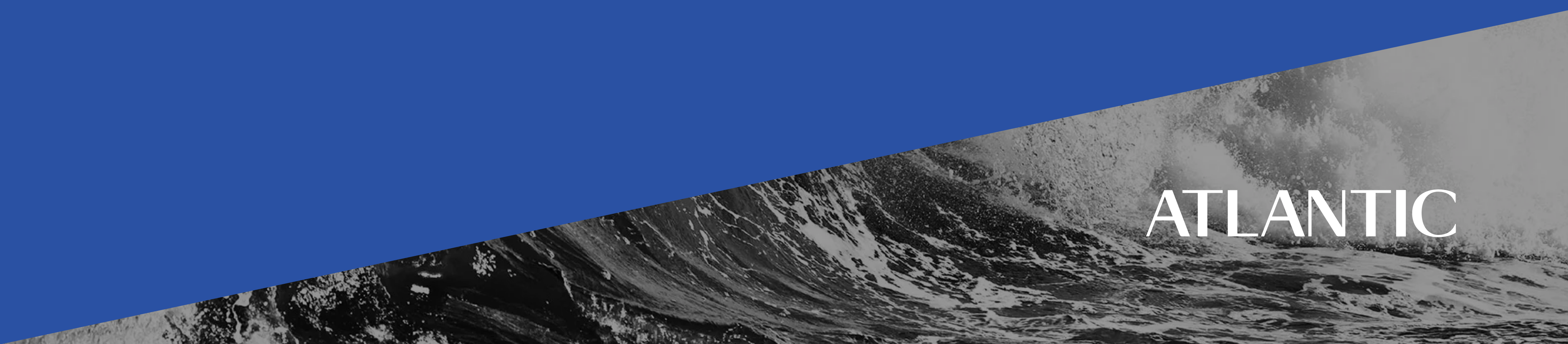
ATLANTIC GLOBAL RISK

2023 Insights and 2024 Outlook

REPRESENTATIONS & WARRANTIES INSURANCE



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KEY TAKEAWAYS FROM 2023

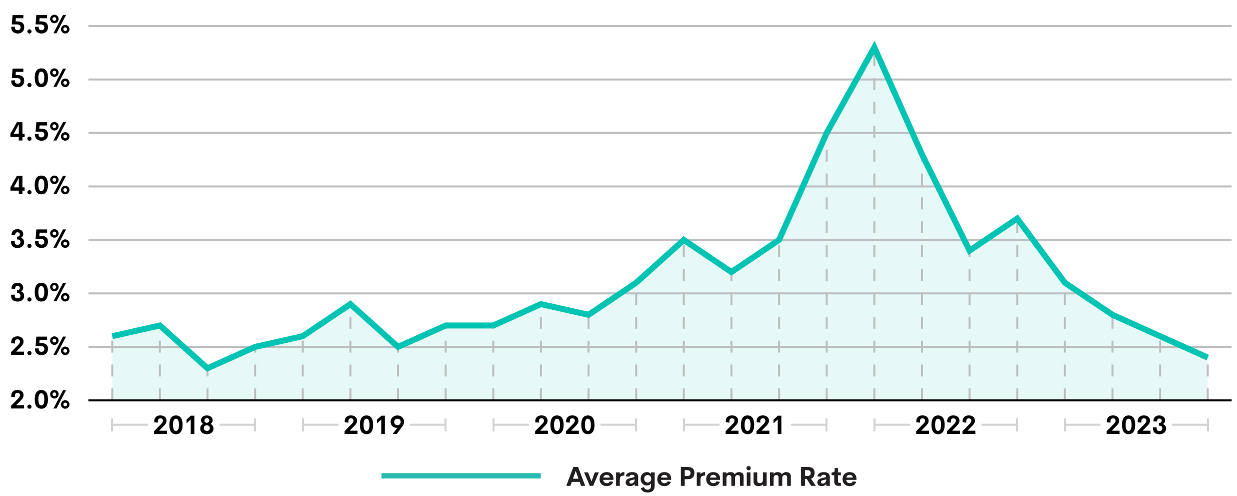
- **Premium rates declined by 35% in 2023 and rates are now well below 3%, leading to certain carriers questioning the profitability of the product at current rates.**
- **As premium rates declined, premium rate variance narrowed from 0.6% in Q1 2023 to 0.2% in Q4 2023, indicating insurers are heavily competing on price.**
- **Across all deal values, initial retentions decreased by 22% in 2023 and drop-down retentions by 13%. For $51m - 1bn deal values, initial retentions fell by 37%.**
- **Penetration of the product slightly decreased (as expected given the reduction in PE activity) but lower minimum premiums enabled a larger number of small deals (<$50m) to seek insurance.**
- **Policy limits slightly increased as buyers took advantage of lower premium rates.**
- **Premium and retention decreases for smaller deals were kept in check by insurers' minimum requirements.**
- **Increased use of RWI on alternative deal structures (including take-privates, preferred equity and secondaries transactions) and an increased appetite from insurers to cover heightened risks (cyber, product liability etc.), challenging sectors (healthcare, financial services etc.) and LatAm deals.**
- **Despite submission count across the market contracting by 11%, Atlantic grew transaction count and policy count by 11% and 31% respectively.**

INTRODUCTION

The broader transactional liability insurance market contracted sharply in 2023 with our estimates placing market submission count and total gross written premium down by 11% and 40 - 45% respectively, reflecting a sharp decline in M&A activity and lower premium rates.

