2022 INSIGHTS REPORT

TRANSACTIONAL RISK INSURANCE

ATLANTIC

# ATLANTIC GLOBAL RISK

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# INTRODUCTION

Use of Representations and Warranties Insurance ("**RWI**"), now almost ubiquitous on US and European private deals, broadly reflected M&A deal volumes in 2022, with a strong H1 followed by a weaker H2, and an overall contraction of approximately 20% vs. 2021.

## KEY TAKEAWAYS

- **Premiums reduced each quarter and are now broadly reflective of rates seen in Q1 2021. We expect further reductions in H1 2023.**
- **Alternative deal structures (*e.g.*, preferred equity, public-to-private, minority and secondaries transactions) regularly being insured.**
- **Initial retentions have fallen at a faster rate than dropdown retentions. We expect initial and dropdown retentions to continue falling during H1 2023.**
- **Increased competition for <$50m deals has seen minimum premiums and retentions fall and more of these deals being insured.**
- **Strong activity in the renewables sector continues. Tax insurance remains a significant feature of these deals and the IRA will likely enhance this trend.**
- **Increased appetite for LatAm deals; subject to the sector and jurisdiction, 5-10 insurers now offering primary terms.**
- **6-10 terms per deal commonplace vs. 1-2 in Q4 2021. Attractive deals seeing 15-20 terms.**
- **Tax insurance being used more regularly, with premium rates as low as 1-2.5% for numerous risks.**

As deal volumes dropped and RWI capacity constraints witnessed most acutely during Q4 2021 reversed, leverage swung firmly back towards insureds, with multiple insurers chasing every deal. The average number of insurers providing terms per deal jumped from 1.9 in Q4 2021 to 8.4 in Q4 2022 and, in turn, the average non-binding premium rate fell from a high of 5.41% to 3.75%. Tax premiums, which did not spike in 2021, remained low in 2022, with many known tax risks supported by a "should-level" opinion insurable for a rate of 1-2.5%.

Retentions fell too, especially in H2, with most insurers offering 0.75-0.9% of enterprise value ("**EV**"), dropping to 0.5% of EV after 12 months for mid-market deals ($51-500m EV). For deals >$500m EV, insurers are now willing to offer initial retentions of 0.5-0.75% of EV, dropping to 0.25-0.5% of EV after 12 months. Previously, such retentions were reserved for deals >$750m and securing a dropdown retention below 0.5% of EV was a rare occurrence. Pricing and retention drops did not see insurers narrow cover either, with carriers conscious of the need to be considered a straightforward counterparty to work with in order to win mandates.

**Broader protection offered today vs. Q4 2021 includes cyber security matters, which insurers will now typically cover on a flat basis rather than on an "excess of and no broader" basis.**

Matters with high claims frequencies such as billing/coding on healthcare deals do however remain challenging to secure cover for, with only a handful of insurers able to underwrite such risks, and even then, only if specific diligence has been undertaken and the findings are positive.

While penetration of RWI on mid-market US PE transactions has been close to saturation for some years now, competition among insurers has led to appetite growth for small deals (EV <$50m), which, in turn, has led to PE buyers deploying RWI for small add-on acquisitions. Appetite for LatAm deals also increased with 5-10 insurers now willing to provide primary terms, subject to the industry sector.

Despite the drop in deal volumes, the RWI market fundamentals remain strong, with 27 insurers able to deploy up to an aggregate policy limit of $1.5bn. Insurers are also increasingly willing to apply RWI to alternative deal structures (*i.e.*, preferred equity, 363 sales, public-to-private, carve-out, minority and secondaries transactions).

During 2022 Atlantic placed RWI policies on numerous such deals, reflecting the increased prevalence of these deal structures as sponsors sought ever more creative ways to deploy capital.

This capacity has also led to RWI carriers diversifying to provide tax insurance for increasingly complex risks and contingent risk insurances, such as judgement preservation insurance, which has become a tool for companies seeking to monetize contingent legal awards or achieve certain objectives (see page 14). We expect to see the trend of insurance being used to solve ever more complex situations continue throughout 2023.

# ABOUT ATLANTIC

Atlantic is a specialist insurance broker with solutions to support M&A transactions, provide liquidity to investors, optimize balance sheets and reduce capital constraints.

With offices across the United States and Canada, we work with many of the world's leading law firms, private equity sponsors, real estate investors, strategic acquirers and investment banks. We have a reputation for thoughtful advice, firm advocacy on behalf of policyholders and unparalleled execution.

Our collaborative culture ensures that our clients benefit from the collective knowledge and experience of our industry leading experts. Our professional backgrounds include attorneys (M&A, tax, litigation), investment bankers, insurance professionals and tax & accounting experts.

