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MANAGING TRANSACTIONAL RISK

The management of transactional risk is becoming more dynamic and specialised. While traditional risk areas such as financials, material contracts and compliance with laws remain critical, new technologies, shifting regulatory regimes, and fast changing geopolitical and trade risks are pushing diligence beyond the traditional playbook. As a consequence, insurers will need to continue developing insurance products to assess increasingly sophisticated risk exposures – tools that can deliver huge value to insurers and insureds alike. ■



THE PANELLISTS

**MARC SHERMAN**

Managing Director, Alvarez & Marsal
T: +1 (202) 729 2129
E: msherman@alvarezandmarsal.com
www.alvarezandmarsal.com

Marc Sherman is a managing director and partner at Alvarez & Marsal in Washington, DC. He was previously national partner-in-charge of forensic services and regional partner-in-charge of corporate restructuring and valuation for a Big Four firm. For the past 13 years, he has managed a practice at Alvarez & Marsal that assists insurers with global claims and underwriting of representation & warranty and warranty & indemnity insurance.

**NICK TULIEBITZ**

Co-Head of M&A Insurance, North America, AssuredPartners
T: +1 (914) 220 6920
E: nick.tuliebitz@assuredpartners.com
www.assuredpartners.com

Nick Tuliebitz is the co-head of M&A insurance at AssuredPartners, a top 10 retail insurance broker in the US. He is a former practicing M&A attorney who transitioned to brokering insurance in 2016, advising private equity and strategic buyers on the placement and use of representation & warranty insurance on deals across nearly all industries.

**MIKE SHERRY**

Head of Transactional Risk, DUAL North America, Inc.
T: +1 (973) 631 7575
E: mjsherry@dualinsurance.com
www.dualinsurance.com

Mike Sherry is the head of transactional risk at DUAL North America, Inc. He has extensive experience in underwriting and broking transactional risk and financial lines products, having previously held senior roles at a leading US brokerage and insurer. Before his insurance career, he spent over a decade owning and operating a range of businesses in the professional cycling industry.

**SEAN KIM**

Managing Director, Euclid Transactional, LLC
T: +1 (646) 720 8392
E: skim@euclidtransactional.com
www.euclidtransactional.com

Sean Kim is a managing director at Euclid Transactional, LLC. He works across a wide range of industries with sophisticated partners, including financial sponsors and corporate strategists, to underwrite representations and warranties insurance policies for complex M&A transactions. Prior to joining Euclid, he practiced law as a corporate associate in the private equity and mergers and acquisitions practice groups at Ropes & Gray LLP and Sidley Austin LLP.

**ROY H. REYNOLDS**

President, M&A Liability Division, Great American Insurance Company
T: +1 (917) 202 1385
E: rreynolds@gaig.com
www.greatamericaninsurancegroup.com

Roy Reynolds has been underwriting tax indemnity and representations & warranties insurance since 2001, making him one of the most experienced underwriters in the US market. He practiced M&A and tax law before transitioning into insurance. He earned his JD from Georgetown University and an MBA from the University of Chicago's Booth School of Business.

**DAVE J. BARTOLETTI**

Partner, Taft Stettinius & Hollister LLP
T: +1 (317) 713 3481
E: dbartoletti@taftlaw.com
www.taftlaw.com

Dave J. Bartoletti draws on his experience as buy-side and sell-side M&A counsel, tax counsel and former Big Four tax consultant to offer holistic, practical advice to clients on transactions across industries and market capitalisation. He is co-leader of the firm's transactional risk practice group, which specialises in advising underwriters placing representations and warranties insurance, tax insurance and contingent risk insurance.

FW: Do you think acquirers are paying sufficient attention to identifying and assessing risks during transactions? Are there any particular areas where they are falling short in today's market?

Sherman: Generally, today's buyers have tight windows to conduct due diligence. So, it is not surprising that some risks may not be uncovered. The level of attention and assessment varies by deal and acquirer, but notwithstanding the limited time frames of the M&A process, sophisticated buyers continue to exercise significant effort identifying and assessing risks in the transaction. While transactional insurance provides coverage for certain of the hidden risks, it is not a substitute for diligence. Nonetheless, we do find that certain risks that take little time to diligence have high occurrence rates, for example, in the areas of asset condition, information technology and customer representations.

