

Insights into W&I Insurance Claims in Asia

What half a decade of data tells us



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Introduction: Evolution of Warranty and Indemnity Insurance

An exponential increase in the uptake of Warranty and Indemnity (W&I) Insurance in M&A transactions in Asia cements its viability as a deal-enabler and alternative dispute resolution mechanism.

In 2014, Marsh Asia placed the first onshore Malaysia and Philippines W&I insurance policies. We had been offering the product since 2007 in Asia with some traction, but that was insignificant compared to the volume we now place. Six years on from those first deals, it is safe to say that times have significantly changed — the number of policies placed in Asia has increased exponentially, between 40% to 65% year on year, since 2015. The increasing universality of W&I Insurance in deal structuring clearly shows that clients see the product as a useful tool to insure and transfer their risks in a deal.

In our inaugural edition of the Transactional Risk Insurance (Asia) Claims Study, we investigate the reasons behind the popularity of W&I Insurance by analyzing claim trends, and examine: (1) how the claims environment has changed; (2) why this is; and, (3) what developments the future may hold based on current trends and our observations in more established W&I Insurance markets.

Our findings are groundbreaking. A snapshot of the most recent statistics reveals that the increased purchase of W&I policies comes with a rapidly growing claims count year on year. Between 2015 and 2019, we recorded a staggering 250% growth in the number of claims filed with Insurers. In total, there were 43 notifications lodged with Insurers across 16 different jurisdictions - showing that W&I Insured risks are now truly globalized.

We also reaffirmed that notwithstanding extensive due diligence being conducted prior to acquisition, some risks remain difficult to fully diligence — an overwhelming majority of the alleged breaches of W&I related to typical due diligence categories such as Tax, Financial Statements, and Compliance.

Given that W&I policies are long-tail¹ in nature (notifications can often arise even a few years after the Target has changed hands) it is not surprising that about 30% of notifications were lodged a year or more after their respective policies were issued. Our data reveals, however, that a majority of notifications were lodged within the first 12 months of their respective policies' lives.

Even as uninsured M&A deals are likely to continue to be commonplace in Asia, the increased uptake and corollary claims count demonstrate that W&I insurance is increasingly valued by both buyers and sellers in managing their risks and deals.



299
DEALS



43
NOTIFICATIONS



16
JURISDICTIONS



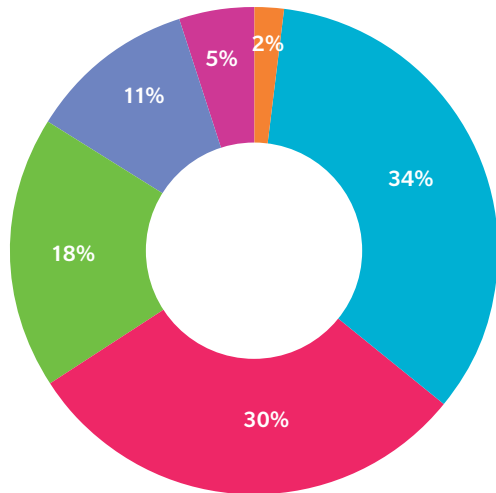
5 Years
TIME FRAME

¹In Asia, business and general warranties are usually covered for up to three years post-Closing, whereas tax and fundamental warranties typically have a longer coverage time limit of up to seven years after Closing.

Industry highlights

FIGURE
1

Notifications recorded by Insurers



Insurer A	Insurer B	Insurer C
Insurer D	Insurer E	Insurer F

Over the last five years, there have been more deals (which required W&I Insurance) placed by Corporate entities than Private Equity clients, which translated to a majority of notifications being filed by Corporate clients. As a general rule of thumb, the higher the placement rate, naturally, the higher the notifications count will be.

- We recorded a **250% growth** in the number of claims filed between 2015–2019.
- Approximately **15.46%** of all policies placed in 2019 received at least one notification.
- **74%** of all notifications were for deals with enterprise values of **< USD 500m**.
- Tax and Financial Statement breaches continue to be the most prevalent categories of breaches.
- Singapore and Japan clients place the most number of W&I insurance in Asia and, thus, lodge the most number of claims.
- **58.13%** of notifications are filed by Corporate clients as opposed to Private Equity clients.

FIGURE
1A

Notifications by type of clients

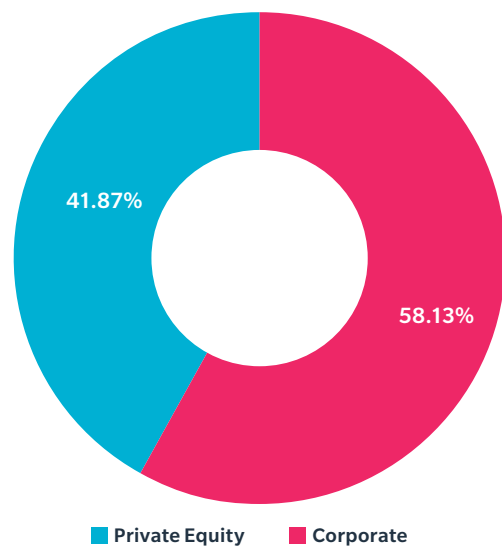


FIGURE
2

The total number of notifications increased sharply from 2017

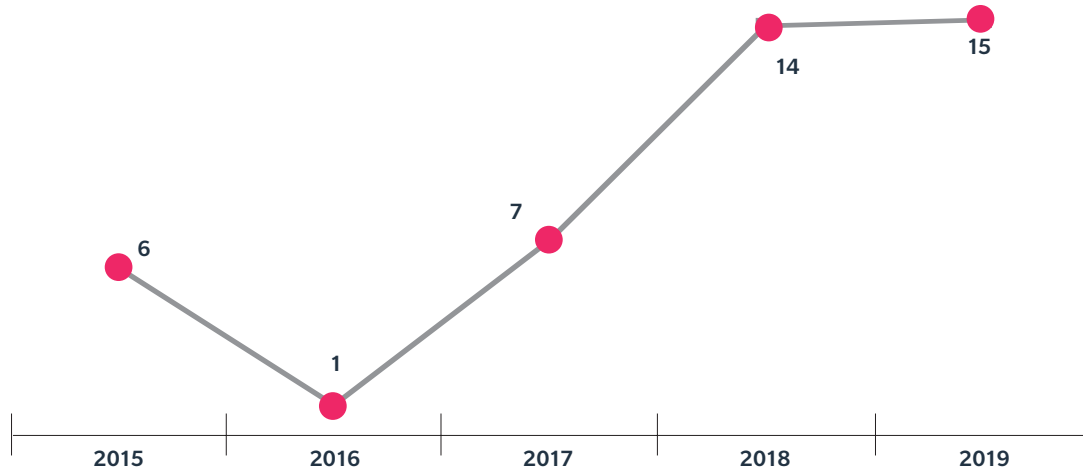
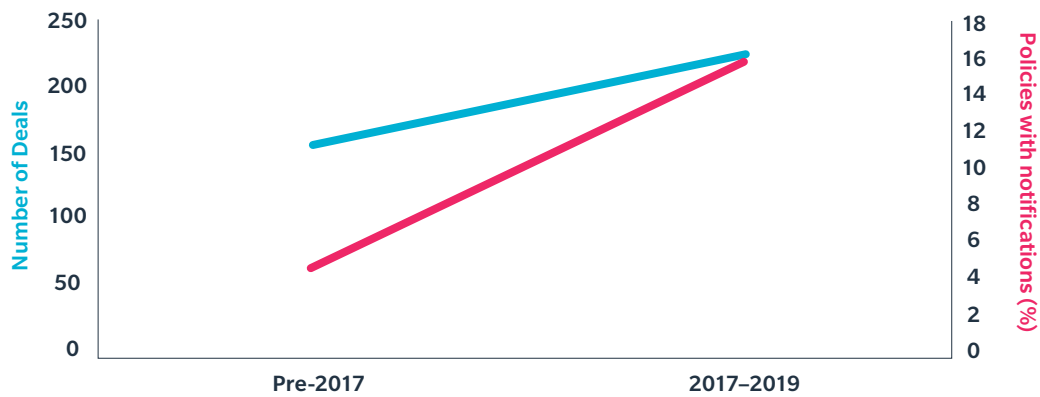


