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Emerging Risks in Private Equity

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Questions

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Meet Your Presenters

Elan Kandel, Member

Bailey Cavalieri LLC

Anne Catapano, Vice President, Financial Lines Claims

Ascot

Kate Gookin, Vice President, Financial Lines

Sarr Adjustment Services, Inc. – A Member of Sarr Companies

Joe Macchiarola, Senior Counsel of Financial Institutions Claims

Bowhead Specialty Underwriters, Inc.

Teresa Milano, Senior Vice President, Professional Risk and Executive Risk

Lockton Companies

Dennis Van Dina, Assistant Vice President, Head of Public D&O, Financial Institutions, Transactional Risk

Sarr Adjustment Services, Inc. – A Member of Sarr Companies

Agenda

- Federal and State Regulatory Focus on Private Equity
- The Rise in Portfolio Company Backed Bankruptcies
- Private Equity Says Hello Again to IPOs?
- The Explosive Growth of Continuation Funds
- Private Equity Dealmaking is on an Upswing
- The Rise of Private Equity in Private Credit
- Broker/Underwriter Forum

The SEC's Regulatory Focus Remains on PE

- August 15, 2025: the SEC announced settled charges against TZP Management Associates LLC, a registered investment adviser to private equity funds, alleging breaches of fiduciary duty arising from its fund management fee calculation and offset practices.
- The order alleges that TZP's actions resulted in charging its funds over \$500,000 in excess management fees.
- TZP was censured and ordered to pay a civil penalty of \$175,000, as well as disgorgement and prejudgment interest, through a fair fund.

The SEC's Regulatory Focus Remains on PE

- March 2025: Enforcement action against David Yow Shang Chiueh and his investment advisory firm, Upright Financial Corp., for misconduct and for investing more than 25 percent of Upright Growth Fund's assets in a single company over multiple years, causing losses of \$1.6 million.
- March 2025: SEC filed settled charged against registered investment adviser Momentum Advisors LLC, its former managing partner Allan J. Boomer, and its former chief operating officer and partner Tiffany L. Hawkins, for breaches by Boomer and Hawkins of their fiduciary duties when they misused fund and portfolio company assets.

Regulatory Focus Remains: SEC Takeaways

In view of the return to more “bread-and-butter” issues and enforcement cases, the following traditional issues involving private fund managers should still be in play:

- **Fiduciary Obligations** –situations involving allegations of potential fraud, breach of fiduciary duty, or conflicts of interest; expect greater scrutiny where the alleged conduct involves pecuniary gain to the manager or investor losses or other harm. Issues relating to fees and expenses, allocations, valuations, etc.
- **Retail Investors** – matters that can be framed as protection of individual investors

Regulatory Focus Remains: FTC

Concurring statement of then Commissioner Ferguson in Welch Carson (January 17, 2025):

I concur in today's Commission action because it is a routine law-enforcement matter embodying a traditional approach to competition law. A reader might reach a different conclusion given the agency's rhetoric in connection with the public announcement of this settlement. The press release and the Chair's statement both suggest that this case is extraordinary because it involves "private equity" and "serial acquisitions," and hint at antipathy toward private equity. I write to pierce through this breathless rhetoric to make clear that this case is an ordinary application of the most elementary antitrust principles. That Welch Carson is a private equity firm is irrelevant; the antitrust analysis would be the same if Welch Carson were, for example, an individual or institutional investor....

Regulatory Focus Remains: FTC

Texas et al. v. BlackRock, Inc., Case No. 6:24-cv-00437, in the U.S. District Court for the Eastern District of Texas.

- The lawsuit, filed by Texas Attorney General Ken Paxton and joined by several other states, argues that BlackRock, State Street, and Vanguard acted as an "investment cartel".
- By participating in ESG initiatives, they allegedly agreed to use their collective influence to pressure coal companies to reduce production.
- The state contends that this pressure led to an artificial reduction in the coal supply, which caused an increase in energy prices for consumers. The complaint claims the asset managers profited from the higher fees and returns resulting from their influence.

Regulatory Focus Remains: FTC

- The lawsuit applies antitrust theories, such as Section 7 of the Clayton Act and Section 1 of the Sherman Act, by challenging the actions of large, non-controlling shareholders.
- In August 2025, the court largely denied the defendants' motion to dismiss in August 2025, allowing the case to proceed.
- The FTC and DOJ filed a "Statement of Interest" in the case, supporting the states' right to challenge this type of coordinated action.

