Jurimesh

W&I INSURANCE: FROM THE UNDERWRITER'S DESK

PAPER 3

THE W&I SERIES

By Jurimesh, in conversation with Tanya Nash (RiskPoint), François Piquet (Acquinex) and Martin Roberts (Liberty GTS)

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This is the third paper in the Jurimesh series on W&I Insurance. The first provided an overview of the topic, while the second explored it from the broker's perspective. This third paper shifts the focus to the underwriting side of the table. It is built as three conversations, each in its own chapter.

Together they take us through what underwriters look for when a due diligence report lands on their desk, what makes them cautious, and where AI is starting to change how deals get underwritten.

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CHAPTER ONE

From the underwriter's desk

Tanya Nash
RiskPoint

"We encourage advisors and clients to consider the use of AI to support and expand due diligence and to assist the sell-side in the location and provision of key information."

Tanya Nash was a corporate lawyer for close to two decades, a partner at Dentons and Ince & Co, before moving into transaction-risk underwriting. She is now Chief Underwriting Officer for Transactional Risk at RiskPoint. Here she takes us through what she looks for when a due diligence report lands on her desk, what makes her cautious, and where AI is starting to change how deals get underwritten.

1 How an underwriter reads a DD report

When a DD report lands on your desk, what are you actually looking for in the first five minutes? Where do you go first?

Tanya: Let me take one step back. When we decide whether to quote a deal at all, we look at who is doing the due diligence, who the advisers and internal team members are. We put an enormous amount of reliance on the quality of the team: their experience, their knowledge, their professionalism. It is a huge factor in whether we write a risk at all.

Once we are appointed and the diligence arrives, the first and most important thing we do is read the scope of work, and in particular what was not reviewed. When we agree to take on the risk of unknown problems in a business, we do it on the basis that a competent, experienced buyer and their competent, experienced advisers have looked under enough rocks, and the right rocks, so that the chance of there being an undiscovered/undisclosed problem is small enough to accept the risk at the market rates for our policies. Scope is the first and most important thing we look at.

Something clearly described as a known problem is less interesting to us because we do not cover known issues. What we are really looking for is what the diligence teams did not look at, or did not look at in much detail, measured against our own view of the key risk areas for that business and against the warranties we are being asked to insure.

What does a DD report look like that makes you think this team understood what they were doing? And what are the signals that make you cautious before you have even finished reading?

Tanya: It is comforting to see advisers we have dealt with repeatedly and have real confidence in. (Although even the best advisers can be given a very restricted scope by their client or restricted information from the sell side). We also derive a lot of confidence from the identity of the buyer. We are most comfortable when the buy-side team clearly knows what they are doing, knows the sector and the jurisdiction well, because that experience will inform where they focus their diligence and that is apparent in a well targeted diligence exercise focusing on the real risk areas.

Things that make us cautious on reviewing a DD report include (1) a lack of focus by appropriate specialists on key risk areas to that particular business, (2) material gaps in the scope of the DD exercise, (3) gaps in information provided by the target/seller on key risk areas or (4) a lack of analysis or specificity on discovered issues.

Before we get to see any DD, it sometimes appears from questions at quoting stage that there is perhaps an intention to rely on the insurance cover in place of a normal level of due diligence (with some explicitly selecting insurers based on how little diligence they will require the buyer to do). What is appropriate and proportionate will vary between deals but, we have to factor evidence of such approach into our appetite and reflect it carefully into our underwriting (digging more ourselves where necessary) and coverage.

When a lawyer says "we reviewed everything and found no material issues," how do you interpret that? Does it give you comfort, or does it raise questions?

Tanya: It depends on the business. If it is a straightforward business, for example it bought a building five years ago and has only three leases, you would not expect any problems and it is actually great to see a confident assertion of no issues. If however it is a complex international regulated business with thousands of employees and complicated contractual frameworks, we might be more sceptical of such a broad brush statement because it would be unusual for nothing to be slightly askew somewhere.

It is all about context, and it is very important that we understand the scope of what was looked at. We set out underwriting focus areas in our quotes, which is our view of what is important for that particular business. We want reassurance that the team looked at those areas.

What's the relationship between the quality of the DD report and the exclusion list you end up issuing? Is it roughly proportional, or do other factors matter more?

Tanya: While there are of course immaterial subject areas/jurisdictions where we can and do take a view, one of the most common reasons for an exclusion is that there are material gaps in the diligence. This is where AI can be a useful solution enabling a much wider scope of review if you have a tool that can do it reliably and quickly. Gaps in diligence is therefore a category of exclusion I would expect to see less of with AI-supported review.