Sherry: We find that most acquirers are diligent when it comes to addressing the core risks typically covered by representations and warranties (R&W) insurance policies. With brokers setting high standards and underwriting counsel bringing deep expertise, the bar for diligence is substantial. However, we still see gaps in emerging risk areas – artificial intelligence (AI) governance, international trade uncertainty and evolving data

privacy risks come to mind. These are often less developed within the diligence process and can pose challenges during underwriting. As the deal landscape becomes more complex, we believe buyers need to sharpen their focus on these fast-evolving risk categories.

Reynolds: R&W insurance is an important risk management tool, but it should not replace thorough due diligence. As a rule of thumb, a buyer usually purchases a policy limit of 10 percent of the economic value of the transaction, leaving the insured with significant skin in the game, especially for material issues. One area where R&W insurers are seeing increased frequency and severity of claims is the condition of the target company's assets. A buyer's diligence should include a thorough assessment of the condition of the target company's assets, so the buyer knows what it is buying and minimises unforeseen problems. Many recent condition of asset claims result from issues that should have been identified during the due diligence process. R&W policies are not intended to cover issues that should have been discovered during due diligence, but only situations in which a seller misrepresents the condition of the target company's assets to the buyer.

Kim: The amount of attention given to a particular transaction can vary depending on the sophistication and experience of the parties and the specific

circumstances of each transaction. Acquirers are increasingly sophisticated and aware of transactional risks, but many still underestimate the complexity and breadth of exposures that can arise. Especially in competitive and fast-moving transactions, parties can overemphasise financial deal points such as valuation and neglect other critical due diligence areas. It is therefore important to engage the proper slate of third-party advisers to assist in the due diligence, as parties can underestimate and overlook risks in key areas when timelines are tight.

Bartoletti: Most acquirers and their diligence teams focus on the risks they find most relevant to assessing and preserving enterprise value. This approach, while practical, can occasionally leave some areas underexamined. For example, a strategic acquirer might unconsciously use its company's own operational successes and failures as a lens when evaluating a target, which can create blind spots. Similarly, lawyers focus on legal compliance and may miss key customer or vendor relationship risks that go beyond the four corners of a contract. So, it is not so much a systemic flaw as it is a natural byproduct of the human element in these processes.

Tuliebitz: Despite increased competition and pressure on insurers to be commercial and efficient, I do not think the quality of underwriting or requirements

for thorough diligence have diminished; rather, expectations around the insured's diligence work product may have lessened. Quality of earnings (QoE) spreadsheets and workbooks are pretty standard in lieu of requiring the formal, glossy QoE report presentation. On deals with internal diligence, many insurers – referring both to institutional insurers and managing general underwriters – have grown more comfortable with not receiving written diligence reports for certain topics. However, internal due diligence teams should be encouraged to have some form of written documentation regarding their diligence efforts.

FW: What key areas should be considered during the due diligence process? How is the scope of due diligence expanding to include 'non-traditional' areas of assessment?

Sherry: Traditional risk areas such as financials, material contracts and compliance with laws remain critical, particularly since these continue to drive the majority of claims. However, we are seeing diligence stretch into new areas like AI integration, trade and tariff exposure, and the eligibility criteria tied to tax credits under potential new legislation. These new frontiers often require specialised expertise and tailored diligence protocols. We have found that insurers and acquirers are increasingly aligned in expanding scope and deepening risk

analysis to keep pace with emerging exposures.

Reynolds: Key areas of due diligence include financial, legal, operational, commercial and environmental. Other areas also may be important, depending on the nature of the target company – for example, intellectual property for a technology company or environmental considerations for an oil and gas company. Non-traditional diligence can also be useful. For example, a careful assessment of social media may provide unique insight into the target company. In recent years, environmental, social and governance diligence has become increasingly important for some buyers, to ensure that acquisitions are consistent with their values and risk management strategies. Some buyers also conduct diligence around the diversity, equity and inclusion practices of the target company.