FIGURE
3

Notifications as a proportion of all deals placed increased between 2015 and 2019



Notifications at a glance

Between 2015 and 2019, the number of W&I insurance claims notifications increased steadily in terms of both volume (Fig. 2) and as a proportion of all policies placed (Fig. 3).

The sharpest increase was recorded between the years 2017 and 2018, which proved to be the beginning of an upward trend. In 2019, we ended the year with the most number of notifications filed. Our data also shows that approximately 15% of all policies placed over the last five years received at least one notification against them.

This is an unsurprising trend. The close correlation between placement and notifications counts can be explained by Insureds' attraction to a more cost-effective and less acrimonious alternative dispute resolution mechanism, and increasing familiarity with how to deal with claims under their policies.

Notifications by deal size

Larger deals have more complexities and, thus, often result in a higher rate of breach.

At first blush, it appears that an overwhelming majority, 74%, of all notifications (see Fig. 4) lodged were in respect of deals with enterprise values of less than US\$500 million. This broadly correlates with the fact that most deals (almost 60%) in Asia are for Targets with enterprise values within that range.

When we compared the rate of notifications in their individual categories (see Fig. 5), however, we noticed that the larger deals attracted a higher rate of notifications. For example, a minority of deals (almost 7%) placed were for Targets with enterprise values of more than US\$1 billion. However, the rate of notifications for this category is higher at 21.05% as opposed to 19.63% for deals placed in the US\$500 million category.

Given that the average rate of notifications for all deals is 15%, this is an above-average rate of notification — which can be explained by the numerous complexities at due diligence (i.e. in accurately identifying historic liabilities).

FIGURE
4

Number of notifications grouped by deal size

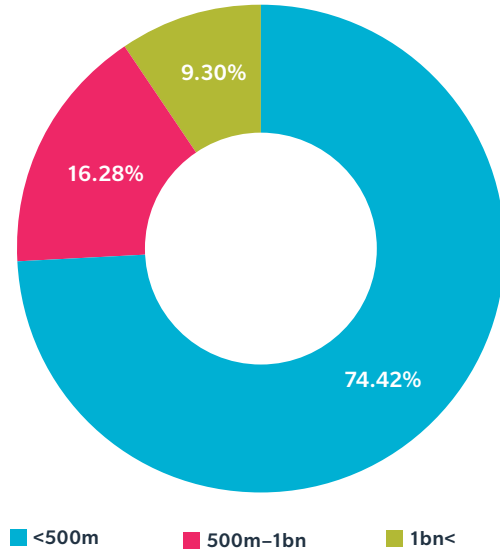
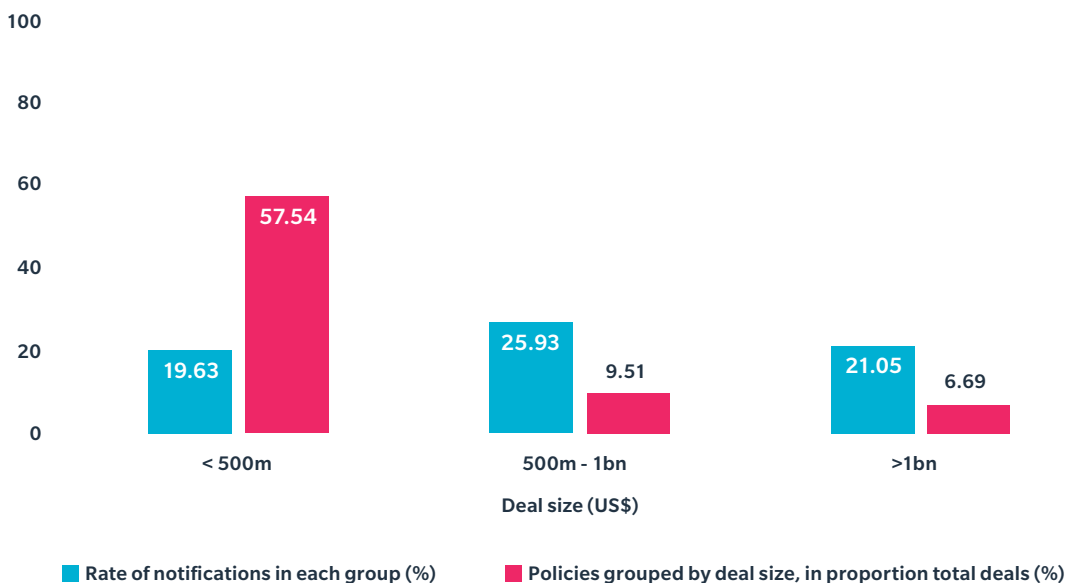


