

Private Equity Risk Outlook Survey

2021



Gallagher

Insurance | Risk Management | Consulting

About Gallagher

Gallagher is one of the world’s largest insurance brokerage, risk management and consulting firms. As a trusted insurance broker and consultant in communities around the globe, we help people and businesses move forward with confidence. With more than 32,000 employees worldwide, we’re connected to the places where we do business. Managing risk with customized solutions and a full spectrum of services, helping you foster a thriving workforce, and always holding ourselves to the highest standards of ethics to help you face every challenge—that’s The Gallagher Way.

Foreword

The impact the year has had on the global economy is hard to fathom. As vaccines have been deployed, the public policy agenda has shifted towards economic recovery and growth. Governments and central banks around the world have implemented massive fiscal stimulus packages. The recovery is underway but it is not assured.

Private equity firms can assist both the corporate world & thus economies to recover, grow and innovate by providing better access to credit and much-needed capital for investment. They can also promote change by working with their portfolio companies to drive productivity and profitability across a wide range of sectors and geographies.

In this report, we investigate activity levels over the past 12 months and the views of private equity houses across the globe on market conditions and the ability to deploy capital. We look at views on where in the world firms are feeling confident about investing, and territories that are less attractive; alongside this we look at which sectors are drawing more attention and why.

We also outline how private equity firms are using insurance to help increase confidence in the transactions they are undertaking. As private equity firms negotiate the current market conditions, insurance is playing an increasingly important strategic tool to overcome certain constraints and reduce risk, allowing private equity firms to deploy more capital towards exciting new ventures.

From simple transactions to the most complex cross-border deals, Gallagher can help to facilitate negotiation, structure policies and mitigate risks to enable a smoother process and give firms increased certainty for successful transaction outcomes.



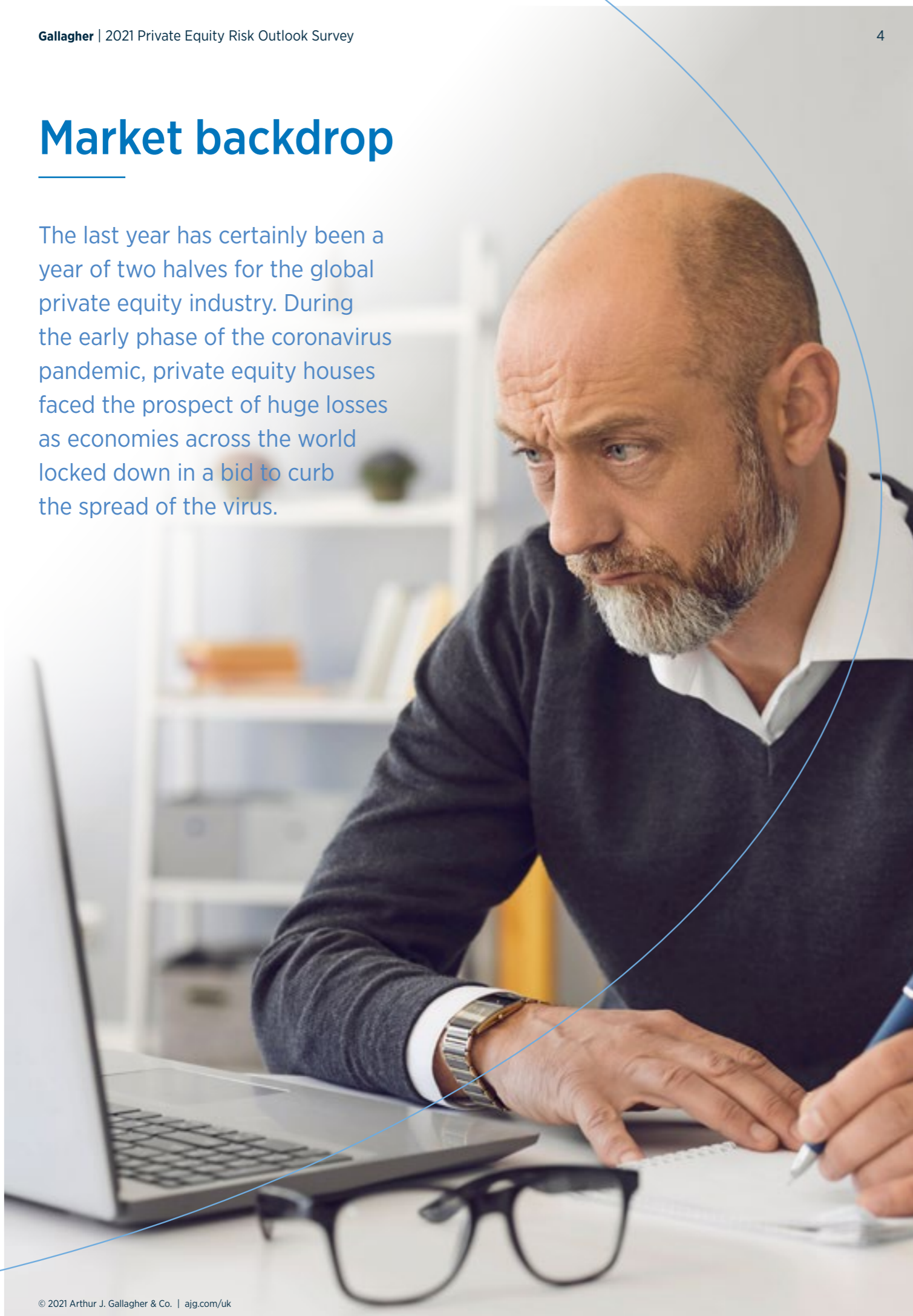
Jon Turner
CEO, Specialty

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Market backdrop

The last year has certainly been a year of two halves for the global private equity industry. During the early phase of the coronavirus pandemic, private equity houses faced the prospect of huge losses as economies across the world locked down in a bid to curb the spread of the virus.



In fact, the true scale of this was shown when academic researchers¹ reported that private equity managers revealed in autumn 2020 that more than half the businesses they owned had been affected by the pandemic.

In the UK, private equity owned companies struggled for months to access the taxpayer-backed coronavirus business interruption loans because the eligibility for the scheme ruled out businesses with high levels of debt.

Unsurprisingly, the number of private equity deals plummeted as much of the world economy went into enforced lockdown. The aggregate value of private equity buyout deals fell by 46% in the second quarter of 2020 to \$64 billion, down from \$120 billion in the first three months of the year, according to data from research company Preqin². The equivalent figure for the second quarter of 2019 was \$130 billion.

The company's full year data for 2020 shows that over the course of the year, the number of deals fell 5% from 5,889 to 5,607, while the aggregate value of deals dropped 7% from \$466 billion to \$436 billion.