Regulatory Focus Remains: FTC

- The “Statement of Interest”
- “The President has declared a national energy emergency, and we need competition in coal production now more than ever to help fuel American energy dominance,” said Assistant Attorney General Abigail A. Slater of the Justice Department’s Antitrust Division. “American consumers suffer when institutional asset managers use shareholdings in competing companies to orchestrate output reductions. As the Supreme Court has held, ‘social justifications’ for anticompetitive conduct ‘do not make it any less unlawful.’ We will not hesitate to stand up against powerful financial firms that use Americans’ retirement savings to harm competition under the guise of ESG.”

Regulatory Focus: False Claims Act Cybersecurity

Aero Turbine/Gallant Settlement

- On July 31, 2025, the DOJ announced that it settled an FCA matter with private equity firm Gallant Capital Partners, LLC and its portfolio company, defense contractor Aero Turbine, Inc. for \$1.75m
- According to the settlement agreement, Aero Turbine under direction from a Gallant employee, improperly provided access to Air Force controlled unclassified information (CUI) to a software company based in Egypt
- The settlement agreement acknowledges Aero Turbine's and Gallant Capital's self-disclosure and cooperation, for which they received credit
- First cybersecurity settlement with a private equity firm, and the first FCA settlement involving a private equity firm since at least 2021

State Regulatory Focus: Health Care

- Private equity remains heavily interested in healthcare
- In the first half of 2025, physician practice transactions remained a cornerstone of healthcare M&A activity, with concentration in high-growth specialties such as oncology, musculoskeletal, cardiovascular, behavioral health, ENT, OB/GYN, ambulatory surgery, and primary care.
- Key Challenges: rise in passage of state laws prohibiting private equity firms from having influence over the clinical judgment of healthcare professionals

State Regulatory Focus: Health Care

- Example: On October 6, 2025, California Governor Gavin Newsom signed S.B. 351 into law.
- The new law prohibits a private equity fund or hedge fund that is involved as an investor or owner with a physician or dental practice doing business in the state from interfering with the professional judgment of physicians and dentists in making health care decisions
- Prohibits such entities from exercising power over specified actions, including hiring practices and coding and billing procedures for patient services
- Prohibits contracts between a private equity fund or hedge fund or an entity controlled by a private equity or hedge fund and a physician or dental practice, if the contract would allow the conduct described above to impose a noncompete or nondisparagement clause.

State Regulatory Focus: Health Care

- The law will take effect on January 1, 2026.
- The state attorney general is empowered to enforce the new law through injunctive relief and other equitable remedies.

Rise in Portfolio Company Bankruptcy Filings

- Private equity was behind 70% of large U.S. bankruptcies in the first quarter of 2025
- 7 out of 10 bankruptcies at companies with over \$1 billion in liabilities were at companies owned by a private equity firm
- In the second quarter of 2025, 6 of the 14 largest bankruptcies, those with over \$1 billion in liabilities, were companies backed by private equity.
- For context, total U.S. business bankruptcy filings for the 12-month period ending June 30, 2025, were 23,043, a 4.5% increase over the previous year

PE says hello again to IPOs?

- In the first three quarters of the year, 20 US-based companies under private-equity ownership priced IPOs in the US—already surpassing last year’s full count, according to PitchBook’s Q3 2025 US PE Breakdown.
- The third quarter alone saw eight such companies go public, spanning sectors from consumer data and education to infrastructure and financial services.

PE says hello again to IPOs?

- According to Pitchbook, the number of sponsor-backed listings by US-based companies on domestic exchanges is on pace to rise 50% year-over-year, reaching 27 by year-end at its current trajectory
- While still far below 2021's record of 143, that tally would make 2025 the strongest year since the peak
- But IPOs are not without risk...

The Rise of Continuation Funds in Private Equity

- A continuation fund is a private equity vehicle created by a general partner to move one or more assets from an existing fund that is nearing the end of its life into a new fund.
- Provides a formal mechanism for the GP to extend its ownership of the asset(s). Existing GPs are given the option to: (1) cash out; (2) roll over; or (3) a combination of (1) and (2)

Continuation Funds by the Numbers

- Investment bank Jeffries reported that buyout groups used continuation funds to exit \$41bn of investments in the first six months of 2025. **That is 60% higher than one year ago.**

The Rise of Continuation Funds in Private Equity

What are drivers behind increased use of continuation funds?

Maximizing value: GPs can continue to manage high-performing assets that have not yet reached their full value potential, allowing for a longer value creation period.

Alternative to traditional exits: Continuation funds offer an alternative exit path when market conditions, such as volatile public markets, make traditional exits like IPOs or strategic sales unattractive.

