4th Edition

THE INVESTMENT INDUSTRY'S GUIDE TO INSURANCE COVERAGE AND TERMS

A handy, quick-reference source for directors, officers, investment advisors, hedge funds, securities broker/dealers, mutual funds and other members of the investment community.

CATEGORIES OF INSURANCE COVERAGE

GLOSSARY OF INSURANCE TERMINOLOGY

Published by

Theodore Liftman Insurance, Inc.

CATEGORIES OF INSURANCE COVERAGE

D & O INSURANCE — *See* DIRECTORS & OFFICERS LIABILITY INSURANCE.

DATA SECURITY AND PRIVACY LIABILITY

Provides protection against third-party claims for unintentional or unauthorized disclosure of a client's personal and private information.

DIRECTORS & OFFICERS LIABILITY INSURANCE (D & O INSURANCE)

Insurance that indemnifies directors and officers of an entity if they are sued by stockholders, employees, clients and others in conjunction with the performance of their duties. Coverage extends to claims arising out of alleged errors in judgment, breaches of duty, and wrongful acts related to their organizational activities.

- Since a director can be held *personally* responsible in some cases, most directors and officers will demand that their organization maintain D & O Insurance to protect their personal assets.

- Directors & Officers Liability Insurance is sometimes confused with ERRORS & OMISSIONS LIABILITY INSURANCE but the two are *not* synonymous. ERRORS & OMISSIONS addresses actual or alleged negligent acts, errors or omissions with respect to professional services; Directors & Officers addresses the execution of business managerial duties.

- Independent Directors Liability Insurance is a type of insurance that exclusively covers the *independent* directors and/or trustees of an entity (for instance, a mutual fund).

- Directors & Officers Insurance may include limited coverage for EMPLOYMENT PRACTICES LIABILITY INSURANCE.

E & O INSURANCE — *See* ERRORS & OMISSIONS LIABILITY INSURANCE.

EMPLOYMENT PRACTICES LIABILITY INSURANCE

Insurance that addresses claims made by employees, former employees or potential employees concerning discrimination (based on age, sex, race, or disability), wrongful termination, sexual harassment, and other employment-related allegations. It covers the company, its directors, officers, employees and former employees.

- Claims against employers are rapidly increasing.

- Higher coverage limits for Employment Practices Liability Insurance have recently become the norm for the investment industry due to the large compensation packages of portfolio and other professionals.

ERISA BOND (FIDUCIARY BOND)

A bond which every fiduciary responsible for managing a pension, profit sharing or thrift plan and every individual/entity who handles the assets of such plan is required to obtain under section 412(a) of the federal Employee Retirement Income Security Act of 1974 (ERISA). The goal is to protect a plan's assets from fraudulent activity. The amount of the bond is fixed at the beginning of each fiscal year of the plan. It must be at least $1,000.00 and never less than 10% of the amount of the funds handled by the fiduciary up to a maximum of $500,000.00 per plan. However, if the plan holds "employer securities," effective for plan years beginning after December 31, 2007, the $500,000 cap in the preceding paragraph is increased to $1,000,000. This applies regardless of the extent of the plan's holding of such securities or which fiduciary (or non-fiduciary who handles plan assets) actually holds the securities and whether the securities are publicly or privately held.

- The bonding requirement under ERISA law generally applies to any person or company providing investment advice to client plans covered by ERISA for a fee or other remuneration, if the advisor has the right or power to exercise discretionary authority over purchases and sales of plan assets. This is so regardless of whether the advisor has custody of or otherwise actually handles assets of the plan, because the bonding rules apply to all plan fiduciaries who have these rights or powers, as well as to non-fiduciaries who handle plan assets.

- An ERISA Bond is a FIDELITY BOND that meets the requirements of ERISA law and responds to claims involving dishonest acts. ERISA Bonds fall into two categories. One type of ERISA Bond covers fiduciaries for claims involving *client* employee benefit plans. A second type, an *In-House* ERISA Bond, responds to claims involving the insured's *own* employee benefit plans.

