GLOBAL FINEX - FINANCIAL INSTITUTIONS

H1 2024 - Asset Manager Market Update – GB & NA

D&O/E&O insurance global market overview and notable trends

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This update analyses our observations of the current market conditions for GB and NA asset managers and is based on our existing clients. It is not a review of the whole market. All rate changes are for guidance only and vary depending on risk profile and individual circumstances.

In respect of NA, this market update only concerns private company D&O. This update does not concern public company D&O and the private equity industry.

Asset Management E&O/D&O Liability

State of the market and risk trends – GB

Key takeaways: The insurance market continues to be favourable for asset management risk. Investment Management Insurance (IMI) renewals are generally achieving premium reductions of between 5-10% with retentions remaining unchanged. Competition among insurers also presents opportunities to further broaden the scope of coverage. These favourable market conditions are expected to continue during 2024.

Rate predictions

	Trend	Range
Primary:	▼	-5% to -10%
Excess:	▼	-5% to -10%

Risk trends

Regulatory actions	Ongoing regulatory change agenda means an evolving risk environment. High levels of regulatory supervision will require firms to (re)assess the current and target states of their operations; risk management policies, governance, and controls; and data and systems infrastructure.
ESG and climate	Special drawing rights (SDR) and anti-greenwashing rules take effect in the UK. ESG risks impact all areas of business; a firm-wide approach should encompass corporate strategy, governance and risk management.
Cybersecurity	Continued prevalence of cyber threats, in particular ransomware attacks and third-party data breaches.
Digital assets	Rapid change to the digital asset ecosystem requires an understanding of how assets fit into existing legal frameworks and financial market infrastructure.
Operational risk	The UK regulators' recent consultation paper (CP26/23), has sent a strong signal to the financial services industry that operational resilience remains a supervisory priority and that the landscape will continue to expand and evolve.
Emerging Technology	Risk and compliance frameworks must keep pace with the increased adoption of emerging technology, in particular AI.

Market conditions

Premiums	Favourable, with most programmes achieving renewal reductions where there is a positive risk profile and no active claims.
Retentions	Retentions remain flat in general.
Coverage	Increased competition is leading insurers to consider broadening cover.
Insurers	Several new insurers have entered the D&O/E&O space, creating competition on renewal programs, though mostly on an excess basis.
Capacity	New entrants to the market have increased excess capacity by £40-50mn. These new participants have looked to increase line sizes and consider providing primary lead options where a risk is within appetite.
Appetite	Asset management continues to be the most desirable financial institutions (FI) subset; though insurers remain highly selective around digital & crypto assets.

Asset management industry trends

Risk trends – regulatory – GB

Observations

- The effect of recent periods of volatility across financial services, for example the UK mini-budget in 2022 and the collapse of Silicon Valley Bank (SVB) in 2023, has led to authorities reviewing both regulation and supervisory approaches.
- UK regulatory focus on sustainability in 2024 with the implementation of Sustainability Disclosure Requirement (SDR) in July 2024 as well as a new anti-greenwashing rule.
- Other regulatory priorities will include operational resilience, artificial intelligence (AI), consumer impact, digital assets and financial crime.
- Regulatory focus on management oversight is likely to increase following the introduction of the Consumer Duty in 2023. This will look at boards as well as management teams and evaluate an overall culture of risk.
- The UK Government is expected to take steps in 2024 to deliver objectives laid out in their green finance strategy, including outlining the UK Green Taxonomy which is currently under consultation.
- There is greater regulatory focus on non-bank financial participants, such as money market funds, hedge funds, private equity and insurers.

Concerns

- Supervision and stress testing of financial services firms by the Bank of England is ongoing, however the likelihood is that this will encompass a larger group of firms in future, in particular technology and data platforms and a larger number of banks.
- The Bank of England is launching its first system-wide stress test of the financial sector in 2024, which will include a wide range of financial services businesses, including bank and non-bank financial institutions, central counterparty clearing house (CCPs), funds and insurance companies.
- The Financial Conduct Authority (FCA) is currently consulting on liquidity risks in money market funds, raising the likelihood of a change to the existing approach.
- Alternative and private markets are also in focus with the FCA. For example, a review is expected soon looking at valuations processes, responsibilities, oversight.
- The rapid growth of non-bank financial institutions within the financial system has raised concern about unseen leverage and opaque strategies operating under lighter touch regulation than the traditional banking sector. This has led to calls for a new prudential risk framework for these types of firms.