**80+**
Employees

**7**
Offices

**17%**
Increase in GWP

**18%**
Increase in Policy Count

**$335m**
Average Transaction Size

**4 Verticals**
RWI
Tax
Structured Solutions
Structured Credit

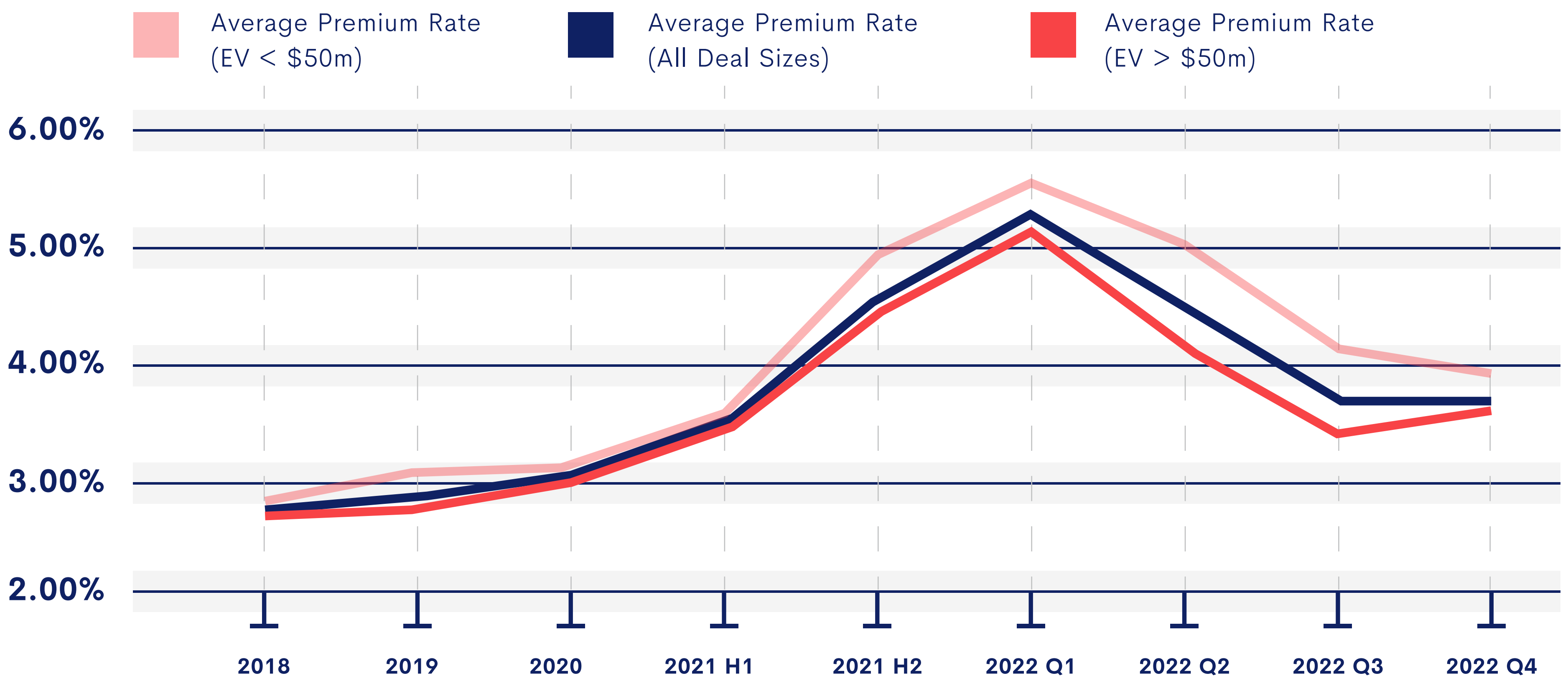
# PREMIUMS

With a similar number of insurers chasing a diminishing pool of deals, it is no surprise that premium rates dropped each quarter throughout FY22. What is a little more surprising is that, despite quoted pricing peaking in Q4 2021[1], the average premium rate for 2022 as a whole (4.08%) was flat with that of 2021 (4.1%).

**Comparing H2 of 2021 and 2022, however, provides a clearer picture of the current trend, with premium rates dropping by more than 20%.**

There remains room for further substantial premium rate decreases if we are to see a return to the 2018-2020 levels, although many carriers have concerns about rates dropping below 3%, citing profitability in what remains an emerging insurance class.

## Average Premium Rate Over Time




**[1]Graph illustrates average premium rate at the point of policy inception. While pricing appears to peak in Q1 2022, this is due to the time lag between quoting a deal and it incepting. Quoted pricing peaked in Q4 2021, with numerous transactions quoted in December 2021 actually incepting in January 2022.**

## Note to all charts

**Policy Terms:** Unless stated, statistics for policy terms are based on buy-side RWI policies bound by Atlantic in 2022, excluding real estate. Premium rates reflect the "blended" rate on line across the tower of insurance on deals where more than one insurer participates.

**Deal Terms:** Statistics are based on purchase agreement terms for deals that utilized a buy-side RWI Policy.

# PREMIUM RATE BY SECTOR

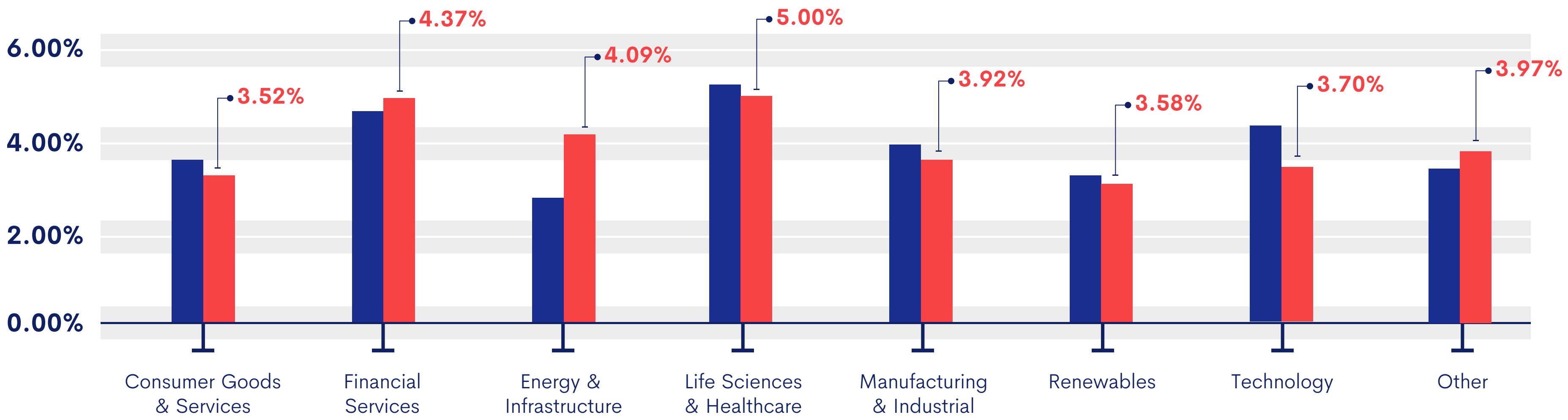
Examining premium rate trends by sector for transactions >$50m, it is clear that life sciences and healthcare deals command a far higher premium rate than all other sectors. This reflects the heightened risk profile of these transactions and more limited competition between insurers, with some high-profile carriers declining to quote for such deals, or excluding key regulatory matters, effectively removing themselves from contention. That said, premium rates for life sciences and healthcare deals did decline substantially throughout 2022 and by Q4, pricing was below 4%.

Financial services remains in the second spot, although insurers are now far more comfortable with non-risk bearing financial services companies (*e.g.*, insurance and wealth/retirement distribution businesses and fintech) than risk bearing entities (*e.g.*, insurers and banks), with the average premium rate in 2022 for the former being 3.74% vs. 4.48% for the latter.

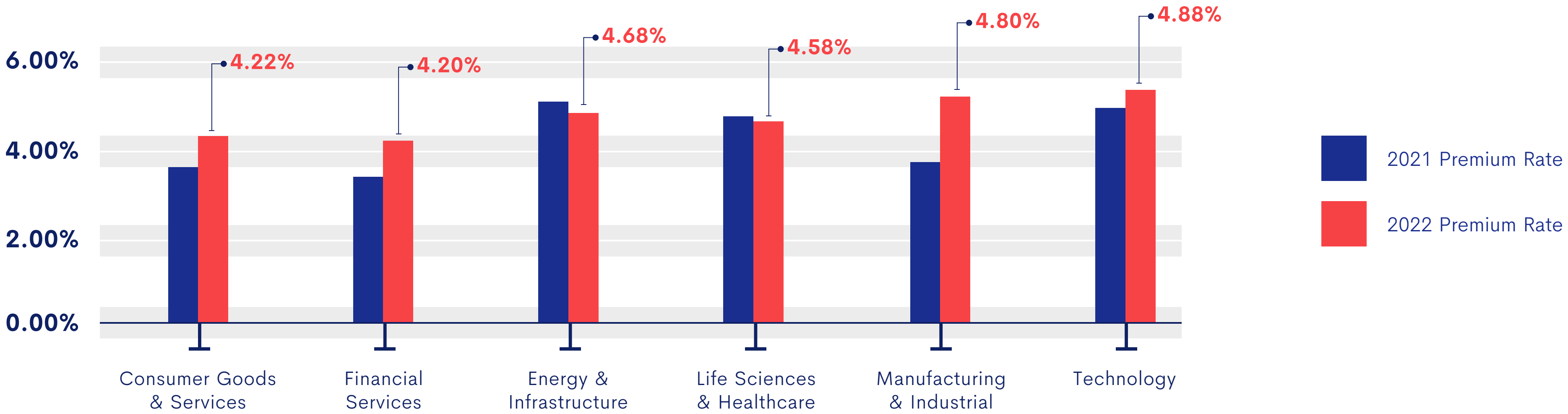
Renewables transactions benefit from lower premiums with healthy insurer interest across North America.