FIGURE
5

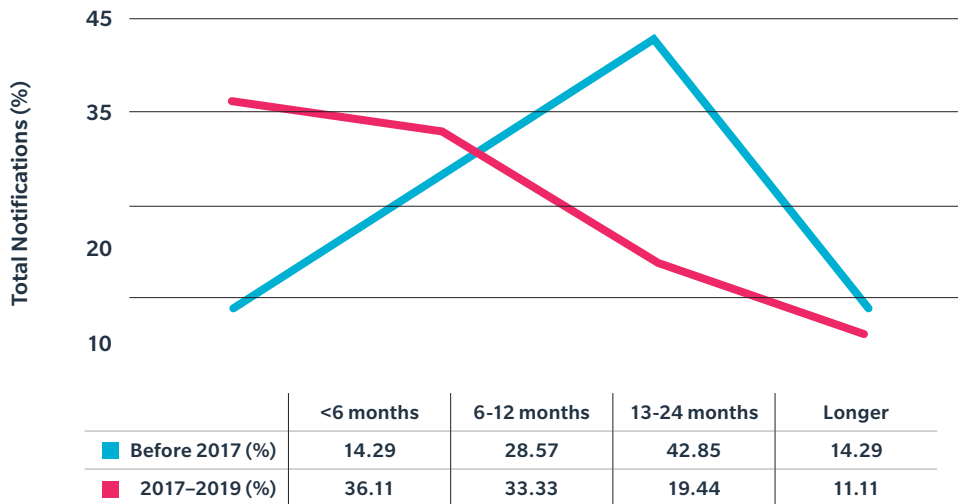
Notifications made as a proportion of its deal size (i.e. policies grouped by deal size)



Timing of notifications

FIGURE
6

Clients are filing notifications earlier



Clients are aware that they must file notifications “as soon as practicable” and act proactively.

Between 2017 and 2019, we recorded a 23% increase in the number of notifications lodged less than six months after a policy was inception — 36.11% of notifications were filed between 2017 and 2019 at this early period. During those same years, 33.33% of notifications were filed within 12 months. Our data proves that clients are filing their notifications early — the vast majority now file within a year of the policy’s commencement date — as increased awareness in the product and claim notification requirements become more prevalent. Indeed, many clients act prudently to file notifications as soon as practicable from the date of their knowledge of the breach, and even in circumstances where a claim has yet to definitively arise. We agree with this approach as keeping Insurers updated of any actual and/or potential liability is always prudent in the unfortunate event that a claim does arise later on.

Later Notifications

Notifications coming in later than 24 months after commencement remain sizeable, forming about 12% of all notifications in the last five years, due to (amongst others) two factors:

- i. W&I insurance policies are long-tail and, in Asia, can be covered for up to seven years, meaning that many policies placed earlier have encountered claims in the latter half of their lives; and,
- ii. Tax issues (which, as we will elaborate, account for a sizeable number of notifications in Asia) notoriously tend to arise several years after a filing has been registered with the authority.

FIGURE
7

Percentage of Closed Claims

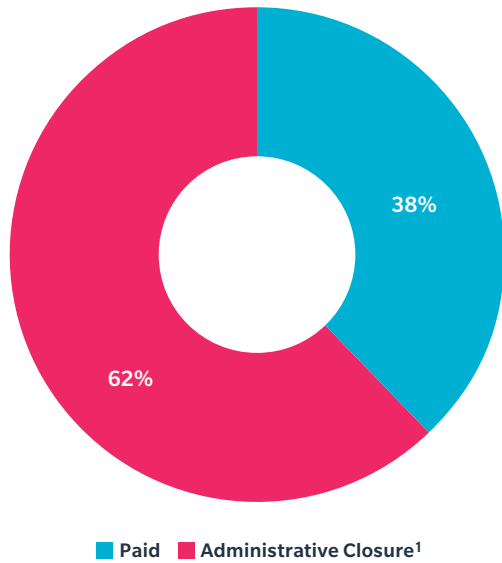
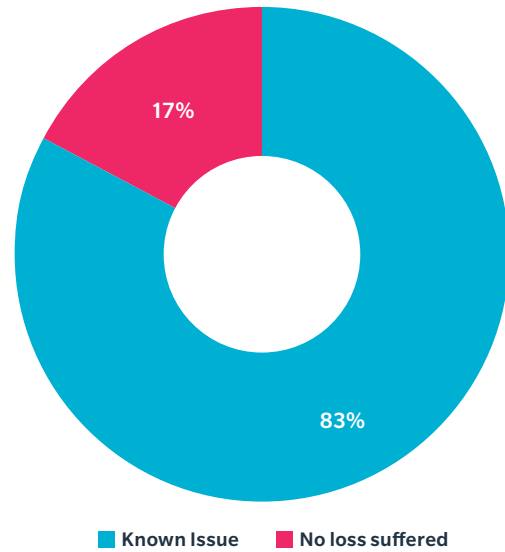


FIGURE
8

Denials



Claims are being paid

Despite being a relatively new line in Asia, 38% of closed claims were paid in the last five years. It must be borne in mind that closed claims (whether settled or not) are few and far between in Asia (a majority of the notifications we have lodged continue to be ongoing matters) given the relative youth of the product and the fact that Insureds tend to require time post-notification to definitively assess the extent of a breach and their loss suffered, and to gather supporting information and documents.

Thus, we fully expect the amount of closed claims and settled claims to increase as clients' understanding of the product, and the evidence required to support their claims, continue to grow.

Actual knowledge and prior disclosure account for a majority of denials

A large majority of rejected claims were denied on the basis of Actual Knowledge or Prior Disclosed Matters, i.e. known issues. This can be attributed to a lack of understanding that insurance only covers unknown risks or a discrepancy between the personal knowledge of the clients during the due diligence process and the information captured in the data room and/or in due diligence reports. Be that as it may, we anticipate that as clients become more aware of these issues, they will pay greater attention to the due diligence process to scrutinize what may be excluded for the purposes of a future claim.



¹A without prejudice closure of the file which reserves the right of the Insured to re-open the claim upon future developments or provision of new information. This is performed for purely administrative reasons.

