

Private Asset Manager Risk:

*Small firm does not
mean small claim*

CNA – Asset Manager Risk

Smaller asset managers confront many of the same management liability risks as large, public corporations. The difference is smaller-sized asset managers may not have the resources to survive an investigation by the Securities and Exchange Commission (SEC) or defend against allegations such as breach of fiduciary duty.

An investigation or lawsuit can jeopardize the longevity of an asset management firm – irrespective of how well it performs. When confronted with a lawsuit or investigation, management can become preoccupied, costs can escalate to millions of dollars, and some losses may escalate into the tens of millions of dollars, even if the firm has done nothing wrong.

Of the largest directors and officers liability (D&O) losses from cases recorded since 2012 involving small asset manager firms, losses above the median insurance limits purchased by these firms totaled \$650 million. Twenty cases involved losses that exceeded the company's average annual revenue. Viewing errors and omissions (E&O) losses in the same manner, almost \$440 million of losses were above the median insurance limit and 14 eclipsed its revenue, according to Advisen data.

“You may think you are prepared and have done your best to prevent it, but a regulatory proceeding or lawsuit can bankrupt an asset manager firm,” said Tom Ruck, Vice president, CNA Asset Manager Program. “Either of these occurrences can trigger a liquidity event with a new set of exposures.”

Few companies are subject to the regulatory scrutiny that applies to the asset management

industry. Various regulators, including the SEC, Financial Industry Regulatory Authority, Commodity Futures Trading Commission and the U.S. Department of Labor are authorized to examine asset management entities

Ruck also noted that asset managers are most concerned about the regulatory risk that confronts the industry.

Subsequent to the financial crisis of 2007-2008, regulators may have focused more on large banks and systemically important financial institutions. Nevertheless, scrutiny of asset managers irrespective of their size has ensued. Since the 2016 presidential election, uncertainty over post-crisis financial regulation has continued notwithstanding expectations that the Trump administration would be more amenable to less stringent regulation of the financial-institution sector. Notably, the SEC continues to pursue its enforcement activities in an aggressive manner.

In fiscal year 2016, the SEC opened 1,063 investigations of possible violations of the securities laws, with 681 formal orders of investigation issued. By the end of September 2016, 1,729 investigations were ongoing from fiscal year 2016 and prior years, which reveals how long investigations may loom.

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“Regulation is not going to go away for asset managers,” Ruck said. “The subpoena powers of the SEC may have been restrained. However, enforcement is anticipated to continue in an aggressive manner.”

Ruck said rules and definitions of “insider trading”, as well as how fees and expenses are allocated, can be ambiguous. Thus, a firm that believes it is compliant ultimately may learn that its insider-trading policy is inadequate or its calculations of asset values on securities may be inappropriate. Moreover, the SEC is expected to maintain a focus on valuations, conflicts of interests, governance, and how fees and expenses are allocated.

While asset managers may not be able to totally eliminate the possibility of a regulatory inquiry, or claim emanating from a regulatory investigation, various risk control strategies may be deployed to help mitigate the potential risk of such events. For example, CNA offers a mock SEC examination endorsement that provides audit specialists to peruse operations and ensure that the infrastructure complies with industry standards.

Notably, regulation is not the only risk encountered by private company asset managers. Litigation may ensue from investors alleging errors of the firm in providing investment advice, employee disagreements with management, investment returns below expectations, partnership disputes.

Private company asset managers should, therefore consider purchasing management liability insurance. Many options are available as a sound risk management tool to provide coverage for the vulnerabilities that arise in this industry and, most importantly, help you to stay in business. In the event that litigation arises, such policies may provide coverage for defense costs in order to help defray the significant costs associated with litigation.

CNA’s enhanced Investment Management Solutions Form provides essential management and professional liability coverage to meet the ever-evolving needs of today’s asset managers. Underscoring CNA’s commitment to the financial institutions industry, CNA’s customizable form ensures that asset management firms are covered in an uncertain financial environment.

Pushing the limit – and beyond

For many smaller asset managers, losses from a private company D&O or E&O related incident can exceed its insurance limits. In some cases, a loss can come close, eclipse, or surpass the annual average annual revenue of a firm.

- Loss Amount
- Median Limit
- Average Annual Revenue

Small, Private Company D&O* 2012 to present



Small, Private Company E&O* 2012 to present



Medium, Private Company D&O* 2012 to present



Medium, Private Company E&O* 2012 to present