Insurers consider these transactions to be at the lower end of the risk profile and, given the strong performance of the sector in 2022, carriers have focused a lot of their attention on winning these mandates. By way of example, when Atlantic placed RWI policies for renewables projects during 2022, we regularly secured more than 10 sets of primary terms.

## Average Premium Rate by Sector (EV >$50m)




## Average Premium Rate by Sector (EV <$50m)



# PREMIUM RATE BY EV

Premium rates tend to decrease significantly as deal size increases. There are several drivers of this:

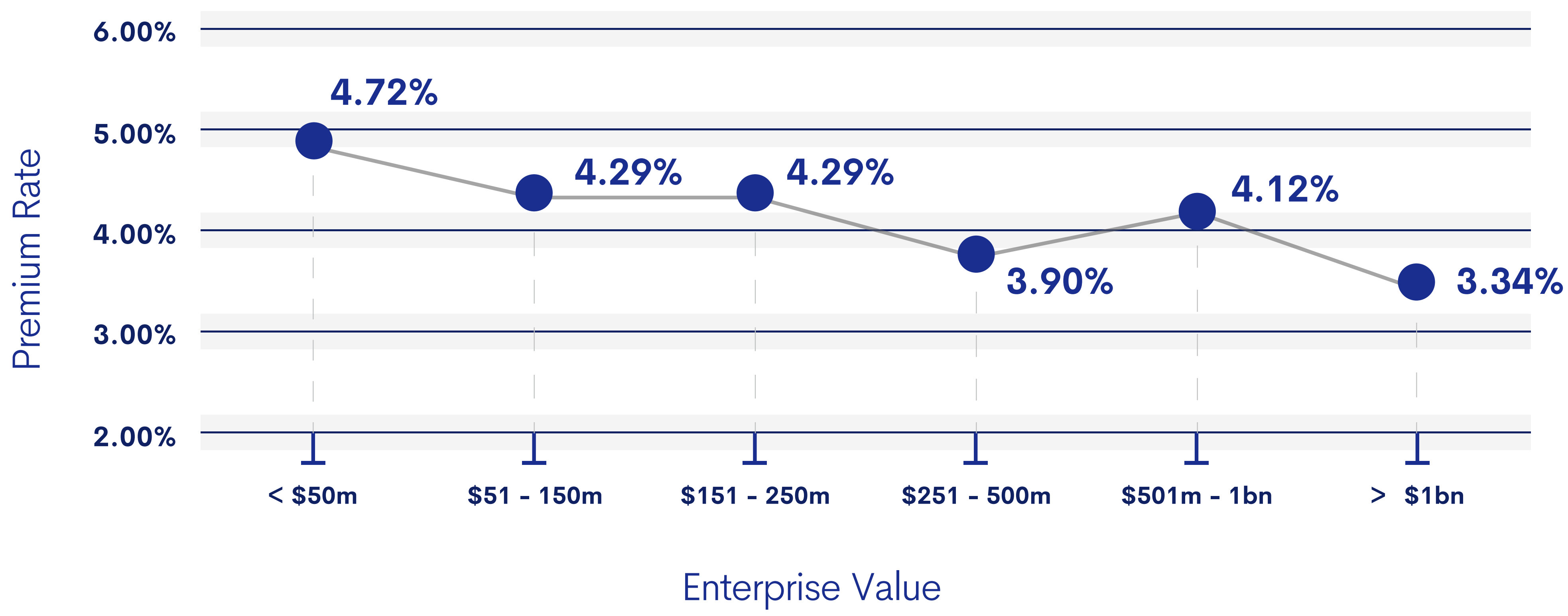
(i) minimum premiums applied to small deals drive the rate upward – this often leads to buyers on small deals taking a relatively large policy limit compared to buyers on mid- or large-cap deals; (ii) perceived risk that small deals are subject to a lower quality diligence exercise and that the retentions, while often larger in % terms, are not significant in dollar terms and can easily be eroded; (iii) large transactions require syndicated towers of insurance, with each layer priced at a discount to the layer below causing the overall blended rate to drop; and (iv) competition is typically greater for mid- and large-cap deals, with insurers able to earn greater premiums per deal and benefit from larger dollar amount retentions (even if smaller in % terms).

These factors saw <$50m deals attract, on average, a 16% higher premium rate vs. >$50m deals in 2022.

It is clear from the premium trends in 2021 and 2022 that competition rather than claims data remains the primary driver of rates. As such, we expect rates to continue to drop during 2023, albeit many carriers will be reluctant to drop much below the 3% "floor" previously discussed. In the medium-term, once deal volumes rebound, we expect rates to stabilize in the 3-3.5% range.

Minimum premiums are likely to drop too, given the heightened competition at the smaller end of the spectrum, so the delta in average premium rates between small- and mid/large-cap deals will likely narrow.

Premium Rate by Enterprise Value



# RETENTIONS

Initial retentions fell throughout 2022 from the highs of Q4 2021. While the default initial retention position for some years has been 1% of EV for deals in the $51-500m range, insurers are now willing to drop to 0.8-0.9% of EV for deals in the $51-250m range and 0.7-0.75% of EV for deals in the $251-500m range.

For deals >$500m, the initial retention customarily remains 0.75% of EV but certain insurers are willing to drop even further (to 0.5-0.6% of EV), especially for deals at the lower end of the risk spectrum (*e.g.*, asset heavy deals, targets operating solely in North America, etc.). For deals in the <$50m range, initial retentions typically exceed 1% of EV, largely driven by minimum retention requirements of insurers, which currently range between $150,000-225,000.