Despite the market contraction, 2023 was a reaffirming year for representations and warranties insurance (RWI) as penetration of the product only slightly decreased and a larger number of small deals (<$50m) are now being insured.

Historic Premium Rates



NOTES TO CHARTS

Unless stated, statistics for policy terms are based on buy-side RWI policies bound by Atlantic for North American transactions, excluding real estate and secondaries.

Statistics for seller liability are based on purchase agreement terms for deals that used RWI policies.

In the case of a 100% acquisition, the transaction value represents the total enterprise value of the target company. In other cases, the transaction value (TV) is the buyer's portion of the target company's total enterprise value.

Premiums are expressed as a percentage of the policy limit.

Limits and retentions are expressed as a percentage of the transaction value.

Unless stated otherwise, we have shown premiums and retentions for deals with a transaction value of $51m - 1bn. Excluding <$50m deals and >$1bn deals better represents changes over time but the text analyzes trends within these small and large deal sizes.

INTRODUCTION

The increasing use of insurance to support small deals has been facilitated by lower minimum premium requirements (making the product cost-effective), lower minimum retention amounts and the application of RWI to a wider range of deal strategies such as buy-and-build and non-control investments.

The relatively stable rate of penetration is notable against the backdrop of a slowing M&A market which naturally alters the balance of power between sellers and buyers. One reason for the meteoric rise of RWI over the last decade has been a strong M&A market that has favored sellers, allowing them to avoid traditional indemnities, with buyers using RWI in lieu. The continued use of RWI, even when buyers might be able to demand a traditional indemnity from sellers speaks volumes for the confidence that M&A participants have in the product – both in helping to get deals done and, most importantly, paying out in the event of a claim.

At Atlantic, we are delighted to have bucked the market trend as we increased our transaction count by 11% and policy count by 31% vs. the prior year, with gross written premium increasing marginally. We are now a top five broker in the RWI market in North America, and the only company of scale in the space that has shown continued growth over the course of the last 24 months. This reflects advisors' and market participants' increasing awareness of Atlantic's unique approach to deal execution and claims advocacy.

The continued use of RWI, even when buyers might be able to demand a traditional indemnity from sellers speaks volumes for the confidence that M&A participants have in the product.

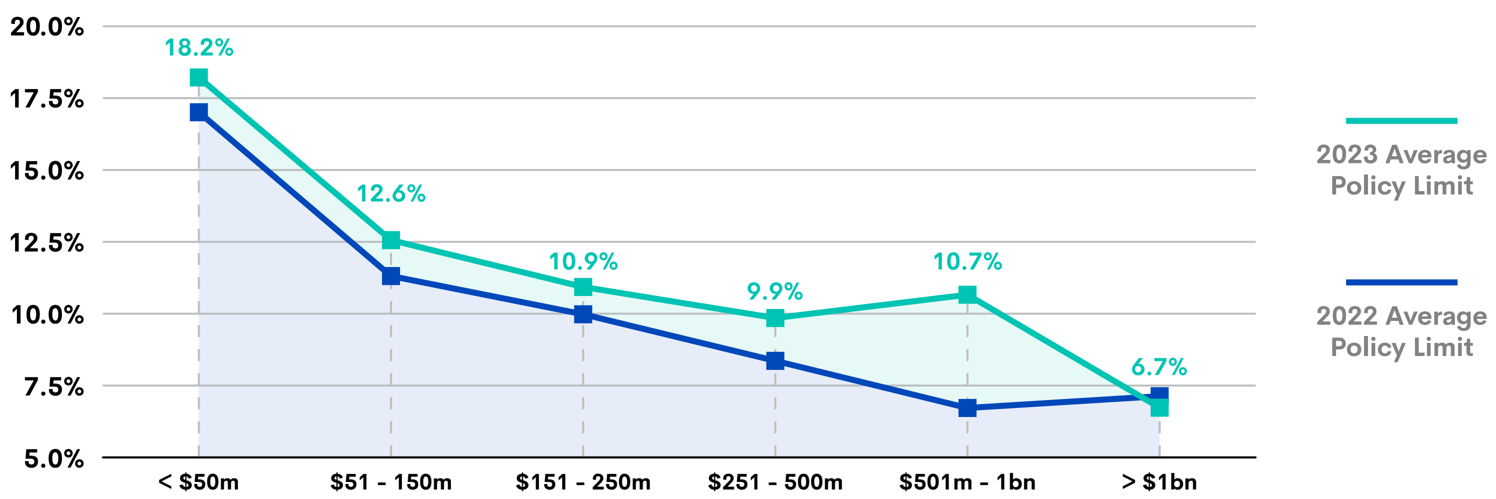
POLICY LIMITS

There is an inverse relationship between deal size and policy limit. Policy limits as a percentage of transaction value increase significantly for <$50m deals.

The reason for <$50m deals having larger policy limits (in relative terms) is driven by a combination of minimum premiums and buyers' desire to obtain a certain monetary level of protection, with policy limits reflecting historical indemnity caps. Before the proliferation of RWI, it was common for buyers to require an indemnity cap of 15 - 30+% of the transaction value on smaller deals while for larger deals, a 10% indemnity cap was customary.

> Policy limits were generally higher in 2023...buyers were able to purchase higher limits while keeping insurance costs below historical levels.

Policy Limit by Transaction Value



POLICY LIMITS

Policy limits were generally higher in 2023, which can be attributed to two factors. Firstly, with premium rates falling by 35%, buyers were able to purchase higher limits and keep insurance costs below historical levels.

