North American Edition

# M&A Insurance: Unpacking material claims in North America

## Our North American edition of AIG's M&A Claims Intelligence report sheds further light on the heightened severity of claims within this market.

Set against the backdrop of an economic downturn, and a deteriorating claims severity, a meaningful correction of Representation and Warranty insurance (R&W) pricing is inevitable. For AIG's R&W book as a whole during the study period, 19% of material claims (up from just 8% from two years previously) were valued at $10m or above, with an average claim size of $20m.[1]

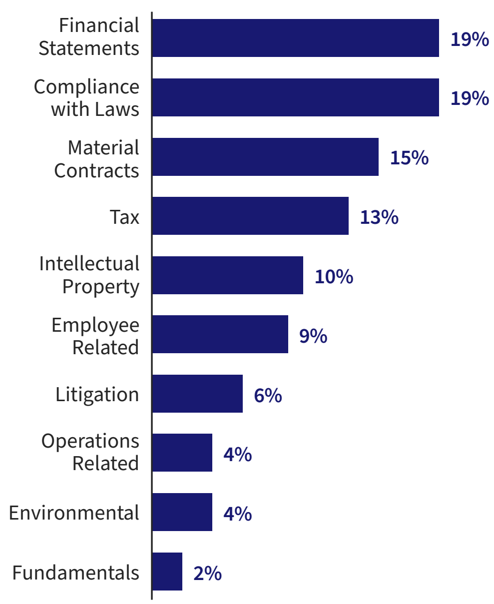
**The full report can be found here**

1 The AIG Report reviewed claims made during the study period spanning policies written between 2011 and 2018 covering approximately 3,500 deals

The increased claim size reflects a number of underlying trends, including more detailed product knowledge. Another contributing factor to the increased claim severity is the impact of EBITDA multiples in valuation. Buyers may use a multiple of EBITDA to determine the offering price for a target company. If a warranty is breached and it turns out that the EBITDA of the target company was overstated because of that breach, the buyer may believe they have overpaid. In these cases the buyer may request that the EBITDA multiple will be considered in the measure of damages for the breach. "While an EBITDA multiple is often not an appropriate way to measure damages, when it is it can have a dramatic effect on the size of the claim" observes Anna Rozin, North America M&A manager at AIG.

For these largest North American claims - claims with an incurred loss of greater than $10m - there has also been an increase in frequency. While AIG's R&W policies as a whole have an overall claims frequency of one-in-five, frequency across all deal sizes is higher in North America. More than one in every five deals results in a claim, and for deals between $500m and $1bn in size, this frequency rises to 26%. Certainly, the larger, most 'diligenced' acquisitions can still result in material claims.

Fig A **R&W reported incidents by breach type – U.S.**




Yet increasing claims frequency and severity is not a development that is limited to large deals alone - small and middle market transactions in the United States and Canada also trend higher than the rest of the world. In fact, North American deals that have an enterprise value of $250m or less still see a 22% claims frequency and account for some of the claims valued at $10m or above.

"The challenge with the higher claims frequency in North America is that it is then also coupled with the most significant claim severity as compared to the rest of the world," says Rozin. "Our claims data in North America indicates that if the breadth of the coverage provided by R&W insurance is to remain, a correction in pricing will be required to help ensure the long term viability of the product."

In terms of the types of policy breaches, breaches of the financial statements representations are the equal dominant driver of claim notifications across all deal sizes, along with compliance with laws breaches (with a frequency that is higher than the global average). For the largest claims (those with an incurred loss greater than $10m), breaches of material contracts and tax representations are also significant drivers of claims.

As the loss trends continue to unfold in North America, it has never been more important to partner with an M&A insurance carrier that has extensive experience in the market, a proven claims payment track record and a commitment to R&W insurance for the long term.

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# For more information see the full M&A Claims Report **here**