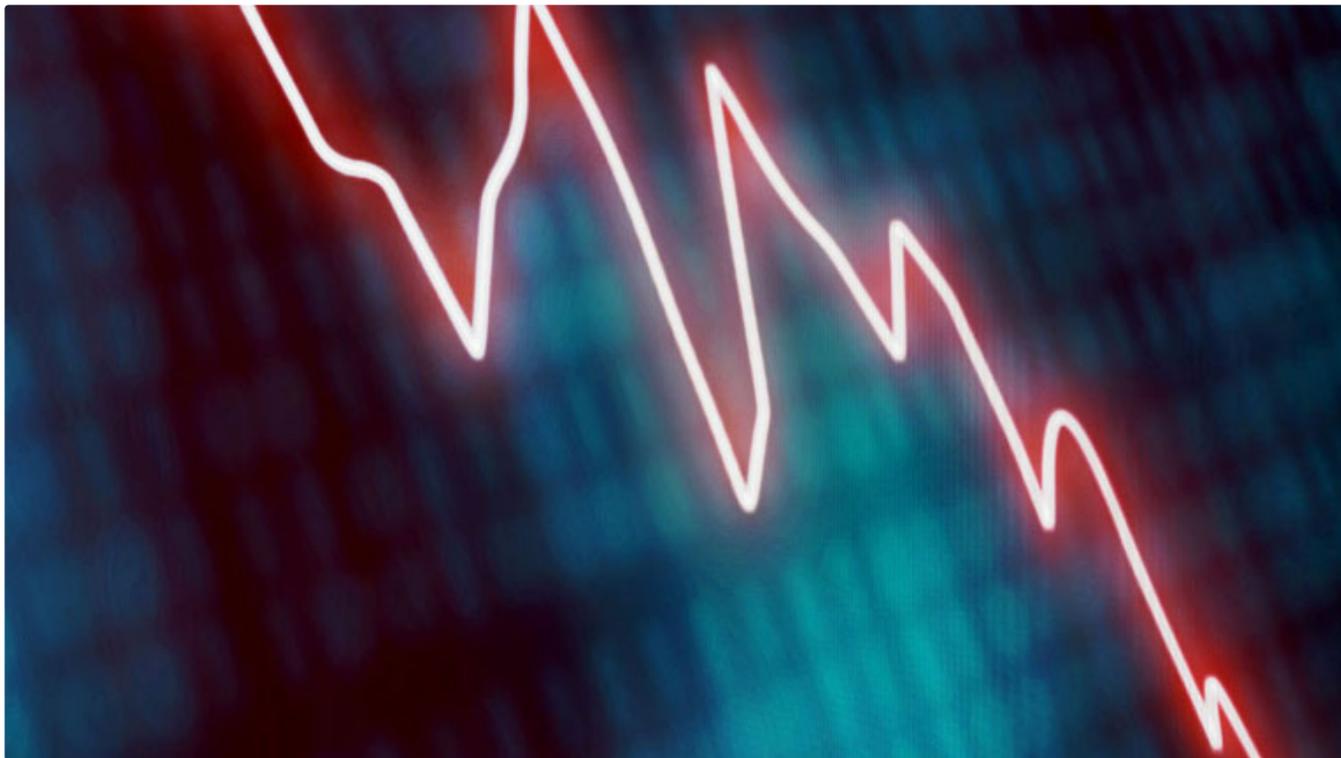


As risks escalate, adequate GPL coverage becomes critical



Amid increased scrutiny from the Securities and Exchange Commission (SEC) and heightened market volatility, many private equity (PE) firms are concerned about the effects on their liabilities, including potential exposure to lawsuits for breach of fiduciary duty, claims for wrongful acts or omissions, and regulatory investigations. PE firms also may face significant liability arising from their purchase and sale of portfolio companies.

A robust general partnership liability (GPL) insurance program should be a critical line of defense for these organizations. However, this program must be

In March 2022, The SEC's Division of Examinations announced its [2022 examination priorities](#). Significant focus areas include private funds, environmental, social and governance (ESG) investing, information security and operational resiliency, emerging technologies, and crypto-assets. Throughout the year, the SEC has also [proposed rule changes](#) in line with these focus areas.