The second factor is claims experience; high-severity claims account for the majority of paid losses across the RWI market, an observation supported by carriers' claims studies, with one carrier reporting that ~69% of claim payments were for an amount exceeding 50% of the policy limit. For $151m - 1bn deals, buyers returned to the long-term trend of purchasing ~10% policy limits, with the lower policy limits of 2021 and 2022 a product of higher-than-average premium rates (which saw buyers purchase reduced limits to manage costs). If premium rates do not increase above 3.5%, we anticipate 10% policy limits for $151m - 1bn deals to remain the default for the foreseeable future, but with certain clients (in particular those who have experienced losses exceeding 10% of transaction value) purchasing limits reflecting their historic losses. In several cases during 2023, insureds successfully claimed the full policy limit (10% of transaction value) solely for the incurrence of defense costs used to fight third-party disputes (in particular third-party claims of IP breach) but were ultimately underinsured.

The statistics in this report do not include excess policies covering only fundamental representations which are known as fundamental top-up policies. The availability and pricing of these policies has fluctuated over the years as a result of market capacity, and pricing is currently ~0.5%. During 2023, Atlantic structured a variety of fundamental top-up policies that included a broader scope of cover than true fundamental representations such as extending cover to include tax, intellectual property and, in one instance, a material contract representation. The pricing for top-up policies that include a broader scope can be higher than 0.5% of policy limit, depending on the nature of the covered risks.

Atlantic structured a variety of fundamental top-up policies that included a broader scope of cover than true fundamental representations.

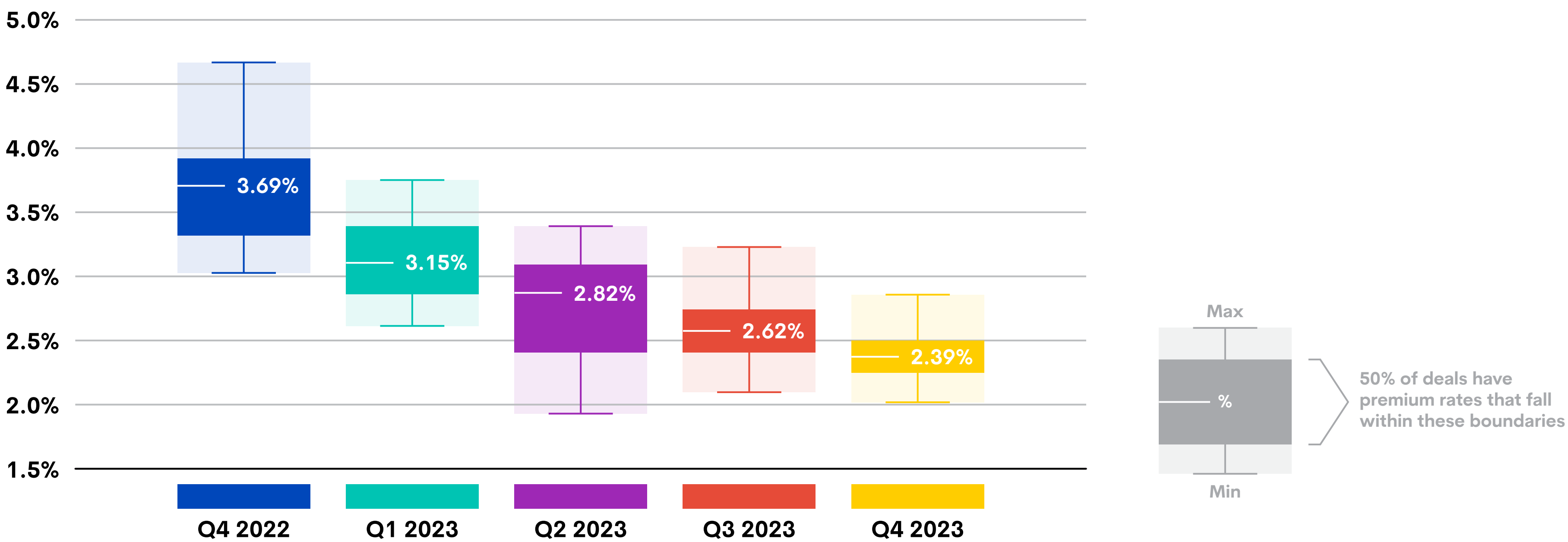
PREMIUMS

For deals with a transaction value of $51m - 1bn, average premium rates fell from 3.69% in Q4 2022 to 2.39% in Q4 2023 - a drop of 35%.

For deals with a transaction value below $50m (not shown on chart), the average premium rate in Q4 2022 was 3.87% while in Q4 2023 it was 3% - a decline of 22%. The lower rate of decline for small deals can be attributed to minimum premiums charged by insurers. With that said, minimum premiums declined in 2023, ranging from $70 - 100k depending upon the insurer. This is a far cry from late 2021 and early 2022 when some insurers had $200 - 250k minimum premium thresholds.

Average premium rates fell by 35%. Smaller deals declined by less given the impact of minimum premiums.

Premium Rate Variance Across $51m - 1bn Deals



PREMIUMS

Reduced pricing hasn't seen insurers narrow their appetite for risk. Although premium rates declined in each subsequent quarter of 2023, insurers continued to offer broad cover throughout the year.