Kim: A robust due diligence process should encompass a wide range of focus areas, including legal, financial accounting, operations, technology, human capital, environmental, regulatory and cross-border risks. In today's environment, there has been an increased focus on a target's international exposure, including with respect to sanctions, tariffs, customs and duties. Acquirers are also placing greater emphasis on evaluating a target's cyber security and data privacy programme,

driven by the escalating threat of data breaches and the tightening of global regulatory frameworks.

Bartoletti: All buyers have to cover the basics. Does the seller have title to the purchased stock and assets? Are the financial statements consistent and reliable? Are all material liabilities known and accounted for? Is the target highly regulated – and if so, does it comply with those regulations? Those fundamentals really do not change. What is interesting is how the scope of diligence keeps evolving. A few years ago, everyone was scrambling to assess pandemic risks. Now, we are seeing more focus on things like supply chain risks and the use of AI, which raise new questions about legal compliance, the strength of customer and vendor relationships, and even asset ownership. It is a moving target, and insurers are adapting right alongside buyers and sellers to address these emerging risks.

Tuliebitz: When planning to use R&W, the easiest measure of scope for diligence is to look at the set of representations expected in the purchase agreement and then outline the workstreams necessary to validate those representations via diligence efforts. Legal, including all subject matters specialists, financial, QoE and tax are still the most material diligence – and subsequently underwriting – topics that almost always merit a written deliverable. IT and data privacy



and security have really become their own workstreams, separate but akin to efforts of intellectual property specialists. Verifying that a target company has sufficient underlying operating insurance coverages is also significant. It is not only important that the target company has adequate pre-closing coverage in place, but also because the company's underlying insurance position may provide insight into management's risk strategy and awareness.

Sherman: There is no 'one size fits all' when it comes to key areas of diligence. Each target company is different, some exceptionally different from what is conventional or traditional. The answer is highly dependent on the industry, the type of business and the specific nature of the target business' operations and idiosyncrasies. The target's uniqueness and peculiarities need to be identified and assessed at the outset with appropriate diligence procedure strategically designed and implemented to deal with each. Of course, due diligence must continue to assess the typical, historical potential risks in areas such as the financial statements, legal, taxes, physical assets and customers. However, atypical and extraordinary risks may arise in some businesses designed to focus on the modern economy and face the potential risks of things like new technologies, AI and similar.

FW: What advice would you give to buyers and sellers on

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DAVE J. BARTOLETTI

TAFT STETTINIUS & HOLLISTER LLP

negotiating representations and warranties (R&W) in M&A transactions? How does R&W, or warranty and indemnity (W&I) insurance, fit into this process?

Reynolds: R&W insurance enables buyers and sellers to streamline negotiation of the R&W in the purchase and sale agreement. Without such insurance, each 'known unknown' risk must be allocated between the buyer and the seller. Such a negotiation process can be contentious and time consuming. With R&W insurance, the insurer assumes many of these risks, freeing the deal parties up to focus on the more consequential aspects of the business deal. After the transaction is complete, insurance can eliminate costly disputes between the buyer and the seller, as claims can be submitted

to the insurer and resolved in an efficient and commercial manner.

Kim: R&W and warranty and indemnity (W&I) insurance has experienced incredible growth over the past decade, making buyers more competitive and facilitating a smoother transaction by allowing sellers to have cleaner exits without escrows, holdbacks or ongoing indemnification obligations. I would encourage parties to engage with R&W insurance professionals early in the process as the decision to use R&W insurance will inform other aspects of the transaction, including the negotiation of the R&W and the structure of any indemnity. However, R&W insurance should not be a substitute for carefully drafting the R&W or proper due diligence. Buyers and sellers should continue to focus on conducting thorough due diligence, properly

populating the disclosure schedules and drafting the R&W with clarity and precision to prevent ambiguity and disputes in the future.

Bartoletti: It is easy for counsel on both sides to get caught up in what is ‘market’, but I always encourage clients to focus on what is actually relevant to the deal. Buyers, in particular, should work with their counsel to identify the key drivers of value and ensure the R&W are tailored to those risks. R&W and W&I products drive even more value when representations are thoughtfully drafted and negotiated, as they can bridge negotiation gaps and give both sides more confidence to move forward, knowing that key risks are covered.

