

Management and Professional Liability Insurance

Alternative Investment Funds/Hedge Funds



In turbulent economic times, the importance of a well designed management and professional liability insurance program—also referred to as directors and officers (D&O) or errors and omissions (E&O)—becomes clear. Market volatility creates greater risk for fund management and administration errors that lead to financial losses. Poor overall market performance affects virtually every firm's investment results, creating litigation opportunities for disgruntled investors at the same time that the firm's resources to defend such claims are stretched thin.

Hedge funds now find themselves the subject of closer scrutiny by the Securities and Exchange Commission (SEC), Department of Justice (DOJ), and other regulatory agencies as a result of scandals like Madoff and Galleon and the recent insider trading allegations made against a number of hedge funds and expert network firms. The regulatory environment is currently in a state of uncertainty due to new regulatory constraints imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as Dodd-Frank). Enhanced SEC disclosure and reporting required by Dodd-Frank could mean heightened scrutiny from regulators as well as investors. In this environment, it has never been more important to have a skilled and experienced intermediary working to design, negotiate, and place an appropriate D&O/E&O insurance program on your behalf.

How Does Marsh Help to Differentiate Alternative Investment Fund/Hedge Fund Firms in the Marketplace?

There are many things that drive the price of a program and the breadth of its coverage. With market conditions setting a spectrum of prices, your company's risk profile is the single largest factor under your control that can affect your program's premium. The risk profile is developed to provide an in-depth qualitative and quantitative analysis of all available information as it relates to management, operating, and financial risks that impact your insurance programs. The purpose of the analysis is to provide a comprehensive and balanced assessment of the criteria that influence an underwriter's evaluation of your risk.

The scope of insurance and risk transfer that we can provide to hedge funds includes:

- Management Liability/Directors and Officers Coverage
- Professional Liability/Errors and Omissions Coverage
- General Partnership Coverage
- Employment Practices Liability Coverage
- Fiduciary Liability Coverage
- General Liability Coverage
- Private Client Personal Liability Coverage
- Cyber and Privacy Liability Insurance
- Cost of Corrections Coverage
- Fidelity (Crime) Insurance
- Rep & Warranties (M&A) Contracts
- Surety (Bonding)
- Unauthorized Trading
- Liability Associated with FASB FIN48 tax disclosures
- Key Man Life Insurance

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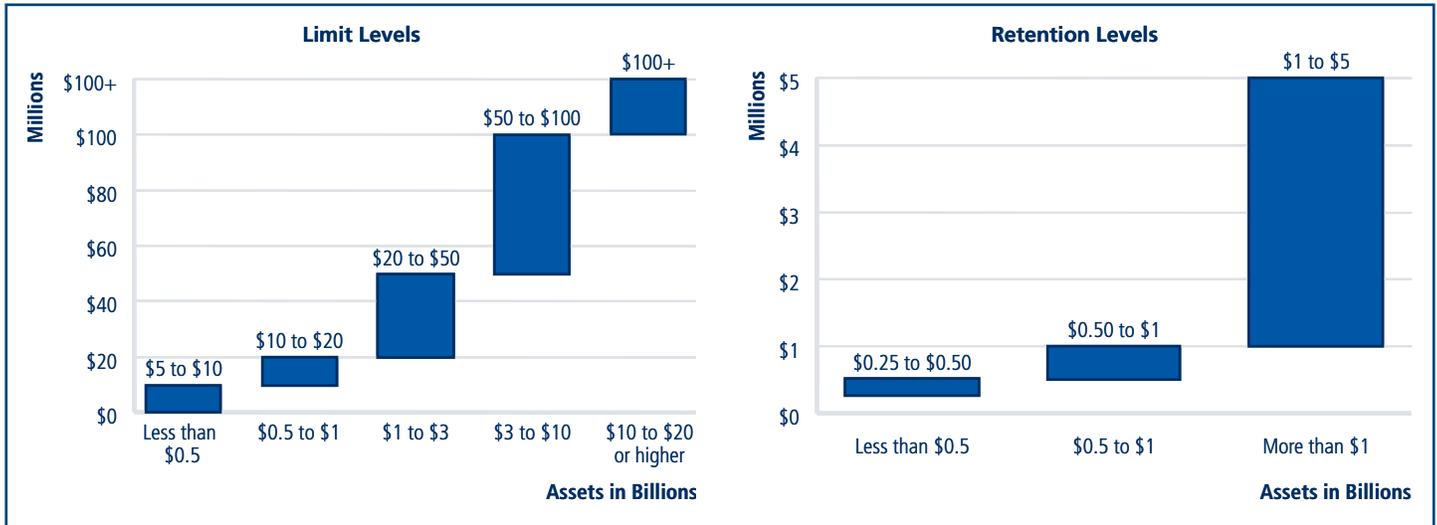
How Do I Design a Suitable Program?