Considerations

- Likelihood of increased levels of regulatory scrutiny on prudential risks, including liquidity and exposure.
- Firms should prepare for more detailed scenario planning and stress testing.
- Firms should review the effectiveness of management information being kept and whether the level of detail is sufficient.
- Competition in the D&O market has led to favourable market conditions for asset managers looking to buy insurance cover. Directors' and officers' liability accounted for 30% of notifications in 2023, but only 25% in terms of cost.
- The Dear CEO letter from the FCA in November 2023 stated "Our supervision is shifting to become more assertive, intrusive, proactive and data driven. We are conducting more short notice and unannounced visits where we deem it appropriate."

Asset management industry trends

Risk trends – environmental, social and governance (ESG), climate and sustainability – GB

Observations

- Regulatory oversight of ESG reporting and climate risk management is increasing globally. Regulators are especially focussed on net zero transition planning, ensuring the carbon markets operate efficiently, and that biodiversity risks are managed effectively.
- ESG rules in the UK and across Europe are evolving. Some existing regulations are being reviewed (e.g. Sustainable Finance Disclosure Regulation (SFDR)), others are at the planning stage, such as an EU anti-greenwashing rule, and others such as the Corporate Sustainability Reporting Directive (CSRD) have recently been introduced.
- It is expected that greater regulatory focus on the carbon market will increase compliance and consistency which, in turn, will encourage participation.
- The International Sustainability Standards Board (ISSB) has identified biodiversity and nature as a key risk area. It is possible that the Task Force on Nature-related Financial Disclosures (TNFD) requirements become a similar reporting obligation to the Task Force on Climate-Related Financial Disclosures (TCFD).
- With reviews being conducted on key aspects of European ESG regulation, uncertainty exists as to what the requirements will be in future. The EU approach appears to favour alignment with UK rules.

Concerns

- Climate risk management is an ongoing focus for regulators, with stress tests being carried out on financial institutions. Those that do not meet expectations could face potential penalties.
- Increasing sustainability-related regulations will drive closer scrutiny of outcomes driven by sustainable investment strategies.
- The UK Transition Plan Taskforce issued its final framework for transition plan disclosures in October 2023. Transition planning forms a critical component of a firm's business strategy, however publishing these plans to customers, shareholders and investors will become mandatory under new rules as the UK looks to lead towards global net zero.
- Increased instances of regulatory investigation and investor litigation relating to greenwashing have made this a significant risk for financial institutions under Sections 90 and/or 90A of the Financial Services and Markets Act (FSMA).

Considerations

- Firms should consider the growing requirements to report on climate impact and their net zero strategies. Nature-related financial disclosures are likely to be introduced under TNFD regulations.
- Biodiversity and nature-related factors will start to play a larger role in strategic planning, risk management and asset allocation decisions.
- Monitoring and implementing changes to disclosure and reporting requirements is time-consuming and requires resource. Complying with a combination of both changes to existing rules and a raft of new ones is a significant undertaking for regulated firms.
- ESG-related claims often come in the form of regulatory investigations and investor litigation. It is important for asset managers to review and understand both the scope and limitations of coverage under their D&O and Professional Indemnity policies.
- Underwriters are increasingly including ESG considerations into their insurance due diligence process.

Asset management industry trends

Risk trends – cybersecurity and operational risk – GB

Observations

- As digitalisation becomes a more integrated part of the financial services sector, firms are having to move quickly to update legacy systems and infrastructure.
- The Digital Operational Resilience Act (DORA) was implemented by the European Commission in January 2023 and has raised the standard in terms of digital resilience and operational risk management relating to technology, external service providers and data governance. The rules will apply from January 2025
- The first set of draft rules were recently published on the UK Critical Third Party (CTP) regime which gives the UK Treasury the ability to designate 'critical' service providers. These firms will then be subject to additional scenario testing, risk management and operational resilience oversight.
- The transition to T+1 settlement for US and Canadian securities in May 2024 represents a significant operational shift for asset managers. Aims to reduce counterparty risk during settlement, however a number of other resulting risks will need to be addressed, such as operational processes, managing currency liquidity. Technology improvements will be key to this transition. If successful, it is likely that the UK and European markets will follow.