Beyond gaps, there are some industry-specific commercial risks we simply cannot cover, (for example, how much oil is in the ground on an upstream oil deal) and there are exclusions for known issues, because W&I policies are priced for unknowns. Those are the three main areas of exclusion and I would expect AI-assisted review to reduce the first of them.

2 The underwriting call

What does a good underwriting call look like versus a bad one? What do the best DD teams do differently?

Tanya: On a US-style deal there is usually a fairly short agenda, some general topics, including the basis of valuation and the drivers for the deal, and then more specific agenda items drilling into key areas, gaps and identified issues. In Europe you get a much longer menu of more specific questions.

All underwriters have template question sets, but it is very important to tailor them to the deal: not to ask questions where the answer will not change our coverage position, and not to ask questions we could answer ourselves by looking in the data room or the diligence. We try to limit our questions to matters that will really move the dial. We will always have more questions where there are holes in the diligence, because there we want to understand why something was not looked at, how material it is and how the buyer got comfortable.

The best DD teams are open and willing to share their views on risks, their materiality and how they are addressed on the underwriting call, assisting the underwriters to understand the client's perspective and thereby to offer the best possible cover position.

Is there a question you always ask that consistently reveals something important that most deal teams don't anticipate?

Tanya: Anyone used to W&I will not be surprised, but a very important one for us is the basis of valuation. It is crucial when we come to quantifying loss if there is a claim, and it also tells us where the key value drivers sit and therefore where we and the diligence exercise need to focus. If for example the main value is in the IP, we need the diligence to have been rigorous there, and the IP warranties will be the most important warranties. So that one question is both information we need on file for a claim scenario and a guide to where we should focus.

3 AI-generated due diligence

Have you seen AI-generated or AI-assisted DD reports come across your desk yet? If so, what was your reaction?

Tanya: We have been told expressly that a report was AI-generated only a very small number of times, and we review and insure hundreds of deals a year. But we are certain that a great many lawyers, accountants and other advisers are using AI in their work, whether that is someone at home with ChatGPT or a structured system built for the purpose; often we will not know.

The clearest case for use of AI, where we would be delighted to see it used more, is where there are hundreds of similar customer contracts/leases/permits. We would much rather have an AI review of everything, even one the buyer cannot formally rely on, than a review of five per cent with the rest left to hope in consistency. Even an unsophisticated, flawed AI review of far more contracts/information/jurisdiction is better than a very limited scope human review. More information is better for us and for the buyer.

For more complex matters, in our view the best case is AI review with human sense-checking, careful human direction and review of any results that seem anomalous or implausible and the use of experienced advisers to spot systemic issues/patterns from the AI review results.

Now whenever we are asked whether we would accept a five or ten per cent sample review of contracts and/or no review of documents relating to smaller revenue jurisdictions, we explain what we would need to get comfortable with that, but we will always encourage the use of AI to fill the gaps.

Is the concern about AI-generated DD primarily about accuracy, or is it more about auditability and being able to defend the output if a claim arises?

Tanya: For us the impact is the same whether an inaccuracy or omission is made by an AI tool or a human. If a junior lawyer reviewing contracts misses something, that is no different in outcome to us than if an AI agent misses something. The problem is there, it was not picked up in diligence, so it was unknown, and subject to the policy that means we are covering it. Humans make mistakes; a junior lawyer reading 300 contracts can certainly make mistakes.

A law firm might take a different view on its own professional-indemnity position depending on whether a human, or a human using AI, missed something, but that is a different question. In terms of coverage, the more diligence that is done, the better the coverage, and the reason something was missed, or who or what missed it, is not really relevant as long as we were comfortable with the overall process.

If you were to formally accept AI-generated DD as a valid basis for coverage, what would need to be true, about the tool, the process, the human review layer, or the output?

Tanya: It depends on what it is. We were underwriting a deal a few weeks ago where, at the very last minute, the sell-side disclosed a large number of additional documents, telling the buyer it was just a tidy-up and none of it was material, with signing due the next day. That is nerve-wracking for the buyer with unreviewed new information generally disclosed through the data room. We agreed with that client to accept an AI-only review of the new information, with human checking if that review suggested any material problem.

Because it was an assorted set of agreements rather than one standard type, we agreed review parameters, what they would search for and which prompts they would use, and then accepted the AI-only review. The law firm attached a full disclaimer to its output, saying it took no responsibility (even stating that the AI results could contain hallucinations), and in that context we accepted it.

The gold standard based on what we see now, is a combination of AI with experienced lawyers, accountants, tax or other advisers. Depending on the subject area, the appropriate human review might be of a small sample, or just a review of the findings so that someone can say "that cannot be right" or "I see a pattern I want to look at more closely." There is no single right answer. The amount of human input we would want to see will vary with the nature and complexity of the business.