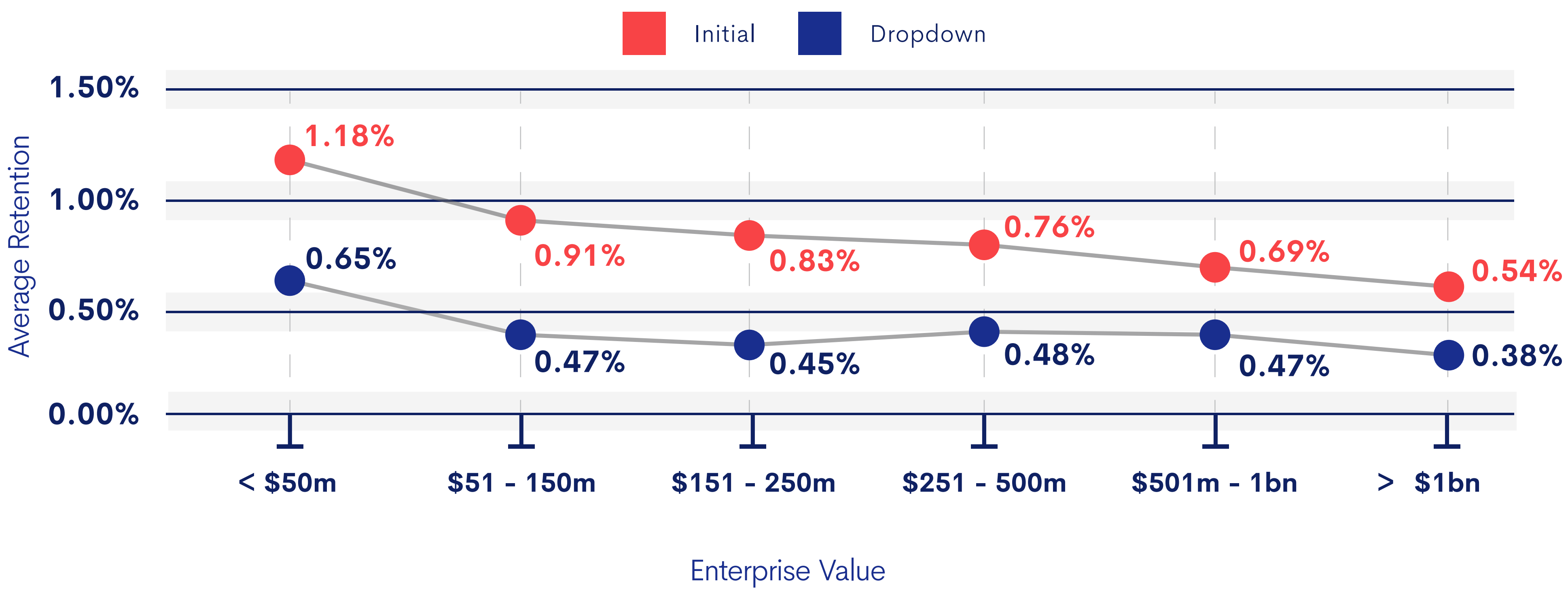
Dropdown retentions have remained fairly steady at 0.5% of EV, with the dropdown occurring after 12 months (assuming this portion of the retention has not already been eroded via valid claims).

The reason for the dropdown levels in the graph below being slightly lower than 0.5% of EV for all deals >$50m is that certain insurers are willing to drop below 0.5% of EV for lower risk transactions – especially for asset heavy renewables deals (*i.e.*, no operations, no employees), where we have seen 0.25% of EV dropdown retentions.

As with initial retentions, dropdown retentions for deals <$50m remain slightly higher, with insurers typically requiring a minimum of $125,000-225,000, irrespective of the EV.

Looking forward, if deal volumes continue to fall, we expect further reductions to both initial and dropdown retentions across all deal sizes. In the midterm, once deal volumes pick up, we expect the retention levels seen during 2022 to become the market norm.

Average Retention by Enterprise Value



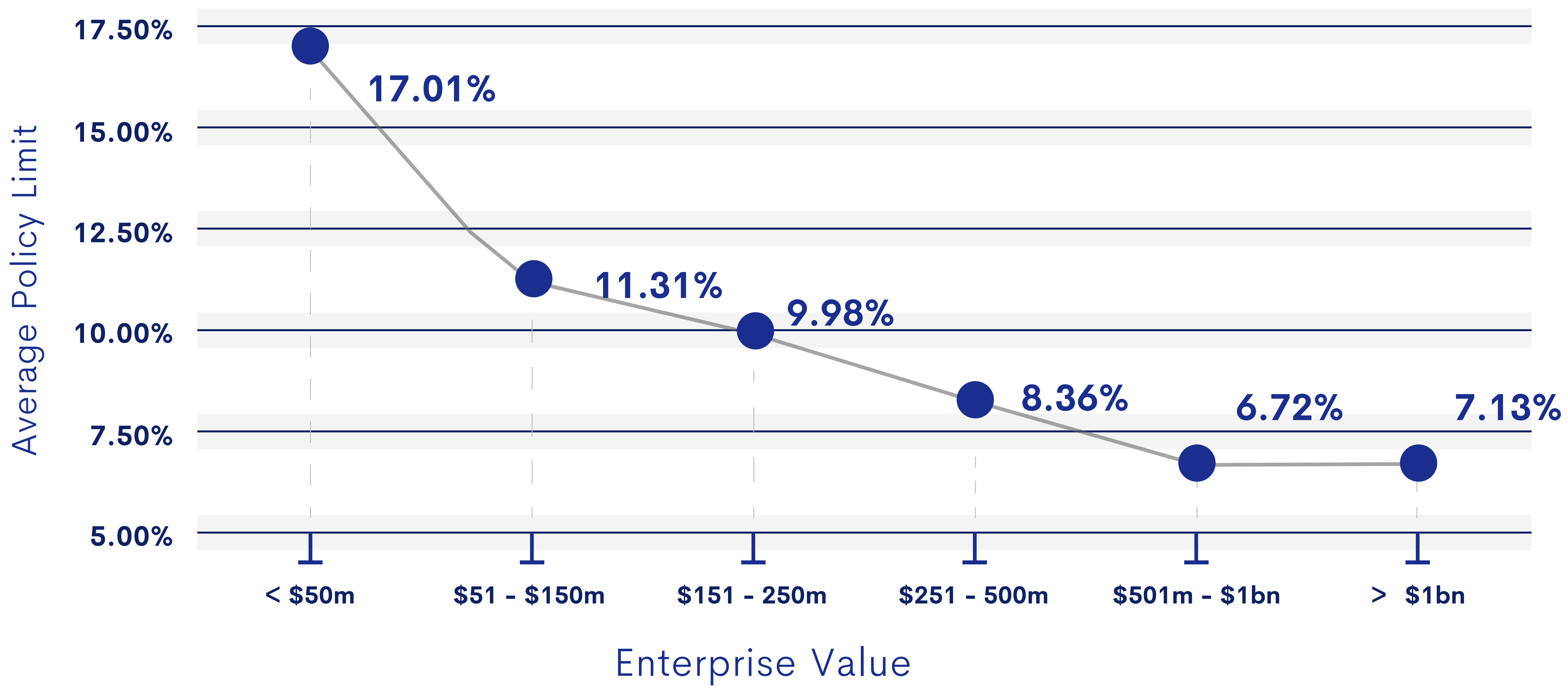
# POLICY LIMITS

Policy limits ratchet up for <$50m deals. As discussed earlier, this is primarily driven by minimum premium requirements of insurers. For example, if an insurer is willing to insure a $30m technology deal for a rate of 3.5%, a typical 10% of EV policy limit would cost $105,000; however, if the insurer's minimum premium requirement is $150,000, the insured will naturally seek to maximize the policy limit available for that premium spend, in this case a $4.3m policy limit, representing 14.3% of EV.

At the other end of the spectrum, policy limits drop off significantly for large-cap deals. Reasons for this include: (i) buyers taking comfort that the absolute dollar value is likely to cover all losses (*e.g.*, a $100m limit for a $2bn deal often "feels" sufficient whereas a $5m limit for a $100m deal does not, despite both limits representing 5% of EV); and (ii) restrictions on budgets allocated to RWI.

Claims data (both across the US and globally), however, does not support this thesis, with large deals typically generating more claims, often with greater severity, compared with smaller deals. Given that well-negotiated RWI policies cover prosecution costs, defense costs and multiplied losses, a relatively small breach event with a recurring revenue impact can quickly erode a 5% policy limit, even on a large deal. Over time we expect claims experience will result in policy limits approaching 10% of EV for >$500m deals.