Concerns

- Increasing digitalisation and interconnectivity in financial services has meant that cyber risks are more widespread and harder to monitor. Cyber notifications that originate through third parties are becoming more common and represent a large percentage of asset management cyber claims.
- Ransomware and malicious data breaches remain the largest cyber risks for asset managers. An increase was seen in ransomware frequency during 2023.
- Increased adoption of AI could have an impact on data protection in the UK. Reform of UK data regulations is underway via the Data Protection and Digital Information Bill that is currently under parliamentary review.
- The CTP regime would represent a significant expansion of the regulators' supervisory remits with regard to operational resilience. It will be a new environment for CTPs, where they will need to comply with a range of rules on governance, operational continuity and regulatory engagement.

Considerations

- Firms should review any changes to their business model and updates to operating infrastructure.
- Operational resilience policies and procedures will need to be regularly audited by ICT auditors.
- As cyber risks have become better understood by underwriters, more insurers have joined the market. This competition has led to increased capacity and premium reductions across both primary and excess layers.
- Asset managers looking to purchase cyber insurance should engage with their broker to fully understand insurability criteria.
- It is important to understand war exclusion variables and factor these into your renewal/purchasing strategy in conjunction with your cyber broker at the start of the process.
- There is a greater focus on the interplay between cyber, PI and Crime policies and the options for addressing any duplication or gaps in cover.

Asset management industry trends

Risk trends – digital assets and emerging technology – GB

Observations

- As AI use becomes more widespread, there are different approaches being taken by countries to regulating its use: Canada, for example, is looking to introduce legislation through the AI and Data Act, whereas others such as the US and Japan are working towards voluntary guidelines. The UK is proposing a framework of responsible AI principles.
- The recent Securities and Exchange Commission (SEC) approval for spot Bitcoin exchange-traded funds (ETFs) has brought digital assets further into the mainstream. These are currently prohibited for sale in the UK by the FCA which classifies them as 'restricted mass-market instruments', however it is now increasingly likely that Bitcoin ETFs gain approval in the UK in the future.
- We are seeing supervisory action in the US and the UK for the marketing practices of crypto assets – the FCA issued new rules that came into effect in October 2023. International Organization of Securities Commissions (IOSCO) has also stated that marketing of crypto assets should be regulated in the same way as other securities.
- A regulatory framework for crypto assets and tokenised instruments is expected in the UK in late 2024. This will cover activities such as issuance, disclosure, custody, market abuse, lending. Further draft rules are also expected on stablecoins in H2 2024.

Concerns

- Asset managers will need to assess the market opportunity of entering crypto asset markets as they mature. Decisions as to how this can be done within existing risk management and compliance frameworks will be needed.
- At the AI Safety Summit in late 2023, the UK Government stated its ambition to lead the creation of global standards for AI. The balance must be struck between regulatory oversight and encouraging innovation. AI capabilities change rapidly and maintaining the appropriate level of control will be difficult to manage.
- Regulators may decide to review existing AI strategies of an asset manager, especially in respect of mandates, investor suitability and marketing material. If these are not seen to be compliant, this may present an increased risk of mis-selling or misstatements.

Considerations

- Firms should consider developing a governance framework for adopting emerging technology to maximise value to the business while understanding and managing new risks. Many asset managers are looking to find a balance between AI, performance, transparency and efficiency. Mis-use of AI, however, could result in greater risks from regulatory investigation costs, regulatory fines, misrepresentation/misstatement liability and reputational damage.
- Management accountability should include awareness and oversight of any new risk factors and applicable regulations.
- Insurers are focusing on cryptocurrency/digital asset exposures and how these are being managed. Some insurers are looking to expand coverage into digital assets, in particular where this forms part of a broader asset mix.

Asset Management E&O/D&O Liability

State of the US market and risk trends

Rate predictions

	Trend	Range
Primary:	▼	0% to -15%
Excess:	▼	0% to -15%

Key takeaways: The insurance market continues to be favorable for most asset managers. Premiums have generally renewed flat to -15%, with retentions remaining as expiring. The competitiveness of the current market also presents opportunities to further broaden the scope of coverage afforded under D&O/E&O programs. These favorable market conditions are expected to continue until at least the end of Q2 2024.

Risk trends	
Regulatory actions	Underscores need for formal and informal investigations coverage.
ESG and climate	"Greenwashing" enforcement actions are an ongoing concern.
Artificial intelligence	Regulators and underwriters are increasingly focused on AI risks.
Marketing rule	Advisers fined for violating rule targeting misleading advertisements.
DOL fiduciary rule	Implications of DOL's proposal to redefine "fiduciary" under Employee Retirement Income Security Act of 1974 (ERISA).
Private fund advisers	New SEC transparency and reporting rules for private fund advisers
Off-channel messaging	SEC fines for failing to preserve messaging app communications.
Bank sweep programs	Focus on conflicts of interest related to bank sweep programs.
Cybersecurity	SEC's proposed rules for registered advisers and funds.
Spot Bitcoin ETFs	Crypto volatility drawing attention to current/potential ETF funds.