As rates continued to decline, certain carriers started to question the profitability of the product. The data supports that premium rates started to stabilize towards the end of the year, with premium rates decreasing by 15% from Q4 2022 to Q1 2023 while the rate of decline from Q3 2023 to Q4 2023 was 9%. Atlantic's experience to date in 2024 supports the thesis that rates will continue to stabilize and possibly increase modestly in mid-2024, with certain carriers unwilling to provide quotes below self-imposed floors on a deal-by-deal basis. Once there is an uptick in M&A activity, we expect rates to increase above 3% across the market but to remain below 3.5% in 2024 unless there is a surge in M&A activity in conjunction with further deterioration in loss ratios.

We use the term pricing variance to determine the band in which 50% of premium rates fall. The pricing variance decreased as the year progressed with a variance of 0.56% for Q1 2023 and just 0.22% for Q4 2023. For deals with a lower-than-average premium rate, the reduced variance is a result of carriers needing to compete while at the same time maintaining a degree of pricing discipline (i.e., not quoting too low). For deals with a higher-than-average premium rate, the reduced variance is explained by fiercer competition and a wide option of alternative markets which means that a carrier with a much higher-than-average premium rate is unlikely to win the deal. That said, Atlantic's focus is to ensure first rate execution, broad cover and an efficient claims process - the premium rate is only one of several factors when discussing recommended carrier options with our clients.

The pricing variance decreased as the year progressed with a variance of 0.56% for Q1 2023 and just 0.22% for Q4 2023.

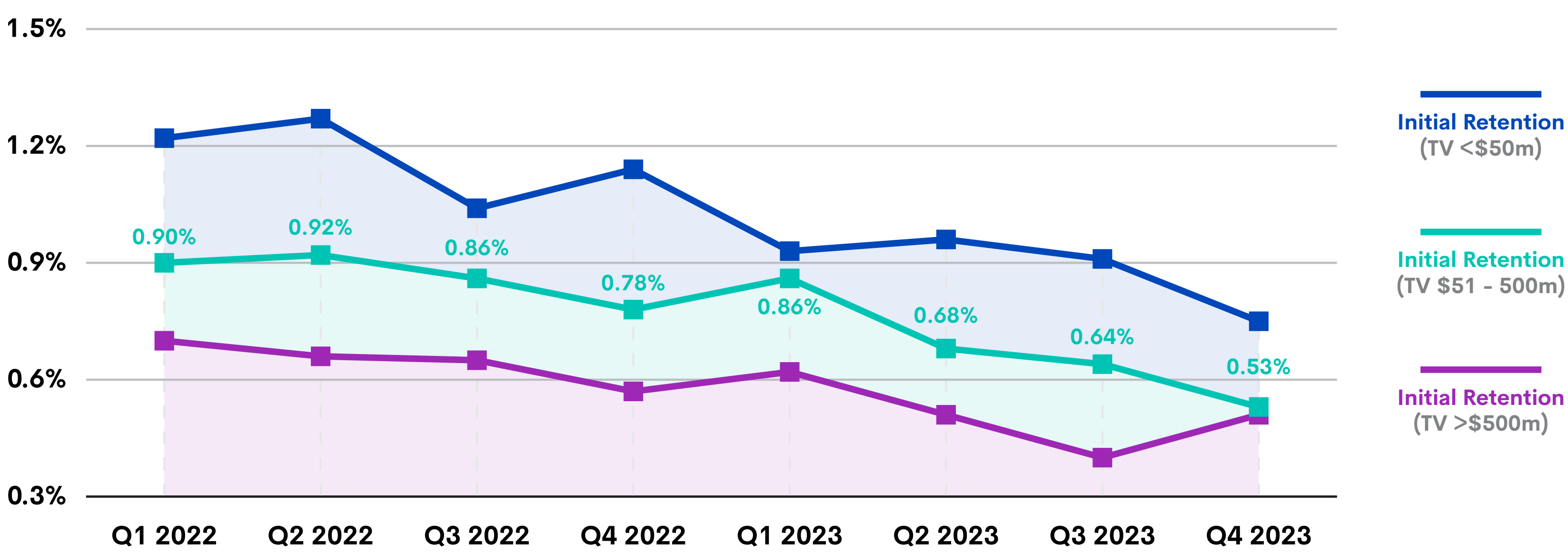
RETENTIONS

Across all deal sizes, initial retentions as a percentage of transaction value fell from 0.89% in 2022 to 0.69% in 2023 - a decline of 22% while drop-down retentions declined by a more modest 13%.

Atlantic was able to leverage competitive tension to obtain lower initial retentions across a wide range of deal values as the year progressed. Historically, insurers only provided retentions below 1% on >$250m deals and retentions of 0.5% were reserved for >$500m deals. While deal size still influences the retention level, the gap is shrinking. Notably, retention levels for deals of $51m - 500m are converging with larger deals. For >$1bn deals, we were able to obtain initial retentions of 0.3% in 2023 for certain deals but insurers are generally requiring an initial retention of 0.4% even on >$1bn deals.

For <$50m deals, the initial retention fell from 1.14% in Q4 2022 to 0.75% in Q4 2023. While insurers can regularly offer 0.6% initial retentions for deals of this size, they are subject to minimum dollar thresholds, typically $125k.