Average Policy Limit by Enterprise Value



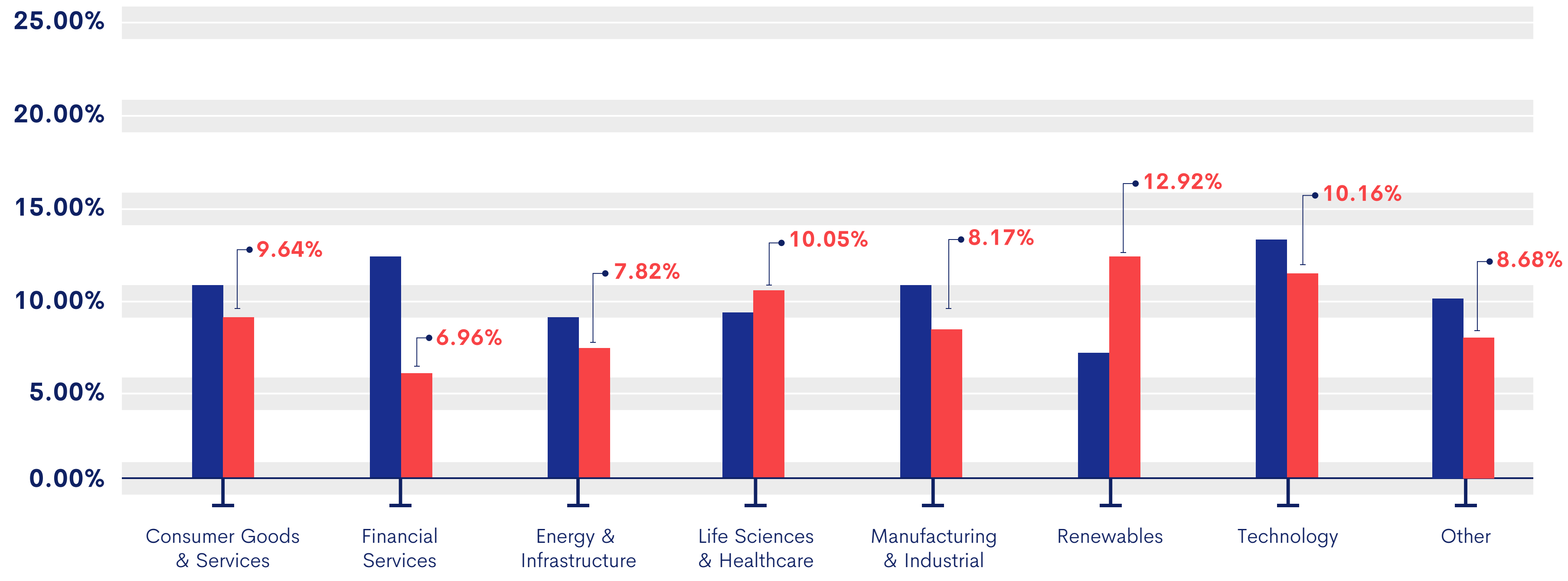
# POLICY LIMIT BY SECTOR

For deals both >$50m and <$50m, policy limits for most sectors remained broadly flat between 2021 and 2022, which was expected given the similar rate environment across each of these years as a whole.

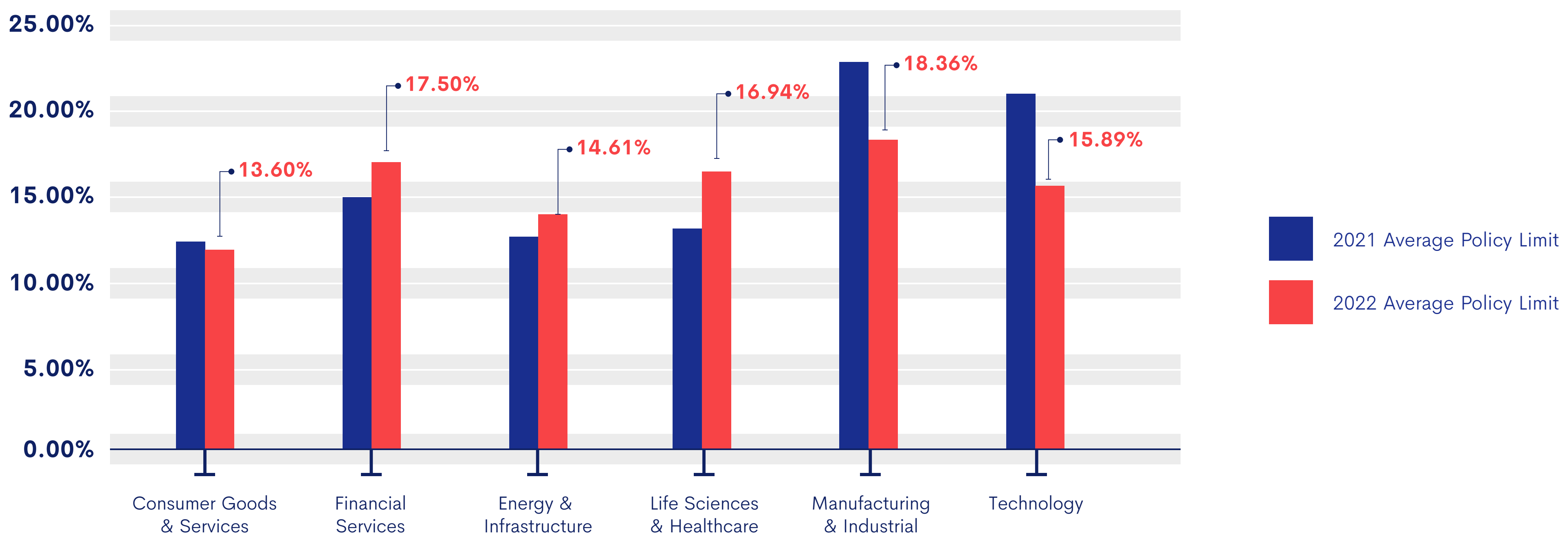
Exceptions for deals >$50m include: (i) renewables transactions, where reduced premium rates saw buyers acquire more limit; and (ii) financial services, where a disproportionate number of large-cap deals (>$500m EV) saw a significant reduction in policy limit vs. 2021.

For deals <$50m the changes in policy limit were driven by minimum premiums rather than any material shift in insureds' policy limit requirements. In the life sciences and healthcare sectors, Atlantic's average deal size for <$50m deals was smaller in 2022 vs. 2021, with policy limits increasing accordingly. The reverse was the case for deals in the manufacturing/industrials and technology sectors.

Average Policy Limit by Sector (EV >$50m)




Average Policy Limit by Sector (EV <$50m)



# SELLER LIABILITY TRENDS

The volume of nil seller indemnity ("**NSI**") deals dropped from 58% in 2021 to 49% in 2022. While the NSI concept is one that both buyers and insurers have become increasingly comfortable with in recent years, the drop in NSI deals during 2022 suggests a modest shift in bargaining power towards buyers. On deals where a seller retains a portion of risk, seller liability has typically remained 50% to 100% of the RWI policy retention amount (*i.e.*, usually not a significant dollar sum in the context of the deal).