Market conditions	
Premiums	Generally favorable, with most programs realizing renewal decreases.
Retentions	Generally flat, as adjustments were mostly made during the harder market.
Coverage	Competition may create opportunities for further coverage enhancements.
Risk profile	Insureds with favorable risk profiles will likely realize positive results. Insureds with material claims, significant growth, unfavorable performance, negative interest rate impact, or meaningful real estate, OCIO, and/or crypto exposures may experience challenges at renewal.
Insurers	Several new insurers have entered the D&O/E&O space, creating competition on renewal programs, though mostly on an excess basis.
Capacity	Most insurers continue to limit capacity to $10M, though some may cap their limit at $5M for more challenged risks
Appetite	Asset Management, in particular RIAs and registered funds, continues to be the most desirable FI subset; though insurers have limited interest in private equity, Outsourced Chief Investment Officer (OCIOs), and business development company (BDCs).

Asset management industry trends

Environmental, social, and governance (ESG)/ climate change - NA

Observations

- Despite its omission from their 2024 examination priorities, the SEC's climate and ESG task force has brought charges against multiple advisers for ESG-related misrepresentations and compliance failures.
- The SEC has also adopted or proposed several rules to address greenwashing risks, including the Investment Company Act's "names rule" and the proposed enhanced disclosures by certain investment advisers and investment companies about ESG investment practices rule, both of which seek to protect investors in ESG products.
- Advisers are also facing an ESG backlash, where certain state treasurers and legislatures are banning or limiting ESG investments. The Tennessee AG also recently sued an asset manager alleging breach of consumer protection laws via misstatements about its ESG strategy.
- The SEC also proposed a climate rule aimed at publicly traded entities, while state regulators, notably California, and foreign regulators have proposed and/or adopted similar rules and regulations.

Concerns

- Increased regulatory scrutiny often leads to an increased risk of regulatory enforcement actions and possible follow-on investor litigation against asset managers, investment funds and potentially fund directors.
- The recent enforcement actions by the SEC, combined with the adopted and proposed disclosure rules both in and outside the U.S., make it clear that ESG continues to be a concern for regulatory bodies across the globe.
- Insurers are aware of the increased regulatory scrutiny of ESG, as well as the growing ESG backlash, and will likely be asking questions on this subject as part of the renewal process.
- Specific areas of underwriting focus may include the types of ESG strategies and products being offered, the credentials of ESG teams, the policies and procedures in place to monitor and mitigate the risk of greenwashing, the process for vetting ESG investor disclosures and statements, and the status of any interaction with regulators and/or those states leading the ESG backlash.

Considerations

- Generally, ESG-related claims and climate-related claims, are expected to come in the form of regulatory proceedings and investor litigation, so it is important to review both the coverage scope and limitations under D&O/E&O policies.
- Coverage for formal and informal investigations should be reviewed in advance of any renewal, and exclusions (e.g. pollution) should be reviewed and modified where appropriate.
- Cost of Corrections (CoC) coverage applies to loss incurred by an Insured to rectify a matter that, if not corrected, would otherwise result in a claim. CoC could apply in an ESG scenario if, for example, a trade error is made in an ESG portfolio, and the adviser proactively makes the investor whole in order to avoid a claim being brought against it. Given the strict reporting requirements applicable to CoC, reporting such matters to insurers in a timely manner is critical.
- For public companies, WTW's ESG Clarified tool can assist in quantifying its ESG risks, which may enhance an underwriters view of the company's ESG risk profile.

Asset management industry trends

Artificial intelligence (AI) - NA

Observations

- Many asset managers use AI in various ways, including to enhance trading systems, provide robo-advisory services, perform research and analysis, support marketing, create customer service efficiencies, and to conduct certain legal and compliance functions.
- With the rapid adoption of AI, regulators are taking steps to protect investors from AI risks, both in and outside the U.S.
- In July 2023, the SEC released a proposal to address conflicts of interest at advisers/brokers who use technologies to make investment predictions (e.g., robo-adviser data set steers investors to proprietary investments).
- In December 2023, the Wall Street Journal reported the SEC is conducting sweeps of advisers, seeking info on marketing, algorithmic models, training, compliance and oversight.
- The White House also issued an executive order outlining AI best practices, while certain US states and European countries have enacted/proposed laws and/or regulatory frameworks.