A glance at breach types

FIGURE
9

W&I notifications by breach type

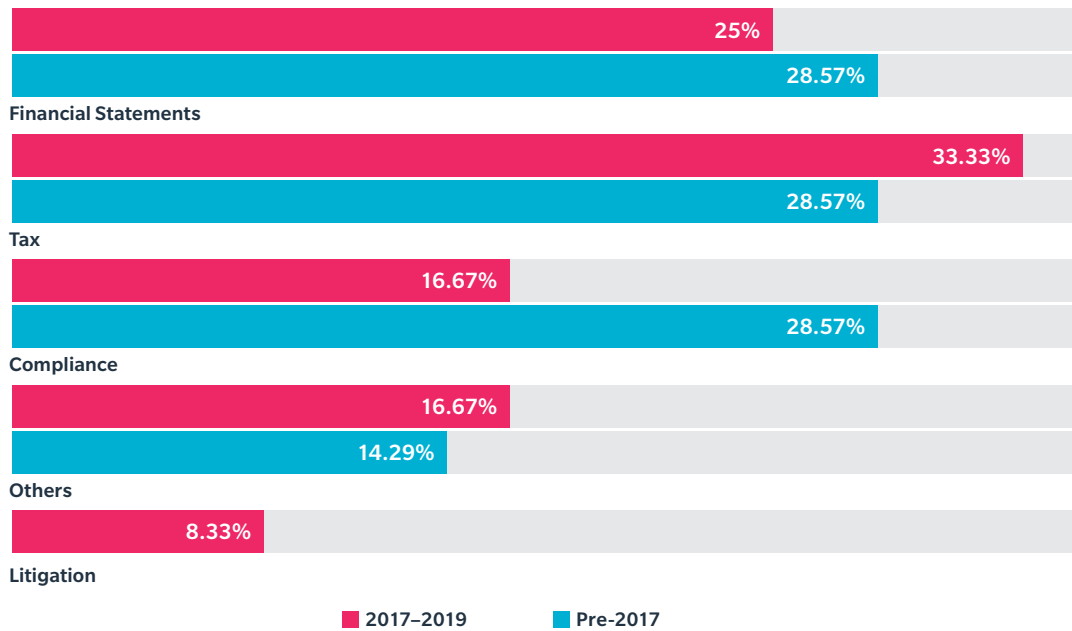


FIGURE
10

Percentage of all notifications grouped by industry type

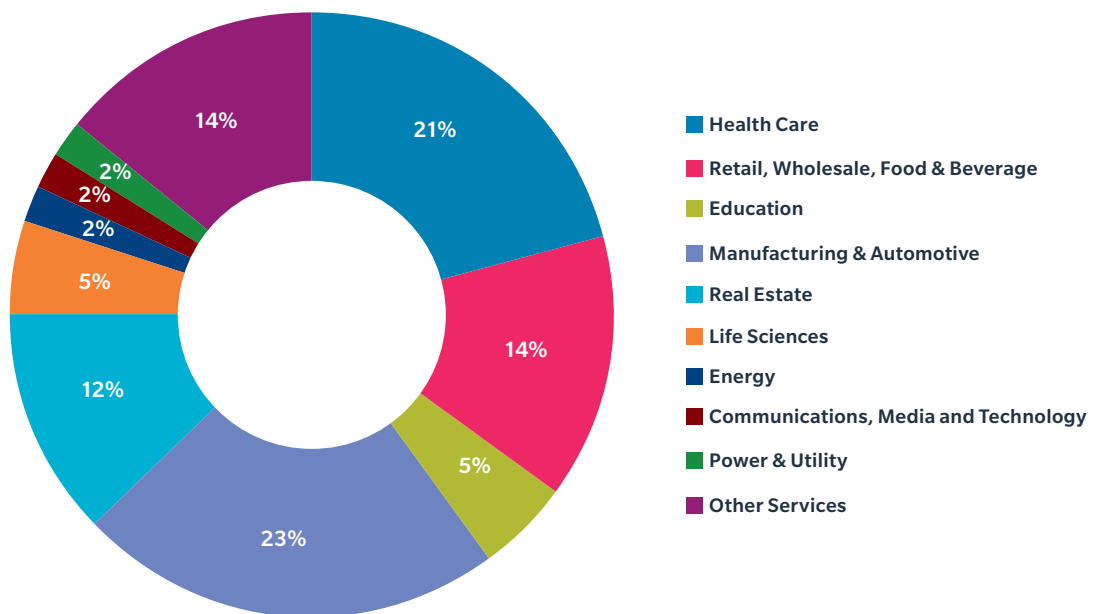
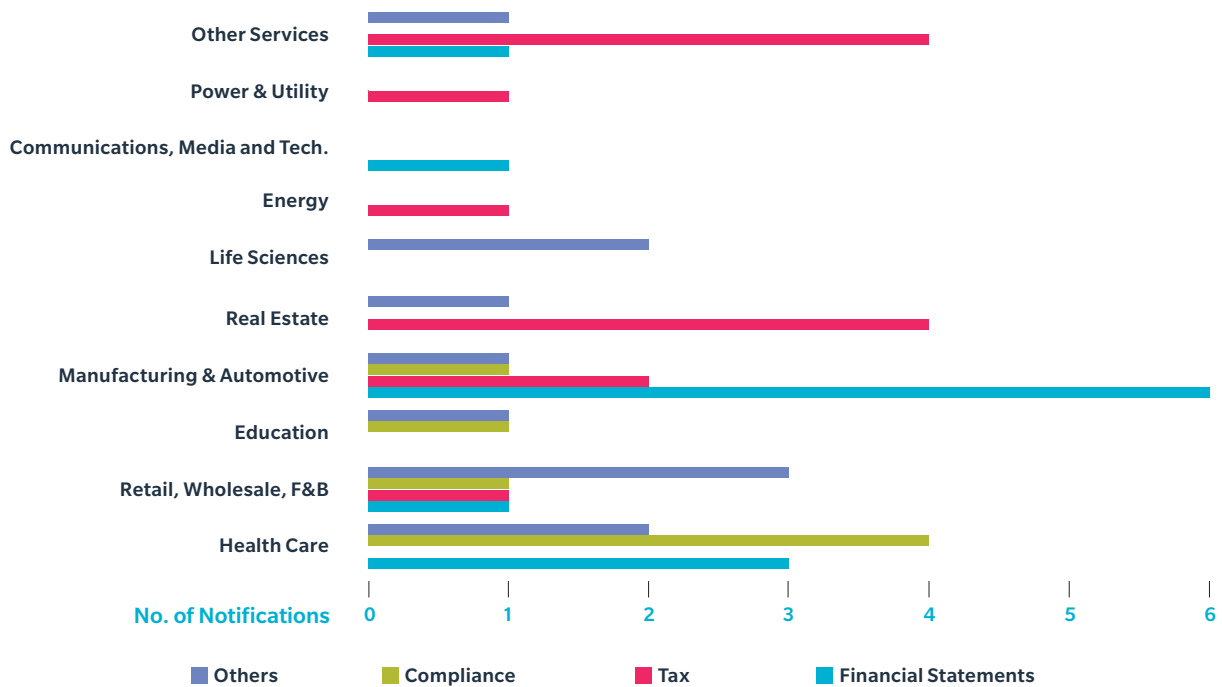


FIGURE
11

Most common types of breaches by industry type



We have seen a marked increase in the total number of Tax and Financial Statements breaches. Taken together, Tax and Financial Statements breaches now account for 60% of the notifications filed with insurers between 2017 and 2019 and, as Figure 11 shows, are the most common type of breaches encountered and notified by Insureds across industries and feature in almost every industry our Insureds are transacting in. The highest claim-rates were recorded in the Manufacturing & Automotive and Real Estate industries. Insureds in these two industries lodged the highest amount of Financial Statements and Tax notifications over the last five years.