Sherman: Transactional R&W and W&I are typically divided into two parts: those that are generic

to every transaction and those that are specific to the current transaction and the specifics of its business. They have been around since the dawn of time and experienced transactional lawyers generally have them figured out. Utilising R&W and W&I insurance, however, adds another party to the transaction, the insurer. Since the insurance company is simply stepping into the shoes of the seller for purposes of the R&W they are insuring, there should be little or no needed change in the negotiated R&W. However, the insurer will need to confirm that representations are consistent with the risks that they are intending to insure, and the buyer and seller will need to consider that in their negotiations. Therefore, it is important that the parties consider R&W and W&I insurance early in the process and engage the

insurer early to allow it the time needed to assess the transaction, the risks and the substance of the representations in order to promote an efficient process for all.

Tuliebitz: I am a proponent of taking some level of middle ground when drafting and negotiating representations in an agreement as opposed to buyer-favourable or seller-favourable extremes. It is no secret that when R&W insurance is contemplated as part of the transaction, then the representations package is expected to be more fulsome to afford the buyer as much protection as reasonably possible, and the seller should be more amenable given its significantly lower and capped, or non-existent, indemnity liabilities. But a seller’s lack of or limited indemnity obligations should not relieve it of the obligation to acknowledge and defend the validity of the representations and disclosures being made.

Sherry: Engaging the insurance team early in the process can greatly improve outcomes. When brought in at the start of a transaction, the insurance team can help structure the policy around the specific risks of the deal and streamline the path to execution. A well-organised diligence process and clear disclosures help avoid delays and allow for more tailored underwriting. There is a need for speed in today’s market as well as thoughtful preparation up front, which often leads to



As the claims process matures, we are generally seeing more transparency and free flow of information between insureds and insurers.

ROY H. REYNOLDS

GREAT AMERICAN INSURANCE COMPANY

more favourable terms and fewer surprises leading up to signing.

FW: To what extent are you seeing an increasing demand for other risk-transfer solutions, including tax liability and contingent risk insurance? What benefits do these policies offer in the M&A context?

Bartoletti: We have seen an explosion in demand for tax liability solutions. In the M&A context, tax insurance either supplements R&W insurance where a risk has been excluded by the insurer as a result of M&A diligence or works in tandem with R&W insurance to address known tax risks at the outset. This combination of R&W and tax insurance serves well those targets where tax efficiency is a material part of the target's value, like real estate investment trusts, renewable energy projects where tax credits helped finance the project and targets whose shareholders hold 'qualified small business stock'. Beyond tax, we have seen increasing interest in creative, bespoke insurance solutions that address contingent risks outside of traditional products such as judgement preservation insurance. These projects require some outside the box thinking from insurers but can deliver huge value to insurers and insureds alike.

Tuliebitz: Tax liability insurance and contingent risk insurance both exist under the umbrella of 'transactional risk' insurance,

The real human collaboration among insureds, insurance carriers, brokers and legal advisers remains indispensable to find optimal solutions to the complex problems that transactions can pose.

SEAN KIM

EUCLID TRANSACTIONAL, LLC

alongside R&W insurance. As opposed to R&W insurance, which is intended to cover unknown liabilities, tax and contingent insurance look to address known, potential exposures. These policies tend to have greater value on the periphery of an M&A transaction, where there is time outside the pace of deal negotiations to thoughtfully address and strategise the ringfencing of these risks. Insurers can certainly handle these risks in a time-pressed deal scenario, but those able to address risks outside the pressure of a transaction can only benefit from it.

Sherry: Demand in the US for tax liability insurance has surged because of the incentives under the Inflation Reduction Act and demand accelerated by uncertainty around the proposed legislation, which could phase out certain renewable

energy project incentives in the coming years. Renewable tax credit insurance has become a mainstay in the transactional liability space and is expected to increase while renewable developers push to place projects in service before the potential incentive phase outs. The R&W insurance market in the US continues to be both robust and competitive. To that end, the underwriting experience from the insured's perspective has become more efficient and quicker than in years past.