Concerns

- **Data accuracy:** AI-driven models rely upon data which, if inaccurate, may generate incorrect or misleading outputs, leading to incorrect decisions and possible losses to the organization/investors.
- **Job displacement:** Where AI is more efficient than individuals, Reductions in Force (RIF) may follow. If such RIFs disproportionately impact protected classes, discrimination claims may follow.
- **Biases:** AI tools generating biased outputs due to biased data inputs or intentional manipulation may result in discrimination claims (e.g.; declining applicants for loans/employment due to age).
- **Regulatory frameworks:** Risk of enforcement actions, reputational harm, and litigation.
- **Cybersecurity:** The misuse of AI tools to execute fraudulent attacks and compromise data raises a host of cybersecurity concerns.
- **Trade execution:** Erroneous trades made via AI software may result in investor damages and reputational harm to asset managers.

Considerations

- As AI risks garner more attention, insurers will likely focus more on this issue prior to renewal. In advance of underwriter meetings, underwriters should be consulted to determine what AI questions will need to be addressed.
- High-level questions underwriters will likely focus on include:
  - Type of AI used by an Insured;
  - How AI is used throughout the organization;
  - The (human) controls monitoring use/output of AI;
  - Employees impacted by any AI-related RIFs and if a disparity impact study has been conducted; and
  - Changes, if any, to cybersecurity and fraud mitigation frameworks.
- AI is continuously evolving, as are the risks and regulations associated with it. As such, the questions and topics underwriters will focus on in advance of renewal are likely to evolve as well.

Asset management industry trends

Marketing rule - NA

Observations

- In December of 2020, the SEC adopted an amended rule, 206(4)-1, or the marketing rule, under the Investment Advisers Act of 1940 ('40 Act), its first update since 1961.
- The new rule replaced the advertising and cash solicitation rules, rule 206(4)-1 and rule 206(4)-3, respectively, and is intended to modernize the governance of an investment adviser's compensation to solicitors and advertisements under the '40 Act.
- The rule prohibits specific practices, including making/omitting material facts, making unsubstantiated statements, causing untrue or misleading implications/references, providing benefits without material risks/limitations, referencing advice that is not presented in a fair and balanced manner, including/excluding unfair and unbalanced performance results, and including otherwise misleading information.
- In advance of the rule's November 4, 2022, compliance date, the SEC issued an alert announcing it would begin examinations focused on compliance with the marketing rule.

Concerns

- In August 2023, the SEC brought its first charges against an adviser under the marketing rule. Among other charges, the SEC said the adviser used misleading hypothetical performance metrics in advertisements and advertised hypothetical performance metrics without having appropriate policies and procedures in place. The adviser was also charged with violations related to other aspects of its business, but settled by paying $192,454 in disgorgement, prejudgment interest and an $850,000 civil penalty.
- In September 2023, the SEC announced charges against nine other RIAs for violations of the marketing rule. The charges were brought for failing to adopt or implement policies and procedures while advertising hypothetical performance to the general public on their website. Collectively, the nine firms settled the charges and paid $850,000 in penalties.
- New rules or regulations increase the risk of claims activity under D&O/E&O policies, as regulators and investors have new opportunities to allege wrongful acts by the adviser.

Considerations

- Most well-endorsed investment management liability policy forms should respond to regulatory or investor claims, subject to the policy's terms and conditions, though fines and penalties are typically excluded.
- Coverage generally applies to defense and legal expenses, as well as any resulting judgements or settlements. It is important, however, for insureds to review the scope (and limitations) of coverage available for such matters, including formal and informal investigations.
- Reviewing the exclusions within the policy are also necessary to understand the full breadth of coverage under these programs. For example, as noted above, fines and penalties are typically excluded under these policies. However, the costs of defending matters resulting in such fines and penalties may be covered, subject to the policy terms and conditions.

Asset management industry trends

DOL fiduciary rule - NA

Observations

- On October 31, 2023, the DOL issued a proposed rule that would redefine the term "fiduciary" under the ERISA, along with amendments to the prohibited transaction exemptions available to investment advice fiduciaries.
- Intended to further protect retirement investors, the proposed rule would impose high standards of care and loyalty on trusted advice providers, requiring them to avoid conflicts of interest and make recommendations that are in their client's best interest, not their own.
- Enacted in 1975, the DOL recognizes that ERISA's current definition of "fiduciary" is outdated and needs to be modernized. For the complete definition, the proposed rule must be consulted, but "fiduciary" would include providers of investment advice/ recommendations to retirement investors, providers of advice or recommendations for a fee/ compensation, and financial services providers where an investor would reasonably expect to receive sound recommendations that are in their best interest.