Initial Retention as % of Transaction Value



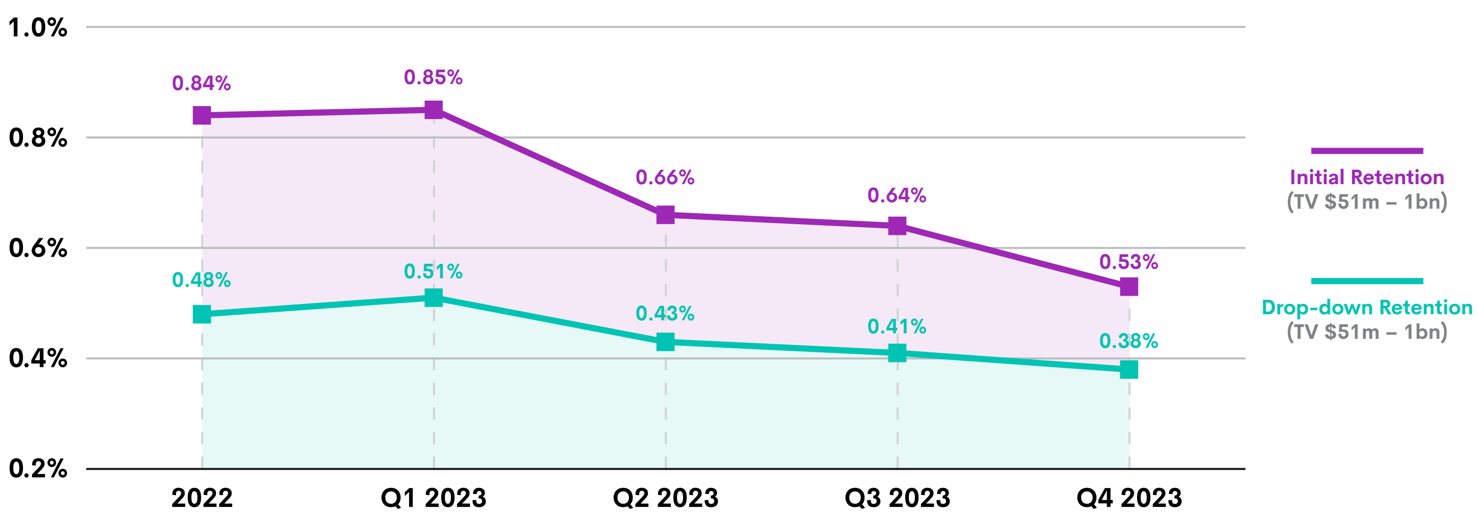
RETENTIONS

For $51m - 1bn deals, initial retentions fell from 0.84% in 2022 to 0.53% in Q4 2023 - a decline of 37%. There was a smaller decrease in drop-down retentions which fell from 0.48% in 2022 to 0.38% in Q4 2023 - a decline of 21%.

The only instances in which insurers were unable to offer drop-down retentions of 0.5% or less were on smaller deals which became subject to minimum requirements. Minimum drop-down retentions vary by carrier but are typically ~$100k and the lowest drop-down retention we obtained during 2023 was $75k.

> Minimum drop-down retentions vary by carrier but are typically ~$100k.

Initial and Drop-down Retention as % of Transaction Value



RETENTIONS

The purpose of the retention in the RWI context is two-fold. Firstly, it helps align the interests between the insurer and the buyer. If the buyer is protected from "first dollar" they might be less incentivized to go the extra yard on diligence to ensure items are discovered that can be factored into the purchase price upfront rather than relying on a post-closing adjustment (in the form of a claim against the insurer). The second purpose is to act as a "buffer" for breaches that are discovered post-closing - this is most important for third-party claims against the target business, for example those that have the potential to result in litigation or tax reassessments. Often such matters are resolved without the target company/ buyer incurring significant costs meaning that the claim settles within the policy retention.

Falling retentions are unlikely to impact the alignment point noted above but it does certainly reduce the buffer for third-party claims. In turn, this is likely to influence carriers' underwriting approach, particularly on target companies with substantial operations and a large workforce. As it relates to claims experience, all things being equal, lower retention levels will increase loss ratios but we don't expect this to be significant. While it is true that many claims settle within the retention, these often involve third-party claims against the target as noted above (i.e., a tax audit). Most of (but not all) such claims should continue to settle within the retention even though such retentions have reduced by 37% over the last 12 months for $51m - 1bn deals. Conversely, if there is a material issue (whether direct or third-party), these claims are likely to quickly exhaust the retention and result in paid losses. In such instances, the severity of the loss will increase but this is unlikely to move the needle too much on overall loss ratios, with the premium rate playing a much larger role in this calculation.

Once M&A activity increases and carriers can exert more influence, we expect their focus, at least initially, to be on premium rate rather than retention levels. As such, we expect the lower initial and drop-down retention levels obtained during 2023 to remain for the foreseeable future.

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SELLER LIABILITY

It is more common for parties to agree to a nil-seller indemnity (NSI) construct for both general representations and fundamental representations when the seller is a financial sponsor.

This is to be expected given the greater pressure funds face to exit transactions with limited exposure so that liabilities do not exceed the life of the fund and proceeds can be returned to investors.