However, as vaccine programmes have been rolled out across advanced economies and businesses have learnt to adjust to a COVID-19 environment, there has been a dramatic turnaround in sentiment. This has in part been driven by the large amounts of cash that private equity funds entered the pandemic with, known as 'dry powder' in private equity circles. At the end of 2019, they had dry powder equivalent to 1.9 times the level of capital calls in the prior year, according to Preqin's data. At the end of the first quarter of 2021, private equity had a record \$1.6 trillion available to spend at the end of the first quarter of 2021.

Since the beginning of 2021, the private equity market has staged a spectacular rebound.

According to Refinitiv, the financial data expert, private equity deals hit record levels in the first half of this year, increasing their share of total dealmaking volumes to 18%.³ This picture was reflected in the UK where KPMG says the level of private equity deals hit a five-year record during the first half of 2021. Between January and June 2021, 785 deals were completed with a combined value of £73.7 billion. This represented a 61% increase in volumes and a 48% in value compared to the first half of 2020. It was also a 58% rise on deal values and a 35% rise on the 582 deals compared to the previous six months.

The number of larger deals closing this year reflected pent-up demand with many having been held back due to the restrictions in place for much of the previous year and there is little evidence of private equity's appetite for UK companies, abating with Californian fund company, Silver Lake, announcing a £3.7 billion stake in RAC in early September.⁴

Preqin data shows that the assets under management (AUM) held by private equity now equates to approximately 9.37% of the total value of global public equities, meaning that it now forms a key component of many institutional investment portfolios.

Despite a small contraction in last year due to the impact of COVID-19, Preqin's Future of Alternatives 2025 study forecasts that

global private equity AUM will be more than double from \$4.74 trillion in June 2020 to \$9.11 trillion by 2025.

This anticipated growth is fuelled by continuing strong long-term appetite amongst investors for private equity and venture capital. A survey conducted by Preqin towards the end of 2020 showed that 44% of investors planned to increase allocations over the next 12 months, while 46% intend to maintain allocations at the same level. This growth across private equity is also expected to be supported by continued easy monetary policies in the U.S. and Europe, and an anticipated global economic recovery in 2021.

Against the backdrop of these extraordinary macro-economic conditions, Gallagher has conducted its second Private Equity Risk Outlook Survey.

150 private equity companies responded to the survey with an average of £452 million worth of AUM each, although the majority (76%) had over \$500 million. The respondents, all of whom have responsibility for their business' strategy and the management of assets, were split equally between Singapore, the UK and the U.S. in terms of where their headquarters were based.

¹Private equity-owned companies in 'intensive care' due to pandemic | Financial Times (ft.com)

²<https://preqin.egnyte.com/dl/2U9LY08Ay2>

³<https://www.ft.com/content/cd9571a3-726c-4995-9954-23a8dcf12b19>

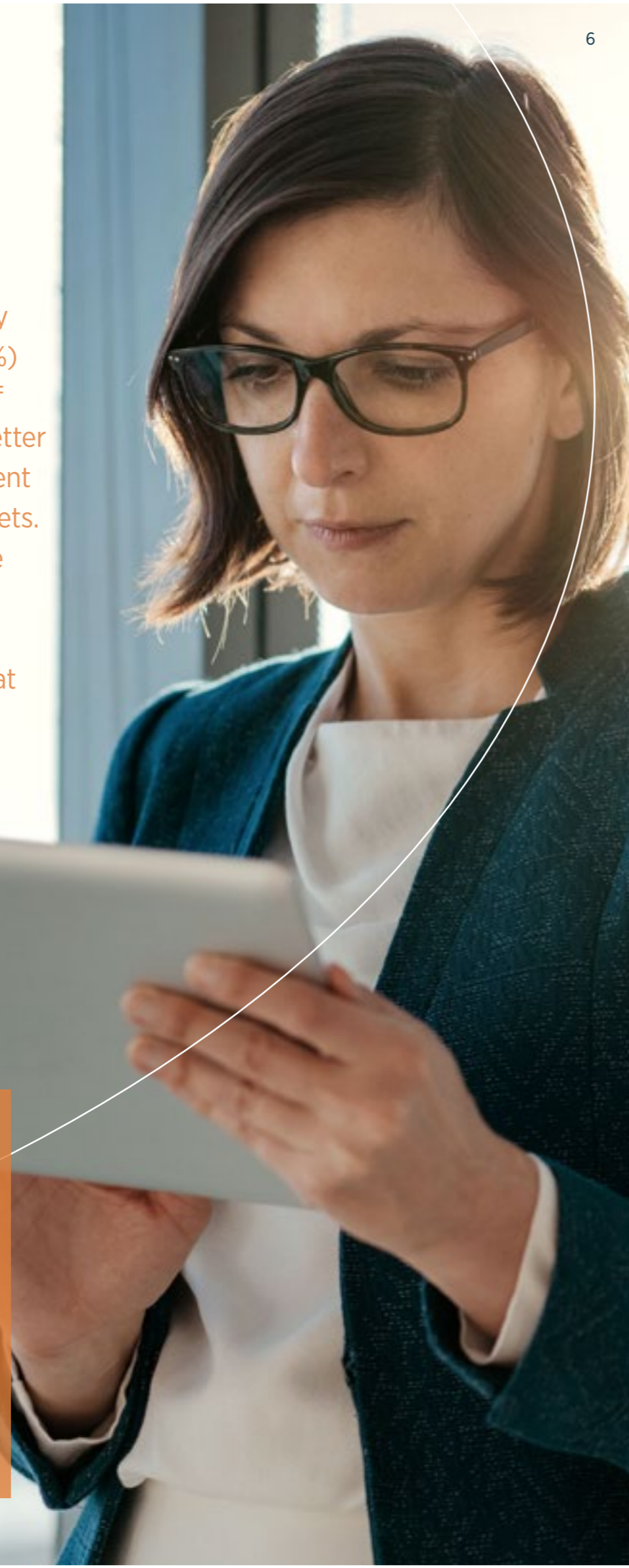
⁴<https://www.ft.com/content/49dfe53b-70e1-43f2-997d-85a66f05fa02>

Out-turn

The findings of Gallagher's 2021 Private Equity Risk Outlook Survey show that nearly three in five (57%) respondents found the out-turn of the last 12 months was same or better than expected, which was consistent across the US, UK and Asian markets. This was significantly down on the finding in last year's survey, when nearly nine out of ten (88%) of private equity houses reported that the out-turn had been in line with their expectations.

57%

of respondents found the out-turn of the last 12 months was same or better than expected, which was consistent across markets.



Reflecting the difficult economic conditions, the proportion saying the out-turn was worse than expected (32%) was three times greater than those who felt it was better (11%). Sentiment about the past year was more polarised amongst U.S. respondents than elsewhere; as more respondents in the U.S. (18%) felt that the year had turned out better than expected compared to UK and Singapore, where the figures were 6% and 8%, respectively.