Concerns

- Similar to rules enacted by other regulators, such as the SEC's "regulation best interest" rule, the DOL's proposed rule is garnering much attention. When new rules, regulations and/or laws are enacted, there are a greater number of avenues regulators and/or investors can take when an adviser fails to comply with these requirements.
- D&O/E&O insurers are following the developments of the DOL's proposal and will be assessing how the rule may impact the risk profile of their insureds.
- As part of the insurance underwriting process, impacted insureds can expect questions around the proposed rule, including how it may impact the business, steps being taken to prepare for the rule, the expected timeline for implementation, how employees will be trained both in advance of the rule and after its inception, and how compliance will monitor adherence to the rule.

Considerations

- Most well-endorsed investment management liability policy forms should generally respond to regulatory or investor claims, subject to policy terms and conditions.
- Coverage typically applies to defense and legal expenses, as well as any resulting judgements or settlements. It is important, however, for insureds to review the scope (and limitations) of coverage available for such matters, especially with respect to formal regulatory investigations (i.e., where a wrongful act is alleged against an insured) and informal regulatory investigations (i.e., where a wrongful act is not yet alleged against an insured).
- Reviewing the terms and conditions of the D&O/E&O policy and making any necessary amendments (e.g., narrowing the applicability of the ERISA exclusion to apply only to ERISA violations involving an insured's own benefit plans) is recommended prior to the rule being implemented, if adopted.

Asset management industry trends

Private fund advisers - NA

Observations

- Citing the need to enhance investor protection, the SEC adopted new rules under the Investment Advisers Act of 1940 that require greater transparency from, and imposes additional reporting obligations upon, registered investment advisers to private funds.
- Advisers subject to the rule would be required to, among other obligations, (i) issue quarterly investor statements, (ii) obtain private fund audits, (iii) obtain fairness opinions in adviser-led secondary transactions, (iv) and refrain from certain prohibited activities.
- One aspect of the rule proposal not adopted was the limitations of liability restrictions imposed upon advisers to private funds. The initial proposal would have prevented advisers from seeking indemnification or limiting the adviser's liability for its willful misfeasance, negligence, bad faith, recklessness, or breach of fiduciary duty to a private fund. Such prohibitions became an underwriting focus as they would have both eliminated an adviser's defense to liability and increased the risk of claim payouts by insurers.

Concerns

- Although the prohibition on a private fund adviser's limitation of liability was not adopted, the final rule will impose other challenges for asset managers going forward.
- When new rules, regulations and/or laws are enacted, there are a greater number of avenues regulators and/or investors can take against an adviser who fails to comply.
- As the Private Fund Advisers rule goes into effect, insurers are likely to inquire about the steps an insured is taking to comply with this rule, such as implementing any new or enhanced policies or procedures.
- Separately, the SEC's 2024 priorities noted that the regulator has brought actions specifically against advisers to venture capital funds, related to fund mismanagement concerns, conflicts of interest, and pay-to-play violations. Advisers of such funds should be mindful of these developments.

Considerations

- D&O/E&O policies generally respond to regulatory claims. Coverage typically applies to defense and legal expenses, judgements or settlements. Insureds must review the scope (and limitations) of coverage for such matters, especially with respect to formal and informal regulatory investigations.
- Insureds should also review the scope of pre-claim" coverage under their D&O/E&O policy. For those matters that do not (yet) satisfy the definition of claim under the policy, Insureds can still choose to report such matters to the insurer. Should the matter subsequently become a "claim", the insurer will retroactively pay the covered costs incurred by the Insured from the point of initial notice to the point it became a claim.
- Insureds should note that some D&O/E&O insurers provide a premium credit if an outside consultant is engaged to conduct a mock regulatory audit. If this enhancements exists on the policy, it should be taken advantage when planning the next mock regulatory audit.