Financial Statements

This is a prevalent issue in transactions — common Financial Statements-related problems include misstatements, failure to comply with accounting rules, and overstatement of profit. These issues are generally not obvious to an Insured as only in the post-acquisition period can the Insured discover the intricacies of the business and whether that has been correctly accounted for in the pre-acquisition financials.

A corollary decrease in the proportion of Compliance issues is explained by increased sophistication and intensity of the due diligence process for most Asian transactions. Evidently, however, as the next most common type of breach, Compliance problems will still continue to affect some clients, particularly in ensuring full compliance with all applicable regulatory requirements in multi-jurisdictional businesses.

Tax

Tax problems will continue to plague Insureds post-acquisition as long as filings are retrospectively reviewed by the Tax Authorities, often a few years after these have been lodged. While sellers may assure buyers that filings have been made, given that buyers are ultimately reliant on the assured accuracy of information and documents provided for during the Tax due diligence process, it is often difficult for Insureds to predict whether they will encounter assessments and/or investigations into those returns post-acquisition. Tax Indemnities prove their value by assuaging buyers' concerns on such retrospective assessment. W&I coverage for market standard Pre-Closing Tax Indemnities proves W&I insurance's value by assuaging, to a significant extent, buyers' concerns.

This tells us that the experience of Insureds are the same across lines; despite extensive due diligence, historic liabilities are being discovered post-acquisition in both the financials and Tax compliance of the Target.

Third Party Demands

A small portion of notifications filed between 2017 and 2019 related to issues regarding prior or pending litigation suits against Targets. This does appear to be more widespread in the United States. The remainder of notifications fall in categories including breaches relating to warranties regarding Information Statements, Intellectual Property, and Material Contracts.

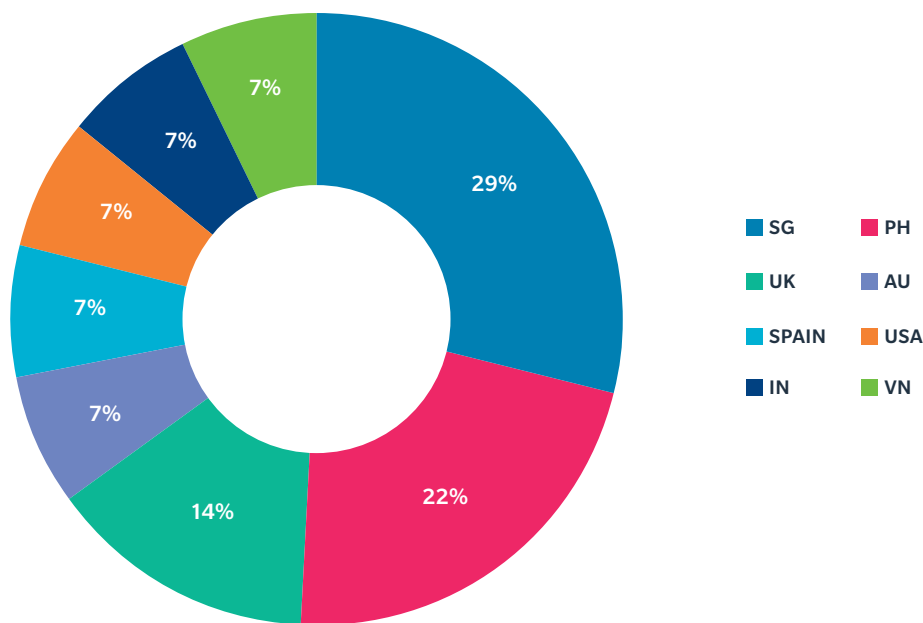
Zeroing in on Tax breaches

Globally, both Tax and Financial Statements breaches have always been amongst the most common types of breaches alleged for notifications. The almost 6% growth in the number of Tax notifications since 2017 is consistent across multiple jurisdictions. Out of the 16 jurisdictions in which Asian-based entities transacted, 50% of the countries registered a Tax-related notification. It is apparent that the highest number of Tax-related notifications have come from entities based in Singapore.

Tax breaches also have a higher rate of appearing later in a policy's life (i.e. 28.57% of Tax notifications were filed more than 24 months after commencement) as opposed to Financial Statements breaches (9.09% of these notifications were filed in that same period). This is probably due to the long-tail nature of the Tax assessment process which may take several years - typically starting with the authorities making queries and (on the basis of those queries) formally investigating potential liability, before issuing any final assessment of additional Tax liability.



FIGURE 12 Tax Notifications

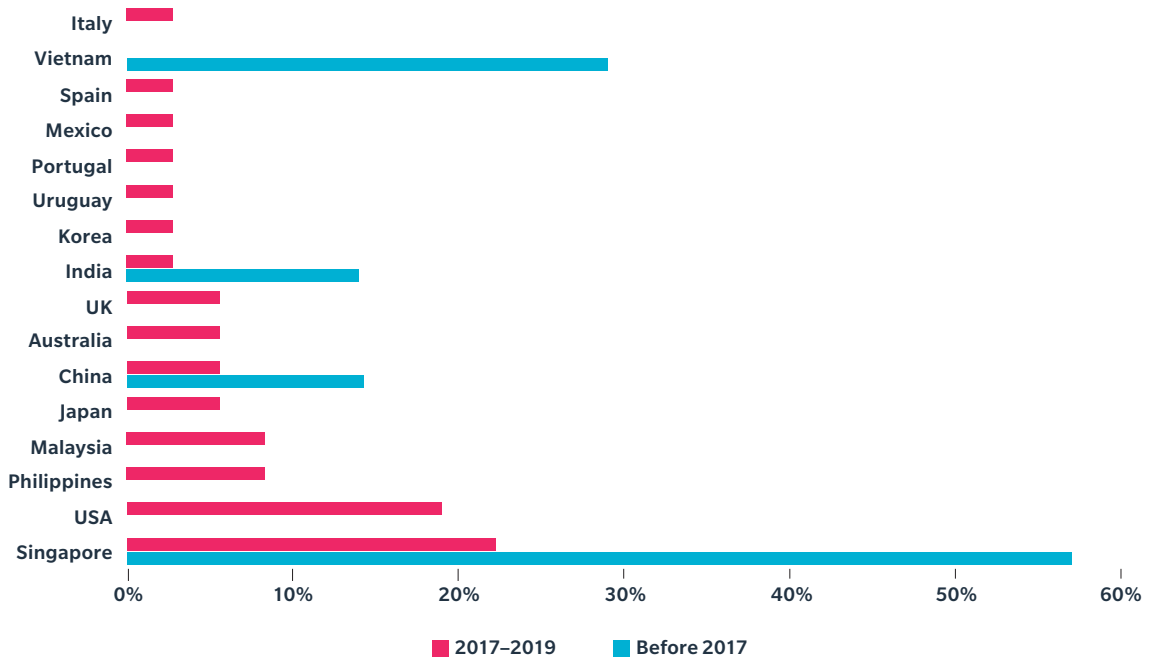


Globalization of transactions lead to globalization of risks

Our statistics track where a Target is headquartered in a transaction. For placements originating out of Asia, Singapore continues to lead the region with the highest number of notifications, as the country is traditionally a hotspot of M&A activity. However, our latest statistics also reflect that with increased volume in cross-border M&As since 2017, there is now a greater exposure for Asian buyers to global risk areas, including Europe and the USA³.