Sherman: While a few years behind R&W and W&I, the demand for tax liability and tax contingency insurance continues to grow and has become a staple of the transactional insurance marketplace. In addition to the growing general acceptance of these risk transfer products, the

uncertainty in parts of the current US tax environment and long tail related to tax matters has provided an increased boost. More recently, tax liability insurance has become popular for companies with increased risks related to tax credits. Related to M&A, additional tax specific insurance coverage by way of a separate tax liability policy is often advisable where there are known tax issues or tax risks that are excluded, explicitly or implicitly, from the R&W and W&I policy. Tax liability insurance in these circumstances can often be an effective tool to help close gaps between the seller and buyer on risk transfer or price.

Kim: Recently, the demand for tax liability insurance has surged. As tax laws constantly change and new tax-related complexities and risks continue to arise, we have

seen more parties opt to mitigate the financial risks of tax-related liabilities with a tax liability insurance policy. In M&A deals, tax uncertainties can take centre stage and lead to hostile negotiations or even derail transactions. Using tax liability insurance allows buyers to avoid self-insuring or negotiating complex indemnities or escrows, while sellers gain protection from future claims. As obtaining private letter rulings can be time consuming, even strong tax positions carry some risk. Tax liability insurance offers a practical solution for such tax positions that may not qualify for their intended treatment.

Reynolds: Demand for tax liability insurance is increasing rapidly, as brokers and insureds become more familiar with the product. In contrast to R&W

insurance, which covers matters that were not known to the buyer at the time of the transaction, tax insurance transfers risk related to known tax issues. These are generally strong tax positions, taken with expert advice from outside advisers, where there remains some residual uncertainty. Tax liability insurance is also available outside of the M&A context – for tax credits or other tax matters, for example, where there is some level of unpredictability. Contingent risk insurance is increasingly hard to place. Many insurers have pulled out of contingent risk insurance, due to a number of very large losses in the industry, particularly with respect to judgment protection insurance.

FW: When choosing between transactional insurance policies on offer, how important is it for parties to evaluate a potential insurer's claims experience, process and track record?

Sherry: A transactional liability policy is only as good as the team that stands behind it. We always encourage clients to ask tough questions about claims handling. Who is on the other end? How quickly do they move? Do they have control over their own process? The best experiences come from specialised claims teams who know this space. Communication matters too – timely updates, clear information requests and a collaborative tone can make a world of difference. Brokers and insureds



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MIKE SHERRY

DUAL NORTH AMERICA, INC.

should be focused on in-house expertise and historical speed to resolution.

Sherman: Claims experience and track record are important and should serve as indicators to the policyholder. The goal of the claims process is to get to the right answer as efficiently and effectively as the complexity of the claim and the responsiveness of the policyholder allow. If the insured should need to file a claim, it should want to deal with an insurer that understands and follows an efficient process in a collaborative way. Insurers can differentiate themselves by providing a collaborative and effective claims process.

Kim: The ability to pay out claims in a timely, efficient and fair manner is an important factor in any insurance product, but it is arguably even more important and visible when dealing with the uncertainties and complexities of M&A transactions. The sophistication, size and experience of the claims team at the insurer that will be handling the complex claims after R&W insurance is in place should be strongly considered in choosing a potential transactional insurer.

Tuliebitz: Nothing is more important than claims. Claims are the only reason transactional insurance policies exist. Each insurer in the transactional insurance space is keenly aware of that fact, so they are all expected to address claims with the respect and

attention that they merit. Inevitably, however, some insurers will rise above the pack in reputation. It is not because of lacklustre delivery by insurance competitors but rather from the extraordinary efforts, results and investments made by these insurers. Equal importance should be allocated to both an insurer's claims process, and its claims results. R&W insurance claims should be handled as an extension of the transaction that the insured and insurer entered into at the time of the deal and the placement of the coverage. It should not be adversarial. It should not be acrimonious. There are obviously a lot of other nuances to navigating a successful claims experience, but all sides should strive to maintain a positive tone, respectful interactions and general

congeniality that should guide the process.

