

What to Expect in the Claims Process

| A Guide
for Insureds

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Introduction

The most important consideration in purchasing insurance is arguably the most inherently difficult to measure—your insurer’s philosophy and approach to handling your insurance claims. Any “savings” in annual premiums that you may obtain from an insurer are illusory if you must pay out significant sums or incur significant delays in recovering policy proceeds for valid insurance claims.

At ICI Mutual, we pride ourselves on our even-handed, rational, and prompt approach to claims handling—an approach mandated both by our philosophy and by our position as a “captive” insurer owned by the mutual fund industry. Most insureds continue to remain with us long after their insurance claims are resolved, which we view as the most convincing test of good claims handling.

Our history suggests that no fund group is immune to claims. In fact, over the past five years alone, more than half of ICI Mutual’s D&O/E&O insureds have notified us of potential insurance claims.

Since its formation in 1987, ICI Mutual has made insurance payments to mutual funds and their advisers, directors, and officers of more than \$550 million, and has received over 1,400 notices of potential insurance claims from insureds under ICI Mutual’s core products—Directors and Officers/Errors and Omissions Liability Insurance (Policy), Investment Company Blanket Bond (Bond), and Independent Directors Safety Net Liability Insurance (IDL Policy).

This brochure is intended to familiarize insureds with the insurance claims process by providing a general overview. By necessity, our comments generalize as to the steps involved in making and

resolving an insurance claim. Of course, this brochure should not be viewed as superseding or modifying any of the terms of an ICI Mutual insurance policy, or any applicable law. Except where defined herein, capitalized terms used in this brochure have the same meanings as given in the Policy or Bond (as appropriate).

Providing Prompt Notice

Relevant sections of the Policy and Bond provide details on when and how you must provide notice to ICI Mutual.¹ Your obligation to provide notice is triggered when (1) a lawsuit, informal or formal regulatory investigation, or other Claim is made against you for which insurance coverage may be available under the Policy, (2) you discover an Unrealized Liability for which Costs of Correction coverage may be available under the Policy,² or (3) you discover a loss for which coverage may be available under the Bond.³

Notice of the Claim or other matter (Underlying Matter) must be provided in writing to ICI Mutual’s Manager of Professional Liability Claims at the address specified in the Policy and Bond. (Please note that disclosures made in responses to questions in your insurance application do not satisfy this requirement.) We stress the importance of providing ICI Mutual with prompt notice of the Underlying Matter, as failure to do so can jeopardize the potential availability of insurance coverage.

Insureds sometimes inquire as to whether notice should be provided on matters that are not expected to result in insured losses. Whenever in doubt, you should report a particular matter to ICI Mutual even if the ultimate loss or other details are not yet known—again, in order to avoid jeopardizing your ability to recover under your Policy or Bond as a result of late notice.

If time is of the essence (as may sometimes be the case, for example, when corrective actions must be taken), you should contact ICI Mutual immediately by telephone, as well as by letter.

The Policy and Bond do not require a specific format that you must follow in providing notice of an Underlying Matter. However, by providing the most complete information you have at the time, ICI Mutual may begin to work on your insurance claim as soon as possible.

For example, as regards a lawsuit made against any insured, you would typically forward, along with your notice letter, a copy of the complaint filed in the lawsuit. Where the Underlying Matter is not a lawsuit (as, for example, in the case of a fraudulent redemption that may trigger potential coverage under the Bond, or an operational error that may trigger Costs of Correction coverage under the Policy), you should provide as detailed a description as possible.

Sometimes, after an Underlying Matter has been noticed to ICI Mutual, a new but interrelated matter may commence. For example, a regulatory settlement may be followed by multiple private lawsuits based on the same underlying allegations. The Policy and Bond also require notice of any such subsequent matters that may also be the subject of your potential insurance claim.⁴

ICI Mutual's Reservation of Rights

Depending on the nature and complexity of the Underlying Matter, ICI Mutual may assign your claim to our own outside counsel. But even when we do, we remain familiar at all times with your claim, as we consult frequently with outside counsel as to the status and issues associated with all pending insurance claims. Consequently, if at

any time during the claims process you have questions that you wish to discuss directly with us, you are encouraged to contact ICI Mutual's general counsel or other in-house counsel.⁵

After reviewing your notice, ICI Mutual or our counsel will then provide you with what is commonly referred to as a "reservation of rights" (ROR) letter. The ROR letter, as is customary in the insurance industry, will seek to identify and explain policy provisions that may affect the potential availability of insurance coverage, based on what we know about the Underlying Matter at that time.

The ROR letter will also typically review certain policy provisions relating to your rights and obligations as an insured, and will generally instruct you to provide ICI Mutual on an ongoing basis with certain materials relating to the Underlying Matter.

The letter will also remind you that, as is standard insurance practice, you must receive consent from ICI Mutual *before* you admit any liabilities, incur any Costs of Correction, or make any settlements. Also, and as with most insurance, the Policy and Bond contain subrogation provisions regarding any rights of recovery that you may have against third parties.