FIGURE 13

Notifications by location of the risk



Singapore risks in detail

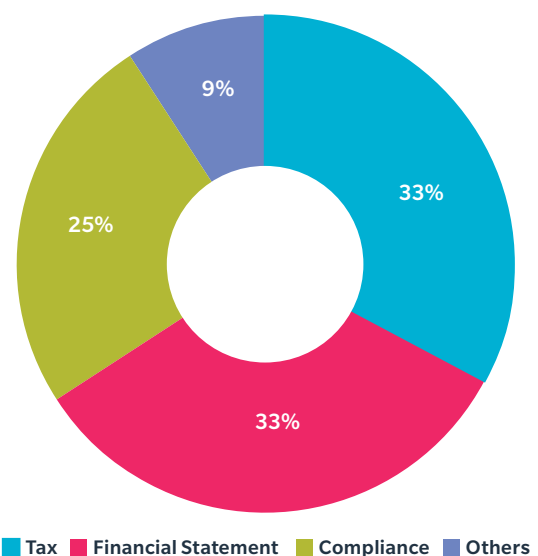
The majority of Asian risks originated from and involve Singapore-based entities. As a brief background, majority of our Singaporean clients have to date acquired Targets in the Health Care and Real Estate industries. While the most common types of breaches for the Health Care industry involves Financial Statements and Compliance issues, the Real Estate industry frequently faces Tax issues as regulators tend to scrutinize property holding companies to ensure that the correct rates have been applied in property transactions.

To elaborate, our analysis shows that many of the Tax-related breaches are in respect of inaccuracies in filing corporate income tax returns and in the application of tax reliefs (which may be used for certain expenses). This makes sense, given that the tax regime imposes the computation burden on tax payers, who are given the discretion of subjecting their tax returns to deductions at the time of filing. Expectedly, common mistakes include wrongful claims of non-deductible expenses, or simply inaccurately computing the total tax payable.

³Our placement volume has also increased over the last three years. This should not detract from the observation of increased cross-border transactional risks for entities.

FIGURE 14

Singapore notifications by breach type

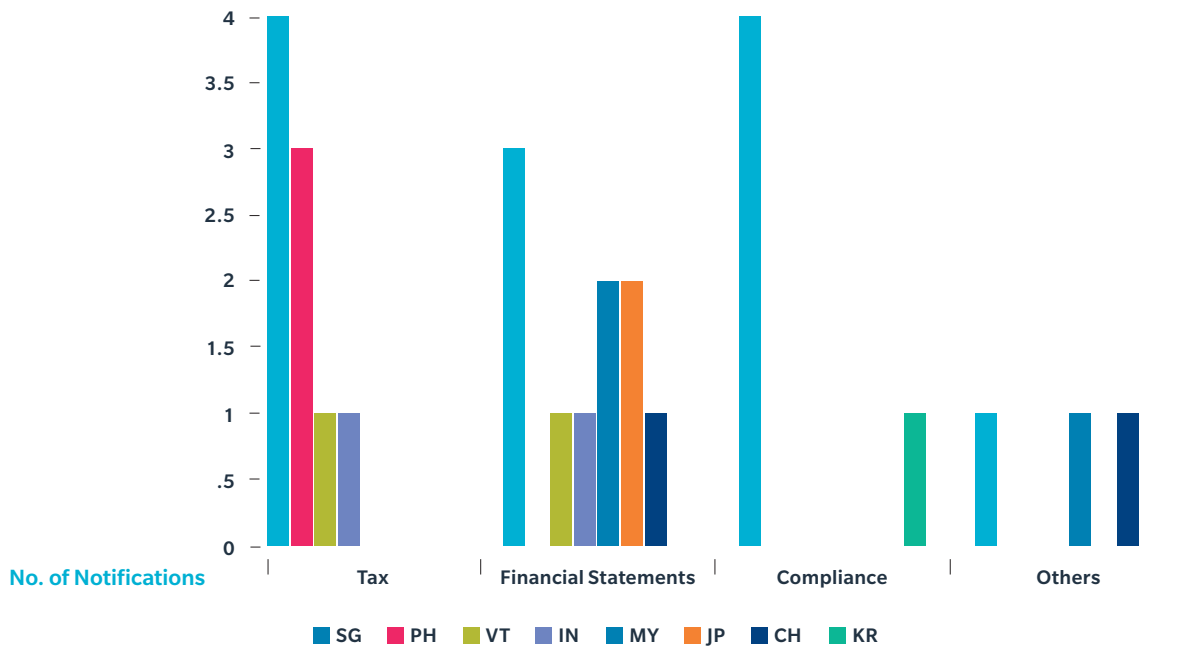


Rest of Asia risks

Across the rest of the region, risks faced by Targets located in the Philippines, Japan, China, and Vietnam have a very similar trend as in Singapore, i.e. Tax and Financial Statements breaches continue to be the most common, followed by Compliance issues.

FIGURE
15

Asia risks by breach type



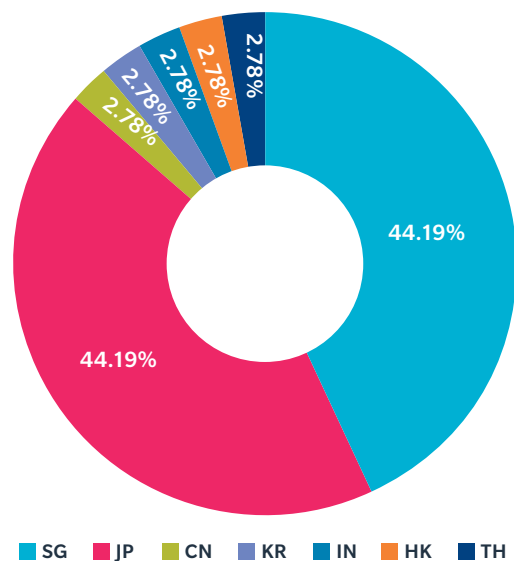
Singapore and Japanese clients file the most notifications

Our statistics also track the country in which the deal originates. In this regard, Singapore and Japanese deals, inclusive of cross-border transactions for foreign Targets, recorded the most number of notifications in the last five years. This is unsurprising as the two markets account for a majority (53%) of deals across the region.