LP liquidity needs: They provide LPs with a structured way to access liquidity, which is beneficial in a market where cash distributions from traditional exits have slowed.

Risks Associated With Continuation Funds

- Conflicts of Interest: The GP is essentially the buyer and the seller. Potential conflicts involve valuation of the assets.

Private Equity Deal Activity is on an Upswing

- According to Pitchbook, while exits still lag, deal activity is on track for the second-best year since a record set in 2021
- The third quarter's estimated 5,083 deals worth a combined roughly \$595 billion brought the year's global tally to 15,107 deals worth \$1.606 trillion through September, according to PitchBook
- In 2021, private-equity firms clinched 21,675 deals worth a record \$2.33 trillion

Private Equity Deal Activity is on an Upswing

- Record dry powder: PE funds are sitting on significant amounts of unspent capital ("dry powder"), and there is considerable pressure from investors to deploy this cash. This creates an urgency to execute deals and put capital to work.
- Aging portfolio backlog: The slowdown in dealmaking and exits in prior years resulted in a large backlog of portfolio companies that PE firms have been holding longer than usual. Improved market conditions in 2025 offer a chance to exit these aged investments and return capital to limited partners.
- Rise of secondaries: While IPO and traditional M&A exits have been challenging, the secondary market has surged. This provides a valuable alternative for PE firms to generate liquidity and cash out of older investments.

The Rise of Private Equity in Private Credit

- There is a synergistic relationship between private credit and private equity.
- Private equity firms often rely on private credit to finance their acquisitions, creating a robust pipeline of opportunities for private credit providers.
- This symbiotic relationship has led to the development of dedicated private credit arms within private equity firms, further driving the growth of the private credit market.

The Rise of Private Equity in Private Credit

- There was some \$3 trillion committed to private credit at the start of 2025, according to Morgan Stanley
- Many of the largest and most well-known private equity firms have dedicated and often massive private credit divisions.
- Several of these firms have become dominant players in the private credit market as traditional bank lending to middle-market companies has declined.

The Rise of Private Equity in Private Credit

Major private equity firms with significant private credit arms include:

Blackstone: The firm was an early entrant into private credit, and its Blackstone Private Credit Fund (BCRED) is one of the largest offerings for wealthy individuals.

Apollo Global Management: A giant in the alternative asset management space, Apollo has a huge presence in private credit

Ares Management: While considered an alternative investment manager, Ares is a world-class credit investor, with both private equity and extensive private credit investment strategies.

KKR & Co.: This major alternative investment firm has a strong focus on private credit in addition to its traditional private equity and real estate investments.

The Carlyle Group: Through its AlpInvest division, Carlyle is heavily involved in private credit, managing billions of dollars in assets for its investors.

The Rise of Private Equity in Private Credit

- Rise of private credit means that firms “will from now on be held exclusively by private owners and private creditors, with no robust trading market to provide discipline and a measure of objectivity as to valuation. Firms will trade hands in transactions involving severe information asymmetries between buyers and sellers.”
- Potential Impact “more examples of wildly mistaken or misleading valuations of private companies...”
- “In at least some cases, they [private credit] will have strong incentives to give maturity-date extensions and forbearances to borrowers, even when those decisions may not be in the best interests of the corporation as a whole.”

Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 Yale L.J. 696 (2025).

The Rise of Private Equity in Private Credit

If, instead, the corporation owes money to a private credit lender, that lender can essentially choose when and where to take losses in many situations. As a result, private credit lenders may simply delay taking losses to avoid informing limited partners of potential problems with their portfolio. A private lender can accomplish this by agreeing to extend the terms of repayment or by providing forbearances.

As a result, the economy may have more so-called “zombie firms,” or companies that have too much debt but that delay taking actions to reduce their debt, even though their debt forces the company to pass up profitable investment opportunities. As a result, the core business of these firms may erode, leaving little value for bankruptcy law to try to maximize. These zombie firms may encounter bankruptcy at a relatively late phase in their financial distress, leaving bankruptcy judges with little to do other than preside over liquidations.

Jared A. Elias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 Yale L.J. 696 (2025).

The Rise of Private Equity in Private Credit

- “My antenna goes up when things like that happen. I probably shouldn’t say this but when you see one cockroach, there’s probably more. And so everyone should be forewarned at this point,” said JPMorgan CEO Jamie Dimon on a post-earnings analyst call last week.

Broker/Underwriter Forum

- Is there room for even broader language?
- How can PE firms and portfolio companies better assess their limits adequacy?
- How can PE firms address the macroeconomic conditions going forward?
- Will we see more take-private transactions?

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