Proskauer

Protecting Sponsors from Emerging Portfolio Company Risks through Insurance

The Capital Commitment on **June 3, 2025**

In addition to the normal operational and legal risks associated with owning and managing portfolio companies, 2025 has introduced or exacerbated a wave of geopolitical and macroeconomic risks such as inflation, tariffs, trade, depressed consumer sentiment, political risks, and credit risks. The resulting, increased risks faced by portfolio companies has caused a need for private equity sponsors to focus more closely on the insurance maintained at the portfolio company level, and not only the sponsor's own policies. It is critical for sponsors to work closely with management of their portfolio companies, insurance brokers, and experienced coverage counsel to review and negotiate strong insurance for their portfolio companies. Savvy sponsors are able to utilize their leverage to negotiate bespoke, manuscript policy forms that can be used across their portfolio to provide consistent, strong protection for each of the sponsor's portfolio companies.

Legal risks at the portfolio company level can impact sponsors not only by harming the value of their investment but also by leading to direct claims being brought against individuals the sponsor appointed to the portfolio company's board and against the sponsor itself. These risks are particularly acute during times of economic distress or uncertainty, where creditors and other constituents commonly bring claims for breaches of fiduciary duty against directors and aiding and abetting claims against the appointing sponsor.

Coverage disputes in this scenario are both more likely and more difficult when strong coverage under both sets of policies – the sponsor's own policy and the portfolio company's policy – has not been negotiated and attention has not previously been given to ensuring that the two sets of policies work together. For example, careful attention needs to be given to policy provisions addressing whether and how a policy applies when an individual serves in multiple capacities and is sued in both capacities (*e.g.*, as an employee of a sponsor and a board member of a portfolio company) and in what order multiple, potentially implicated policies (*e.g.*, the sponsor's policy and the portfolio company's policy) apply. Additionally, particularly careful attention needs to be given to the renewal of insurance policies for portfolio companies experiencing financial distress, as insurers often use those circumstances as a basis for adding exclusions and provisions that can significantly limit coverage, such as exclusions that bar coverage when the company becomes insolvent, exclusions for claims brought by creditors, and other problematic provisions. Careful review, negotiation, and coordination of the language and structure of portfolio company policies and private fund-level policies can help mitigate the risks arising from portfolio companies to sponsors and their associated individuals.

One promising development we have seen in the last year is that more sponsors (but still a distinct minority) have begun to negotiate strong, manuscript policies for all of their portfolio companies. Historically, the quality of coverage provided under directors and officers ("D&O") policies issued to portfolio companies has been poor – and that continues to be true of the majority of portfolio company policies – but as more sponsors begin focusing on the quality of their portfolio companies' policies, that should change.

Relatedly, we have also seen an increased focus on protecting individuals against the legal and regulatory risks they face from serving as directors of portfolio companies. This increased focus on individual protection has included an increased emphasis on obtaining dedicated insurance limits for individuals when the company is unable to provide indemnification (called "Side A" policies") at the portfolio company-level and to negotiate enhancements to such policies. It is critically important to ensure that sponsor policies and portfolio company policies respond seamlessly and in a prearranged coordinated fashion in these claims.

Of course, the types of litigation and regulatory risks covered by D&O policies are far from the only risks faced by portfolio companies and that can impact sponsors. For example, the increased frequency and severity of data breaches, ransom demands, and social engineering theft has made protection against cyber risks through strong cyber insurance policies critical for portfolio companies and their sponsors. The market for cyber insurance has hardened in the past several years, however – with increased premium costs and additional limitations on coverage – due to cyber insurers having paid out more and larger claims than they had anticipated for cyber events. The more challenging market has made it even more important for careful analysis and review of potential insurance coverage, particularly because it is rare for all cyber risks of concern to be covered under the same policy. Instead, it is common for cyber "crime" risks (for example, social engineering and fraudulent transfers) to be covered under a crime policy or endorsement to a fidelity bond, with other cyber risks (for example, data breaches and business interruption from cyber events) to be covered under a separate cyber policy. Coordinating these separate coverages is important to ensure that as broad a spectrum of cyber risks as possible are covered.

As the risks facing sponsors and their portfolio companies continues to evolve, the insurance they purchase must likewise evolve to match those risks. It is imperative that sponsors and their portfolio companies work with sophisticated insurance brokers and experienced coverage counsel to ensure that their portfolio companies obtain strong coverage. Sponsors also should enhance their leverage to negotiate manuscript policies that can be used by all of their portfolio companies (rather than placing coverage piecemeal) with additional enhancements added as needed – to help protect the sponsor's investment and their individuals from the developing risks faced by their portfolio companies. This approach also will provide enhanced commercial leverage and legal protection to resolve claims more expeditiously and efficiently for greater amounts of coverage in order to manage emerging complex risks more effectively.

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