The remaining markets, i.e. China, Korea, India, Hong Kong, and Thailand, filed an equal number of notifications amounting to almost 14% (in total) of all notifications.

FIGURE
16

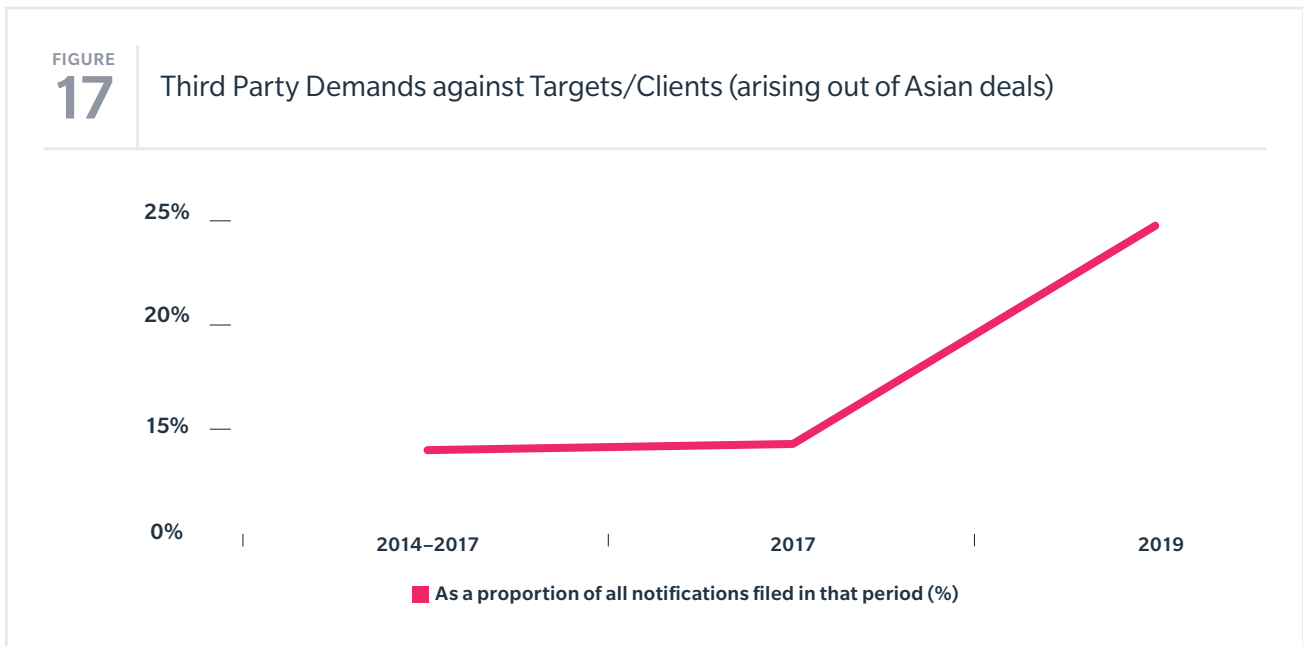
Notifications by placement office (%)



Globalization of risks: Increasing number of Third Party Demands

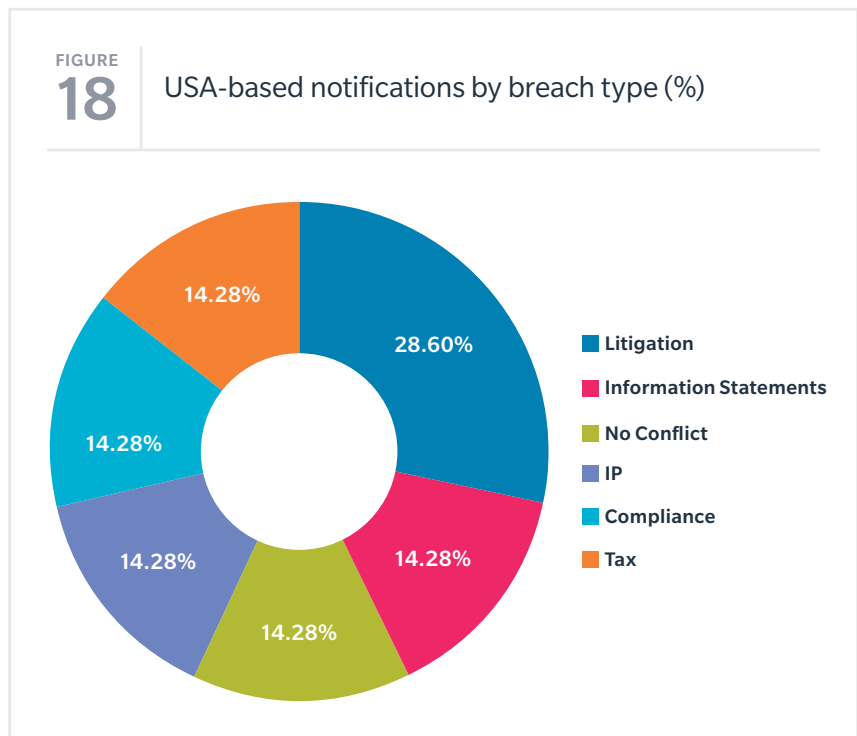
The increased volume of cross-border transactions for Asian entities has similarly globalized the risk locations for both buyers and sellers with Targets located across regions. Although, Asia has not embraced the class action lawsuit model that is prevalent in the USA. However, our data suggests that Asian clients are increasingly dragged into class actions vis-à-vis their Targets with USA operational exposures. The table below also shows an increase between 2017 and 2019 in the number of clients who are facing post-acquisition Third Party Demand suits against them or the entities which they purchased.

In particular, we have noticed that the bulk of these Third Party Demands have arisen out of Japanese clients' deals for international Targets (i.e. this forms 56% of all Third Party Demand notifications) correlating to the fact that cross-border transactions increase the risks faced by entities, particularly in litigious regions.



A notoriously litigious region is the USA where a substantial proportion of the uptick in notifications (relating to Asia placed transactions) are traced to Litigation warranties, i.e. where a Seller has warranted that there are no prior or pending litigation suits against the Target.

Further, our data shows that class-action regimes do inherently contribute to the rising trend of lawsuits against Targets. If these companies are publicly-listed, it is common for shareholders to allege inaccuracies in the Information Statements (which sellers often represent are accurate in W&I) provided to them prior to approvals for M&As.



⁴This statistic excludes tax assessments by tax authorities.

Conclusion and possible developments

Increased claims count

Even as we ended 2019 on a high note with the highest amount of placements recorded in Marsh Asia's history, from a claims perspective, we also recorded the highest amount of notifications. It is our view that one should expect an even higher notification count in the upcoming years as the product becomes more popular and Insureds begin to see it as a viable tool to expeditiously resolve their breaches.