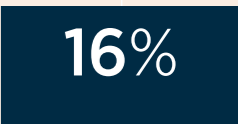
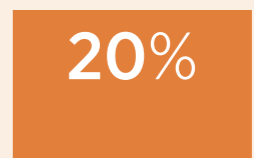
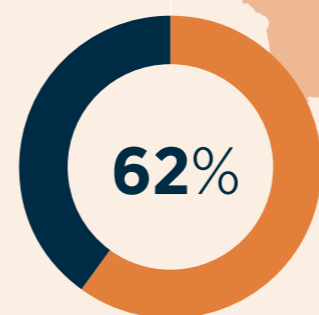
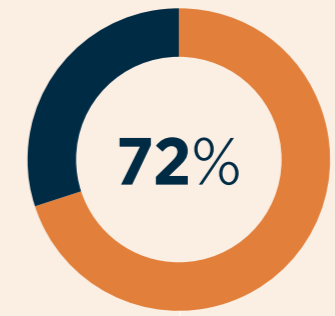
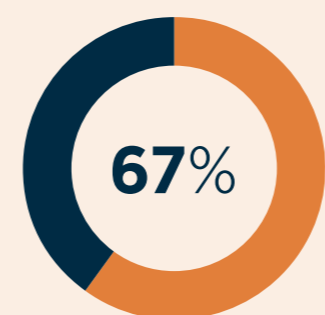
Of those surveyed in Singapore, 66% said the out-turn had been in line with expectations, a higher level than in the U.S. and UK. This may reflect the less disruptive impact that the COVID-19 pandemic has had on the East Asian economies that the city-state principally serves.

Unsurprisingly, all respondents surveyed stated that market conditions over the last year have impacted their business in some way.

Two-thirds of respondents (67%) said market conditions over the last 12 months have prevented their business from deploying capital, a far higher proportion than last year (37%). This factor was most acute in the UK (72%) and least in Singapore (62%), again probably reflecting the greater impact COVID-19 has had on Europe's economies than those of Asia.

On the flipside, 20% reported that market conditions had provided encouragement to deploy capital, a proportion that dipped to 16% in the UK.

The main risks impacting a firm's ability to deploy were, according to the survey, economic weakness, regulatory restrictions, and cost of capital.



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Holding periods

The uncertain economic conditions of the past year may have been expected to encourage private equity houses to hold on to their investments. However, Gallagher's research shows that private equity houses' hold on their current portfolio companies decreased from an average of 4.3 years in last year's survey to 4.1 years in the last 12 months, continuing a trend seen over recent years. These average holding periods were greatest in Singapore (4.3 years) and lowest in the U.S. (4 years) with the UK in the middle (4.1 years).

4.3 years



4.1 years

Singapore respondents to the survey were also more likely to report average holding periods of five years or more for portfolio companies (18%), compared to 14% and 10% for their U.S. and UK counterparts, respectively.

However, shifts in firms' holding periods tend to be gradual with 67% reporting no change compared to five years ago. The direction of travel can however be seen in the finding that 27% said their holding term has decreased in the past five years, while only 6% reported the opposite.

Average reported holding terms had decreased by the most in the U.S. (32%) and least in Singapore (20%), again indicating the more patient in East Asia pattern of ownership.

In the immediate aftermath of the pandemic, private equity businesses were understandably concerned about the environment for exiting their investments. However, those fears have subsided as the stock markets have recovered from the historic lows seen early in lockdown.

The reduction in holding periods is backed up by Dealogic data showing that exits from private equity ownership jumped roughly 40% to nearly \$600 billion during the year ending March 2021, up from \$426.7 billion during the previous 12 months.⁵

The strength of Initial Public Offering (IPO) markets and sales to special purpose acquisition companies (SPACs), a relatively new phenomenon, contributed to a spike in deal value and volume not seen in a decade. Improved confidence, following the success of the vaccine rollout, prompted a three-year peak in exits from private equity companies during the fourth quarter of 2020 in the UK, according to KPMG.⁶

The decline in holding periods, revealed by the Gallagher's research, looks likely to continue. Half of private equity executives are planning exits to public markets through IPOs or SPACs in the next 18 to 24 months, according to a separate survey carried out by EY.⁷

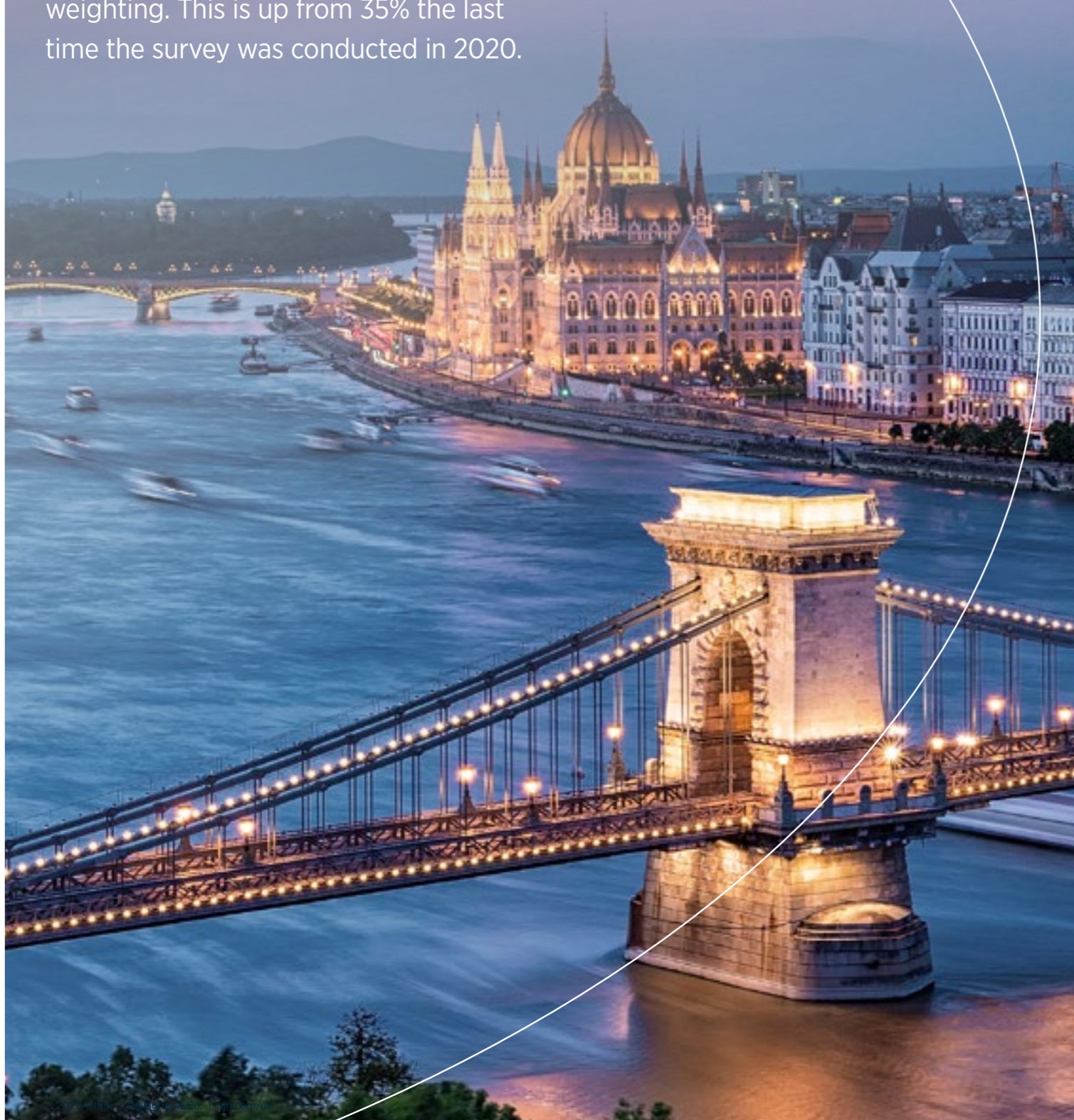
⁵2021 Global Private Equity Divestment Study | EY Australia
⁶UK Mid-market Private Equity Review: H1 2021 (assets.kpmg)
⁷2021 Global Private Equity Divestment Study | EY Australia