ERRORS & OMISSIONS LIABILITY INSURANCE
(E & O INSURANCE or **PROFESSIONAL LIABILITY INSURANCE)**

Insurance that protects the corporation, its officers, directors and employees in the event they are sued by clients for any actual or alleged negligent act, error or omission committed in the scope of performing professional services. Coverage includes legal defense costs even where allegations are baseless.

- Errors & Omissions Insurance may include FIDUCIARY LIABILITY INSURANCE coverage for client ERISA plans.

- Errors & Omissions Insurance is *not* synonymous with DIRECTORS & OFFICERS INSURANCE.

FIDELITY BOND

A bond that covers the insured entity against dishonest or fraudulent acts committed by an employee (subject to bond terms and conditions). Riders may be added to cover losses caused by non-employees for Property In Transit, Computer Fraud, Document Forgery or Alteration, and Securities Forgery. Fidelity Bonds are

required by some state and federal laws, but it is a good business practice to obtain fidelity protection even when there is no legal requirement.

- MUTUAL FUND FIDELITY BOND
  A type of Fidelity Bond which protects against larceny, embezzlement and in some bonds includes other dishonest acts by "employees." It is *required* for mutual funds under section 17-g of the Investment Company Act of 1940.

- SECURITIES BROKER/DEALER FIDELITY BOND
  A type of Fidelity Bond which regulatory authorities *require* for securities broker/dealers.

FIDUCIARY BOND — *See* ERISA BOND.

FIDUCIARY LIABILITY INSURANCE
A type of ERRORS & OMISSIONS LIABILITY INSURANCE which provides additional coverage against a breach of duty by a fiduciary of an ERISA plan.

- FIDUCIARY LIABILITY INSURANCE addresses such situations as an investment advisor's violation of the "Prudent Investment Rule" or his failure to diversify an ERISA plan's assets.

- Breaches of duty with respect to the insured's *client* benefit plans are sometimes covered under an ERRORS & OMISSIONS policy. However, breaches of duty with respect to the insured's *in-house* benefit plans require either a separate Fiduciary Liability policy or a special endorsement onto an ERRORS & OMISSIONS policy.

LOST INSTRUMENT SURETY BOND (LOST SECURITIES BOND)
A bond which transfer agents require before replacing a person or corporation's stock or bond certificate that has been mislaid, lost or destroyed. Lost Instrument Surety Bonds provide indemnification to the transfer agent in the event the original certificate is found or surfaces and is sold, traded or transferred in a manner which causes financial loss to the transfer agent or issuer of the certificate.

- An instrument is an original document that evidences ownership such as a stock certificate, common or preferred stock and federal, municipal or corporate bonds.

LOST SECURITIES BOND — *See* LOST INSTRUMENT SURETY BOND.

MAIL INSURANCE
Insurance which covers damage or destruction to negotiable and non-negotiable securities while they are being sent through the mail. Covered items may include securities, warrants, and bonds. One or more mail categories can be used to ship including registered mail, first class mail and common carrier (UPS, FedEx, etc.).

PROFESSIONAL LIABILITY INSURANCE — *See* ERRORS & OMISSIONS LIABILITY INSURANCE.

STAMP GUARANTEE BOND
(SECURITIES TRANSFER AGENTS MEDALLION PROGRAM BOND)

A surety bond which covers securities transfers submitted by banks and other financial institutions that have guaranteed the signature of their customers. A STAMP Guarantee Bond protects the transfer agent against the guarantor's inability to meets its obligation.

- An SEC rule permits agents to reject securities transfers submitted by banks and other financial institutions that have guaranteed the signature of their customers but do not belong to a signature guarantee program such as STAMP.

- Membership in the Securities Transfer Agents Medallion Program does not include the cost of a rubber signature stamp and requires a STAMP Guarantee Bond.