Do you think W&I underwriters will converge on a standard for AI-generated DD in the next few years, or will it stay insurer by insurer? Is there a role for the market to set that standard collectively?

Tanya: I do not think the market should set the standard, for a couple of reasons. First, we would get it wrong. Transactional Risk underwriters are mostly lawyers and accountants and the technology is moving so fast that any benchmark would be out of date before we finished writing it down. What is appropriate also varies enormously by business and by complexity.

Secondly, in many ways it is not our role. Where an accountancy firm or a major law firm is using AI, we are inclined to trust them to decide how they use it and how much review they need to be able to look their clients (and PI insurers) in the eye. We already trust those firms to select, train and supervise their teams and to run proper quality control, because their reputations, and their professional-indemnity cover, depend on it. So I would be most inclined to trust them to do their jobs, exactly as we do now when they are supervising people.

4 Claims

Looking at your claims experience, is there a pattern in the deals where claims arise, something about the DD or the deal structure that, in hindsight, was a warning sign?

Tanya: I do not have an easy answer for that, because if we saw clear patterns they would already be affecting which deals/parties/jurisdictions we chose to insure. The largest claims in financial terms are almost all accounts-based: revenue recognised too early, something treated incorrectly in the accounts that was not fixed. The next biggest set by volume is tax, and after that material contracts claims.

The biggest material contract claims are usually not about what was in the data room, they more often relate to what was not: the variation to a contract that was not disclosed, the letter from the biggest customer giving a termination notice or asserting breach that was not disclosed. One place AI will I believe be particularly useful is before the deal even starts, on the sell-side, in populating the data room. If AI can go into the seller's systems and reliably find every agreement and letter relating to a key contract/licence/subject area, that should materially reduce the scope for nasty surprises.

We see strong incoming demand for vendor due diligence too. Have you ever seen sellers actively hide things?

Tanya: Yes, some of our biggest claims paid to date arose from alleged seller or target management fraud (or fraud-adjacent) or known errors/issues not being corrected despite assurances they had been. We do not attribute that to increasing use of VDD however. Fraud is unlikely to be documented for review by any adviser, whoever that adviser is engaged by, although a buy-side adviser might be more free to critique/question information.

Good VDD is very valuable as the authors have direct access to the sell side and target management and generally have a longer time frame to complete their review than buy-side advisers would have, particularly on a compressed timetable auction deal.

Outside of instances of fraud/deliberate non-disclosure or false information, we have seen matters that look like they have been "glossed" in DD reports (with language that looks like it has been negotiated, for example "this is not necessarily an issue" or "this is not unique"). That presentation may be for the buyer's eyes in a VDD report and/or for underwriters' eyes in the buy-side report.

When a claim comes in, what's the most common reason it becomes a dispute rather than a straightforward payment?

Tanya: Quantification of loss. It is extremely subjective, and you can do the maths in many different ways. Insured parties might ask for very large multipliers even where the problem was a one-off, or might ask for compensation where the matter was in fact remedied or did not in fact impact the target in real world terms. That is where the biggest divergence can sit. It happens rarely, most claims process very smoothly, but that is probably where there is the most room for disagreement.

5 In closing

If you were advising a law firm or a PE fund on how to structure their DD process so that W&I coverage is as strong as possible, what would you tell them that they probably don't already know?

Tanya: Most responsible investors of course know that more diligence and analysis is a good thing. Some appear to deliberately minimise their DD and select their underwriter based on who requires the least DD, perhaps to reduce their costs or to seek to avoid matters they would otherwise discover from being excluded from cover. I understand why, on certain deals (for example on secondaries deals where limited DD and limited warranties are the norm), that can be a valid approach. But I would not want to invest in a fund/corporate buying big, complex, operational business deliberately knowing as little as possible about what they are buying. Strong knowledge of a target business through good diligence of course has a much wider purpose than warranty and insurance coverage: identifying areas where processes need to change, facilitating integration and planning and delivery of expected efficiencies and/or the investor's value creation plan.

What genuinely helps us is when a team that has chosen not to look at something, or to do only a limited or AI-only review of an area, is ready to explain why that makes sense in the context, why that matter is not a high exposure for this business. Ideally that is front-loaded, rather than waiting for an underwriter to spot a gap and then start asking questions. Early stage conversations about scope and context, right at the start of the underwriting process, save a lot of time.