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Geographical changes

For 42% of the private equity houses that participated in Gallagher's Private Equity Risk Outlook Survey, market conditions have impacted their geographical weighting. This is up from 35% the last time the survey was conducted in 2020.



Private equity houses in the UK were most likely to report that conditions over the past 12 months had resulted in a change to the geographical weighting of their portfolios (48%), which was much higher than in the U.S. (38%), although this may be explained by the wider geographic footprint of the U.S.

The geographic weighting of private equity firms' current portfolios remains heavily influenced by where the firm is based. This is most clearly the case for U.S.-based companies, 94% of which say their portfolio is mostly weighted towards North America. This is also true for UK firms' portfolios, 88% of which say they are weighted mostly towards Western Europe.

A much higher proportion (42%) of U.S.-based firms are planning to make further investment in North America in the next year, dwarfing the figure for their counterparts in Singapore (4%).

Meanwhile, more than a third (38%) of U.S. respondents are looking to reduce their exposure to Asian investments.

U.S. private equity houses are adopting this bearishness towards Asian markets in spite of expectations that the region is expected to drive future growth in the sector, as AUM across the region is forecast to swell by 25.2% per annum until 2025, compared with a more muted 5.4% for both North America and Europe.

These findings would indicate that firms are most confident operating in home markets and managing local investments, a tendency which has been reinforced by the worldwide unpredictability caused by the pandemic.

The move to digital transactions during the pandemic may have helped to level the playing field for overseas investors, however, private equity deals more often than not involve some kind of face-to-face interaction, which has been difficult to arrange over the past 18 months and it may be that firms feel that they can better manage local investments in an environment where global travel has been so restricted.

The biggest geographical focus of interest for private equity companies surveyed was Europe.

A higher proportion (39%) of organisations are looking to invest in Central and Eastern European markets in the next 12 months than any other region, followed by investment in Western Europe (34%). These findings most likely reflect a perception amongst investors about Europe's safe haven status in an economic climate which remains uncertain.

Furthermore, the relatively rapid uptake of vaccine programmes across the continent provides a strong platform for growth after an unsteady economic outlook since the pandemic took hold.

The focus on Central and Eastern Europe was greatest amongst UK respondents of which 56% identified the region as a place to invest in over the next 12 months. Both U.S. and Singaporean-based respondents were more enthusiastic about the prospects for Western Europe (44%) than their UK counterparts (14%).

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of organisations are looking to invest in Central and Eastern European markets in the next 12 months, followed by 34% in Western Europe.



Africa tops the list across the board where private equity firms are looking to reduce exposure (59%). This is followed by Middle East at 41%. Reluctance to invest in Africa is likely to reflect the slow roll-out of vaccinations and a lack of transparency surrounding the progress of the virus across the continent. This is coupled with a wider aversion to invest in emerging markets at a time of heightened economic uncertainty and ongoing concerns about political instability.

The biggest factor influencing firms' appetite for investing in particular regions or markets was the impact of COVID-19 on the economy, which was cited by 65% of respondents, rising to 68% for those based in Singapore. The proportion citing economic weakness as a reason not to invest in a specific territory held steady at 40%. However, fewer Asian respondents cited this as a factor (42%) than last year (56%).

The proportion of UK-based private equity firms concerned about political stability fell from 43% to 32%, which may reflect an ebbing of Brexit tensions following the conclusion of the country's withdrawal agreement with the EU at the end of last year.

There was also a big drop in the number of respondents citing economic sanctions as a reason not to invest in a particular geography, compared to last year's survey. Sanctions were cited by 40% of those surveyed last year as a factor not investing in a particular region or country, making it the most important single influence on the geographical weighting of their portfolio, however, this proportion had fallen to 27% in this survey.

The decline in concern about sanctions may reflect the shift in the geo-political landscape over the past years following the election of Joe Biden—who has adopted a less aggressive stance on trade with China than his predecessor Donald Trump—as U.S. President. However, it may also be that pandemic-related economic concerns have crowded out worries about sanctions.

Africa tops the list across the board where private equity firms are looking to reduce exposure

59%



Sector changes

The last year has seen a significant shift in the sectoral weighting of investment portfolios reported by respondents to the Gallagher Private Equity Risk Outlook Survey. Just over a third (36%) of respondents reported that they had shifted the sectoral balance of their portfolios over the past year as a result of market conditions, rising to 40% of firms based in the UK.



Around half of businesses surveyed said their portfolios are weighted towards technology (54%), retail (52%) and life sciences/biotech (45%) sectors. This marks a dramatic change compared to last year's survey when the top three sectors in terms of exposure were financial services (59%), business services (21%) and real estate (18%). Technology was in fourth place on 18% with business and financial services falling to fourth and sixth places, respectively. The majority of businesses surveyed planned to increase weight in life sciences/biotech, technology, business services, retail and financial services.

Nearly all (94%) of the respondents, who have a significant weighting towards technology, plan to increase their exposure to the sector over the next 12 months, rising to 97% in Singapore. The sharper focus on technology can be seen in the value and volume of technology private equity deals, which exceeded any other sector in the second quarter of this year with 674 deals worth \$194.1 billion announced, according to Mergermarket.⁸ This included the largest private equity technology deal in the quarter, which was the acquisition of ride-hailing firm Grab by U.S.-based SPAC Altimeter Growth for \$34.7 billion.⁹

Business services also looks set to be another big area for acquisition targets with 92% of those with exposure to the sector aiming to increase it, according to Gallagher's research.

In fact, business services and technology combined accounted for the majority (62%) of private equity mid-market investments in the UK, according to KPMG. The sharpened interest in these sectors reflects how the impact of the pandemic has accelerated growth in certain parts of the economy, rather than dampening it and would indicate that private equity houses are increasingly focusing on digitalised business operating models and routes to market.