Reynolds: An insurance policy is simply a contract to pay valid claims, so the claims experience, process and track record of the insurer is crucial to selecting a transactional risk insurer. Many transactional risk insurers are managing general agents (MGAs). Such MGAs do not take the risk themselves; instead, they underwrite on behalf of their insurance company backers. An MGA arrangement enables insurers to exit the space quickly and efficiently if they choose to do so. However, if the MGA or the insurer exits the market, they will have little incentive to pay claims. Transactional insurance policies are large-limit, long-term policies, so it is important for

Stability, consistency and reliability with both underwriting and claims handling will continue to be critical to maintaining the integrity and viability of the product.

NICK TULIEBITZ
ASSURED PARTNERS

brokers and insureds to consider the stability and commitment of the insurer providing the coverage. I believe that an insured is better off purchasing a transactional risk policy from an established company that is committed to the transactional risk business and has an overarching brand to manage and enhance.

Bartoletti: Unlike even a few years ago, more carriers have a track record and can demonstrate that they pay meritorious claims. I think this has led to a little less differentiation and allowed purchasers to focus more on finding the best scope of coverage at a price that pencils out for them. That said, for frequent users of the product and in the largest deals, claims experience and process still carry substantial weight, and some buyers do have strong preferences for – or

against – individual carriers based on their past claims interactions.

FW: How do you expect the claims process for transactional insurance to improve in the months and years ahead? Where are we likely to see further enhancements made?

Tuliebitz: Ultimately we are all hoping that the transactions using R&W insurance are successful investments and the parties do not have to suffer losses leading to R&W insurance claims. By the numbers, only one in every four or five deals that use R&W insurance have a claim at all. Claims are relatively infrequent when considered against overall deal volume, so the R&W insurance industry continues to learn and grow with each new claim. Patterns of claims can lead to adjustments in how an insurer

underwrites a certain topic. Claims experience has also driven enhancements to policy language on both the insured and insurer sides. So, overall, the R&W insurance claims process will continue to be honed and improved to the benefit of all involved. I have no doubt that AI will have some influence over how future claims are handled, but given the sensitivity of claims I expect any implementation to be thoughtful and not rushed. ‘Tried and tested’ carries a lot of weight in comparison with the benefits of ‘state of the art’ when dealing with insurance claims.

Kim: We expect the claims process to continue to improve as the product matures and parties become more familiar with the product. With the increasing frequency and complexity of claims, it is now more critical than ever to have an experienced team properly staffed to service the claims.

Sherman: Transactional insurance, while around for nearly two decades, is still young. The annually increasing volume of claims and the experiences of insurers has resulted in the growth of dedicated and experienced insurance claims teams, leading to a more efficient and collaborative process driven by these dedicated claims teams. Many claims are very complicated and require time to assess and validate. Nonetheless, insurers continually strive to make the process more efficient for the insureds, and they will



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MARC SHERMAN
ALVAREZ & MARSAL

continue to work toward that goal. Policyholders are gaining a better understanding of the need and time required to validate complex claims and are working harder toward quicker turnaround of information requested of them. Further enhancements will come about from better and more timely collaboration. It is unclear at this point whether new technologies such as AI will be advantageous in the claims process or be able to help create further efficiencies.

Reynolds: As the claims process matures, we are generally seeing more transparency and free flow of information between insureds and insurers. A cooperative approach is more effective than an adversarial one, because it gives the insurer the information it needs to pay a claim quickly and in a commercial manner. On large towers, we are often, but not always, seeing cooperation among carriers with respect to claims investigation and sharing of information. Such cooperation benefits the insured by expediting the process and improving the claims experience. Certain brokers, counsel and experts have become specialists in R&W claims. In many cases, these professionals are able to manage expectations and facilitate fair and efficient outcomes, because of their thorough understanding of the issues and the process. Other advisers, however, can introduce antagonism and delay by being overly aggressive and adversarial. One key claims issue facing the

R&W insurance industry is the scope of claims covered. These policies are intended to cover misrepresentations by the seller, not the general business risks associated with the target business. There are a number of significant claims in process throughout the industry that will set important precedents regarding the scope of this kind of coverage.

