

# Financial Institutions

## Federal Insider Trading Investigation Targets Hedge Funds

The November 20, 2010 edition of the Wall Street Journal reported that federal authorities are preparing to bring criminal and civil claims for insider trading against numerous hedge funds, mutual-fund traders, and their advisors. In particular, the investigation and prosecution of hedge funds reportedly centers on allegedly non-public information provided to hedge fund personnel by “expert network” services, consulting groups that provide institutional investors with industry-specific knowledge and expertise to assist in their investment decisions.

The pending investigation was reportedly coordinated between federal prosecutors in New York, the FBI and the Securities and Exchange Commission. It comes after the SEC previously sent subpoenas to some 30 hedge funds last Fall. While those subpoenas largely focused on trading preceding specific large mergers and acquisition between 2007 and 2009, the current investigation is reported to be far wider in scope. Taken together with continuing efforts by the SEC to increase regulation of hedge funds, as well as the new provisions of the Dodd-Frank bill, this investigation reinforces the growing need of hedge funds to consider themselves the likely target of state and federal investigations.

One relevant aspect of risk management concerning potential investigations such as these should be the comprehensive review of a firm’s insurance coverage. In the hedge fund industry in particular, many funds have failed to appropriately respond to the changing regulatory environment and enforcement environment and remain uninsured or underinsured against the risk of investigation and suit. The costs of responding to such investigations and defending or resolving

subsequent criminal and civil suits can be tremendous, fundamentally and negatively impacting a fund’s performance and potentially prompting investor complaints as well.

However, appropriately structured insurance coverage for hedge funds can provide coverage for legal fees and other defense costs incurred in responding to investigations by the SEC, and other regulatory agencies, as well as for the defense of civil and criminal suits against a fund and its personnel. Depending upon the circumstances, and subject to certain limitations, an insurance policy can also fund the resolution of such investigations and suits. It is therefore imperative for hedge funds to discuss their potential exposure and available risk management options with qualified professionals, including an experienced and knowledgeable insurance broker. Otherwise, as is becoming increasingly clear, a hedge fund may find itself incurring significant investigative and defense costs with no funding other than the fund assets themselves.

## Claims Advocacy

Marsh's claims advocates and client advisors are available to discuss the issues emanating from the insider trading investigations further and possible coverage under GPL and E&O programs. There has been a spate of recent case law addressing the extent to which professional liability policies respond to regulatory investigations. Therefore, it is critical that clients and prospects understand the nuances of these developments to maximize their coverage

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**For more information on this topic, please contact your FINPRO representative or**

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