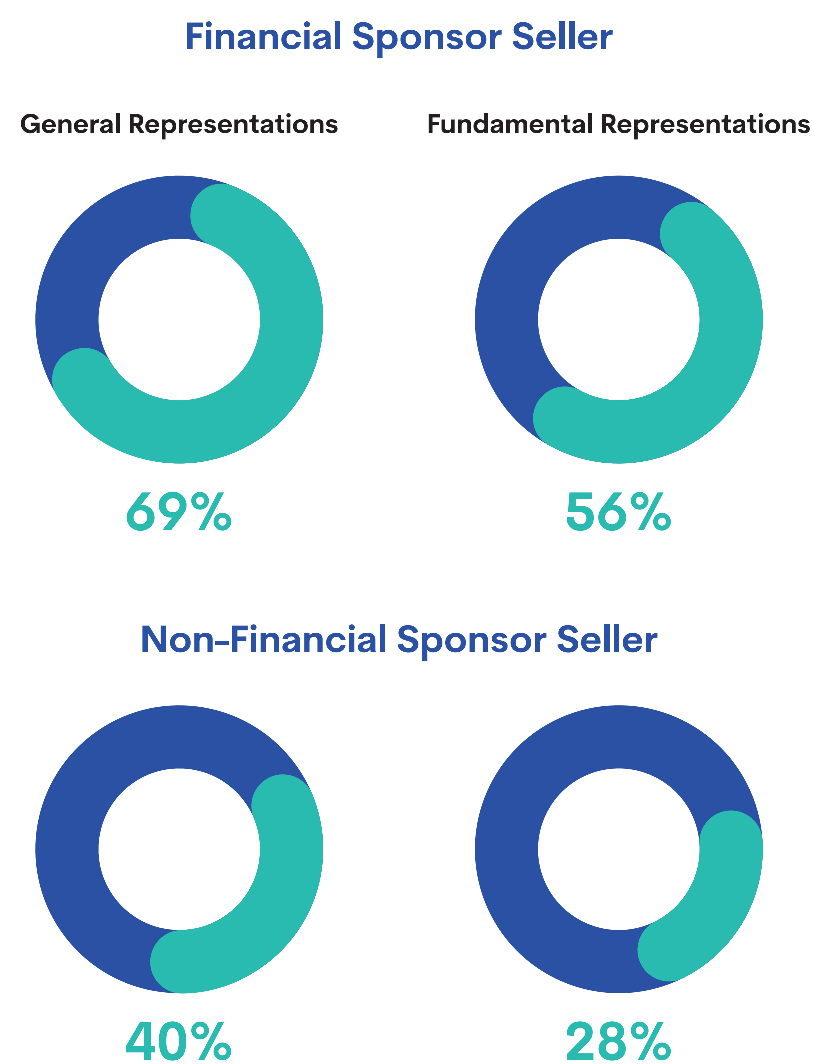
Both financial sponsor and non-financial sponsor sellers are less likely to secure an NSI structure for fundamental representations than they are for general representations. Financial sponsors were able to secure an NSI structure in 69% of deals for general representations but only 56% of deals for fundamental representations. Non-financial sponsors secured an NSI structure in 40% of deals for general representations but only 28% of deals for fundamental representations. This is primarily driven by (i) buyers' desire to obtain a higher cap for fundamental representations - often the full purchase price - and (ii) sellers' greater willingness to give such representations versus general representations (even when capped) given the lower level of risk associated with such representations.

Seller Indemnity

Seller has full or partial liability under the purchase agreement for the relevant representations. For general representations, seller's liability is typically limited to a low monetary amount (i.e., 50% of the policy retention). For fundamental representations (i.e., title, capacity, authority) seller's liability is typically capped at the transaction value.

Nil-Seller Indemnity

Seller is not liable under the purchase agreement for the relevant representations.



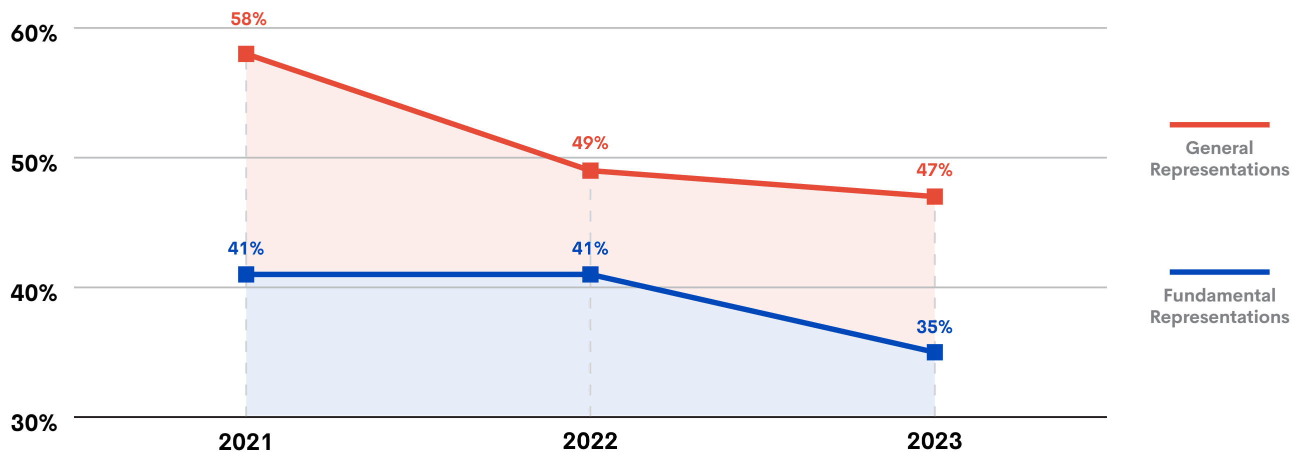
SELLER LIABILITY

For both general and fundamental representations, the frequency of NSI structures for all seller types has reduced over the last few years. It is reasonable to expect this trend given the M&A market has slowed and negotiating leverage has naturally swung back towards buyers.