Bartoletti: We will see a continued push among insurers to provide more efficient and predictable service. To get there, insurers need to standardise timelines and communication protocols while pushing their external claims counsel to streamline documentation and information requests to simplify the claims process. These efforts will be warmly received by regular users of the product, including the major law firms that represent a disproportionate share of buyers, and could be the next frontier in differentiating among carriers in a world where meritorious claims are generally paid.

Sherry: We are already seeing a shift toward greater specialisation and faster resolution. Where transactional claims were once handled as part of broader financial lines portfolios, insurers now increasingly deploy dedicated claims professionals with M&A backgrounds. This domain expertise enables them to assess losses more effectively and collaborate more constructively with all parties

involved. Transactional liability claims handling is evolving from a reactive function to a strategic component of the insurance experience. Ultimately, efficiency, transparency and subject-matter alignment will define the next generation of claims handling.

FW: How do you expect transactional risk management to evolve in the coming years? How might attitudes, strategies and techniques change?

Kim: Overall, transactional risk management can be expected to be increasingly sophisticated with bespoke and customised solutions for the nearly limitless possibilities and challenges that arise in transactions. The growth of secondaries transactions is an example of how the industry continues to evolve and find risk management solutions to areas of friction in transactions. Technology and innovations such as generative AI may play a role in the evolution of the risk management solutions, but the real human collaboration among insureds, insurance carriers, brokers and legal advisers remains indispensable to find optimal solutions to the complex problems that transactions can pose.

Reynolds: Demand for tax liability insurance is growing. While R&W insurance usage has expanded dramatically in recent years, the growth of tax liability insurance has been more measured. Now, awareness of the

tax product is growing robustly, as more brokers, underwriters and tax lawyers specialise in it. Together, they are driving a trend toward using insurance to protect insureds against uncertainty related to the potential tax consequences of certain tax credits as well as corporate transactions. Now is a volatile time for M&A. Political uncertainty and extensive tariffs are impacting most businesses. Geopolitical risk is also high, as formerly stable trading relationships have become much more adversarial. The effect of all this uncertainty on M&A transactions, on the demand for transactional risk insurance, and on transactional risk claims remains to be seen. However, since demand for insurance is driven by risk, I would expect demand for these products to grow, along with commensurate increases in claims and pricing.

Sherman: In terms of conventional R&W and W&I coverage, M&A deal size has grown significantly, leading to more deals with higher policy limits. Retentions have dropped and policy pricing has moderated. As deal volume continues to rebound, pricing will need to rise, which is healthy for the continuity of the product as prices had dropped too much for a long term sustainable product.

Outside of traditional products, tax indemnity and contingent liability coverage will continue to grow.

Bartoletti: I expect the R&W insurance product will continue to expand into new markets, with venture capital transactions and real estate transactions immediately coming to mind as areas where a foothold has already been established. AI will be a game changer in this industry. That is not to say humans will be replaced, but rather that AI tools will allow underwriters to harness internal and external data to assess and price risks based on documents provided at submission. Of course, these same tools will be available to buyers. This may exert some downward pressure on underwriting fees in the medium to long term, while simultaneously accelerating the underwriting process.

Sherry: Transactional risk management is becoming more dynamic and specialised. New technologies, shifting regulatory regimes, and fast changing geopolitical and trade risks are pushing diligence beyond the traditional playbook. We believe we will see greater collaboration among legal, financial and technical experts during diligence

and policy negotiation. At the same time, insurers will need to continue developing tools and talent to assess these increasingly sophisticated exposures. While the landscape is evolving, the core mission remains unchanged: helping clients identify, allocate and mitigate risk so deals can proceed with confidence and clarity.

Tuliebitz: Looking back to 2016, the state of transactional risk insurance was drastically different than it is today. While I am hopeful that the industry has matured and hit a stride that would not require extreme changes, it would be naïve to think the product will not evolve. The more regular use of R&W insurance in secondaries transactions, pure real estate transactions and more complex energy transactions are all encouraging signs for the increasing value of transactional risk insurance products. Stability, consistency and reliability with both underwriting and claims handling will continue to be critical to maintaining the integrity and viability of the product. Fortunately, there are a lot of great people in this industry who I am confident will continue to steer the ship in the right direction, collectively. ■

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