And be upfront. If your diligence has shown you an issue, or you are a seller who knows about one, put it on the table early, because the market can often do something with it: a higher retention for that matter, only specific elements of a known issue being excluded, a contingent risk or specific tax policy covering the point ..., many solutions are possible. Even if the outcome is an exclusion, that gives a clear position (avoiding time and fees spent interpreting the cover position) and gives a firm basis for a negotiated solution between the parties. The best deals with the best outcomes are highly collaborative between the underwriters and the deal teams. It should not be adversarial.

Anything you'd add?

Tanya: Again that "more is more" on due diligence. You will do better deals with more information; do not be afraid of it. Some people worry that knowing more means more cover exclusions, but if you know the problems, you talk to the seller, the broker and to us, and we will help to find ways to deal with known issues or gaps in information. AI is an increasingly powerful tool and it is very encouraging to see law firms, accountancy firms and technical specialists adopting carefully tailored, managed, specialist solutions (rather than an individual quietly using a general tool that is drawing its answers from who knows which unreliable sources). Structured, targeted AI products used by well-trained specialists are going to massively enhance M&A diligence. The only material risk I see is of an excess of information, and that just brings the experienced humans and their judgment back in, to focus on what really matters.

CHAPTER TWO

From the mid-market desk

François Piquet
Acquinex

"We prefer a good AI to do the job that was usually given to an intern or junior without specific due diligence training."

François Piquet is the Head of France and Benelux at Acquinex, which built its reputation on small and mid-market deals with a deliberately streamlined underwriting process, and is now extending that approach across Europe, notably France and the Benelux. Here he explains how the market is growing up, why France and the Benelux still differ, and how Acquinex approaches AI-generated due diligence.

1 The mid-market, and a market growing up

You built a reputation around small and mid-market deals with a deliberately streamlined underwriting process. What does that mean in practice, and how is the market changing?

François: That reputation is really Acquinex's. It was built on smaller deals, and it is something we are now extending across Europe, but notably for France and Benelux (thanks to my prior experience on bigger and more complex deals). Our core appetite sits between roughly €40 million and €400-500 million, though we also regularly quote and underwrite smaller deals, we go up to €1.5 billion on real estate deals and have some appetite for excess on deals in excess of €1.5bn. What we are doing is bringing to bigger deals the efficiency we built on smaller ones: no underwriting call, no successive tranches of questions, limited use of lawyers, questions focused on the key matters, and a first cover position within a short timeline. That efficiency is how we and a few competitors were able to disrupt the market, notably against the larger and longer-established players.

The market itself has changed. When I started, more than seven years ago, the differences between players were important, most notably in their processes (and outcomes): long question lists, underwriting calls, conservative coverage approaches and pricing. The whole market is moving towards fewer questions and often no underwriting calls. What drives differentiation now is the difficulty of the deal and the nature of the business, and how we can understand it and underwrite it efficiently, rather than applying an underwriter's "house style" (although this remains a consideration). As the market matures, policies are converging, rates and retentions are both coming down, and the real place to differentiate is the underwriting itself: efficient, technical and senior-led, rather than low-cost, not tailored to the deal and junior-heavy.

A key aspect to the market is also how insurers can manage claims. Acquinex has an experienced and dedicated claims team that can efficiently manage claims, making the process from quoting to claim payments user friendly.

2 Jurisdictions and language

Within the Benelux and across Europe you see real differences, especially between the Netherlands, France and Belgium. What drives them?

François: It is a combination of things. There is a culture of being insured in the Benelux. In France, many people still held a negative view of insurance, and the W&I product was seen as a UK or US product for a long time, so brokers and some insurers, including me, had to do a lot of work to explain that it facilitates a deal rather than blocking it, that the product works (i.e., claims are efficient and paid) and it is tailored to the markets in which it is used.

The Benelux had a few years' head start on maturity, and the Netherlands is more advanced than either France or Belgium. But the gap is closing: France and the Netherlands now see similar deal volumes, Belgium less so (because it is a smaller economy), and Luxembourg remains a small market to be developed. Lawyers are increasingly advising clients to take out a policy, including smaller, fully domestic firms that would not have done so before.

In general, we see more complex deals in France, with longer negotiations. The understanding of the deal specific parameters and ability to underwrite such deals as other deals has become key (e.g., just recently, the team and I, have underwritten (i) distressed deals, (ii) internal reorganisations, (iii) commandités-commanditaires structures, (iv) synthetic policies, (v) mix of acquisition and (vi) capital increases). The French Put Option – Signing – Completion structure[1] is important to be reflected in policies (and is something non-French underwriters or brokers may not be familiar with). Language can also be a barrier for some brokers and underwriters.

Does language have a real effect on the work?