Interestingly, the drop in NSI deals where the seller was a sponsor (71% in 2021 to 59% in 2022) was greater versus non-sponsor sellers (49% in 2021 to 41% in 2022), however overall, it remains far more common for sponsor sellers to negotiate an NSI deal. This is unsurprising given the greater pressure funds have to exit transactions as cleanly as possible.

Although not reflected in the diagram opposite, the number of deals where NSI also applied to fundamental representations ("**FR NSI Deals**") remained flat year on year at 41%. Sponsor sellers slightly increased the number of FR NSI Deals from 51% to 56%, with funds who accepted to retain a degree of liability for the general representations and the tax indemnity still seeking to avoid assuming liability for fundamental representations.


Seller Liability for General Representations:
All Seller Types

51% Seller Indemnity

49% Nil Seller Indemnity

Seller Liability for General Representations:
Financial Sponsor Sellers

41% Seller Indemnity

59% Nil Seller Indemnity


Seller Liability for General Representations:
Non-Financial Sponsor Sellers

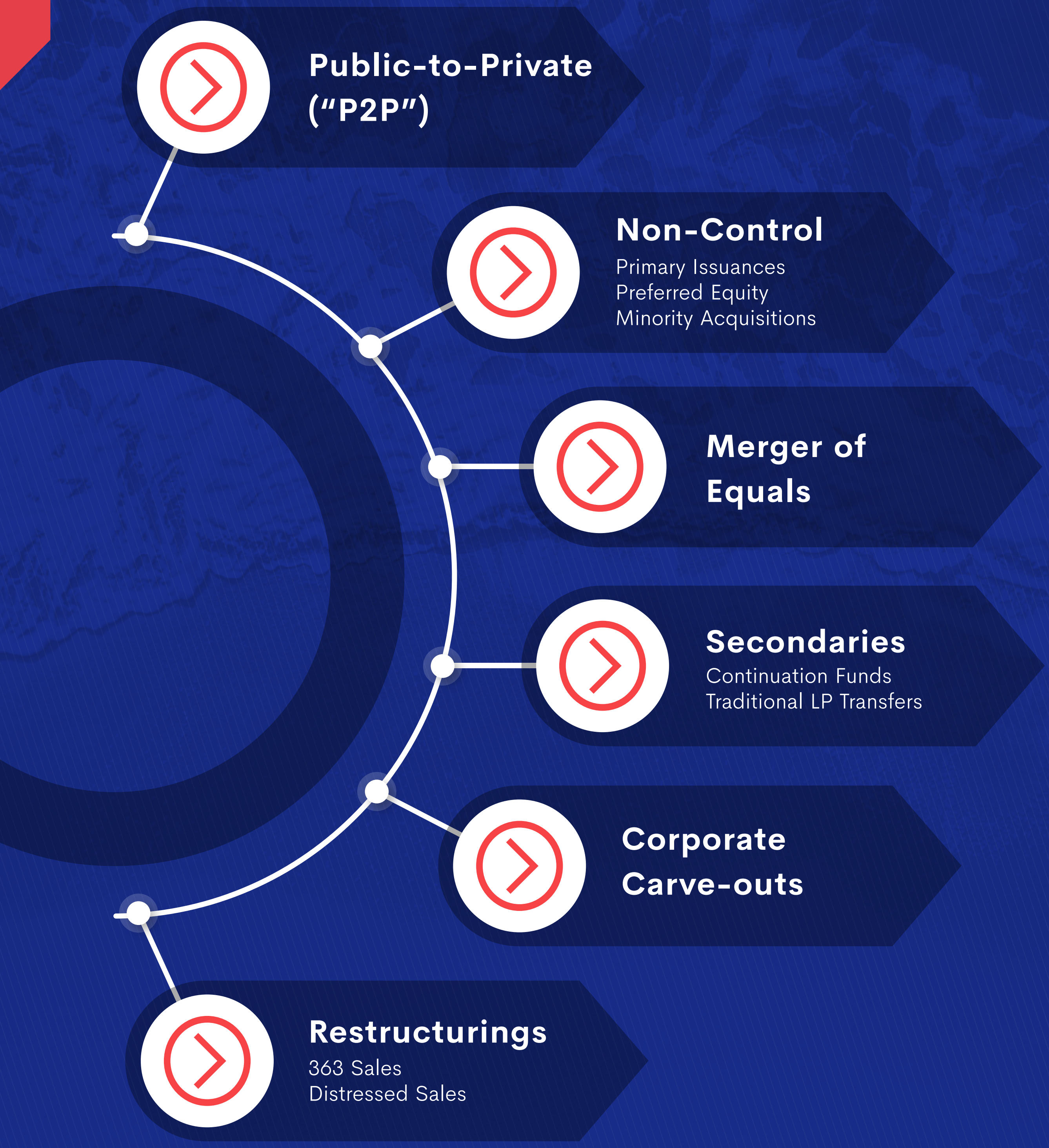
59% Seller Indemnity

41% Nil Seller Indemnity


**Seller Indemnity**
Seller is liable under the purchase agreement for the general representations. Seller's liability is typically limited to a low monetary amount (*i.e.*, 50% of the retention) and for a short survival period (*i.e.*, 12 months).

**Nil Seller Indemnity**
Seller is not liable under the purchase agreement for the general representations. Seller may remain liable for the fundamental representations and certain specific indemnities.

# ALTERNATIVE DEAL STRUCTURES




While for several years RWI has been an established feature of private M&A involving a controlling interest in a company, it is only in recent years that insurance has begun to be applied to "alternative" deal structures. In our previous insights reports, we noted the increasing adoption of RWI to support corporate carve-outs, restructurings and secondaries transactions.

In addition to these deal structures, RWI is gaining traction as a tool to support: (i) non-control investments including primary issuances and preferred equity; and (ii) P2P transactions, both of which we explore in further detail in the following sections.

# NON-CONTROL INVESTMENTS

Although there is broad insurer appetite for non-control transactions, there are several key considerations that investors and advisors must navigate when introducing RWI.

An important position to establish early in the process is whether to include the target company as an "additional insured" under the policy alongside the investor as the "named insured". Including or omitting the company as an additional insured has implications for the definition of loss, particularly as it relates to defense costs and prosecution costs incurred by the company.

Furthermore, the universe of insured entities will determine any policy modifications that are required in respect of the conduct and settlement of third-party claims.

For later stage venture capital investments (*e.g.*, series C) or growth equity which involve a primary issuance of equity by the company, RWI remains under-utilized.

However, RWI is gaining traction as an alternative to traditional risk allocation mechanisms used by investors such as diluting legacy investors in the event of a loss arising from a breach of representations given by the company in connection with the investment. For transactions involving a primary issuance, Atlantic will negotiate with carriers on various aspects such as an insurer's acceptance that limited subrogation rights will exist.

Although certain investors will forgo RWI on preferred equity deals in light of the protections built into the structure by the preference in the waterfall, Atlantic advised on multiple preferred equity investments in 2022 and we expect this to continue in 2023.

Key considerations on these deals include the conditions and timing for the preferred equity to convert to common and the associated definition of loss under the policy.

# PUBLIC-TO-PRIVATE

Atlantic has supported several P2P transactions in the US and Canada over the last few years despite acquirers of public companies historically avoiding RWI. In 2022, Atlantic experienced growing interest from clients and advisors in the use of RWI and other transactional risk insurance products to support P2P transactions.

