. We have expanded our team to over 50 individuals in North America and have proactively constructed the team to evolve alongside the rapidly developing transaction liability industry, and we remain steadfast in our commitment in helping our clients manage risk with bespoke insurance solutions.

READ LOCKTON'S U.K. 2024 TRANSACTIONAL RISK UPDATE

The U.K. and Europe saw strong demand for transactional risk insurance throughout 2023-24, despite heightened geopolitical tensions in Europe. Prices for Warranty & Indemnity (W&I) Insurance are close to a historical low, while capacity and coverage continue to improve. More insurers are also offering RWI policies US-style coverage enhancements, following the uptick in U.S.-based sponsors and corporates looking to acquire European assets.

For more market insight, including the latest on Tax, Contingent & Litigation Risk, and Intellectual Property insurances, **read our U.K. Transactional Risks Market Update**.



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UNCOMMONLY INDEPENDENT

QUESTIONS?
Contact hannah.haley@lockton.com

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