Largest Hedge Funds Buy More, Pay Less for Protection Against SEC and Investor Lawsuit Costs Says SKCG Group Study

New York-based Insurance and Risk Management Advisory Firm Releases Benchmark Study on Typical Amounts of E&O/D&O Insurance Coverage Purchased by Emerging, Medium and Large Hedge Funds

White Plains, N.Y. – May 9, 2011 – Large hedge funds with over $10 billion in assets under management (AUM) typically purchase $40 million or more in professional liability insurance coverage, nearly 200% more than medium funds between $1 billion and $3 billion in AUM according to a benchmark study by SKCG Group, the risk management and insurance advisor to some of the world's largest hedge funds. The study of 250 hedge fund liability insurance purchases also revealed that, dollar for dollar, the bigger funds pay less for their coverage. This, coupled with a more strenuous regulatory environment and heightened investor expectations, is making it impractical for these larger funds to self insure – that is, pay out of pocket – for the costs of trading errors, investor and SEC lawsuits and investigations.

"Before the financial crisis, it wasn't uncommon for large hedge funds to just eat the costs of investigations and lawsuits resulting from trading errors and other mistakes. This simply doesn't make sense anymore when the price of insurance against these costs has declined by as much as 20% in the last 2 years and is even more inexpensive to the largest funds who buy higher limits," said Wayne Siebner, Senior Vice President and Manager of Executive and Professional Liability for SKCG Group.

The secret behind the favorable pricing for big hedge funds lies in the special way that policies over the typical $5 to $10 million in face value are underwritten. When a fund needs a larger amount of protection, special programs are created which layer coverage from multiple carriers. One carrier will assume the risk for the first $5 to $10 million while another will assume the risk for the next $5 to $10 million, and so on. Naturally, the premiums paid to the insurer of secondary and tertiary layers are less than that of the primary layer because that coverage is less likely to be drawn upon. This means that a large fund which purchases $40 million in protection may have as many as 7 carriers underwriting those limits with each carrier getting paid less than the one before it based upon the order in which they assume risk.

"Other than favorable pricing, the second factor driving large funds to purchase E&O/D&O coverage is investor demand. Years ago, if a trader made an error the fund would simply incur the loss and try to make it up somewhere else. Investors aren't having that anymore, nor are they keen to have defense costs for lawsuits and investigations come out of their potential returns," added Thomas R. Kozera, CEO of SKCG Group. "This means that today, seeing that a fund is properly insured is gaining rapidly in priority on investors' due diligence check lists."

Click here to download a PDF of the SKCG Benchmark Study of E&O/D&O insurance purchasing trends.

About SKCG Group
SKCG Group is one of the largest privately-held insurance and risk management advisory firms in the United States. SKCG serves U.S. and international commercial and private clients who require sophisticated advice addressing multiple risk factors. SKCG's technical expertise in identifying and dissecting risk, coupled with its ingrained culture of senior-level attention and client service, results in high levels of customer trust and loyalty. From insurance and private client services to group benefits and retirement planning services, SKCG's marketplace success is due to its industry knowledge, analysis, experience and unique carrier relationships.

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