By understanding current market conditions and emerging business and legal trends, Marsh is well-equipped to differentiate our alternative investment fund/hedge fund clients in the current and constantly evolving environment. We have extensive benchmarking data as well as extensive global placement

and advisory expertise, which allow us to design a customized program for each client with appropriate terms and conditions and adequate limits to meet their unique needs.

Below are sample reports that illustrate proprietary limit and

retention benchmarks for hedge fund D&O liability insurance and E&O liability insurance. These reports are some of the many analytical reports Marsh will provide to enable a robust decision-making framework.



What Are Typical Claims Faced by Alternative Investment Funds/Hedge Funds?

The alternative investment fund/hedge fund industry's growth has made it a target for opportunistic lawyers. The increasing involvement of institutional investors has also increased the risk of litigation for alternative investment/hedge funds. At the same time, notable high profile fund failures and scandals have increased both private and regulatory scrutiny of fundraising, investment, and compensation at alternative investment/hedge funds. Such private claims can result in a fund being required to expend significant defense expenses; make restitution to investors; and pay consequential damages, punitive damages, and plaintiffs' attorneys' fees. Regulatory investigations can likewise result in substantial defense costs and require the payment of fines, penalties, and restitution to investors. Examples include:

- **Fundraising Claims**—Private lawsuits by investors and

regulatory investigations against alternative investment/hedge funds and their managers alleging that investors were recruited through fraudulent and misleading representations as to the investment strategy of the fund, the experience and success of the fund managers, and the absence of conflicts of interest.

- **Management Claims**—Private lawsuits by investors and regulatory investigations concerning whether alternative investment/hedge funds and their managers followed the fund's investment parameters, accurately reported fund performance, and appropriately handled funds invested.

- **Third Party Claims**—Lawsuits by other investors in a publicly-traded company alleging that alternative investment/

hedge funds manipulated the company's stock price through some fraudulent scheme, so as to benefit the fund to the detriment of other investors.

- **Feeder Fund Claims**—Lawsuits by fund investors against alternative investment/hedge funds and their advisers alleging that due diligence was insufficient or non-existent, thereby resulting in huge losses in the event of fund failures such as those seen in the Madoff and Stanford situations.

- **Insider Trading Investigations**—A recent spate of investigations by state and federal authorities concerning whether alternative investment/hedge funds benefited from inside information concerning potential investments illegally provided by expert networks or other sources.

How Do I Ensure My Program Has Appropriately Tailored Policy Wording and Adequate Limits of Liability?

The insurance marketplace is dynamic from both a pricing and coverage standpoint.

In order to achieve broad and appropriate coverage, Marsh utilizes a structured framework that is depicted below. This peer review process brings together a broad group of resources

from our financial institutions practices. It enables colleagues that are not involved in the account to provide a new perspective, focus in on potential coverage enhancements, and make recommendations based on what has been achieved on other accounts. For example: Are informal regulatory investigation costs covered

under the policy? Does the policy contain a “costs of corrections” clause in the event of a trading mistake? This peer review process results in better information sharing, progressive coverage improvements at each renewal, and ultimately the most appropriate, customized coverage options for our clients.

<p>Step 1: Marsh Peer Review: In-depth Critique and Analysis of Current Coverage</p> <ul style="list-style-type: none"> ■ Analysis of primary and excess policies by the assigned FINPRO adviser ■ Periodic peer review of primary and excess policies by a team of well-qualified Marsh FINPRO advisers who specialize in placing insurance programs for hedge fund clients ■ Review of possible coverage enhancements to be made in light of recent legal, business, and marketplace developments ■ Final review by Marsh coverage counsel 	<p>Step 2: Proprietary Coverage Benchmarking—Peer Review</p> <p>Analysis of critical coverage terms and policy wording recently negotiated and available in the current marketplace. For example, critical D&O/E&O provisions for investment advisors and hedge funds would include:</p> <ul style="list-style-type: none"> ■ Informal investigation coverage ■ Cost of corrections coverage ■ Final adjudication trigger for personal conduct exclusions (fraud, personal profit) ■ Severability of the application 	<p>Step 3: Collaboration and Prioritization</p> <ul style="list-style-type: none"> ■ Mutually agree upon, and prioritize, critical policy wordings ■ Finalize agreed upon wordings with insurers prior to binding to ensure accuracy and intent ■ The coverage prioritization process positions you to maximize recovery from a filed claim and foster an efficient claims resolution process
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If a Claim Were to Occur What Kind of Resources Can Marsh Provide?

Historically, most claims and charges filed against alternative investment/hedge funds and their directors and officers are also lodged against the manager and other service providers. Claims against funds and their managers and advisers are often complicated and involve many parties.