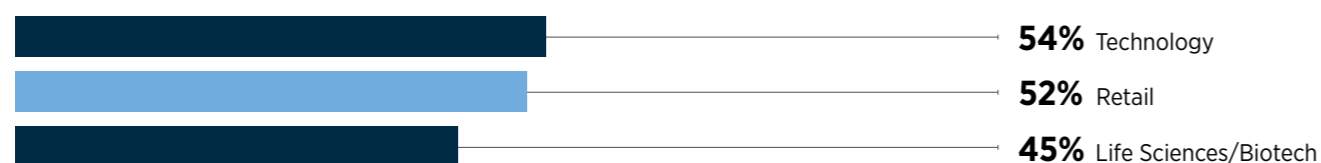
The widespread shift to remote working by office employees, which has helped to catalyse digital transformation programmes, has made both technology businesses and tech-enabled business services firms more attractive targets for investment.

Surprisingly in the context of the widespread shutdowns that the sector has undergone across the globe over the last 18 months, 88% of those with exposure to retail want to increase this weighting. This proportion is highest (93%) for companies in the UK, where stalwart names like department store Debenhams and clothing retailer Top Shop have gone out of business during the pandemic.

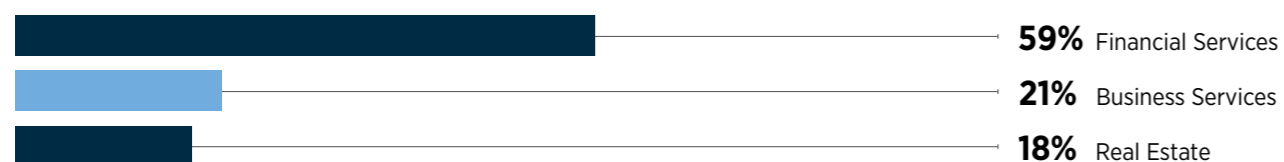
This apparently counter-intuitive level of interest in retail assets could reflect pricing and the growing digitalisation of businesses in this sector. Many traditional bricks and mortar retailers have struggled in the pandemic environment, however, e-commerce businesses that serve consumers directly have boomed as a result of the switch to online shopping over the past year, which looks set to be embedded despite the re-opening of physical stores across western economies. In addition, some retail opportunities are likely to be keenly priced which may attract investors.

In terms of reducing exposure, 83% of those surveyed plan to cut their weighting to leisure and hospitality, the sector which has probably been hit hardest than any other during the pandemic.

TOP THREE EXPOSURES BY SECTOR 2021



TOP THREE EXPOSURES BY SECTOR 2020



⁸<https://www.mergermarket.com/info>
⁹<https://www.jdsupra.com/legalnews/global-pe-posts-record-buyout-value-in-3743107>

Uncertainty over the continued impact that COVID-19 may have, and the serious challenge increasing labour costs, plus availability of staffing pose to existing business models could dampen private equity appetite for investing over the course of the upcoming year.

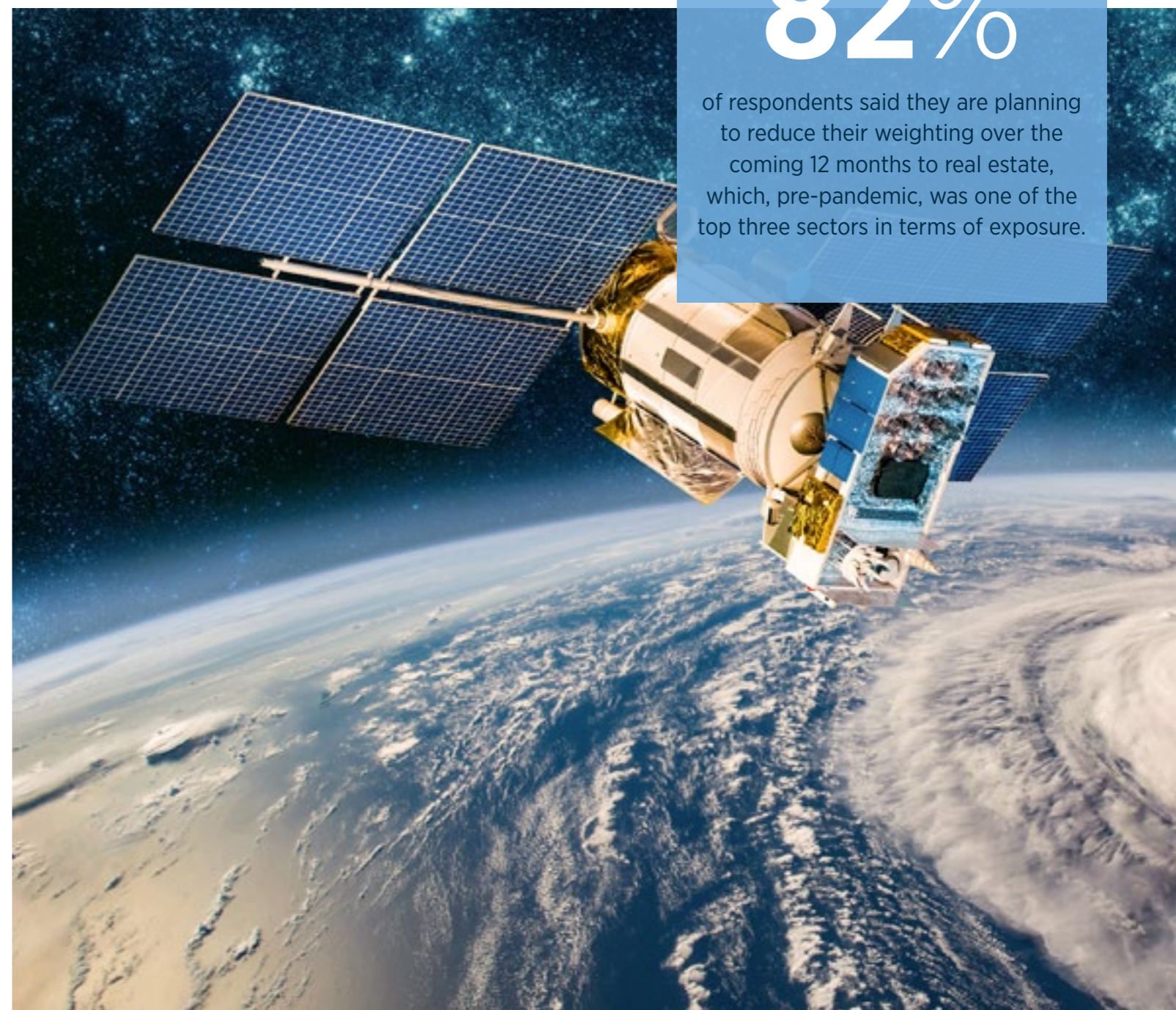
In addition, 82% of respondents said they are planning to reduce their weighting over the coming 12 months to real estate, which, pre-pandemic, was one of the top three sectors in terms of exposure. This bearishness towards property is greatest amongst U.S. companies (91%).

