

## DODD-FRANK: ARE YOUR INSURANCE POLICIES READY FOR THE SEC?

The deadline for private fund managers to apply for 'Securities and Exchange Commission' (SEC) registration under Dodd-Frank (the Wall Street Reform and Consumer Protection Act) is now 30th March 2012.

Non-U.S. managers will come under the SEC's scope if:

- They have more than USD 25 million AUM attributable to U.S. clients
- They have 15 or more U.S. clients, irrespective of related AUM, where US clients include U.S. investors in a fund (i.e. U.S. individuals, corporations, trusts etc).

Many non-U.S. based asset managers meet these criteria, however full SEC registration applies only to managers that actually undertake activities in the U.S.. Those that do not have a place of business in the U.S., but otherwise meet the criteria must report to the SEC as 'Exempt Reporting Advisers' (ERA's) or make use of another exemption.

The ERA category provides exemption from the SEC registration; however this creates new obligations for non-U.S. based managers. A firm can be exempt from SEC registration but still subject to many of the same responsibilities of a SEC regulated firm, under the reporting requirements, including the threat of external SEC examinations.

Whether required to register or just comply with the reporting requirements, for some non-U.S. firms this will be their first encounter with U.S. statute and regulation by the SEC. We are therefore recommending to impacted firms that, as part of the review of operational and compliance procedures, it is critical to review your operational risks and corresponding insurance protection at the same time.



## IMPACT ON PROFESSIONAL INDEMNITY AND DIRECTORS' & OFFICERS' LIABILITY POLICIES

While Dodd Frank does not introduce any new 'genus' of liability which is not already dealt with – either positively or negatively – in most good professional indemnity and directors' and officers' liability policies, the act does, of course, underline the need to obtain the optimum policy conditions to the degree that they concern U.S. exposures.

The changes inherent in the Dodd-Frank Act clearly have significance for insurance. U.K. Insurers have for some time exercised great caution when considering U.S. exposures generally and exposures to SEC regulation and U.S. statutes in particular.

For those investment advisers who are now to be caught up in SEC regulation, it will be vital to ensure that their insurance policies adequately reflect the new position. Regarding the insurance implications, we suggest some checks which should be made with your insurance broker.

### SEC EXCLUSIONS

Some professional indemnity policies exclude breach of U.S. statute in general unless the breach would have given rise to certain common law liabilities in the absence of the statute. Even where this general exclusion does not apply, it is common to see an exclusion of SEC Acts in a similar fashion.

### INVESTIGATION COSTS

With regards to the scope of regulatory cover in your policies:

- Are costs of preparing for (not just attending) regulatory investigations covered for directors' and officers' and when is cover triggered?
- Are regulatory and administrative proceedings and investigations separately and adequately included in definitions and elsewhere?

- Is criminal prosecution included in cover for directors' and officers'?
- Is there a definition of 'regulator' wide enough to include any regulator (including self regulatory persons or bodies) and, importantly, the SEC?
- Are 'Restitution Orders' specifically included in terms of orders to make compensation by any regulator worldwide?

### MITIGATION COSTS

The requirement in Dodd-Frank for there to be policies and procedures to **remedy** violations, emphasises the need for adequate cover in this respect. Standard policies do not allow the Insured to take any action when potential claim situations occur without insurers' prior consent. Where regulators demand immediate action be taken to rectify transactional mistakes, this can lead to problems for the Insured who must act but has not had time to obtain such prior consent.

### OTHER POINTS TO CHECK

#### IS THERE ADEQUATE COVER FOR:

- Actions by regulators or others to remove directors' or officers' title to property or restrict their residence?
- Extradition costs, public relations expenses including assets and liberty costs/prosecution for removal of approval of licencing, etc?
- Regulatory crisis response costs?
- 'Nomenclature' – are the functions described in the definition of 'Directors and Officers' or 'Insured Persons' sufficient to include all the positions required under U.S. jurisdiction?

## FINES AND PENALTIES

You should check that punitive, exemplary and aggravated damages, civil fines and civil penalties are covered where legally insurable in the jurisdiction where claims are made.

## BE AWARE

### OTHER U.S. COVER RESTRICTIONS

Restrictions might appear in the provision (which should be made) for automatic cover for subsidiaries or funds acquired during the policy period. Many liability policies – both professional indemnity and directors’ and officers’ – will not provide this ‘automatic’ facility for U.S. entities.

Additionally, under virtually all directors’ and officers’ liability policies:

- ‘Outside entity coverage’ will not automatically be given for new outside entities
- Directorship positions adopted during the policy period in the U.S. will not be covered
- ‘Insured versus insured’ claims are excluded, with some exceptions – the nature of these exceptions should be checked carefully with your broker.

## IN SUMMARY

The Act will undoubtedly bring more entities than hitherto within the ‘catchment’ of the SEC regulation and it is important for those entities to check the standing of their professional indemnity and directors’ and officers’ liability policies to ensure that U.S. exposures are covered to the maximum extent possible.

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## WILLIS HAS EXTENSIVE IN-DEPTH EXPERIENCE OF FINANCIAL INSTITUTES INSURANCE COVER AND ARE ALWAYS READY TO ADVISE ON SPECIFIC CONDITIONS AND OFFER A NO OBLIGATION COVERAGE REVIEW.

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## CONTACTS

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