

Investment Management Alert

Akin Gump
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Insurance Coverage for Disgorgements— Considerations for Private Fund Managers

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On November 23, 2021, the New York Court of Appeals **held** that an investment firm’s \$140 million disgorgement payment to the Securities and Exchange Commission (SEC) was not an excluded “penalty imposed by law” under the firm’s insurance policies because it served compensatory purposes and represented an estimate of the firm’s clients’ wrongfully obtained profits (as distinct from a penalty payment that “was not derived from any estimate of harm or gain flowing from the improper trading practices”). The Court emphasized that its conclusion was specific to the insurance context and was based on New York principles of insurance policy interpretation, which require that exclusions be given a “strict and narrow construction.”

Given the potential for a broader universe of sanctions to be covered by insurance, it is more important than ever for any fund manager facing an SEC investigation, or other action, to coordinate with their counsel on when, and how best to, disclose the situation to their insurance carrier. It has always been true that ambiguities in or questions about the precise scope of coverage can lead to complex and costly disputes between investment firms and their insurance carriers, but this recent decision only increases the need to preserve all possibilities for coverage under an insurance policy.

Early discussions with the manager’s counsel can help obtain clarity on the insurer’s position regarding the scope of coverage, can preserve the ability to contest a denial of coverage and may help avoid unwelcome surprises and costly disputes at a later stage.

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