Real estate funds have been hit by their traditional reliance on commercial property like offices and retail, which have been heavily impacted by working from home and a shift to online shopping.

With office occupiers, looking set to rationalise their floorspace in the long-term, the shake-out in real estate looks set to continue.

Other sectors that private equity investors intend to cut their weighting to over the next year are infrastructure (87%) and extractive industries (83%), the latter perhaps reflecting growing angst towards businesses operating in this sector.

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Environmental, Social and Governance

Until relatively recently, private equity has largely avoided the spotlight in regard to the growing pressure from law makers, regulators and investors to meet stricter environmental, social and governance (ESG) standards. However, that picture appears to be changing, the findings of this year's Private Equity Risk Outlook Survey show.

The vast majority of private equity firms (91%) state that the increase in ESG disclosure agreements is having an impact on investment approach and strategy. This increased impact of ESG considerations reflects the increased focus of asset owners, from large pension funds to individual retail investors, on the environmental and social impact of their investments. In fact, according to research, commissioned by global asset manager AGF Management Ltd, 47% of North American and European asset owners now factor ESG criteria into investments.¹⁰

The greater focus on ESG, which has developed over recent years, is now filtering down to private equity. An analysis of all UK private equity investments made in the first half of 2021 indicates that 79 deals had an ESG component, which represented 10% of the deals.¹¹ Of these investments, 38% were made into business services companies, followed by energy, technology, media & telecoms and healthcare.

Meanwhile, a number of specialist PE funds have been set up with a specific focus on ESG. Brookfield Asset Management and U.S. private equity manager TPG have recently announced \$12.4 billion for impact funds, which will be dedicated to accelerating the shift to net-zero emissions economies around the world.¹²

The increased appetite amongst investors for companies with good environmental and social track records means that private equity houses see opportunities to capture an ESG premium. Nearly three-quarters of private equity firms (72%), say they expect to capture an ESG premium in businesses that they are considering exiting, leading many to actively courting potential buyers with a strong ESG record, according to EY.¹³

Social impact policies, including diversity and equality commitments, appears to be the area of greatest focus globally (57%).

¹⁰Sustainable Investing: What We're Hearing from Institutions and Why it Matters – AGF Perspectives
¹¹<https://assets.kpmg/content/dam/kpmg/uk/pdf/2021/07/kpmg-mid-market-PE-2021-report.pdf>
¹²<https://www.responsible-investor.com/articles/world-s-pension-funds-throw-weight-behind-sustainable-mega-funds-in-usd12-4bn-fundraising-drive>
¹³https://www.ey.com/en_uk/divestment-study/private-equity

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Managing risk – insurance buying trends amongst private equity firms

In the research, Gallagher also investigated buying trends amongst private equity houses and how they have changed from last year.



The vast majority (85%) of respondents to the 'Private Equity Risk Outlook Survey 2021' stated they had 'comprehensive' knowledge of the insurance market and that they were aware of, and use insurance for capital efficiency. Of the remainder, 14% said they are somewhat aware of insurance and the role it plays. The proportion of respondents professing a 'comprehensive' knowledge of insurance was highest in Singapore (90%).

This professed level of awareness is the same as last year (85%) and demonstrates the continued importance of the role that insurance can play in the sector. This focus on insurance means that buyers take time to develop an understanding of their insurance needs and how the strategic purchase of certain classes of insurance can enhance their business activities—such as M&A/W&I insurance, political risk insurance, and specialist financial lines products designed specifically for the PE segment.

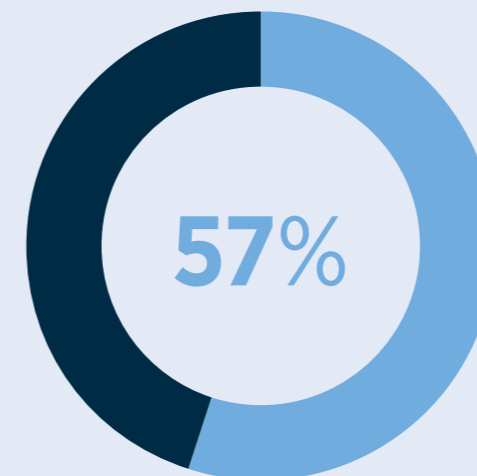
When it comes to buying insurance, nearly three in five (57%) of respondents stated that they buy insurance for their private equity firm/fund only and not their portfolio companies, which remain responsible for their own insurance. The bulk of the remainder (41%) state they buy insurance for their portfolio companies as well as their own private equity firm or fund.



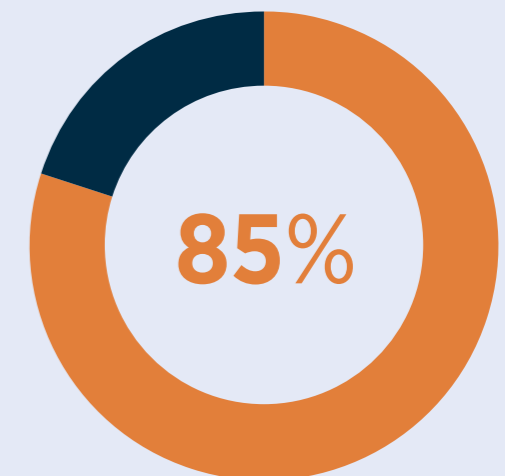
The Gallagher View

Charles Russell
Head of Transactional Risks, Gallagher

"It is encouraging to see that the majority of global PE firms have some understanding of the insurance market, as using insurance as a strategic tool can bring added confidence to deals for both buyers and sellers. Our research shows that a risk manager is responsible for insurance purchasing in just a third of PE firms, so it is incumbent on brokers and the wider insurance industry to ensure that firms are fully aware of the risks that can be addressed through the use of insurance. In today's economic conditions, improving deal certainty, enhancing a negotiating position, or mitigating certain financial risks are key elements to prioritise."



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of respondents said they use insurance for capital efficiency.

The survey's finding shows that a majority of private equity firms tend to buy cover for themselves probably reflects a continuing view, rooted in the sector's venture capital roots, that portfolio companies should have a high degree of operational independence.

Involvement in insurance buying is likely to be greater at the start of the relationship with the portfolio company, as part of the due diligence process. After this stage, private equity houses are more likely to step back and let portfolio companies make their own arrangements and some will be reluctant to dictate the insurance their portfolio companies should buy, trusting the closer knowledge of the markets that they operate in.

However, over recent years, there has been a slow move towards a more collaborative approach towards the buying of insurance jointly. This approach can bring benefits to both the firms themselves and the portfolio companies, from a coverage and cost standpoint, and this desire for greater involvement by private equity owners is understandable given that insurance is an important element of operational expenses.