Among other things, the proposed rules require private fund advisers to provide investors with enhanced disclosures in their fund prospectuses, annual reports, and adviser brochures. Additionally, advisers would need to prepare and distribute quarterly statements and obtain annual audits of each private fund.

The rules would also bar advisers from engaging in certain activities or practices that the SEC has deemed contrary to the public interest and protection of investors. These activities may include charging certain fees or expenses to a private fund, seeking limitation of advisers' liability by the private fund or its investors for a breach of fiduciary duty in providing services to the private fund, and borrowing money from a private fund client. All private fund advisers would be prohibited from providing preferential treatment to certain investors in a private fund, unless the adviser discloses such treatment to other current and prospective investors.

Further, PE firms will be expected to strengthen their regulatory compliance programs and operational resiliency practices, especially to account for ESG, [cybersecurity](#), emerging technologies, and crypto-assets. The Division of Examinations will analyze whether advisers have met their standard of conduct when advising investors and if policies and procedures in place account for the unique risks posed by these exposures.

Responding to market conditions

capital, and mezzanine investing are not completely dependent on general economic cycles, their returns are often correlated to economic trends. [Traditional investment vehicles may face challenges](#) to find investment opportunities with an appropriate risk profile during an economic downturn. The reverse is true of distressed lending, however, as a weak economy typically generates increased investment opportunities.

Historically, if a limited partner (LP) wanted to pull out of its commitment to a PE fund, the LP would typically be responsible for selling its assets to a secondary buyer. In today's environment, [general partners \(GPs\) themselves are more active in the transactions](#). GP-led secondary transactions may provide the current LPs with liquidity (by giving them the opportunity to cash out) and allow GPs to continue to manage their existing portfolio of assets. Although GP-led secondary transactions may be beneficial for GPs, they are not without their risks, such as increased regulatory responsibility and conflicts of interest.

GPL insurance program considerations

After 24 months of challenging insurance marketplace conditions for buyers of GPL coverage, most insurers are no longer reducing limits, and there is new insurance capacity. Additionally, insurers have become more receptive to requests for coverage expansions. This provides an opportunity for PE firms to revisit their current coverage and assess where there may be gaps.

Review available coverage options

PE firms should contemplate expanding the scope of coverage afforded under their risk transfer policies that protect against liabilities associated with regulatory enforcement actions or private litigation. Below are some coverages

a fee, such as investment management activities, it is crucial that it be appropriately tailored for GPL.

- Dedicated coverage for individuals — Increasingly, regulators are pointing to C-suite personnel as gatekeepers for governance and controls. The CCOs' failure to effectively supervise the compliance function could have significant legal consequences to individuals.
- Crime coverage for theft of crypto assets — This coverage can respond to losses as a result of acts committed by employees or third parties and apply to said losses of covered property in cold, warm, and hot storage wallets.
- Cyber coverage — This coverage provides coverage for first-party losses, third-party liability, and regulatory liability associated with network security, data privacy, and system failure events.
- Representations and warranties coverage — This coverage reimburses buyers or sellers for financial loss if misrepresentations or inaccuracies are contained within the representations or warranties of a purchase and sale agreement.

Re-evaluate limit adequacy

In addition to expanding the scope of coverage, PE firms should also evaluate whether they have adequate limits on their policies. In the face of the SEC's proposed rules, it is especially prudent that PE firms consider the potential that defense expenses would exhaust or substantially deplete the available limits of its private equity professional and management liability insurance program. Without a thorough review of all considerations affecting limit adequacy, insureds may find themselves facing litigation with insufficient funds available

- Recent purchasing trends among peer firms
- Implications of proposed regulatory changes
- Frequency and severity of fund litigation
- Outside directorship liability exposure
- Defense costs for securities litigation and regulatory enforcement actions

For PE firms to best protect themselves against the increased risks associated with the changing regulatory landscape, they should prepare by working with risk professionals to design and implement a general partnership liability program best suited for their practice.

For more information about general partnership liability, please contact your Marsh representative.

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