The primary consideration from an RWI perspective for such deals is the target company's approach to the disclosure exercise, given it is customary for the representations to include extensive qualifiers in respect of materiality and material adverse effect ("**MAE**"). If the target company and its management team elect to undertake a "light-touch" disclosure exercise given the extensive MAE qualifiers (*i.e.*, only disclose matters above the MAE threshold), this will present a challenge as insurers are unlikely to offer a synthetic double materiality scrape which is required to provide meaningful protection to the buyer.

So long as management is willing to engage in a fulsome disclosure exercise (*i.e.*, disclose matters as if the MAE threshold did not exist), insurers are willing to provide a synthetic double materiality scrape and fulsome RWI cover can be achieved. Furthermore, it is important to establish insurers' comfort with the lack of express fraud carveouts to the non-survival provisions in the agreement and the potential impact this may have on an insurer's right to subrogate, a point that Atlantic will negotiate at the indication stage.

# RESTRUCTURINGS

In our 2020 Insights Report, we explored the use of RWI and contingent risk insurance to support distressed transactions or corporate restructurings. During 2022, each of Atlantic's RWI, Tax, Structured Solutions and Credit teams were approached by clients seeking insurance solutions in the context of a potential or ongoing restructuring.

In this section, we explore the use of RWI and Contingent Risk Insurance to support such transactions.

## RWI FOR 363 SALES

One use of RWI in formal bankruptcy proceedings is to support a sale of assets under section 363 of the US Bankruptcy Code ("**363 Sale**"). A 363 Sale agreement will generally include a set of company-level representations for which the seller (*i.e.*, debtor) will have no liability post-closing given the need to distribute sale proceeds to creditors. The lack of contractual protections available to a potential buyer in a 363 Sale can impair value due to the following "risk areas" that RWI helps solve.

Firstly, although a 363 Sale benefits from a court order providing that the buyer will acquire the assets free and clear of all "interests" pursuant to 363(f) of the US Bankruptcy Code, this does not guarantee that existing pre-363 Sale liabilities will be extinguished. Specifically, the buyer might find itself assuming historical liabilities that were not extinguished by the bankruptcy court such as product liability, environmental and employment matters.

There are several well-known cases where a buyer of assets under a 363 Sale found itself liable for historical liabilities that emerged post-acquisition. One such case involved class-action lawsuits brought against General Motors after its bankruptcy in 2009.

The second area in which RWI can provide value is to protect a buyer against losses arising from representations that underpin a company's value such as representations to financial statements, material contracts and relationships with key customers.

As explained in the claims section of this report, breaches of these types of representations are typically a core focus of underwriting as they have resulted in the most material claim payouts historically. However, the risk to a buyer from breaches of these types of representations is no more or less on a 363 Sale than it is on a standard entity transaction.

As such, obtaining cover for these representations on a 363 Sale provides a buyer with meaningful protection that should increase value for the debtor and its creditors by achieving a higher purchase price.

## CONTINGENT RISK INSURANCE

The various parties involved in a restructuring process – debtors, equity holders, creditors, trustees and courts – each have differing objectives and varying levels of risk tolerance. As a result, any underlying legal or credit risks can result in drawn out proceedings and liquidity constraints such as cash being held back at the order of a court or bankruptcy trustee.

Our Structured Solutions team includes legal and structuring experts that design tailored insurance policies to unlock value in a range of situations, including restructurings.

In one case last year, our team placed a judgement preservation insurance policy that allowed a debtor to advantageously exit bankruptcy proceedings. The debtor had a sizeable trial court award that was being appealed, making the award a contingent asset subject to appellate risks. The judgement preservation insurance policy provided the debtor's major creditor with the requisite comfort that the debtor's obligations would be repaid by the proceeds of the insurance policy in the event the award was reduced or overturned on appeal.

# SECTOR FOCUS

## RENEWABLE ENERGY & INFRASTRUCTURE

The Inflation Reduction Act ("**IRA**") is the most comprehensive energy policy in decades and has already resulted in a significant impact to the US renewable energy market, presenting new challenges and opportunities for the transactional risk insurance market. Atlantic's energy & infrastructure team is working closely with its clients to design insurance solutions to support M&A, tax equity financing, tax credit transfers, debt financing and hedge arrangements.

### RWI

During 2022, Atlantic placed RWI policies on renewable platform and portfolio acquisitions totaling more than 30GW. Key considerations for platform acquisitions include a customized due diligence approach that is practicable to execute, particularly for early-stage projects, while obtaining full cover under the policy. For platforms with projects that are post- "notice to proceed" or are operational, Atlantic's tax team will work with the buyer to understand the existing tax equity arrangements, including support obligations, to ensure fulsome RWI coverage and, if required, standalone tax insurance.

For fully contracted and operating projects, Atlantic will negotiate with carriers to ensure the policy terms reflect the attractive risk profile of these deals while at the same time managing risks in respect of condition of assets, tax equity financing and certain regulatory matters (*e.g.*, FERC, NERC).

As noted in last year's report, Atlantic is increasingly engaged by developers prior to negotiating with tax equity investors, and this continued in 2022. Representative tax equity deals in 2022 include a combined RWI and tax policy to support the largest single-asset tax equity solar financing ever completed in the US.

### TAX EQUITY

As it relates to changes introduced by the IRA, Atlantic has established insurers' diligence requirements around Adders/Bonus Credits (*e.g.*, wage & apprenticeship, domestic content, energy community and LMI community/qualified building).

With respect to the transfer of credits under Section 6418, Atlantic is currently working on multiple transactions which will utilize the newfound ability to transfer the credits and, as soon as the IRS guidance is provided, will negotiate with insurers to "lock in" this cover.

Beyond the new implications of the IRA for investment tax credits and production tax credits, Atlantic has seen an influx of energy and infrastructure projects leveraging new, expanded or enhanced tax credit regimes across a broad range of technologies and applications – advanced energy projects, advanced manufacturing, carbon capture & sequestration, clean fuel production, clean hydrogen, renewable natural gas, standalone storage, renewable natural gas, etc.

## SUB-INVESTMENT GRADE CREDIT

With the prolific growth of renewables over the last 20 years, the North American market has reached a stage of relative maturity. As a result, the universe of power purchase agreement ("**PPA**") offtakers has shifted from investment grade utilities and investment grade corporations to a broader range of offtakers and associated credit profiles and increasingly creative offtake structures (*i.e.*, virtual PPAs, synthetic PPAs). When engaging with a non-traditional PPA offtaker such as a community choice aggregator or smaller corporation, the lower credit rating (or perhaps lack of a formal rating at all) can present a challenge to obtaining tax equity or debt financing.

In 2022, Atlantic's credit team was engaged on several projects to arrange insurance to protect against default risk under PPAs which, in turn, allowed the project to be financed on favorable terms. This is a theme we expect to continue gathering momentum into 2023 and beyond and to be applied in a broader spectrum of project types (*e.g.*, microgrids, energy efficiency).

## SWAPS

In response to capital and liquidity constraints which emerged during the course of the year, Atlantic's Structured Solutions team designed insurance solutions to assist sponsors and developers. These novel solutions help reduce liquidity constraints on energy producers imposed by hedge counterparties by replacing the need to cash collateralize energy price swaps with an insurance policy. The insurance provides an alternative and unfunded way of covering the hedge counterparties' credit exposure to the energy producer – reducing liquidity risks and releasing trapped capital.

