CLAIMS TRENDS UPDATE

Lucy Macdonald of Travelers talks to *HFMWeek* about the current trends in claims

Lucy Macdonald is a qualified solicitor with nine years' experience in insurance litigation, primarily focusing on financial institutions. She joined Travelers' FI claims team in July 2014, initially on secondment from insurance law firm Reynolds Porter Chamberlain.

HFMWeek (HFM): What claims trends are arising among fund managers? How have they developed?

Lucy Macdonald (LM): Travelers has been underwriting financial institutions insurance, and fund manager liability insurance in particular, for nearly a decade. Traditionally, we have seen insurance claims by fund managers arising out of three main problem areas:

1. **Third-party claims for breach of investment mandate:** complaints from customers regarding investment strategy. These may vary from a disgruntled customer who hasn't made any money to a client complaining that their investment manager has made investment decisions vastly beyond their remit.
2. **Operational errors:** administrative or processing errors resulting in loss to the client. These claims are also referred to as "fat-finger claims" which reflects the ease with which certain mistakes can be made, for example, a trader may have accidentally pressed the "send" button twice or ordered double the amount of the financial product which they were intending to purchase. This is also the area in which we have seen a recent increase in claims.
3. **Regulatory investigations:** these have, perhaps unsurprisingly, developed over the period in which Travelers has written FI/fund manager business, but we have not seen a particular increase in number of regulatory claims in recent years. We do see some fund managers with global operations subject to the requirements of a number of different regulators.

Recently we have seen an increase in fund manager insurance claims generally – both in terms of frequency of notifications and also severity. In particular, we have seen a marked increase in notifications arising out of trade errors, administrative or operational errors leading to loss of client funds. It isn't possible to identify one main driver behind the increase in claims activity since we have seen such a range of different claims. However, a common theme with the trade error claims is that, however the initial error has occurred, there is often a secondary error in that the approval system or supervisor has not noticed the error.

> "THE MOST SIGNIFICANT EMERGING RISK IS CERTAINLY CYBER FRAUD"

From the point of view of a fund manager who is considering purchasing insurance if they don't have it already, there has never been a better time. It is important to consider the actual cover which each insured is buying too, for example in the area of cyber fraud, regulatory investigations and trade errors, there are a number of different insurers in the market and a number of different policy wordings. At the outset, it is very important that each insured reviews the policy wording together with their broker in order to ensure that the type of coverage available under the policy and the policy limits are adequate for the particular company's needs.

HFM: What emerging risks are prevalent and what is causing these?

LM: The most significant emerging risk is certainly cyber fraud. We have experienced an increasing number of claims in the last year whereas, historically, Travelers hadn't seen any cyber fraud claims in the fund manager space. Specifically, we have seen social engineering fraud (where fraudulent emails are sent from a client's email account, instructing the fund manager to pay out funds or move money), which is emerging as a common theme

across all types of professional indemnity business (conveyancing law firms, for example, where client funds are being moved on a daily basis, are frequent victims of social engineering fraud). Additionally, we have seen straightforward cyber-hacking where fraudsters have managed to access the insured's private databases to obtain third-party data.

HFM: What has been the general reaction to the rise of cyber fraud?

LM: Generally, our insureds have been aware of and concerned by this issue for quite a while. Cyber fraud was a hot topic last year. There have been lots of discussions around how to address cyber-related issues, such as installing the right systems or recruiting appropriate personnel, among insureds, insurers and law firms, but obviously frauds are still taking place.

In my view, it will be a case of ongoing monitoring – both of how fraudsters are breaching company systems and how to ensure that adequate security systems / verification processes are in place. This issue is here to stay – we must learn to cope with the threats and remain vigilant and protected.

HFM: How can all these risks be overcome? What advice do you have?

LM: With regard to both cyber fraud and regulation, insureds are aware that they need to keep on top of developments. It is also important that they are aware of breaches from across the globe and are prepared to learn from these.

With regard to trade errors, fund managers will have supervision and transaction approval processes in place and it is crucial that they are robust and consistently applied. We have seen a number of cases where losses of several million have been sustained because a mistake in a transaction or series of transactions was not spotted by a senior manager. Such processes should ensure that the approver understands the intention of the transaction and that all required steps have been properly put in place. So it is important for all to double-check the effectiveness of their systems.

HFM: Over the next year, what key claims trends will be of the most significance to the industry and why?

LM: It will be very interesting to see the impact of Brexit on claims in the next year. We have already experienced an immediate impact following the referendum, largely as a result of exchange rate fluctuations. We have seen new claims and an increase in severity of existing claims.

In terms of the long term impact, while the political outcome is uncertain, Brexit may affect the scope of regulatory oversight, and/or there may be foreign regulatory issues arising out of relocation (if insureds see a need to relocate/set up new offices in mainland Europe). Overall, it will be something to watch. ■