Markel Cambridge Alliance
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Risk management news

For investment advisors and brokers Vol. 2, 2011

Social media

Be compliant

A hot topic of discussion among advisors is the usage of social media platforms such as Twitter, Facebook, and LinkedIn. These services provide an additional channel for advisors to reach clients, prospects, and other advisors. Advisory practices considering taking the plunge into social media need to give the idea careful thought to maintain compliance with SEC policy.

Unfortunately, advisors looking for clarity from the SEC on social media may be disappointed, as SEC advertising rules have not been updated since the 1990s. The most applicable portion of these rules prohibits advisors from using testimonials and issuing recommendations or advice in advertising. Client comments on a Facebook page or recommendations on LinkedIn could both be viewed as testimonials even though they were not posted by the advisor. Advisors must also be careful to consider employees' personal use of social media, as the advisory business could be mentioned on personal pages, potentially putting the advisor at risk.

A good practice is to monitor and record all activity that takes place on a firm's social media sites. Most services allow customized settings to limit the scope of what can happen on their page. Also screen for mentions of the firm on the sites of others, and have all employees agree to a stated social media policy. Finally, if you plan to make use of social media, it is always a good idea to speak with a compliance consultant with experience in this area.

Regulatory update

Dodd-Frank Act

The Dodd-Frank Act continues to be a topic of conversation. More than half of the rules required by the 849-page bill have yet to be drafted. Of particular interest to both registered investment advisors and broker-dealers is the mandated fiduciary study. The study was designed to explore the potential implementation of a universal fiduciary duty for all retail advice. SEC staff conducting the study were scheduled to provide its recommendation by June 2011, but the SEC announced that it will delay its recommendation until later in the year. Also in June, Representative Barney Frank, an original sponsor of the legislation, urged SEC Chairman Mary Schapiro to acknowledge and preserve the differences between broker-dealers and registered investment advisors.

At your disposal

Got questions?

A distinguishing feature of Markel Cambridge Alliance's program is that our staff is readily available to answer questions from advisors. We willingly accept questions from both prospects and policyholders alike. While advisors access our program through independent insurance brokers, we encourage our current and prospective clients to contact us directly with issues or concerns they may have about our coverage. We answer questions about the insurance application, coverage features, and our experience in this field.

Another important policy feature is the "incident trigger" in our coverage that encourages policyholders to contact us for advice on how to deal with an issue which may turn into a claim. We frequently offer advice based upon our extensive experience with the profession, and we may even expend some of our own funds (not against the claim limit or an advisor's deductible) if we feel it will mitigate the possibility of a claim. Additionally, where we see an opportunity, we offer advice on contracts, investment policy statements, and many other relevant issues. Feel free to contact us directly at 800-691-1515.

Insurance concepts

Prior acts coverage vs. tail coverage

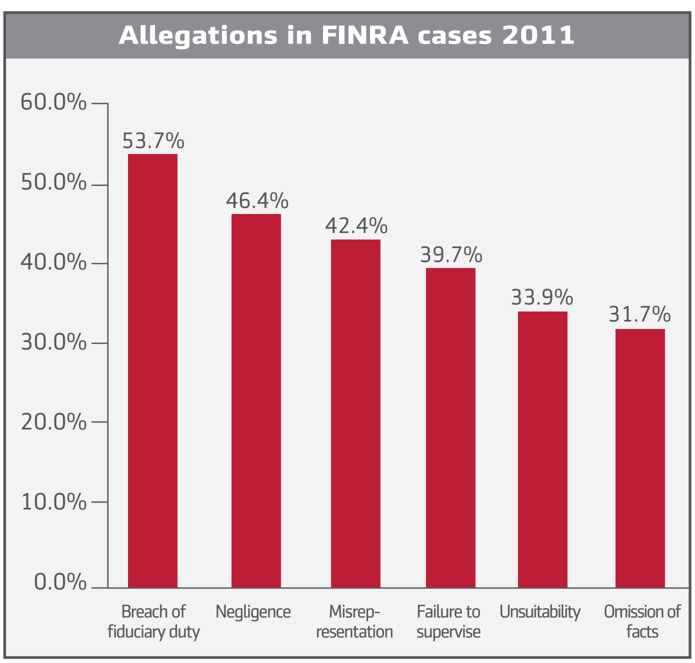
Prior acts coverage - When advisors change E&O insurance carriers, they often ask whether they lose coverage for acts that arise while insured by their previous carrier. This concept is referred to as “prior acts coverage.” The answer depends on several factors. First, prior acts coverage can be offered only when there has been continuous coverage between the old and new policy. When there has been a significant coverage gap, the new carrier usually opts to not offer prior acts coverage. The second factor relates to the nature of the coverage provided by the old carrier. Assuming there has been no break in coverage, the new carrier may offer prior acts coverage which is consistent with the terms of the prior policy.

Tail coverage - When advisors retire or leave their practice, they are often concerned about claims that arise from actions taken when they were actively practicing. To cover this potential liability, insurance carriers can offer an extended reporting period endorsement often referred to as “tail coverage.” Extended reporting periods typically run from 1-3 years and allow an advisor to report and be covered for a claim for an act that occurred while they were actively practicing. Several conditions determine whether this coverage can be offered. First, the coverage can be offered only by the carrier whose policy was in force while the advisor was actively practicing. Second, the coverage is typically offered at a premium that is a percentage of the premium that was in place at the time the advisor stopped practicing.

Loss environment

2011 statistics

Through May 2011, the most common allegations in FINRA claims are breach of fiduciary duty, negligence, and misrepresentation. These are the most frequent allegations in complaints filed with FINRA against financial advisory professionals.



Avoid a common claim

Execution errors

Execution errors tend to be the most frequent cause of losses. While there are many different types of such errors, it is clear that the SEC requires the advisor to document them and make the documentation available for inspection when an audit is conducted. Execution errors are typically small in dollar amount and resolved rapidly, or in any event, should be resolved rapidly. The burden falls upon the advisor to place the client in the same financial position in which he or she would have been had the error not occurred. Liability is typically beyond dispute.

Our program covers the cost of corrections, subject to the per-claim deductible. But the simplest way to minimize their impact is through a simple procedure—every trade should be matched to the confirmation generated by the broker-dealer through which the trade is made, requiring careful and thorough recordkeeping. In other words, such errors arise frequently but are relatively easy to control procedurally. Here are two examples from our claims files:

1. An advisor placed an order by fax, but it was sent to the incorrect fax number. The error was not discovered for months and costed the advisor his largest client.
2. An advisor placed a trade late on a Friday prior to a three-day weekend and denominated the trade in shares rather than in monetary terms. The cost of the trade was $70 per share, which meant he had a long open position of $3.5 million over the three-day weekend. By the time the trade was reversed, a disproportionately large loss of $70,000 had occurred caused by a small movement in the share price.

Another tip: When the market is volatile, trades should not be made at either the opening of the market, when prices are unstable, or at the end of the day when it may not be possible to reverse the trade until the following day.

Markel Cambridge Alliance can help

Do you have a question for our team?

Please contact your insurance professional or call us directly at 800-691-1515. www.markelcambridge.com