Steps Financial Advisors Can Take To Help Avoid Professional Liability Claims

Insights from a Leading Industry Expert

David A. Benfield, *Managing Director & Counsel | Asset Management & Insurance Company | Claims*
Travelers Bond & Specialty Insurance

Introduction

David A. Benfield
Managing Director & Counsel
Asset Management
& Insurance Company
Claims

Travelers Bond
& Specialty Insurance

Financial advisors work in a high-liability environment. Market turbulence, shifting regulations, demanding clients, and complex investment vehicles all contribute to an increasingly litigious climate. At Liftman Insurance, we've specialized exclusively in serving financial professionals since 1957. That's over 68 years of protecting investment advisors, broker-dealers, hedge funds, and RIAs from professional liability exposures.

Recently, we interviewed David Benfield, Managing Director & Counsel for Asset Management and Insurance Company Claims at Travelers Insurance, one of the largest insurance carriers in the U.S. With decades of claim experience, he offered insights into some of the most common—and costly—mistakes that land advisors in legal trouble. His advice confirmed what we've seen over the years. With the right preparation, most professional liability claims are preventable.

This white paper blends his insights with our hands-on expertise to help advisors reduce risk, protect their reputation, and avoid becoming another cautionary tale.

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CHAPTER 1

Most Claims Aren't About Fraud—They're About Miscommunication

> *Most claims don't involve fraud or gross negligence. They come down to poor communication and missing documentation.*

Benfield explained, "Most claims don't involve fraud or gross negligence. They come down to poor communication and missing documentation." Whether it's a client misunderstanding a recommendation or an advisor failing to explain a product's downside, it's almost always a gap in communication that results in a claim.

BEST PRACTICE: Assume that every important conversation could someday be reviewed in court. Document all discussions, investment rationale, and instructions. Email is better than phone calls. Meeting notes are better than memory. Store records in a secure CRM system with time-stamped entries.

As he explained, "The types of claims I've seen... a lot of them repeat. You can't stress enough the importance of communication and documentation." Many lawsuits, he noted, stem from client confusion or unmet expectations—not bad intentions. "We've seen clients sue for millions over investments the advisor didn't even recommend—simply because that advice wasn't put in writing."

CHAPTER 2

Manage Expectations Proactively—Especially in Volatile Markets

> *Proactive communication keeps clients informed and reassured, even when returns are negative.*

Clients rarely sue when markets are up. The trouble begins when investments under-perform or suffer losses—and expectations weren't aligned. Often times, advisors are held accountable for market drops that they never promised to shield against.

Benfield explained, "We've had claims where clients sue over losses from investments the advisor didn't even recommend. But because the advisor didn't clearly document the advice — or clarify what was and wasn't being recommended — they were left exposed." He emphasized that managing expectations isn't just about setting them up front; it's about reinforcing them in writing over time. "When a client says, 'You didn't tell me this could happen,' your best defense is an email that says, 'Here's exactly what I told you.'" He advised advisors to recap conversations, use plain language, and confirm major decisions in writing: "You can't rely on memory when money is lost."

BEST PRACTICE: Be transparent about potential losses. Reiterate risk levels frequently, not just during onboarding. Provide written summaries after volatile periods explaining why performance varied. Proactive communication helps keep clients informed and reassured, even when returns are negative.

CHAPTER 3

When Clients' Lives Change, So Should Your Documentation

Life events such as death, divorce, or the addition of a successor trustee create legal gray zones. If an advisor continues to manage a portfolio without updating key documents and verifying the new decision-maker's goals, the risk of a claim rises sharply.

"When a spouse dies or a couple divorces, we've seen it over and over — the surviving or separating client sues, claiming the advisor didn't protect them," said the interviewee. "You've got to treat that client as brand new."

He advised initiating a full reset: new client contracts, updated risk tolerance questionnaires, and a fresh investment policy statement. "Just because you had a signed document from their spouse doesn't mean it still applies. We've seen cases where the surviving spouse says, 'I never agreed to that level of risk.' And if the documentation wasn't updated? That claim sticks."

> *"Treat any major life event as the beginning of a new relationship."*

BEST PRACTICE: Treat any major life event as the beginning of a new relationship. Re-do the Investment Policy Statement. Ask for new risk tolerance forms. Review the account's objectives. Claims often emerge when the "new" client feels neglected or left out of decisions.

CHAPTER 4

Know Your Limits

> *Keep a clear line between your advisory role and areas that belong to other professionals.*

Advisors put themselves at risk by offering advice outside their management contract — especially advice around tax or legal topics. What might feel like a helpful tip can quickly become the basis for a lawsuit if the client acts on it and experiences loss.

BEST PRACTICE: Know your limits. Refrain from offering opinions on legal or tax matters unless you're credentialed. Instead, coordinate with the client's lawyer or CPA, and document that collaboration. Keep a clear line between your advisory role and areas that belong to other professionals.

"We've seen advisors get pulled into lawsuits simply for making introductions," Benfield said. "They think they're helping — referring a client to a fund or a CPA — but if it goes badly, the client turns around and says, 'You recommended it.'" He shared examples of claims where advisors were sued for guidance given outside their licensed capacity. "Even if you weren't paid, even if it wasn't in writing, the perception that you endorsed something can be enough." His advice: set boundaries, avoid off-the-cuff opinions, and always clarify in writing when a decision is beyond your scope. "Stick to what you're licensed to do."