However, a closer look at the data reveals that larger deals are much more likely to have an NSI construct, particularly for the general representations. For all sellers across $251m – 1bn deal sizes, 78% of deals in 2023 were structured as NSI for general representations vs. 17.5% of deals <$50m. As such, the true driver behind the reduction in NSI deals in recent years seems to be the prevalence of small deals coupled with the relative unwillingness of buyers to accept NSI constructs on such deals. Clearly, buyers of $251m – 1bn targets are confident in the use of RWI as their means of protection, although the trend of increased NSI for such deals may also be due to (i) many of the large platform deals trading over the last 24 months being high quality assets, with sellers retaining a fair degree of leverage and (ii) the decline in retention levels placing less pressure on buyer demands for sellers to provide a partial indemnity.

Both financial sponsor and non-financial sponsor sellers are less likely to secure an NSI structure for fundamental representations than they are for general representations.

Frequency of nil-seller indemnity structures for the general or fundamental representations in the purchase agreement

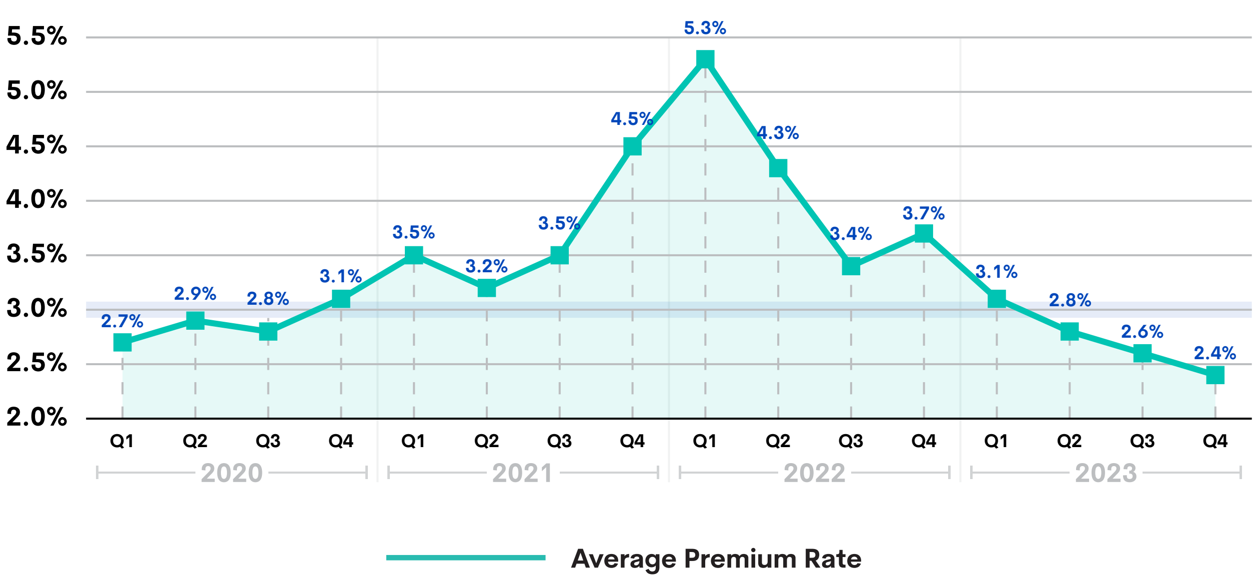


DRAWING THE LINE ON PROFITABILITY

Q4 2023 saw North American RWI premium rates fall to record lows, causing several established insurers - with strong claims track records - to flag concerns around the long-term profitability of the class.

With rates below 3%, RWI market participants are questioning the impact of current rates on profitability and asking "what rate is required for claims to continue being paid in an efficient manner?"

Premium Rate by Quarter



DRAWING THE LINE ON PROFITABILITY

Prior to 2015, growing demand for the product resulted in premium rates rising year-on-year, with rates exceeding 4%. From 2015, increased supply in the form of new market entrants and greater availability of (re)insurance capacity resulted in a downward rate trajectory, with rates falling below 3% by 2018.

In early 2020, premium rates started to increase in response to rising RWI claims and a hardening of the broader property & casualty market, particularly financial lines (D&O and E&O, etc.).

By Q4 2020, premium rate increases had gathered pace with our average premium rate reaching its peak of 5.3% in Q1 2022. The reasons for the dramatic increase in pricing were (i) surging demand as widespread adoption of the product by dealmakers converged with record deal flow and (ii) carriers having insufficient capacity to meet the demand. While some of the capacity constraints were financial in nature (certain insurers maxed out allocated premium targets in 2021), the binding constraint was human capital – the RWI market did not have sufficient underwriters to service the influx of deals. These factors pushed premium rates to a much higher level than could be justified by underwriting profits/ losses alone.

Carriers responded to the 2021 crunch by investing in people. Having solved the human capacity constraint, deal activity slowed significantly by the second half of 2022. Moving into 2023, deal activity dropped off further and, as carriers competed for a dwindling pool of deals, they chased premium rates down, resulting in Q4 2023's record lows.

> Pre-2017 underwriting years were marked by relative stability and strong profitability...for more recent years, loss ratios continue to develop.

DRAWING THE LINE ON PROFITABILITY

With rates well below 3%, RWI insurers are questioning the impact this has on profitability and asking "what rate is required for claims to continue being paid in an efficient manner?". Two common metrics to determine underwriting profitability are (i) loss ratios and (ii) combined ratios. The loss ratio is a measure of incurred claims in relation to gross written premium. The combined ratio is a measure of incurred claims as well as certain expenses (including MGA and broker commission) in relation to gross written premium. In many lines of insurance, it is common for combined ratios to run at 100% or more, with insurers still able to turn a profit based on investment returns.