STATE SURETY BOND

A bond which certain investment professionals are required by law to post with some states. It is a contract whereby an insurance carrier (the *surety*) agrees to have secondary responsibility to the state (the *obligee*) for any violation of its laws and/or regulations by an investment professional (the *principal*). It generally permits the state and residents of the state to sue under the bond for damages incurred as a result of the *principal's* violation of the conditions of the bond and/or the state's securities laws. The bond indemnifies the *obligee* for losses sustained as a result of such default, up to the amount of the bond. The bond is written in lieu of a letter of credit, therefore, the *principal* must indemnify the *surety* for any losses the surety sustains in fulfilling the failed obligations of the *principal*.

GLOSSARY OF INSURANCE TERMINOLOGY

CLAIMS MADE BASIS COVERAGE

A coverage condition whereby if a claim is made during the policy period, there is coverage *regardless of when the event causing the claim occurred* (subject to any RETROACTIVE DATE).

- Claims Made Basis Coverage is *not* the same as OCCURRENCE BASIS COVERAGE.

COINSURANCE

A coverage condition whereby the insured is required to pay a percentage of claims expenses above and beyond the policy RETENTION amount.

- Coinsurance is usually limited to policies which would benefit from a reduced premium or which cover hard to insure risks.

CONTINUITY DATE — *See* RETROACTIVE DATE.

COST OF CORRECTIONS COVERAGE

A coverage option which provides that the insurance carrier will correct a situation arising out of an actual or alleged wrongful act where in the absence of a correction, the wrongful act would have constituted a covered loss. Cost of Corrections Coverage is unique in that it is triggered *prior* to notice of a claim from a third party.

- Cost of Corrections Coverage is *sometimes* available under ERRORS & OMISSIONS LIABILITY INSURANCE and mutual fund DIRECTORS & OFFICERS LIABILITY INSURANCE.

- Cost of Corrections Coverage may be subject to an additional premium, a higher RETENTION amount, COINSURANCE percentage, and/or sublimit of liability.

- Cost of Corrections Coverage addresses situations such as trading errors by an investment advisor or pricing errors by a mutual fund group.

DEDUCTIBLE — *See* RETENTION.

DISCOVERY PERIOD (OPTIONAL EXTENSION PERIOD)

A coverage condition whereby an individual or entity whose policy is cancelled by the *insurance carrier* has the right to purchase additional time to report a loss that occurred during the policy period.

- A Discovery Period is usually offered for an additional premium equal to a percentage of the policy's annual premium.

- A *bilateral* Discovery Period gives the insured the right to purchase a Discovery Period regardless of whether it is the *insurance carrier* or the *insured* that cancels the policy.

EXEMPLARY DAMAGES COVERAGE — *See* PUNITIVE DAMAGES COVERAGE.

EXTENDED CLAIMS REPORTING PERIOD — *See* TAIL COVERAGE.

OCCURRENCE BASIS COVERAGE

A coverage option which provides that if an event causing a claim occurs during the policy period, there is coverage *regardless of when the claim is actually made*.

- Occurrence Basis Coverage is *not* the same as CLAIMS MADE BASIS COVERAGE.

OPTIONAL EXTENSION PERIOD — *See* DISCOVERY PERIOD.

PENDING & PRIOR LITIGATION EXCLUSION

An exclusion from coverage for claims arising from litigation prior to or pending as of a specific date.

- A Pending & Prior Litigation Exclusion (if any) may be included in an insurance policy or added by endorsement.

PRIOR ACTS COVERAGE

Optional coverage for acts, errors or omissions that occurred prior to the date that the policy started.

PUNITIVE DAMAGES COVERAGE (EXEMPLARY DAMAGES COVERAGE)

Optional coverage for those damages awarded to the plaintiff in a lawsuit against the insured over and above what will compensate the plaintiff for his financial loss, where the alleged wrong done to the plaintiff was aggravated by the defendant's malice, fraud, or wanton and reckless conduct.

- Punitive Damages are intended to punish the defendant for his behavior and to make an example of him.

- Coverage for Punitive Damages is *not* always available or insurable in certain states.