# SECONDARIES

Several additional insurers entered the market in 2022 and provided primary terms for the first time. This resulted in premium rates for secondaries deals dropping by 40% from a high of 4.03% in 2021 to 2.41% in 2022. However, meaningful differences in the scope of cover provided by insurers remain, in particular the willingness to provide affirmative cover for the excluded obligations ("**EO**") indemnity.

## LP-TRANSFERS AND CONTINUATION FUNDS

Historically, the demand for RWI to support traditional secondaries transactions involving a transfer of limited partner ("**LP**") interests has been very low. Reasons for this include the limited scope of representations and, importantly, that insurers have been unable to cover the EO indemnity.

In connection with fund continuation transactions, Atlantic has been successful in obtaining affirmative cover for the EO indemnity in recent years. Covering the EO indemnity on a fund continuation transaction presents a significantly lower risk for the insurer than it does on the transfer of LP interests. This is because a fund continuation transaction involves the equity interests of the portfolio company being transferred into the continuation vehicle and the lead investor being granted LP interests in a new fund. By contrast, an LP transfer involves the investor becoming a new partner in the existing fund.

Notwithstanding the higher risks associated with covering an EO indemnity on an LP transfer, we have been successful in getting an insurer comfortable covering the EO indemnity under the right circumstances.

## SECURING "FLAT" COVER

As many predict 2023 to be a bumper year for secondaries transactions, we expect RWI to be utilized across both fund continuation and, increasingly, LP transfer transactions. In addition, we predict both sponsors and lead investors will place more emphasis on the scope and style of covered representations. For example, we were able to secure flat cover of certain key representations (*e.g.*, financial statements, environmental and permits) on more than half of the GP-led transactions we advised on in 2022 without the sponsor or lead investor needing to supply more diligence or disclosures than initially contemplated.

We expect this trend to continue as the secondaries market becomes more aware that flat cover for certain key company-level representations can often be obtained based on the scope of initial disclosures and/or narrow and targeted diligence scopes.

# RWI CLAIMS

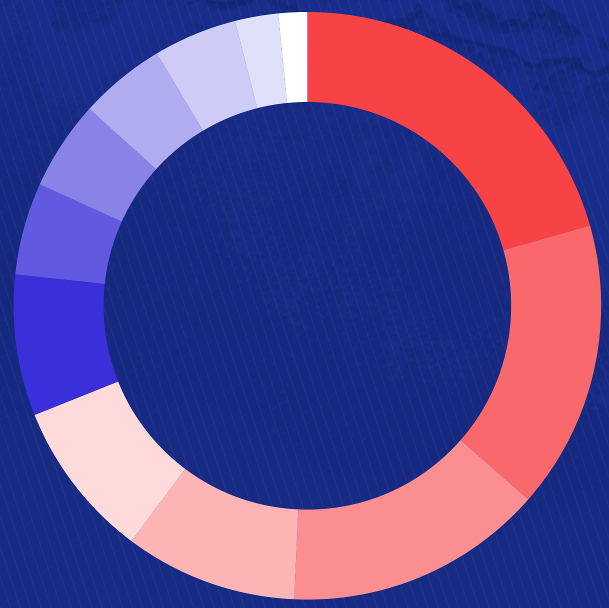
Atlantic's claims team handled a record number of claims in 2022, an expected result of the increased number of policies that we placed in prior years. As the transactional risk insurance market has evolved, insurers' track record in managing and paying claims has become increasingly important to carrier selection. The close link between our execution and claims teams ensures that our claims experience is incorporated into our policy negotiations and, ultimately, carrier selection.

Undisclosed liabilities, financial statements and material contracts representations account for almost 50% of claim notifications. It is perhaps surprising that undisclosed liabilities representations account for the highest percentage of breach notifications at 20.60%. Examining the underlying data reveals that the representation is almost always notified in conjunction with other breaches such as compliance with law, employment/labor matters, taxes, cybersecurity and environmental matters.

One reason that the undisclosed liabilities representation is increasingly notified is that the representation has become broader in recent years. While sellers historically limited the scope of the representation to liabilities that need to be shown pursuant to relevant accounting standards (*i.e.*, US GAAP), insurers can generally cover the representation without such an accounting qualifier. This enables the buyer to bring a claim for any liability of the target company that existed prior to closing, whether or not such liability would need to be shown in accordance with the relevant accounting standards. This is one example of how the widespread adoption of RWI over the last decade has resulted in a "shift" in the scope of representations given by sellers in the underlying agreement. Compliance with law accounts for 9.5% of breaches and, one area in which we have experienced activity is in relation to healthcare regulatory matters, as referenced earlier in this report.

Financial statements and material contracts representations account for ~30% of breach notifications but more than 50% of paid losses on policies placed by Atlantic since 2018. Breaches of these representations often involve a multiplied damages claim, and the calculation of loss typically dominates the claims process. How quickly the buyer and insurer can reach an agreement on the amount of loss for claims based on a multiple of EBITDA and/or revenue is instrumental to the overall claims experience. Atlantic advocates on behalf of policyholders to secure an agreeable outcome on the calculation of loss in a timely manner. Insurers' ability to reach a settlement for such claims will remain an important factor in carrier selection.

**Claim Notifications by Type of Breach**




Claim notification by type of breached representations for North American buy-side RWI policies placed by Atlantic between 2018 and 2022. Where multiple breaches of representations are included within a claim notice, each category of breach is included within the statistics.

# 2023 OUTLOOK

H1 will no doubt pose challenges, but there are early signs of reasonable deal flow. While large-cap transactions (other than those in the renewables and infrastructure sectors) will be few and far between, we are seeing a healthy flow of small and mid-cap transactions across the healthcare, technology and financial services sectors. In addition to the robust pipeline of smaller deals, including add-ons, we have seen a steady stream of larger deals with an enterprise value of >$500m.

The risk of recession and higher interest rates will likely result in an uptick in restructurings while debt constraints will likely see the alternative deal structures described within this report (especially minority and secondaries deals) feature prominently in 2023's deal landscape. In the first six weeks of the year, insurers have shown a willingness to accommodate some of the more unique alternative deal structures discussed in this report, and we expect demand for insurance on these deals to continue to grow.

Premium rates and retentions will continue to fall in H1 across all sectors, albeit with a less pronounced drop for life sciences and healthcare deals. Although insurers have historically been reluctant to let premium rates drop below 3%, we have seen several insurers provide terms below this "threshold" and expect this to continue until deal flow recovers.

**At Atlantic, despite the economic uncertainty, we expect continued growth in terms of deal count, policy count and headcount.**

Tax and contingent risk insurance will be used in ever more creative ways, with principles and advisors more comfortable than ever with the use of unfunded A-rated insurance products to solve their problems, especially those created by new legislation such as the IRA. On the supply side, the number of sophisticated insurers operating in this space continues to grow, which typically translates into a broader array of risks being insurable over time.

## 2023 PREDICTIONS

Rates and retentions will continue to fall throughout H1.

Broad RWI cover will remain available despite premium and retention drops.

Tax and contingent risk insurance will be used in ever more creative ways.

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