For RWI underwriting years 2010 through 2016, carriers now have a reasonable degree of certainty in final loss ratios which are likely to be in the region of 30 - 40%. Assuming an expense ratio of 35%, this results in a combined ratio of 65 - 75%. It is important to note that during this period there was a narrower scope of cover and policy retentions were significantly higher than they are today. Not only were policies more insurer friendly, the scope of underlying representations was narrower (as previewed in prior reports, the scope of representations for deals backed by RWI has expanded over the years as dealmakers and advisors seek to maximize the value of insurance). In summary, pre-2017 underwriting years were marked by relative stability and strong profitability but during this period, premiums were generally in excess of 3%, initial retentions were higher (typically 1%+ of transaction value) and cover was more restrictive.

For more recent years, loss ratios continue to develop. Although most claim notices are received within 24 months of closing, large and complicated claims can take time to resolve, e.g., one noteworthy claim from a 2019 policy, likely to settle in the hundreds of millions of dollars, remains open. For 2017 to 2020, when premium rates hovered around 3%, the view is that loss ratios of 50 - 60% are a reasonable estimate. Adding expenses would increase the combined ratio to between 85 - 95% but for certain insurers, combined ratios exceeded 100% in some years.

Although most claim notices are received within 24 months of closing, large and complicated claims can take time to resolve.

DRAWING THE LINE ON PROFITABILITY

While loss ratios for 2021 and 2022 are still unclear, insurers are confident that the combination of (i) high premium rate and (ii) relatively restricted cover (as compared with 2023) will result in favorable loss ratios, even though they expect to pay a significant dollar amount in claims under 2021 and 2022 policies. Their real concern around profitability lies with 2023, driven by the perfect storm (from an insurer's perspective) of broad cover, low premium rates and low retentions. If such market conditions continue, concerns will remain for 2024 and beyond.

Atlantic places utmost importance on securing an efficient and equitable outcome for our clients in the event of a claim. Maintaining a positive claims experience going forward will require the RWI market to "find its feet" with a premium rate that supports profitable underwriting. Uncertainty as to the appropriate rate remains but the consensus is that rates below 2.5% are unlikely to be profitable in the long run. As mentioned in this report, our expectation is that rates will return to the long-term average of approximately 3% once M&A deal activity increases, potentially increasing to 3.5% if there is a significant increase in M&A activity. We believe it is unlikely that premium rates will increase above 3.5% in the foreseeable future unless there is adverse deterioration in the development of historic loss ratios and a withdrawal of (re)insurance capacity from the class.

Our expection is that rates will return to the long-term average of approximately 3% once M&A deal activity increases.

2024 OUTLOOK

The first six weeks of 2024 have continued in a similar vein to Q4 2023, with a steady but modest submission volume reported by Atlantic and the broader market. There are signs of activity picking up but it remains to be seen if the tide is turning.

Given the broader economic environment, we expect to see a continuation of RWI being used on alternative deal structures, whether that be carve-outs (where there are unique RWI considerations that Atlantic's team of experts can navigate), take-privates (including targets that undertook de-SPAC transactions in 2020 - 2022), non-control investments (including preferred equity transactions) or fund continuation transactions (with greater flexibility on cover for flat portco-level representations) and the emerging use of insurance to support traditional LP transfers.

We have already seen an effort by certain carriers to stabilize and lift premium rates and we expect this will start having a broader impact when M&A activity levels increase. As noted earlier in this report, we expect that rates will stabilize just north of 3% unless there is a material increase in deal activity, in which case rates might tick up towards 3.5%. We do not expect premium rates to increase above 3.5% in the foreseeable future unless prior underwriting year loss ratios significantly deteriorate.

We expect retention levels to remain at the lower levels we were able to obtain in the second half of 2023 and for this to remain the case even when deal activity increases, with carriers focusing on premium rate hikes instead.

The way carriers respond to a growing number of claims and their ability to efficiently reach a resolution on large claims will be an increasingly important factor when deciding upon which carrier to instruct. We also expect carriers to focus underwriting on high-risk areas in which they have experienced material losses, including financial statements, material contracts, intellectual property infringement risks for high-risk sectors (in particular defense costs exposure) and condition of assets matters on infrastructure transactions.

2024 PREDICTIONS

- **Retention levels to remain at low levels reached in 2023.**

- **Premium rates to increase to ~3% when M&A activity recovers. Increases above 3.5% unlikely.**

- **Broad RWI cover will remain available but carriers will increase focus on risks arising from claims experience (i.e., condition of assets, material contracts, financial statements).**

ABOUT ATLANTIC

Atlantic is the only independent specialist insurance broker with M&A, tax, structured credit and contingent risk practices under a single banner.

Our insurance solutions facilitate M&A transactions, provide liquidity to investors, optimize balance sheets and reduce capital constraints.

We are a truly diverse workplace bringing the best minds from outside insurance, inside. Our collaborative culture ensures that our clients benefit from the collective knowledge and experience of our industry leading experts, who have backgrounds in law (M&A, tax, litigation, in-house), investment banking, tax, accounting and insurance.

With 9 offices across the United States and Canada, we represent many of the world's leading 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 dedicated RWI claims practice, led by one of the most experienced litigators focused on RWI in the US, has a stellar record in securing positive claims outcomes for our clients.

85+
Employees

9
Offices

11%
Increase in Deal Count vs. Prior Year

31%
Increase in Policy Count* vs. Prior Year

$389M
Average Transaction Size

$11bn
Largest Deal Size

*Includes all primary and excess RWI, fundamental top-up, IP top-up and tax top-up policies.

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