REPORTING PERIOD

The period of time in which an insured must report a claim to the insurance carrier after its discovery.

- The Reporting Period is indicated in the insurance policy

RETENTION (DEDUCTIBLE)

A provision which states that the insured must pay a pre-determined amount of money in the event of a loss.

RETROACTIVE DATE (CONTINUITY DATE)

The earliest date on which an act, error or omission will be covered by a policy if a claim is subsequently made.

- A Retroactive Date is contained in most CLAIMS MADE BASIS liability policies.

RUN-OFF POLICY

An insurance policy which permits an individual or entity that was formerly insured to report a loss that occurred during the policy period.

- A Run-Off Policy is similar to a DISCOVERY PERIOD but covers a longer period of time.

SEVERABILITY CLAUSE

A provision in an insurance policy that keeps the remaining coverage in force if any other portion of the policy is voided.

SUBROGATION CLAUSE

The section of an insurance policy which gives an insurance carrier the right to take legal action against a third party responsible for a loss to an insured and for which a claim has been paid.

TAIL COVERAGE (EXTENDED CLAIMS REPORTING PERIOD)

A coverage option which extends the policy period of an insurance policy written on a CLAIMS MADE BASIS.

- A liability policy that was written on a CLAIMS MADE BASIS requires the insurance carrier to pay *only those claims that were received during the policy period*. However, liability claims are often made long after the event that causes the claim. Therefore, Tail Coverage is desirable in order to protect against claims that the insured does not know about at the end of the policy period. (*But note*: the act, error or omission giving rise to the claim must have occurred during the covered period of time under the policy for the Tail Coverage to respond.)

PLEASE NOTE THE FOLLOWING:

This guide is only intended to provide general explanations of certain insurance coverage and concepts. It is merely an educational tool. Provisions regarding coverage, terms, conditions, and exclusions vary greatly from one insurance carrier to another. Therefore, you cannot assume that the definitions herein apply to your own policy. Only the provisions that your insurance carrier has included in your policy govern you. If you have questions regarding your policy, read it carefully and contact your agent or insurance carrier.

ABOUT THEODORE LIFTMAN INSURANCE, INC.

Since its founding in 1957, Liftman Insurance has focused solely on providing insurance to the investment industry. We have developed a reputation for professional excellence, as well as for maintaining close contacts within the insurance, legal and accounting communities. In addition, Liftman Insurance represents many leading insurance carriers so that we may provide you with an unparalleled selection of coverage.

At Liftman Insurance, we are dedicated to offering personalized service to clients both large and small. Our staff of registered insurance brokers is knowledgeable and specially trained to work with members of the investment industry. Also, at least one member of our senior management team reviews the unique insurance requirements of each and every client before the agency recommends a coverage solution.

The purchase of a policy is only the *beginning* of a client's relationship with Liftman Insurance. Our staff is in constant communication with clients. We work to continually improve coverage, terms and conditions, and we always keep abreast of the legal and regulatory changes that impact our policyholders. For all these reasons, Liftman Insurance is proud to have a world-class client roster which we service from our headquarters in the heart of Boston's financial district.

Today, Theodore Liftman Insurance is one of the most respected independent financial insurance agencies in the country. Directors, officers, mutual funds, hedge funds, securities broker/dealers, transfer agents, and investment advisors all rely on us to obtain the broadest coverage at competitive rates. Contact Liftman Insurance today to see how *you* can benefit from our vast experience and commitment to client satisfaction.

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Theodore Liftman Insurance, Inc. specializes in:

- Data Security and Privacy Liability
- Directors & Officers Liability Insurance
- Employment Practices Liability Insurance
- ERISA/Fiduciary Bonds
- Errors & Omissions Liability Insurance
- Fidelity Bonds
- Fiduciary Liability Insurance
- Independent Directors Liability Insurance
- Lost Instrument Surety Bonds
- Mail Insurance
- Professional Liability Insurance
- STAMP Guarantee Bonds
- State Surety Bonds

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