The main types of insurance cover private equity houses bought for themselves, according to the Private Equity Risk Outlook 2021 survey, were property (47%), professional indemnity (40%) and casualty (37%).

Private equity firms were much more likely to buy professional indemnity insurance for themselves in Singapore (46%) than in the UK (34%). However, Singaporean respondents were least likely to buy casualty cover (34%), compared to 40% in the U.S.

The main types of cover bought by private equity companies for their portfolio companies were Warranty & Indemnity insurance (41%), professional indemnity (39%), and property (36%).

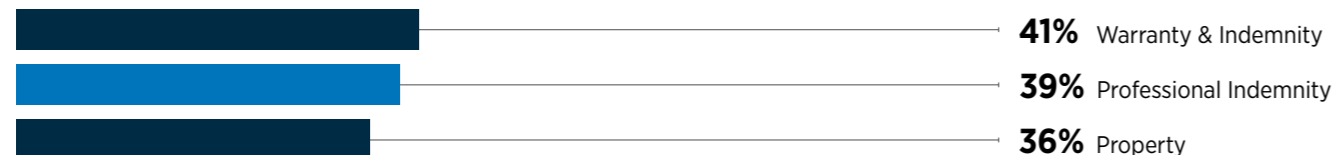
The main roles responsible for purchasing insurance for the business were Head of Procurement (49%), Head of Legal (43%), and Head of Compliance (41%). The key roles responsible for purchasing insurance for their portfolio companies were the CFO/Finance Director (45%), Head of Legal (39%), and Head of Procurement (39%).

When purchasing a business, the main policies that firms assess during the due diligence process are public liability (55%), professional indemnity (45%), and Warranty & Indemnity insurance (43%).

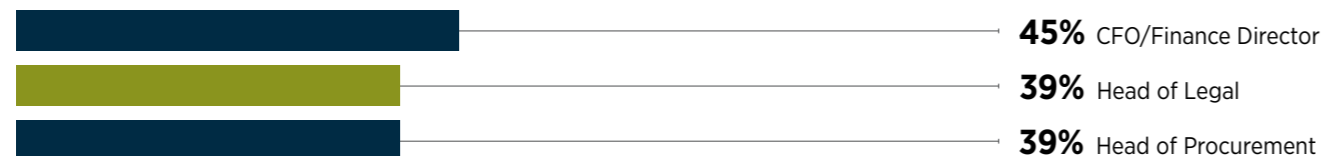
SPACs

Of the firms surveyed, there was a fairly even split between those investing in Special Purpose Acquisition Companies (SPACs) (52%) and those not (48%). For more than half (59%) their business' interest in investing in SPACs has stayed the same over the last year, and 37% state the interest has decreased. When investing in a SPAC the main policies firms assess during the due diligence process are professional indemnity (50%), public liability (44%), and employer liability (44%).

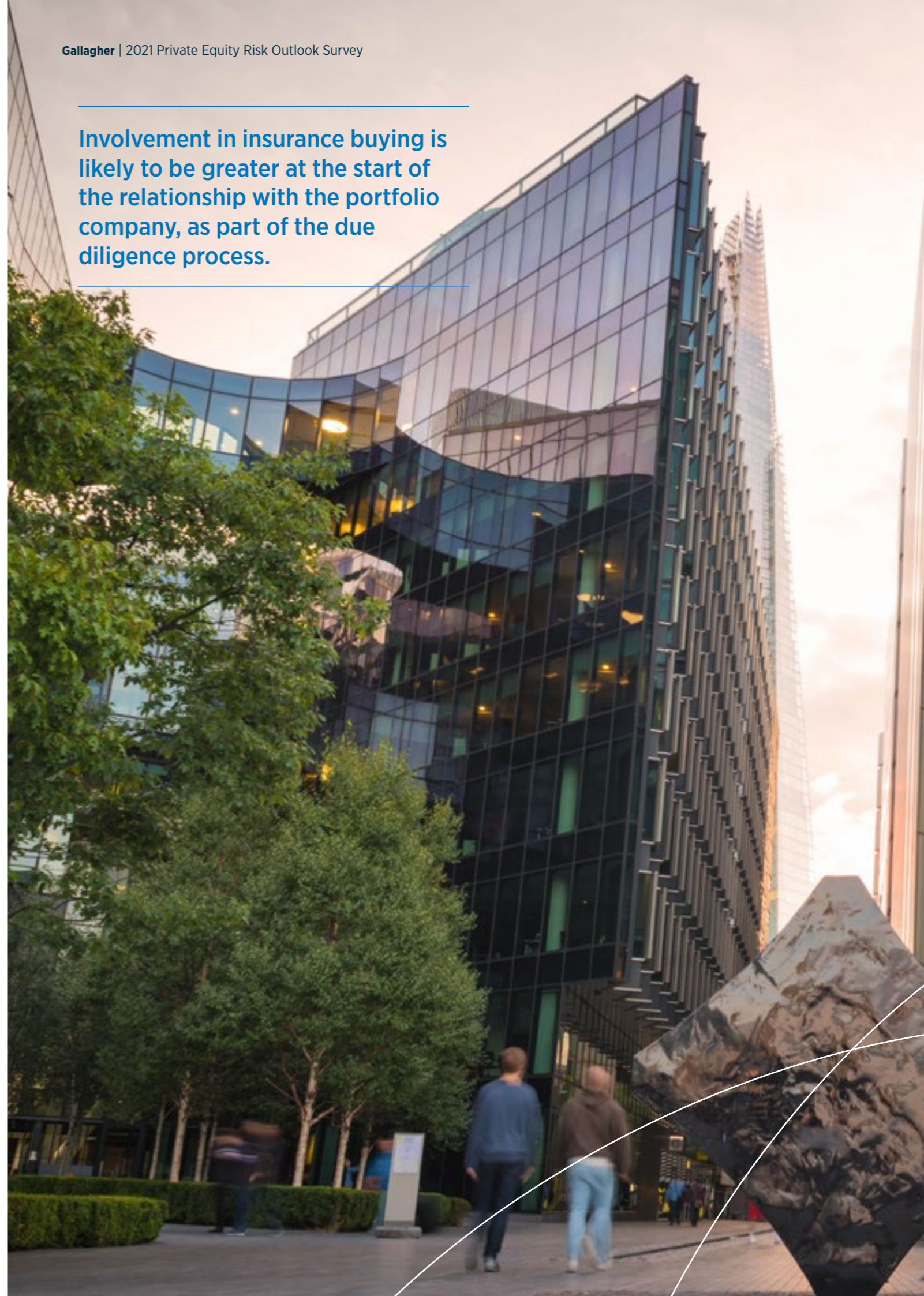
MAIN TYPES OF COVER BOUGHT BY PRIVATE EQUITY COMPANIES FOR THEIR PORTFOLIO COMPANIES



KEY ROLES RESPONSIBLE FOR PURCHASING INSURANCE FOR THEIR PORTFOLIO COMPANIES



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Directors' & Officers' insurance

Almost three-fifths of respondents (59%) to the Private Equity Risk Outlook Survey 2021 state they are involved in arranging Directors' and Officers' (D&O) insurance cover for their portfolio companies.