François: In the Benelux most of it is done in English, with the occasional Dutch part; it is not as pronounced as elsewhere. France is different: the SPA, the DD reports, sometimes the whole process, are in French. Some parties do not fluently speak English, and some state-related entities need a French language document to be able to sign. Increasingly we get requests for a fully French language process. This is true not only in France - we have had a few similar requests for Belgian deals too recently, and the demand has grown a lot this year. We are set up to run the full process in French (the policy, the underwriting questions and the document review), for both France and Belgium (and even recently for a Swiss deal).

1 The French put option structure. In France, a buyer usually cannot sign a binding SPA before the target's works council has been consulted. The buyer therefore first signs a put option, a binding promise to buy, with the SPA attached in agreed form. Once the consultation is complete, the seller exercises the option, the SPA is signed, and completion follows. A W&I policy has to account for all three stages, which differs from the two-step sign-and-close sequence common elsewhere.

3 How an underwriter reads a DD report

When a DD report lands on your desk, what are you looking for in the first few minutes, and what tells you the deal will be straightforward or complex?

François: The first thing is to check which reports we have received, because each type of deal has an expected set. If a financial or tax report is missing, that is the first flag. Then we check the dates, so the reports are not outdated, and then the scope, to make sure there is no gap against the transaction: the target's business, the location of the risk, the warranties. If the scope of the reports is adequate, and the reports are well drafted, the underwriting is expected to be more straightforward and the client can anticipate broad and efficient coverage. If reports are missing or outdated, we know there will be more diligence necessary, more questions, and/or an impact on the final cover position.

In general, underwriters consider the reputation of the advisers. As a principle, we have no recourse against the lawyers, and we do not do our own diligence or check the data room in the level of detail an auditor would, so we rely on their work. With experience, you can read known lawyers work faster, and reports are increasingly drafted to take into account the W&I process, so the risks are easy to see. But the main risk remains in the gaps, what is not in the reports, and this is a key reason why underwriters need to be experienced.

We also commit to being efficient with questions: we do not ask the proposed insured nor advisers to confirm matters/items we can already read in the documents, we keep the general questions to the key ones to understand the deal and complete our policy, and we make the specific questions detailed enough to avoid a second or third round of questions. It takes a little longer up front but the process is much quicker overall, with far fewer follow-up questions and prevents the need for an underwriting call.

What's the range of DD quality you see, and what impact does it have?

François: Quality is improving, partly because brokers have done real work warning and educating clients that insurance is not there to compensate for a lack of review or a lack of disclosures from the sellers. Some clients still want a policy without doing fulsome due diligence work, and unfortunately, the final coverage reflects this. But reports are clearer than they used to be with their approach to W&I. They are often red-flag reports with a summary organised by category, which makes them quicker to read and easy to reference for our underwriting questionnaires. In addition, the answers to our questionnaires are generally more helpful than the old "yes, no, confirm" I saw in the past in France.

Quality also depends on disclosure from the seller, as we need both, and where there is no review, or no disclosure, it will lead to some limitations in cover. Coverage positions can still be improved post signing, via an endorsement to the policy, if adequate disclosures and due diligences are completed.

The drafting of the acquisition agreement is also important, as insurers must check the definition of loss, the disclosure mechanism and how the warranties set and disclosures against the warranties reconcile to the due diligence reports and their findings.

The insurance cannot save a bad deal but can facilitate deals by removing some difficulties in the transaction.

4 AI-generated due diligence

You've seen the same AI questions coming from brokers in France and the Netherlands. What are they actually asking, and how do you approach it?

François: Funnily enough, the day prior to our discussion, I reviewed the first report I have seen with a clear statement that it was prepared with AI.

Our approach is pragmatic: as a principle we accept AI, provided we are sure of its quality. A general tool like ChatGPT or Grok raises concerns about data privacy and adequacy of the method and results being provided. But an AI developed and controlled by a law firm, used by lawyers trained to use it, can add quality, summarising large numbers of contracts, for instance, so the lawyers can focus on the added-value work. Our general answer is that we prefer a good AI to do the job that was usually given to an intern or junior without specific due diligence trainings.

What we want is senior human quality control, so AI "hallucinations" and misinterpretations get caught, and a sense of why AI was used for a given task. The good example is exactly what I saw in that report: a paragraph at the end of the scope of work naming the internal AI, explaining it was developed by the firm's lawyers with its IT team, used by trained lawyers, and that its output was checked by an experienced, senior lawyer. That is what we expect.

Some PE funds want to bring an AI-generated report straight to underwriters, with almost no lawyers on smaller deals. Can you underwrite on that?