CHAPTER 5

Compensation Transparency Isn't Optional

> *Clients don't sue because you got paid.*
> *They sue because you didn't tell them.*

Fee-based confusion remains one of the top complaint drivers. Even when compensation structures are fully legal, the perception of hidden fees or conflicts of interest often leads to litigation.

"We've seen cases where advisors were sued simply for failing to disclose a referral fee," Benfield said. "Even if the investment was legitimate, clients felt misled — and that alone can lead to a claim." He explained that when money changes hands, clients assume a recommendation was in their best interest unless told otherwise. "The moment a client learns you were compensated and didn't tell them, credibility evaporates." Whether it's a referral to a fund, an outside manager, or an insurance product, the message is clear: "Disclose it, document it, and let the client make an informed decision. You can't afford gray areas."

BEST PRACTICE: Clearly outline all compensation models in writing—including advisory fees, commissions, and third-party incentives. Reconfirm this disclosure at regular intervals. Over-communication helps prevents future misunderstandings.

CHAPTER 6

Don't Overlook "Unmanaged" Accounts

> *You can't charge a fee and then claim you weren't managing the money. That defense never holds up.*

A recurring problem legal experts highlight involves accounts that advisors bring into their platform but don't actively manage. If these accounts incur losses, even without advisor intervention, the perception of responsibility can still exist—especially if fees were charged.

BEST PRACTICE: Be explicit with clients about which assets you manage and which you don't. Put it in writing. If an account is included in performance reports or fee-based billing, courts may assume you bear responsibility. The rule of thumb: if you're touching it, you're liable for it.

"Unmanaged accounts are a major blind spot," Benfield explained. "We've seen claims where advisors charged fees on accounts they weren't actively managing — and still got sued when those accounts lost value." Even if the advisor never gave advice on the assets, courts and claimants often don't see the distinction. "If the statements go out from your platform, or you're charging a fee, you're responsible in the client's eyes." His advice: never blur the line. "If it's not under management, don't charge a fee, don't give advice, and document clearly that it's excluded from your scope of services."

CHAPTER 7

The Allure of High Returns: Managing Risk and Client Expectations

> *Beware clients who spend beyond their means and are looking for "home run" investments to maintain their lifestyle. It often does not end well.*

Alternative and specialty investments can have a place in client portfolios, but in moderation. Benfield observed that clients and advisors can "fall in love" with high performing and riskier assets and not moderate the allocation. Benfield explained – If the fund or product "blows up," your client may develop amnesia to any verbal warnings.

Suitability depends upon the clients' circumstances – what could that client afford to lose, 5% of their portfolio, 10%, or is it less? If there is a larger allocation to a single investment that fails, the advisor may be vulnerable to a claim.

Some firms have 70-80% of a portfolio invested in a single specialty investment which the advisor believed was a conservative investment, but the strategy failed. With the benefit of hindsight, the investments were highly risky and inadequate due diligence was performed.

BEST PRACTICE: Avoid overconcentration in high-risk investments, especially for clients chasing unrealistic returns. Document risk discussions and ensure allocations reflect what the client can truly afford to lose.

CHAPTER 8

Trade Errors Happen— Make Sure You're Covered

Mistakes in trade execution are more common than most firms want to admit. From mismatched orders to overlooked transactions, these errors can create ripple effects across hundreds of accounts.

"Even the most seasoned advisors make trade errors," Benfield said. "You're trading across hundreds of accounts, so simple errors are magnified and can become large losses." He emphasized that while mistakes happen at the best firms, how you respond matters. "Too often, advisors try to fix the error before notifying their carrier, and that can jeopardize coverage." He advised reporting immediately and checking the policy wording closely.

Some insurers' "cost of correction" coverage allow insureds to correct trade errors without a carrier's prior consent. "Ideally, get the carrier's consent before correcting anything. If you don't — and your fix creates a new problem — they may decline part of the cost." His bottom line: "Own the error, report it fast, and follow the protocol. It's the difference between coverage and conflict."

"Trade errors don't kill your coverage. Mishandling them does."

BEST PRACTICE: Secure "cost of correction" coverage, a crucial endorsement that not all carriers offer by default. This allows you to address and rectify trade errors without incurring full financial liability. Understand your policy's terms —especially regarding when you must notify the carrier to qualify for coverage.

Why Advisors Choose Liftman Insurance

Since 1957, Liftman Insurance has been more than just a broker—we've been a trusted partner to over 2,000 financial advisory firms across the country. Founded by Theodore Liftman, a pioneer in the field of financial industry insurance, we've remained a family-run business focused solely on serving investment professionals.

What sets us apart? Depth of knowledge. Concierge-level service. And a legacy of doing the right thing—every time. Our team includes former underwriters who understand how carriers assess risk and price coverage. That insider expertise allows us to design policies that anticipate pitfalls and avoid surprises.

We're available when others aren't. Whether it's late at night or over the weekend, we answer the phone. Clients stay with us for decades because we earn that trust through action—not promises.

We don't just know the products—we know the people. We have long-standing relationships with underwriters, claims managers, and legal teams at the top insurance carriers. When coverage questions get murky, we're the ones who can pick up the phone and advocate for you directly.

Mark Liftman
President

Liftman Insurance

Travelers Casualty and Surety Company of America and its property casualty affiliates. One Tower Square, Hartford, CT 06183
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Whether you're reviewing an expiring policy, launching a new firm, or just want a second opinion, Liftman Insurance can help you navigate the complexities of professional liability and risk management with clarity and confidence.

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