EMEA Edition

M&A Insurance: Unpicking material claims in EMEA

The EMEA edition of AIG's M&A Claims Intelligence report sheds further light on the heightened severity of claims within this market.

For AIG's Warranty & Indemnity (W&I) policy 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]. European claims are in line with this trend, with more severe claims than before, especially on larger deals valued at over $1 billion.

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

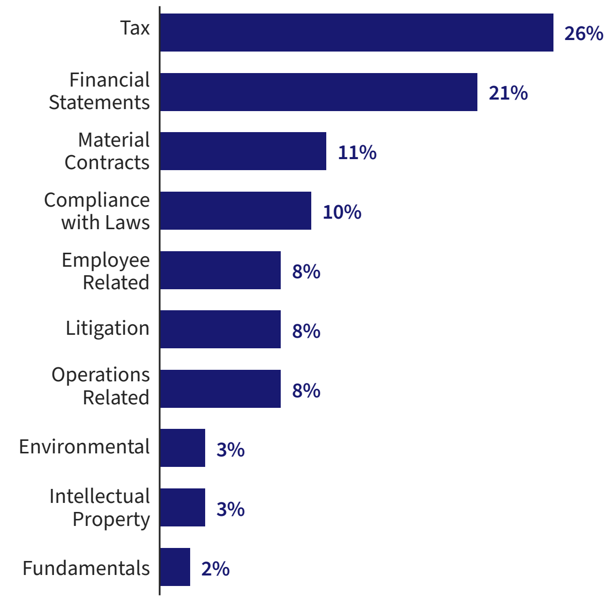
The increase in claim size reflects a number of underlying trends, including greater use of W&I insurance as a deal facilitator and more detailed product knowledge on the part of buyers and their lawyers. With this deteriorating claims severity, a correction in rates and reduction in liability limits is almost inevitable.

"We see claims for large values in EMEA, meaning that severity is an issue for non-US transactions too," observes Michael Turnbull, UK M&A manager at AIG. "It's worth noting that historically there has been a bias in EMEA towards placing large limits with a single insurer, which can have a dramatic effect on profitability in a severity book. In order to maintain the sustainability of the market, a rethink may be needed with regards to spreading large limits of liability across a number of insurers."

"The market continues to be competitive," he adds," although there have been some exits - largely MGA capacity. It's interesting to note a continuing tendency of some markets to be aggressive on softening rates, particularly in the context of other lines of insurance hardening at the same time. It appears that for some markets, their priority is short-term cash flow, rather than the longer-term sustainability of the business."

It is not just within EMEA where severe claims have been occurring. In Emerging Markets, specifically Latin America and Africa, sizeable claims have also been notified. Some of these claims have been characterised by unpredictable positions taken by local tax authorities.

Fig A **W&I reported incidents by breach type – EMEA**



Claims frequency is also steady within EMEA. "Frequency is a bit lower than in North America," notes Turnbull. "But we still see highest frequency in the larger transactions, in particular those from $500m to $1 billion in value."

From the perspective of policy breach type, breaches of the tax warranties are the predominant driver of claim notifications, accounting for 26% of all reported incidents in EMEA. It is followed by financial statement breaches, which are responsible for 21% of reported incidents. The frequency of tax claims is highest in the UK, in comparison to the rest of Europe, North America and APAC.

"Corporate income tax claims account for around 40% of all tax claims for Continental Europe," observes David Rasmussen, head of M&A, AIG Europe. "However, part of the reason for the large number of tax claims can be found in the statutory audit circles in a number of European jurisdictions where tax authorities are regularly conducting tax audits. These normally trigger a claim notification under the policy although there may not be an actual claim in the end."

"Tax claims do remain one of the most frequent claims types and also prove the increased complexity of taxes across Europe and hence also on M&A transactions," he continues.

Within Emerging Markets, the severe claims have resulted from breaches in relation to tax and financial statement warranties. The lack of transparency around both the rule of law, but also the internal processes of the relevant regulatory authorities that we have in some [tax] claims supports our view that these sorts of deals require a different approach to pricing and coverage to more developed jurisdictions.

By industry, claims notifications continue to emanate from a broad range of sectors. "Real estate transactions seem to contribute to a higher claims frequency in some regions of Europe and also account for some of the more severe claims," observes Rasmussen. "This is interesting because real estate has historically been considered low risk, but the claims activity indicates this is no longer the case."

Key M&A Contacts

Michael Turnbull
UK M&A Manager
T: +44 (0)20 7954 8306
M: +44 (0)7395 854 488
michael.turnbull@aig.com

David Rasmussen
Europe M&A Manager
M: +45 9132 5136
david.rasmussen1@aig.com

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