François: In theory, yes. We can underwrite on a fully AI-generated report, provided the AI is good quality, the prompts and the documents given to it are good, and it is under the control of someone with enough experience, because there is no such thing as a senior or partner AI. It is the same test we apply to a law firm: a good AI is fine, a bad AI is not, exactly as a good or bad law firm would be. AI is also very useful on asset-heavy portfolio deals, where we used to request a costly sample; a traditional review plus an AI top-up on what would otherwise not have been looked at increases our comfort.

Are France and Benelux underwriters converging on a view of AI-generated DD, or are there still real differences?

François: It is hard to say, because these questions only really started about four months ago, from three or four brokers, so there is not much data yet. From what brokers tell me, Acquinex seems to have one of the more developed positions. Some competitors are still restrictive; others say they are fine with AI without spelling out what they are fine with. But I have not heard anyone say they will not accept AI at all. I think most are still building their own view, and that in general market will have to follow a general AI trend to fulfil clients' requests.

5 In closing

If you were advising a PE fund on their first W&I deal, what's the one thing you'd tell them that their lawyers might not?

François: Lawyers are increasingly experienced with W&I, so it is almost more a broker question now. The point I would make is that W&I exists for PE funds even where the practice, notably in France, is to give no warranties. You can keep that practice and still have protection through a synthetic policy, and that is exactly the kind of conversation I am regularly having with law firms and brokers.

If AI becomes the standard in DD production, will it change how you operate, or mainly the quality of what lands on your desk?

François: The product itself will not change, because an AI model trained by a law firm will be trained to produce the report the way the firm wants it. What changes is that you can review more, so quality goes up, and that makes our work even more about human risk selection: more detailed reports, fewer questions, and the decision that matters is choosing the risk and being able to understand the client's needs. I do not see AI replacing underwriters, including juniors, because a lot of this is a human business, selecting risk and meeting people. We see it as an efficiency tool rather than an existential risk for underwriters.

CHAPTER THREE

From the Benelux desk

Martin Roberts
Liberty Global Transaction Solutions

"The cleaner the policy is, the faster we can move, and the more value we can add."

Martin Roberts is Head of Benelux at Liberty Global Transaction Solutions. He practised as a lawyer at one of the Netherlands largest corporate law firms before moving into transactional risk underwriting. Here he takes us through how he reads a due diligence (DD) report, what the Benelux market looks like from the underwriter's seat, and what requirements need to be met to underwrite an M&A transaction based on a report produced largely by a machine.

The views in this interview are general observations from an underwriting perspective and are not legal or insurance advice, an offer of insurance or a commitment to provide cover. Any insurance coverage is subject to the circumstances of the individual transaction, final underwriting approval by the relevant insurer, the applicable policy terms and conditions, and applicable law.

1 How an underwriter reads a DD report

When a DD report lands on your desk, what are you looking for in the first few minutes, and what tells you whether a deal is going to be straightforward or complex?

Martin: Let me take a step back to the first phase in the underwriting process, the "non-binding indication" phase. The broker approaches us with certain transaction materials, typically an SPA and an information memorandum, based on which we can form an initial view of whether the transaction is within appetite. There are certain elements which are overarching in determining whether this is the case, most notably the ownership structure, the sector and the jurisdiction. There are further multiple ancillary factors that increase or decrease the risk profile of a transaction.

First, we form an initial view of what the company does and how it is being run. To achieve this, we naturally review the materials ourselves but we also deploy certain proprietary AI tools that collate and summarise certain information, including the factors I already mentioned but also the financials of the target and any adverse online media. Once we have developed an initial understanding of the target's business, we dive further into the transaction documents and the wording of the warranties and indemnities in the SPA.

And once you are instructed and the DD reports arrive, where do you go first?

Martin: There are various DD reports that are always provided: in any event legal, financial and tax. I look at financial first. If a company is profitable and growing, the deal is inherently less risky than a company facing headwinds or in distress.

After forming a view on the financial situation of the company, I will continue to review the other key reports and any other ancillary reports prepared. This review is more detailed. The review naturally covers all key risk areas of the transaction with special attention for certain topics which we know, from experience, more frequently result in claims being made, as well as certain sector or jurisdiction specific issues.

What does a DD report look like that signals the advisory team understood what they were doing, and what are the warning signs that make you cautious before you have even finished reading?

Martin: A large part of it depends on the reputation of the adviser. We have worked with certain law firms previously and extensively, and we know their DD reports are of good quality. Due to our experience, we know how they work and it is very uncommon to see them present a DD report that is not materially aligned with the warranties sought, and it is unusual for them not to fully understand what the business does.

Secondly, I focus on is whether the scoping of the DD report matches the scoping of the warranties. It is very hard to underwrite warranties when no DD has been done into those warranties unless they are clearly less material to the business.

