



# *Hedge Fund Protector<sup>SM</sup>*

COVERAGE INSIGHTS

**AIG** Executive Liability<sup>SM</sup>

The number of hedge funds has more than doubled since 2002, reaching over 8,200 in 2005.<sup>1</sup> The investment regulatory environment has been changing at a rapid fire pace—and more changes are on the way, posing even greater threats to the individuals managing these firms.

*Hedge funds, a unique breed of investment vehicle, require a unique breed of management and professional liability insurance solutions.*

#### **Regulatory Issues:**

- Of particular note are new regulations requiring most hedge fund managers to register with the U.S. Securities and Exchange Commission (SEC) and designate one of their own as a chief compliance officer.
- Registration brings a host of technical and substantive requirements and subjects managers to SEC inspections, all of which expose managers to risk.
- Internationalization of the industry brings growing exposure to foreign regulatory schemes. For instance, the Financial Services Authority (FSA) has recently implemented “constant” monitoring of certain hedge funds. Dealings with foreign regulators can be time-consuming and often require access to costly experts.

Additionally, the recent explosion in hedge fund creation has left many funds “boxed in” by a lack of quality investment opportunities. All of the heightened regulatory scrutiny of hedge funds can put managers in an uncomfortable spotlight.

Given these developments, the management and professional liability exposure of hedge funds and their managers is soaring. Under increased regulatory scrutiny, the approximately \$1 trillion hedge fund industry, and the personal assets of those who manage hedge funds, are becoming a more alluring litigation target for the plaintiffs’ bar.

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<sup>1</sup> [www.thehfa.org](http://www.thehfa.org)

## Litigation Issues:

- Securities litigation tends to be extremely complicated, time-consuming, labor-intensive and expensive. Even an ultimate “win” on the merits can be extremely costly in terms of the expenses of defending against a claim.
- Potential plaintiffs are not limited to investors, e.g., institutional investors, broker-dealers, service providers and other market participants with adversarial interests, which vastly increases potential liability.
- Negative media scrutiny following recent industry scandals increases public and investor skepticism and adds fuel to the fire.
- Plaintiffs’ attorneys understand that the hedge fund business is lucrative and that managers will be attractive “deep pockets” defendants. Civil litigation is often initiated after the SEC takes action.

One avenue to litigation surrounds the valuation ambiguity of illiquid securities—those which are not normally traded on an exchange—and which are difficult to value in hedge fund portfolios. In addition, many hedge funds have lowered minimum investment thresholds; further heightening exposure by ushering in an expanded class of potential plaintiffs. Suitability claims are a likely result.

All of these developments coupled with general litigation trends, are raising the likelihood of management and professional liability lawsuits being filed against hedge funds and their managers.

## *Why should hedge funds purchase insurance?*

- Increased regulation and scrutiny increases the risk of being sued and in today’s environment, litigation outcomes are uncertain—even baseless actions are expensive to defend.
- Pension and multi-employer investors are now seeking to diversify portfolios with hedge funds. And as these institutional investors become increasingly active in the litigation arena, attention to the level of fiduciary duty owed this client base has grown dramatically.
- The fund’s portfolio will not have to be disturbed to cover defense costs.

*The Financial Institutions Group of AIG Executive Liability<sup>SM</sup> is addressing this exposure with Hedge Fund Protector<sup>SM</sup>— Directors and Officers, partnership and professional liability insurance designed exclusively for hedge funds and their managers. AIG Executive Liability will work with you through its advancement of fees provisions to help control defense costs and is backed by the financial strength of AIG Companies®.*

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*Hedge Fund Protector is tailored to the hedge fund industry and the coverage endorsements provide additional options tailored to your needs.*

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Claims are handled by AIG Executive Liability's team of in-house financial institutions claims specialists. Insureds also have the services of their choice of attorney from AIG Executive Liability's Panel Counsel, which is comprised of some of the nation's leading securities attorneys who specialize in defending hedge funds and their managers in management and professional liability claims.

## *Coverage Highlights*

Hedge Fund Protector coverage includes:

- ▲ Extensive directors and officers partnership liability insurance to protect the fund, partners, managing members and insured persons (including the chief compliance officer);
- ▲ Expansive protection for claims arising from allegations of errors and omissions in fund management;
- ▲ Expansive definition of hedge fund services, specifically including "valuation";
- ▲ Defense costs coverage for formal securities investigations of natural person insureds;<sup>2</sup>
- ▲ Automatic coverage for newly formed hedge funds that have the same investment personnel as the existing funds;
- ▲ Severability of the application for all natural person insureds;
- ▲ Order of payments coverage to prioritize individuals before the entity;
- ▲ Bankruptcy waivers; and
- ▲ Worldwide coverage.

In addition, Hedge Fund Protector includes options for separate cover, including:

- ▲ Employment practices liability;
- ▲ "Side Pockets"—private equity/venture capital professional liability;
- ▲ Administrator liability;
- ▲ Plan assets fund liability; and
- ▲ Outside not-for-profit directorship liability insurance<sup>3</sup>; outside for-profit directorship liability insurance provided as scheduled on the policy.

<sup>2</sup> Coverage triggered upon issuance of a formal investigative order as to such Insured.

<sup>3</sup> Coverage available by endorsement.

**AIG Executive Liability is a member company of American International Group, Inc. (AIG). AIG is a world-leading insurance and financial services organization with over 85 years of experience. Hedge Fund Protector is backed by the expertise of AIG Executive Liability's Financial Institutions Group, which has been a leading provider of management liability, professional liability, fiduciary liability, fidelity and other specialty insurance solutions exclusively for financial institutions for more than three decades.**

**To learn more, contact your broker or your local AIG Executive Liability representative. You can also email [executiveliability@aig.com](mailto:executiveliability@aig.com) or visit [www.aig.com/aigexecutiveliability](http://www.aig.com/aigexecutiveliability).**

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