Where previously the market may have imposed a stringent timeline upon Insureds, e.g. within 30 business days, there are a number of Insurers who are willing to amend this notification period to "as soon as practicable" in recognition of the reality that full details and information may not be available to the Insured at the start of the notification process, so long as these are provided later on. In any event, whether there is a fixed notification time period or otherwise, we fully expect Insureds to continue to lodge claim notifications early because they are increasingly aware of the importance of updating Insurers, even if they do not necessarily have all the facts, and prudently reserving their rights under the policy.

Tax and Financial Statements claims will continue to feature

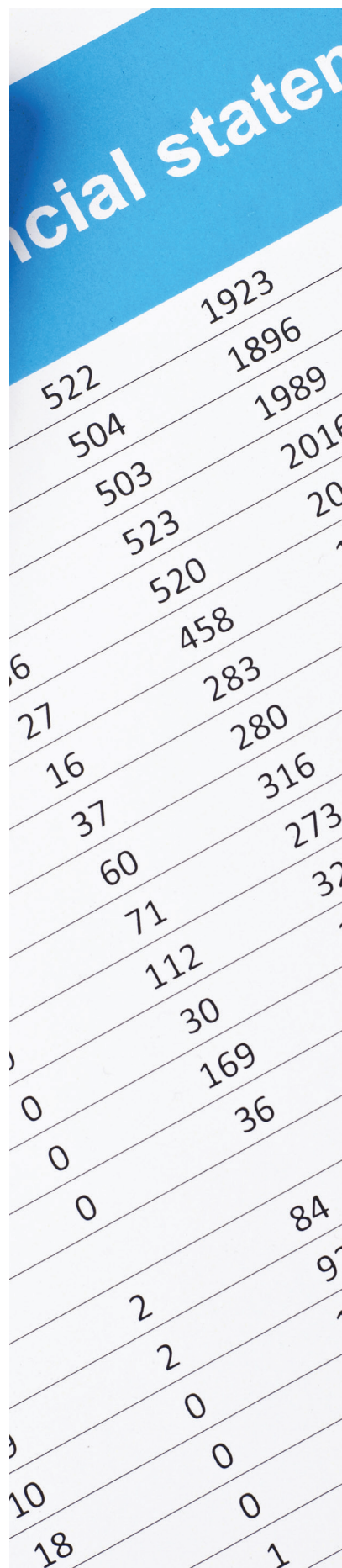
Based on the types of breaches we have observed in the last five years, and the consistent trend of Tax and Financial Statements being the two most common types of breaches year on year, these two categories of breaches will likely continue to be the most common issues an Insured will face in any given transaction. Whilst it is to be hoped that increased due diligence should be able to pick up historic issues, it is often difficult to predict:

- A. Whether a Target has correctly filed its returns in the pre-acquisition period;
- B. Whether a Target has correctly reported its financials prior to the buyers taking charge of the entity and performing its own audit after understanding the inner workings of the business.

Summary

Even as cross-border M&A increases, based on our findings, the globalization of transactions inevitably creates and increases risks for clients. To this end, where check-box due diligence may have previously assured buyers of the potential risks they may face in a given deal, our data reveals that some risks, like the accuracy of reported Financial Statements, remain difficult to fully diligence before the company changes hands.

In the midst of all that uncertainty, Insureds are persuaded to allocate their risks in a more expeditious and cost-effective way than traditional M&A has previously known. The evolution of W&I insurance puts it in prime position to both facilitate deals and protect Insureds against unknown risks. It is for this reason that we expect the product's popularity to grow year on year.



For more information about M&A insurance and other solutions from Marsh, visit www.marsh.com, or contact your Private Equity and M&A Practice representative.

CHEOW AI LING

Ai Ling leads both the Asia Practice of Private Equity and Mergers & Acquisitions Services and Transactional Risk in Singapore. Ai Ling's principal responsibility is advising private equity and corporate clients in their risk issues through their deal cycle. Ai Ling has pioneered the development and growth of warranty and indemnity insurance throughout Asia where she has achieved milestones such as placing the first onshore warranty and indemnity policy in Malaysia and Philippines, placing the first Litigation Buyout policy in Asia Pacific and placing the policy with the largest limit in Asia in 2015. Since then, Ai Ling has grown both the team and the market share of Marsh in all countries in Asia.

PIN LI LIM

Pin Li is a Claims Advocate handling Private Equity and M&A, Financial Lines and Professional Liability claims in Marsh's Global Claims Practice. Pin Li has successfully argued high quantum and complex claims in a variety of different matters – including white collar crime, cyber-attacks and directors' and officers' liability. Pin Li is also an admitted advocate and solicitor of the Supreme Court of Singapore and member of the Singapore Academy of Law. Prior to joining Marsh, Pin Li practised as a litigator in a number of Singaporean law firms.



ABOUT MARSH JLT SPECIALTY

Our Asia PEMA practice began life in 2006, growing from strength to strength since then. We now hold the largest market share of any PEMA related work in Asia. Marsh Asia also works with more than 200 private equity funds, which translates to almost 42% of our placements. This has given us the deepest deal experience in the insurance broking industry and has provided clients with a smooth implementation process.

Marsh's global network of risk and insurance advisors focusing on W&I insurance allows sellers to flip Marsh to buyers in any jurisdiction, with the assurance that the buyers will have on the ground support from Marsh to complete the W&I insurance process. Our regional team in Asia comprises more than 30 specialists, amongst whom are ex-M&A lawyers from reputable international law firms who advise clients on policies and negotiate bespoke coverage packages for them with the Insurers.

ABOUT MARSH

A global leader in insurance broking and innovative risk management solutions, Marsh's 35,000 colleagues advise individual and commercial clients of all sizes in over 130 countries. Marsh is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), the leading global professional services firm in the areas of risk, strategy and people. With annual revenue over US\$17 billion and nearly 76,000 colleagues worldwide, MMC helps clients navigate an increasingly dynamic and complex environment through four market-leading firms. In addition to Marsh, MMC is the parent company of Guy Carpenter, Mercer, and Oliver Wyman. Follow Marsh on Twitter [@MarshGlobal](#); [LinkedIn](#); [Facebook](#); and [YouTube](#), or subscribe to [BRINK](#).

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About Marsh

Marsh is the world's leading insurance broker and risk adviser. With over 35,000 colleagues operating in more than 130 countries, Marsh serves commercial and individual clients with data driven risk solutions and advisory services. Marsh is a business of Marsh & McLennan Companies (NYSE: MMC), the leading global professional services firm in the areas of risk, strategy and people. With annual revenue approaching US\$17 billion and 76,000 colleagues worldwide, MMC helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer, and Oliver Wyman. Follow Marsh on Twitter @MarshGlobal; LinkedIn; Facebook; and YouTube, or subscribe to BRINK.

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