Third, I look at how the warranties align with the underlying business of the transaction. I want to see warranties that are specific or relevant to the business being acquired. It does not fill me with confidence when a lawyer provides an incredibly generic warranty suite which could apply to any deal and is not tailored to the risk areas of the business being sold.

Based on those factors I can already form an informal view of the DD before starting a more detailed review and asking questions where there are open ends.

When a lawyer writes “we reviewed all material contracts and found no significant issues”, how do you interpret that? Does it give you comfort, or does it raise questions?

Martin: Somewhere in between. It is a little bit broad brushstroke, and it is a very absolute statement. I would ask a follow-up question to understand the methodology applied, what has been reviewed, and what has not.

What is the relationship between DD quality and the exclusion list you ultimately issue? Is it roughly proportional, or do other factors play a bigger role?

Martin: The number and type of exclusions are determined by a multitude of factors. What I can say is that if the scope of the warranties is significantly broader than the DD materials reviewed, that may lead to exclusions for areas that were not reviewed. Further, if a company is fundamentally less professionally run or there are certain key areas of non-compliance, this also may result in less broad cover for those known issues.

2 The underwriting process

How does the underwriting process work in practice? What are you trying to find out?

Martin: There is a macro-level answer to this and a more granular one. The macro answer is: why do you, the buyer, want to acquire the business and why do you think it is a good deal? What are the main drivers of the acquisition: geographical expansion, a strategic investment or portfolio diversification or consolidation? I have seen varying answers, each of which sheds a little light on to how competitive a bidder in an auction process is potentially likely to be.

On a more granular level, you are trying to understand, to the extent that is not already clear from the scoping of the DD, what a potential buyer looked at and what they found. If they have not reviewed a certain topic, that does not automatically lead to an exclusion, but we would look to understand why they have not reviewed it. If certain topics are, in the view of a buyer, irrelevant for a certain type of business, and if they provide a brief explanation to their rationale, we can quickly gain a lot of comfort.

We also look to flesh out as many points as possible to give as clean a policy as possible. If there are open ends in the DD, we try to close them so that each party fully understands the issues raised.

3 The Benelux market

How would you characterise the Benelux W&I market right now, in terms of deal volume, deal complexity and how sophisticated buyers and advisers are compared to the UK or the Nordics?

Martin: The Benelux market is definitely more modest in size, both in terms of deal size and volume, than the UK and potentially also the Nordics. There are significantly fewer multi-billion euro deals in the Benelux.

W&I penetration, to the extent I can see it from my perspective and from speaking with colleagues and competitors, is largely similar, especially on large sponsor-owned deals. In my experience, W&I is commonly considered on larger sponsor-owned transactions, particularly those with an enterprise value of € 500 million and above.

The quality of advisers, especially in the Netherlands, is broadly very good.

Within the Benelux, product penetration in the Netherlands is higher than in Belgium. We have seen an increase of the use of W&I in Belgium over the last five years, with advisers also becoming better versed in using the product. This is in part due to more brokers setting up in Belgium or dedicating more marketing efforts towards that market from their Dutch offices, driving product awareness and familiarity.

4 AI-generated due diligence

Have you seen AI-generated or AI-assisted DD reports come across your desk yet, and how would they change the way you run the underwriting process?

Martin: I have not seen one yet. I am however fairly sure that some law firms use AI tools to aid their review.

As to how it changes the process: it needs to be clear to me to what extent there has been human oversight, and to what extent the tool has been tested. If a report for example is drafted by a law firm, I would expect them to be comfortable enough with their tool to provide reliance on their report as if associates had conducted the DD. If they would not be willing to provide that, I would probe significantly more on the methodology behind such DD.

In addition it depends on the complexity of the business, but also on the topic areas. Certain topics are more suited to AI-generated DD, for example identifying change of control clauses in contracts. It becomes more nuanced when the materials become more complex. I would be rather confident a well-developed AI tool can review one permit and its key terms. But if you have a financial institution that is heavily regulated by multiple regulators, can the tool review the whole permitting landscape and the total compliance, and analyse the gaps, when that is significantly more complicated than, for example, a less regulated, smaller business in a single jurisdiction?

When you think about what you need from a DD report to underwrite comfortably, which of those requirements does AI make easier to meet, and which does it make harder?

Martin: AI is very new in the legal industry. Some people are very positive about it, some say the developments are incremental rather than exponential. I think it is key for us as underwriters to approach it objectively, and not to be biased just because a report has been drafted by AI. There is a case to be made that AI could actually be less error-prone than human employees on certain tasks.

Key to understand is how the model has been tested and the level of human oversight involved in the DD process. Obviously, if reliance is provided on such a report, a lot of comfort can immediately be gained but this does not detract from a clear explanation of the methodology underlying such.