If the amount of your loss is already fixed at the time of your initial notice to ICI Mutual—as may be the case, for example, in certain matters noticed under the Bond and in certain Unrealized Liabilities under the Policy—ICI Mutual's ROR letter will also typically initiate our investigation of the Underlying Matter. (See "ICI Mutual's Factual Investigation," below.)

Coverage views expressed in the ROR letter will be based on ICI Mutual's review of materials then

available to us (typically, those materials provided by you in your initial notice letter and any publicly available litigation documents filed in court). Accordingly, in many cases the coverage views expressed in our ROR letter will necessarily be preliminary in nature, and may be subject to change over time as the Underlying Matter (and/or ICI Mutual's investigation of it) proceeds and more facts become known.

Monitoring the Underlying Matter

In many cases, you will not know the amount of your loss at the time of your initial notice to ICI Mutual. For example, in the case of shareholder litigation or a regulatory investigation, your notice will usually predate (by a period of months or years) any final determination or settlement of your potential liability.

In such cases, ICI Mutual will monitor the Underlying Matter as it develops. In this regard, ongoing communication and cooperation with ICI Mutual is important during the entire duration of the Underlying Matter.

For example, ICI Mutual will typically request that you provide us on an ongoing basis with copies of all pleadings, dispositive motions, and other important documents. Also, while the Underlying Matter remains pending, ICI Mutual may contact you (or your counsel) to obtain updates, to request specific documents or other items of information, and/or to discuss strategic or tactical decisions being made in the matter.

If the Underlying Matter is a Claim, you may select the defense counsel who will represent you in defending against it (subject to ICI Mutual's prior consent). This feature of the Policy gives insureds broad discretion and flexibility in

arranging and controlling their own defenses in Claims made against them.

ICI Mutual and its insured fund groups have a common interest in the strong and effective defense of mutual fund-related litigation and regulatory proceedings. Indeed, defense costs represent more than sixty percent of all insurance payments made by ICI Mutual over its history.⁶

In recognition of the impact that rising defense costs must have over time on insurance premiums, ICI Mutual works closely with its insureds to promote their active management of these costs.⁷ Thus, during the pendency of any Claim made against you, ICI Mutual will monitor the legal and related fees that you are being charged, and can provide you with advice as to whether fees constitute reimbursable Costs of Defense.

In addition, we may request that you instruct your counsel to prepare a litigation budget (to be updated as appropriate), and to share this budget with ICI Mutual. You will also typically be asked to provide ICI Mutual with your counsel's engagement letter and, on an ongoing basis, with copies of your counsel's monthly invoices for legal and related fees.

Your cooperation in this area is important so that we may identify as early as possible any concerns we may have with respect to the fees that you are being charged, and so that we may reimburse you as quickly as possible the Costs of Defense you have incurred.

Finally, it is critical that you keep ICI Mutual apprised of any efforts to settle or otherwise resolve matters while defense efforts are underway. As noted above, you must receive ICI Mutual's consent *before* you admit any liabilities,

make any settlements, or incur any Costs of Correction. These requirements are routine in liability policies, and designed to safeguard the legitimate interests of both insurer and insured.

ICI Mutual's Factual Investigation

As a key part of the insurance claims process, ICI Mutual will conduct a factual investigation of the Underlying Matter. The purpose of such an investigation is to gain an understanding of the relevant facts and circumstances so that we may fairly evaluate whether coverage is available under the Policy or Bond and, if so, in what amount.

If the amount of your loss is already fixed at the time of your initial notice—as may frequently be the case in certain types of claims under the Bond and in certain Unrealized Liabilities for which Costs of Correction are sought under the Policy—our investigation will commence almost immediately.

If the amount of your loss is not yet fixed at the time of your initial notice—as will typically be the case in lawsuits or other Claims made against you—you and we may mutually decide that ICI Mutual's investigation should be deferred until additional development of the Underlying Matter has taken place.

The length of time required by ICI Mutual to complete its investigation will depend on a number of factors, including the complexity of the Underlying Matter and the speed with which the insured chooses to respond to ICI Mutual's requests for information. If an insured gives appropriate priority to ICI Mutual's information requests, our investigation, once commenced, can generally be completed promptly—often in a matter of a few months, or even weeks.

We will usually begin our investigation by sending you written questions and/or requests for documents. In some cases, your response may trigger follow-up questions or requests from us. From time to time, depending upon the nature and complexity of the Underlying Matter, we may also request telephone or in-person interviews with one or more individuals at your fund group who have knowledge of the relevant facts.

We seek to conduct our investigations in a cooperative fashion, and we encourage you to work closely with us so that we may understand the relevant facts and circumstances of the Underlying Matter. Our investigations have frequently assisted our insureds in developing a more complete understanding of precisely *how* and *why* their losses occurred. This more complete understanding, in turn, has often proved helpful to our insureds in their ongoing risk management efforts.

Indeed, an incidental benefit to all insureds of ICI Mutual's claims experience is our institutional knowledge of when, how, and why losses of particular types are sustained by fund groups. Over the years, we have developed a global understanding of claims activity affecting the fund industry. We regularly share what we have learned with all of our insureds (without identifying any specific claimants) through an extensive library of risk management publications and through seminars and conferences.