Marsh has the experience and resources to understand the industry issues at play, address the litigation realities that exist, and help manage any conflicts that may arise among insured parties, insurers, and defense counsel.

The following summarizes our claims advocacy process:

- **What to Report to the Insurer**—We assist our clients in identifying policy requirements for reporting claims as well as analyzing circumstances of concern with our clients to determine whether it

would constitute a reportable event under the terms of the policy.

- **How to Report to the Insurer**—We discuss policy provisions concerning how and to whom initial notification of a claim must be provided in order to protect our clients’ rights under the policy. We will, when instructed by our clients, draft and disseminate notice letters, tracking carrier responses, and requests for information.
- **Selection of Defense Counsel**—We help our clients secure insurer approval of defense counsel and will assist in addressing any objections or concerns insurers may have regarding the counsel arrangements proposed by our clients.
- **Establishing Lines of Communication**—We will meet with the insurers or their

attorneys early in the claim process to develop a procedural framework for the insurers’ investigation, including a basic understanding of what written information the insurers are entitled to regarding legal expenses incurred, litigation strategy, and key developments as the claim unfolds.

- **Preliminary Coverage Analysis**—We advise our clients of the coverage issues raised by a claim and the coverage position that the carriers will likely adopt.
- **Coverage Position Analysis**—We will provide an analysis of the insurer’s coverage response to an initial claim notice, as well as strategize with our clients how best to address potential obstacles to coverage and maximize insurance recovery.

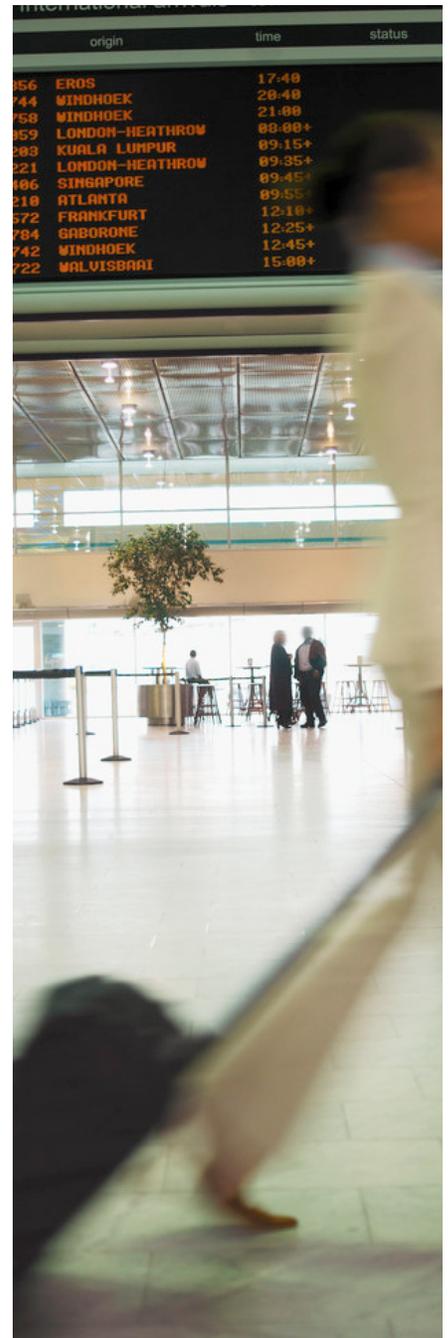
Within FINPRO, we have more than 20 dedicated claims professionals in the U.S., London, and Bermuda, who assist clients with all aspects of claims handling. These individuals have previously worked for major defense law firms, insurers' claims departments, and insurance coverage law firms. It is our philosophy that claims professionals are part of the FINPRO team, working side by side with our advisory brokers and transactions specialists to share their experiences and expertise.

What is Marsh's Commitment to the Alternative Investment/Hedge Fund Industry?

Marsh currently has more than 350 domestic firms as clients engaged in the investment management business. These include mutual funds, investment advisers, hedge funds, venture capital firms, private equity firms, and real estate investment trusts, of all sizes.

Marsh is committed to the ongoing identification and management of the risks faced by the investment management industry and conducts periodic risk management seminars to bring together clients, colleagues, and experts to examine and elucidate the issues facing the industry. In addition, Marsh prepares quarterly updates regarding market conditions, legal developments, and business trends for distribution to clients and colleagues involved in the investment management segment.

Marsh is a market leader in the placement of professional liability premiums with the insurance markets for financial institutions. As a result, Marsh maintains excellent working relationships with all insurers in this segment, including long established and new participants. Through our strong insurance-market relationships, Marsh is able to obtain favorable terms, conditions, and pricing to the satisfaction of our alternative investment/hedge fund clients.



To learn more about our experience with management and professional liability insurance for alternative investment funds and hedge funds please contact your local Marsh representative or one of our professionals below.

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