The top triggers for buying D&O insurance are concerns that decisions made during COVID-19 will bring increased litigation (42%), an increase in litigation against directors (32%), protection of personal assets (31%) and intention to float a business on the public markets (31%).

Concerns about decisions made during COVID were the paramount trigger for buying D&O amongst U.S. and UK respondents. However, these fears were less pronounced in the minds of their Singaporean counterparts, who were more worried about increased risk of litigation.

Prices for D&O cover doubled or even trebled in the year following the onset of the pandemic, due partly to claims arising from COVID-19 but also tightened UK corporate governance rules. Insurers were also cutting their exposure to individual clients, forcing the latter to seek another source of capacity, who were then able to charge higher rates.

However, new entrants are offering D&O cover, attracted by these high premium increases and afraid of missing the opportunities created by this hardening market. This re-injection of competition is now resulting in more moderate levels of premium increases than those seen at the beginning of this year. In addition, insurers are adopting a more transactional approach, asking for less information.

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The Gallagher View

James Hoare
Executive Director of Financial Institutions, Gallagher

"The fears about decisions made during COVID-19 and heightened risk of litigation are likely to be linked given that in companies, which have underperformed during the pandemic, directors will be vulnerable to the target of legal action against disgruntled shareholders. Therefore, an uptick in the purchase of insurance to deal with those risks is to be expected.

In addition, business' balance sheets may not be as robust as previously, because performance has dipped during the pandemic. As a result, directors may feel less confident that the business can indemnify them, and seek the additional protection from the D&O policy either indemnifying them directly if the business can't or reimbursing the business in the event of any large claims."

Warranty & Indemnity insurance

Of respondents to the survey, 78% stated that their business purchased W&I insurance in the past five years, which covers against breaches in representations and warranties given in the sale of a business, for some or most transactions.

78%

stated that their business purchased W&I insurance in the past five years.

Only one in five (21%) stated they only purchased W&I insurance for a minority of transactions. These figures mark a big increase on last year's survey, when just 16% of global PE firms said they had purchased W&I cover during the previous five years.

Most respondents (89%) are aware that there are specific policies providing cover against long-tail transitional tax risks.

Getting on for half (43%) of global private equity firms surveyed said they use W&I insurance regularly for their acquisitions, rising to 48% for Singaporean respondents. The global proportion of firms asked had risen from 37% in last year's survey, although the level for US firms had soared from 15% to 46%. This may indicate more caution from both buyers and sellers during the M&A process, potentially as a result of the unstable economy caused by the pandemic.

The W&I market in Europe is more mature than in other jurisdictions, so there is arguably more room for growth in the US, Asia and other emerging territories. That said, the European W&I market continues to grow as the market has broadened their appetite into new sectors, as well as expanding their deal size parameters. The use of the product in the US, Asia and other emerging territories has sky-rocketed as the product becomes more widely recognised.

Whereas four or five years ago, the use of W&I in European deals was relatively limited it is now considered an essential part of most deals, leading to a significant broadening in capacity. The number of insurers operating in this market has increased over the last five years from under ten to around 40 insurers, providing greater choice and more competition on rates for buyers of the product.

In addition, the maturing of the market has resulted in the process of buying W&I insurance becoming more streamlined with policies negotiated as a standard part of the sale and purchase agreement.

Another recent development is the increased volume of claims being registered. As M&A slowed down during the pandemic, dealmakers arguably had more time to reflect on completed deals and make claims where elements hadn't lived up to expectations. This gives further confidence in the product and its cover.

In addition, cover was previously only available for deals in the range of \$50 million and \$200 million, whereas now cover can be purchased for deals from \$5 million to \$5 billion, potentially opening the door to a significantly larger number of transactions.



The Gallagher View

Charles Russell
Head of Transactional Risks, Gallagher

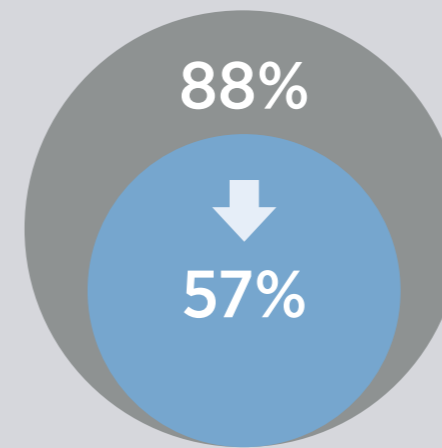
"The overall increased use of W&I insurance reflects how it is gradually becoming more entrenched in M&A activity, as understanding about the benefits of the product increases amongst those involved in deals, such as lawyers and accountants. Ultimately, W&I benefits both buyer and seller so the fact that it has become more mainstream is not surprising."



Conclusion

Overall, the findings of this year's Private Equity Risk Outlook Survey shows that the sector's experience of the last year has been brighter than many would have feared when the pandemic struck in the first quarter of 2020.

The proportion of those reporting that their out-turn over the last 12 months had been the same or better than expected was 57%, down on the previous year's figure of 88%. This apparently downbeat conclusion must, however, be seen in the context of the most severe shock that the world economy has experienced in generations, which brought some areas of activity to a complete halt.



The ramifications of the last year's economic earthquake can be seen though in the shifts in the pattern of investment by private equity companies. While firms' current portfolio strategy is focused on a few key industries and geographies, there are plans to broaden the focus to include other sectors and markets. Life sciences/biotech, technology, business services, retail and financial services are all seen as big areas of future growth, while private equity houses are keen to downweight their exposure to property as working and shopping patterns transform in the wake of the pandemic.

At the same time, private equity houses have focused more on home and less on global markets, partly at least due to the difficulties of international travel over the past year.

The survey also shows a heightened appetite amongst private equity businesses for ESG-compliant investments. All of these factors, combined with the repressed state of the market for much of the last year, have helped to fuel an upsurge in deal making by private equity companies over recent months.

With the rise in premiums resulting from the recent hardening of the market, this survey shows private equity professing a growing awareness of insurance. In addition, as part of the due diligence process, private equity owners are likely to want to ensure that the insurance arrangements of their target acquisitions are in good offer.

This recent surge in deal making activity has in turn fuelled increased demand for D&O and W&I insurance products.

Insurance can play a valuable role helping private equity companies to navigate what is still a fledgling recovery from a historic recession, which could still be derailed by the evolution of the virus.



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Unless otherwise stated all research taken from research commissioned by Gallagher and conducted by Coleman Parkes, amongst 150 private equity companies from 28 June to 23 July.

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