Asset management industry trends

Off-channel messaging - NA

Observations

- The SEC has brought charges against numerous broker-dealers and dually registered broker-dealers and investment advisers for failing to maintain and preserve electronic communications made through off-channel messaging apps, such as WhatsApp and iMessage.
- In many cases, the SEC charges resulted in sizable penalties. As of August 2023, the SEC announced that it has brought 30 enforcement actions, resulting in $1.5B in penalties.
- Recent SEC charges were announced in August 2023, when 10 firms admitted wrongdoing and agreed to pay penalties totaling a combined $289M. A month later in September 2023, the SEC again charged another 10 firms with similar violations, resulting in combined penalties of $79M.
- While the majority of firms charged by the SEC thus far have been registered broker-dealers, there is increased speculation that the regulator will take a harder look at registered investment advisers. This appears to be the case, as 16 firms, including seven dually registered broker-dealers/investment advisers and four affiliated investment advisers, settled with the SEC by agreeing to pay a combined $81 million in civil penalties related to recordkeeping failures.

Concerns

- In their publication Regulatory Enforcement of Off-Channel Communications, ACA Compliance Group (ACA) issued an overview of proactive steps financial services firms can take to prepare for regulatory scrutiny.
- The issues highlighted by ACA are the same areas D&O/E&O insurers may focus on during the underwriting process. Such issues include:
  - **Written policies:** Ensure appropriate policies are in place and that the firm/employees are adhering to them.
  - **Maintain/preserve:** Capture communications where permitted.
  - **Training:** Provide training and engage a third party for surveillance and on-going training.
  - **Culture:** Senior management must both preach and practice what they preach.
  - **Certify/Attest:** Employees at all levels should certify and attest to their compliance with policies governing off-channel communications.

Considerations

- Non-public D&O/E&O investment management policy forms should generally respond to regulatory and investor claims, subject to policy terms and conditions.
- Coverage typically applies to defense and legal expenses, as well as any resulting judgements or settlements.
- Coverage for fines and penalties are typically excluded, though coverage may be available for the costs of defending matters resulting in such losses.
- Insureds should review the scope (and limitations) of coverage available for such matters brought by the SEC or other regulators, especially with respect to formal regulatory investigations (i.e., where a wrongful act is alleged against an insured) and informal regulatory investigations (i.e., where a wrongful act is not yet alleged against an insured).

Asset management industry trends

Bank sweep conflicts of interest - NA

Observations

- In its 2024 Examination Priorities, the SEC noted it will review investment advisers' adherence to their duty of care and loyalty, as well as advisers' processes for managing conflicts of interest, among other areas.
- In particular, the SEC highlighted its intent to focus on investment advisers' compensation arrangements, including their alternative means for increasing revenue, such as sweep programs at affiliated and/or unaffiliated banks.
- Conflicts of interest may arise, for example, when the adviser does not disclose that an investor could earn a higher return if their cash was invested outside of the bank sweep program, or when the adviser fails to disclose revenue sharing arrangements with third parties.
- The SEC has imposed fines and penalties related to numerous investment advisers' sweep programs. The latest action involved an investment adviser's undisclosed conflicts of interest with a sweep program operated by its affiliated custodian. The adviser paid $18M to settle the charges.

Concerns

- As the SEC's pursuit of these violations receive more attention, D&O/E&O underwriters will begin to focus more on this issue.
- As part of the insurance underwriting process, investment advisers engaged in a cash sweep program, or whose affiliate is engaged in a cash sweep program, are likely to receive more questions from insurers.
- Areas of underwriting interest may involve existing arrangements, how much of the organization's revenue is comprised of sweep-related arrangements, what are the existing compliance and other oversight measures in place to avoid conflicts of interest, how often employees are trained on this issue, and what changes, if any, have been or will be made regarding oversight on this issue.

Considerations

- Most well-endorsed investment management liability policy forms should generally respond to regulatory or investor claims (subject to policy terms and conditions). Coverage typically applies to defense and legal expenses, as well as any resulting judgements or settlements.
- It is important for insureds to review the scope (and limitations) of coverage available for such matters, especially with respect to regulatory investigations, both formal (i.e., where a wrongful act is alleged against an insured) and informal (i.e., where a wrongful act is not yet alleged against an insured).
- It is also important to review and amend, where needed, the scope of professional services covered under the policy, as well as any exclusions that may be applicable to these situations (e.g., any banking-related exclusion).

