Ball State's $13.1M Loss on Endowment Highlights the Need for Internal Controls for Investment Managers and the Limitations of Insurance.

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A Ball State University employee, who was its investment manager, lost $13.1 million of the university's endowment by investing in two separate firms, who went on to misappropriate and divert the investment funds. The university treasurer acknowledged that there were inadequate controls in place to properly manage its investment risk through appropriate safeguards. Ball State is not the only school that is susceptible to this kind of fraud: "I'm sure there's a hundred other small colleges that were doing the same as Ball State was doing and they weren't victimized," said Indiana University law professor Anthony Page, in an article published about the loss in The Chronicle of Higher Education. As The Chronicle article suggests, it is unlikely that the loss was covered by insurance. Even though the investment manager was a Ball State employee, a bond typically covers "theft" by an "employee." There was no indication that the investment manager stole the funds; she invested them negligently. The two firms that misappropriated Ball State's investment funds were not Ball State employees and, therefore, would not be covered by its bond. Even if Ball State had an investment advisor errors and omissions policy, it would likely not cover the loss because there is no third party liability insofar as the investment manager was an employee of the university.

Client Tip: *The Ball State situation highlights the need for colleges and universities of all sizes to adopt safeguards and procedures that are common in the investment management industry. Those measures — including the implementation of an approved list of brokers who have been vetted by an investment management team, the use of a single prime broker to cross-check all trades, and recording and reporting trades in a variety of ways at regular intervals to the investment management team and supervisors — may not be foolproof, but they are an added level of security. It is worth noting that if Ball State has an external investment advisor, that entity's errors and omissions policy or other insurance may have provided costs of corrections or liability coverage for a claim by the college or university against the investment advisor. Finally, if a college has an investment advisory agreement with an outside firm, the client should check it closely for limitation of liability (or "hedge") clauses that can prevent a client's recovery for loss in all but grossly negligent errors by the investment advisor and can affect liability coverage as well.*

To read more about the Ball State situation and the insurance implications, please go to www.bdinsurancelitigation.com.