AMWINS®

Adaptability is Paramount When It Comes to Private Equity Coverage

The private equity market has experienced significant shifts and uncertainties in recent years, with 2021 and 2022 marking historic periods for deal flow. While these years witnessed a fair number of add-on transactions, it's clear that there are still deals to be done. However, today's landscape is characterized by a unique blend of optimism and caution, as investors grapple with the question of whether we are already experiencing a rolling recession or if one still looms on the horizon.

Interest Rates and Market Stability

One of the key factors influencing private equity is the fluctuation of interest rates. On July 26, the Federal Reserve approved a benchmark interest rate hike, raising the Federal Funds rate by a quarter percentage point to a target range of 5.25% to 5.5%. In September, the Fed held rates steady, taking a pause from the aggressive rate-hiking campaign that began in March 2022 to fight rising inflation.

The current rate is the highest Federal Funds rate in 22 years. However, despite **Fed officials recently signaling they are comfortable with rates in the current range**, Wall Street is now looking at the **potential for future rate decreases** in 2024.

Stable firms with strong financials are better equipped to navigate the impact of rising interest rates, which can affect the cost of borrowing and the overall investment climate. Yet, the current state of the market is marked by significant instability, making it crucial for private equity firms to assess and manage risk effectively.

CONTACT

To learn more about how Amwins can help you place coverage for your clients, reach out to your local Amwins broker.

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Risk Management Challenges

One notable challenge in the private equity space is the prevalence of firms that do not adequately address discontinued products or discontinued operations. Addressing these gaps is essential, and increasingly, firms are turning to expert advisors and wholesale brokers to help place policies and provide risk mitigation strategies.

Another is that despite greater market stability and an influx of fresh capacity into the market, certain areas, such as heavy or large fleets, premises-driven exposures, residential contracting in CD states, and high-hazard products continue to create challenges for firms. As severity-driven claims continue to occur, the importance of robust risk management strategies and insurance coverage remains.

Emerging Trends and the Future of the Market

In addition to the recent developments in the private equity market, it's crucial to consider the emerging trends and outlook that shape this dynamic landscape. During the second quarter of 2023, private equity firms raised $104 billion, bringing the total for the first half of the year to $209 billion. However, this marks a significant decline, with a 16% decrease in fundraising compared to the second half of 2022 and a 26% decrease compared to the first half of 2022. This decline is largely attributed to the "denominator effect," where limited partners find themselves excessively invested in private markets due to substantial drops in their public market investments. Additionally, challenges related to exiting investments have contributed to the decrease in new commitments in the private equity sector.

Despite prolonged concerns of an impending recession from economists, the macroeconomic performance has shown remarkable resilience. Inflation has been moderated without causing the expected dramatic unemployment increases, and regulators have swiftly responded to shocks in the banking sector. However, the current challenge for private equity lies in the persistent uncertainty stemming from the recessionary expectations, keeping many people in a wait-and-see mode.

Private equity firms are adapting by focusing on opportunistic investments in high-quality assets in sectors showing long-term secular growth potential, such as software, media, logistics, and healthcare. They are also expanding into additional asset classes like secondaries and credit.

Takeaway

In the ever-evolving landscape of private equity, adaptability and risk management are paramount. As the debate over the potential recession persists and interest rates remain subject to change, private equity firms must proactively address risk areas such as discontinued products and liability exposure.

Collaborating with experienced wholesale brokers and underwriters who specialize in the private equity sector can provide the expertise and solutions needed to navigate the complexities of the market. Amwins has been partnering with private equity teams since 2017, crafting tailored insurance solutions to protect against unforeseen liabilities. We can assist retailers by estimating post-transaction insurance costs for challenging risks, so private equity firms can properly allocate insurance costs into the purchase price of the target entity. This is especially important during the due diligence process when it comes to the profitability of the investment.

Our brokers and underwriters have access to unique policies designed to help protect firms acquiring entities. For asset acquisitions, we strongly recommend private equity firms require the selling entity to purchase tail coverage in the form of discontinued products or discontinued operations. For accounts with a completed operations exposure, claims may arise six, seven, or eight years later and still be within the statute of repose in that state. A discontinued operations policy provides coverage for this risk and protects the liability from impacting the go-forward insurance program. A similar exposure exists for accounts that sell products into the marketplace. The liability arising from a product that is sold prior to the date of acquisition should be the responsibility of the selling entity and not impact the go-forward program. Oftentimes, these types of occurrences happen many years after the product was actually sold.

Contact **TJ Collins** to learn more.