Asset management industry trends

Cybersecurity - NA

Observations

- In 2022, the SEC proposed new cybersecurity rules under the Investment Advisers Act of 1940 and the Investment Company Act of 1940 aimed at bolstering cybersecurity for advisers and funds.
- Those subject to the rule would be required to adopt and implement cybersecurity risk management policies and procedures and adhere to new cybersecurity incident reporting and disclosure requirements.
- Fund directors would be required to approve these policies and procedures, including any proposed material changes to them, and review reports on cybersecurity incidents.
- In addition, the SEC adopted its cybersecurity risk management, strategy, governance, and incident disclosure rule in July 2023. Its intent is to enhance and standardize cybersecurity risk management measures within publicly traded companies. Among other requirements, public companies must provide current disclosures involving cybersecurity breaches and the board of director's oversight of cybersecurity risks.

Concerns

- These proposals are the latest in an ever-evolving patchwork of cybersecurity regulatory requirements.
- The potential to run afoul of these regulations raises concern for organizations and their directors and officers and must therefore be carefully navigated.
- Depending on the situation, a cybersecurity event may not only impact the cybersecurity insurance policy; it may also trigger coverage under other lines of coverage as well, such as the fidelity bond (crime) and the D&O liability policy.
- The increasing regulatory risks associated with cybersecurity continues to raise concerns amongst the underwriting community. In addition to cybersecurity underwriters, D&O, E&O liability, and crime underwriters are scrutinizing an organization's cybersecurity risk framework.

Considerations

- **Cyber coverage:** As some cyber policies contain exclusions relating to violations of securities laws, it may be necessary to amend such exclusions so as not to apply to this regulation, if adopted.
- **Investment funds:** Proactively review and understand how coverage applies for funds under a cyber policy. If no coverage is currently afforded, consideration should be given to doing so in anticipation of this new rule.
- **D&O/E&O:** Review the breadth and scope of coverage afforded under adviser and fund policies and be mindful of any existing or proposed cyber-related exclusions.
- **Fidelity bond:** The bolstering of policies, procedures and controls can only improve an organization's risk profile and should be highlighted in the context of bond renewals.
- **CISOs:** Following the SEC's actions against SolarWinds Corp.'s CISO, other CISOs are concerned about their personal liability. As such, consideration should be should be given to potential amendments to the D&O and cyber policy.

Asset management industry trends

Cryptocurrency - NA

Observations

- The SEC has increasingly focused on crypto-related risks and challenges and will continue to do so going forward. In its 2024 Examination Priorities, the SEC noted it will continue monitoring and examining investment managers offering crypto-related products or advice.
- After years of rejecting filings for Spot Bitcoin ETFs, and following a legal battle with Grayscale Investments over the issue, the SEC announced in January 2024 that it has given its approval for 11 Spot Bitcoin ETFs to begin trading.
- Prior to the SEC's approval, the only ETFs with cryptocurrency exposure were those offering Bitcoin futures. ETFs with direct exposure to Bitcoin were not previously available to investors.
- With the SEC approvals, greater crypto-related regulation is expected, both in and outside of the US. Most recently, the Canadian Securities Administrators (CSA) proposed a rule outlining the regulation of crypto-related funds. If passed, certain custodians would be required to carry insurance that a "reasonably prudent person" would maintain for such risks.

Concerns

- The general volatility around cryptocurrency, including Bitcoin, has created concerns not only for regulators, but from D&O/E&O insurers as well.
- ETFs with direct investment in Bitcoin, and potentially additional forms of cryptocurrency in the future, may be viewed cautiously by insurers given the potential for significant swings in the value of the underlying assets.
- As more regulatory bodies introduce or enact frameworks governing Spot Bitcoin ETFs, the greater the risk for insureds to run afoul of these regulations.
- Historically, regulatory enforcement actions in general have often resulted in substantial legal and defense expenses, as well as fines and penalties. Any related investor litigation has added to those losses, creating greater concerns from D&O/E&O underwriters.

Considerations

- In advance of D&O/E&O renewals, insurers will want to know of any Spot Bitcoin ETFs that have launched or are expected to be launched.
- It is reasonable to expect underwriters will inquire about the compliance and risk management functions overseeing these ETFs, including the content of the fund prospectus and disclosures contained within, and the qualifications of the Spot Bitcoin ETF team.
- Given the increased regulatory risk, insureds should consider the breadth of coverage included within the firm's D&O/E&O policy. Particular focus should be given to regulatory investigations, both formal and informal, as well as the scope of Cost of Corrections coverage afforded under the policy.
- While asset management D&O/E&O policies do not typically include express cryptocurrency-related exclusions, it is important to review the exclusionary language within the policy, both within the designated exclusions section and the definitions section, to ensure such provisions are not overly broad.

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