Resolution of the Insurance Claim

After completing our factual investigation, we will advise you as to its results and discuss with you our conclusions regarding insurance coverage. We view this part of the process as an open dialogue

with you on coverage. Accordingly, we will welcome your response to our views, and we will invite you to raise any factual or legal issues that you believe we may have overlooked or misunderstood during the course of our investigation and analysis.

ICI Mutual, in conjunction with making an insurance payment, customarily enters into an agreement with the insured. The agreement underscores the finality of the claim resolution by providing for a release of all claims arising out of the Underlying Matter.

Conclusion

ICI Mutual has more than two decades of experience in addressing mutual fund insurance claims and possesses a wealth of specialized knowledge regarding the operation and regulation of the fund industry.

ICI Mutual applies this experience and knowledge so as to address each and every insurance claim in an even-handed, rational and prompt fashion. This approach to handling insurance claims remains a core guiding philosophy, and reflects our mission as an insurer owned by, governed by, and operated for the mutual fund industry.

Endnotes

- ¹ For ease of discussion, this overview discusses only the Policy and Bond. In general, the IDL Policy is similar to the Policy, except that it provides coverage to only fund independent directors and includes special provisions designed to meet their unique coverage needs.
- ² Section II.B of the Policy affords potential coverage to insured entities for reasonable and necessary costs or expenses incurred to correct any Unrealized Liability. See generally Policy § III.R (defining “Unrealized Liability”).
- ³ In addition, an insured may (but is not required to) seek to preserve potential coverage under its *current* Policy for a *future* lawsuit (or other future Claim) by providing specific notice to ICI Mutual during the Policy Period of a third-party demand or other circumstances that may subsequently give rise to a Claim. (See Policy § VIII.A.) Upon receiving such notice, ICI Mutual will advise whether the notice was sufficiently specific to “bookmark” the current Policy. In the event that a Claim should ultimately arise at a future date, it would also then be necessary to determine (in addition to whether coverage may otherwise be available) whether that Claim arose out of the noticed circumstances.
- ⁴ Generally, multiple Claims that arise out of the same or interrelated wrongful acts (such as a regulatory investigation and follow-on private litigation) are treated under the Policy as a single Claim; this single Claim triggers potential coverage under only the Policy that was in place at the time the earliest Claim was made; and only one deductible and one Policy limit applies. See generally Policy § VI.B. The same is true for interrelated Unrealized Liabilities underlying an insurance claim for Costs of Correction. Similarly, the Bond specifies when multiple losses are deemed a Single Loss.
- ⁵ In our experience, many insureds use their own in-house staffs to process insurance claims with ICI Mutual, and do not necessarily retain outside counsel for this purpose. The decision by an insured as to whether to retain outside counsel to assist with its claim is, of course, for the insured to make. Please note, however, that ICI Mutual views an insured’s costs of retaining outside counsel to assist with an insurance claim as a cost of doing business that is not compensable under the Policy or Bond. By contrast, the costs to an insured of retaining outside counsel to assist the insured in the Underlying Matter giving rise to the insurance claim may frequently be compensable under the Policy as Costs of Defense and/or Costs of Correction, and may in certain cases be partially compensable under the Bond. See generally General Agreement C of the Bond.
- ⁶ Like most liability policies, the Policy affords coverage for Costs of Defense incurred in covered Claims. ICI Mutual’s insurance payments often take the form of “advancements” to reimburse insureds for such costs prior to the final resolution of the Claim. See generally Policy § VII.C.
- ⁷ Our publication *Managing Defense Costs* (2004) discusses the reasons behind the rising costs of defending against Claims, outlines various principles for effective defense cost management, and details particular strategies and techniques frequently used in such management efforts. Copies have been previously distributed to all ICI Mutual insureds, and additional copies are available to insureds upon request and at www.icimutual.com.

ICI Mutual | *an uncommon value*

Aligned Interests:

owned by, governed by and operated for mutual funds and their advisers, directors and officers

Mutual Fund Knowledge and Expertise:

tailored, innovative coverage combined with expert claims handling

Stability and Financial Strength in All Markets:

consistent coverage and strong capital

ICI Mutual is the predominant provider of D&O/E&O liability insurance and fidelity bonding for the U.S. mutual fund industry. Its insureds represent more than 60% of the industry's managed assets. As the mutual fund industry's captive insurance company, ICI Mutual is owned and operated by and for its insureds. ICI Mutual's services assist insureds to identify and manage risk and defend regulatory enforcement proceedings and civil litigation.

ICI Mutual also serves as a primary source of industry information regarding mutual fund insurance coverage, claims, risk management issues, and litigation developments. Publications include an extensive library of risk management studies addressing such topics as corporate action processing, investment management compliance, computer security, defense cost management, identity theft, and independent direction litigation risk, among others, and the *Investment Management Litigation Notebook*, risk manager alerts, and the annual *Claims Trends* newsletter. Additional services include peer group profiles, coverage analyses, and assistance to insureds and their counsel in litigation defense.



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