Law firms often work with samples: they review a set of contracts and check whether the rest look materially the same. AI removes the need to sample. Does that matter to you?

Martin: Where sampling is appropriate, I would always consider positive cover subject to, naturally, the type of the issue and the scope and methodology of the sample. However, reviewing all relevant documents can materially assist the assessment of risk, provided the review is capable of identifying the material issues.

That being said, the same limitation remains. I do need to gain comfort that the tool reviewing those documents has flagged all the material issues, because otherwise I would rather have an associate reviewing ten contracts and know that they have seen everything, than a tool reviewing a thousand contracts where certain topics are consistently missed.

Imagine an AI-generated report with full source traceability, so every finding is linked to a specific document and clause, plus a clear methodology disclosure, an explicit gap analysis and a lawyer sign-off. Would that be sufficient for you to underwrite on?

Martin: I'm hesitant to say yes flat out, but on the face of it, it looks like a very solid approach. My biggest fear is still: what fields has the machine not seen? A well designed tool may assess clearly defined parameters consistently and at scale. However, it remains important to understand whether the parameters are complete and appropriate, and what may sit outside the scope of the review.

Indeed, the lawyer sign-off is very helpful. That is not because we want to hold the lawyers accountable or legally liable. It is rather that I cannot imagine, as a former lawyer myself, I would have been comfortable sharing a DD report without fully being able to stand behind the work product.

And if a PE fund came to you with a fully AI-generated review, where you know exactly which documents were reviewed against which rulebook and which documents were not covered, could you underwrite that without a lawyer sign-off?

Martin: I think there are two elements to this question: to what extent can we get comfortable with a fully AI-generated DD report and is lawyer sign-off a pre-requisite for that. Lawyer sign-off is not necessarily a formal requirement, although it can provide additional comfort. In all cases, we would assess the methodology, scope, limitations and controls of the DD process in the context of the transaction.

On what timeframe do you see that happening?

Martin: That is hard to say, and is transaction dependent. A €100 million Netherlands-only business is a completely different ballgame to a global multi-billion business. I could see it being deployed on smaller transactions sooner, just because of their generally more limited complexity.

Is the concern about AI-generated DD primarily about accuracy, or more about auditability, the ability to trace and defend the output if a claim arises?

Martin: Accuracy is one of a number of relevant considerations. We would also assess the completeness and scope of the review, the methodology, validation and testing undertaken, known limitations and the level of human oversight. Traceability can be valuable, but it does not by and of itself address whether the scope of a review is sufficient.

5 Claims

Looking at your claims experience, is there a pattern in the deals where claims arise, something about the DD process or the deal structure that in hindsight was a warning sign?

Martin: Claims arise for a variety of reasons. Certain sectors or jurisdictions are inherently more risky than others. Furthermore, it should not be underestimated how big a role the profitability of a company plays: you are less likely to be looking to claim under your SPA or your W&I policy when you are growing at double-digit pace.

Why do you think that is?

Martin: I think the answer may be rather straightforward. As a business owner, in the ordinary course of business, stuff goes wrong. You can either say, stuff has gone wrong, can I claim this under my insurance? Or you are so busy growing that you think, something has gone wrong, I am going to solve it, and keep expanding in existing markets and entering new markets. A business owner is not a lawyer but an entrepreneur, and a growth mindset trumps a litigious nature.

When a claim comes in, what commonly determines whether it resolves smoothly or becomes a dispute?

Martin: Some claims are very easy to resolve because they are clear-cut and the quantum is clear from the outset.

Where it becomes more complex is, for example, recurring costs that hit EBITDA. How do you quantify that? Not only the one-year cost, but how far do you model that into the future? Would you nonetheless have bought the business if those costs had been accurately represented? These questions are not immediately easy to answer and require cooperation between us as the insurer and the insured to come to the right outcome equitable to all parties. Complex claims can require close cooperation between insurer and insured to reach an outcome that is fair and equitable in the circumstances. We seek to work constructively with insured parties throughout that process.

6 In closing

If you were advising a law firm or a PE fund on how to structure their DD process so that W&I coverage is as strong as possible, what would you tell them that they probably do not already know?

Martin: I am not sure whether they do not already know it, but: the scoping of the DD and the scoping of the warranties, the closer they match, the better. If there are open items in the DD report, close them out with the seller, so that they are as clear as possible for us.

It's also worth bearing in mind that in the end we also want to provide a good product. It does not only cost me more time to add exclusions to a policy, it also diminishes its value. The cleaner the policy is, the faster we can move, and the more value we can add.