Who’s to BLAME?

by Jen Jacobsen, JD, John Marshall, AAI, CIC, CRM & Pat Fay, AIF, QPFC

Fiduciary liability insurance has been around for decades, yet companies are just beginning to pay more attention to what this coverage really addresses and the nature of this evolving exposure. With a large number of employees set to retire as the baby boomer generation exits the workforce, there will likely be more individuals casting blame on employers and the advisors managing their retirement plans if suspected mismanagement prevents a smooth transition into retirement. In recent years, there have been many class-action lawsuits related to excessive fees that have eroded retirement incomes. While employers have typically relied on outside advisors to manage this risk, it is their responsibility to ensure these advisors are compliant and have the proper education to effectively direct plans. As the cost of insurance and the restrictions on coverage terms both continue to rise, it is important for plan fiduciaries to evaluate their increasing exposures and determine if there are areas for improvement in their current risk management plan.

Who Is at Risk?
The legal rules governing employee benefit plans established under the Employee Retirement Income Security Act (ERISA) are complex. Benefit plan fiduciaries and plan sponsors are confronted with an increasingly active and ERISA-sophisticated plaintiffs’ class action bar. On average, more than 8,200 ERISA lawsuits are filed each year. Employers, plan sponsors and fiduciaries must be engaged and fully understand their responsibilities to avoid costly legal action. A recent survey conducted by AllianceBernstein, a global asset management firm, showed that 37% of respondents did not know if they were a fiduciary, when 100% of those surveyed were indeed fiduciaries. Despite this low level of recognition, 82% of the respondents indicated that fiduciary matters were important and 70% believed that all individuals who served in a fiduciary capacity were aware of their status.

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Under ERISA, a fiduciary is defined functionally. Therefore, a person doesn’t need to be named as a fiduciary in plan documents. Conduct alone can make someone a fiduciary, perhaps unknowingly. When administering a plan, fiduciaries have a duty to act solely in the interest of the participants and their beneficiaries, and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and diversify plan assets, subject to the terms of the plan and in compliance with ERISA. Fiduciaries in breach of their responsibilities may be personally liable to restore any losses to the plan or any profits made through improper use of plan assets. A person is a fiduciary to the extent that he or she: 1) exercises discretionary authority / control over plan management; 2) exercises any authority or control over plan assets; 3) has any discretionary authority over plan administration; or 4) gives investment advice for a fee.

Without a thorough understanding of what is driving losses and regulations, reading an insurance policy and making sense of what it does / does not cover can be a challenge. There is a common misconception that fiduciaries are totally covered by employee benefits liability (EBL) insurance, directors and officers (D&O) liability insurance or an ERISA bond. However, fiduciary liability insurance works to fill the gaps in these coverages. EBL coverage protects against errors in the administration of the plan, but not against the more expensive and complex ERISA claims. D&O policies typically exclude claims for both EBL and breach of ERISA fiduciary duty, only covering activities performed in the capacity of a director or officer. Every plan is required to have an ERISA bond to pay for any loss resulting from theft of plan assets. All of these policies overlap to provide coverage for employee benefit plans, making it difficult to determine which wrongful acts are covered by which policy. Given the severity of fiduciary liability claims, it is imperative to understand not only what fiduciary liability insurance covers, but what and whom it does not cover.

Every insurance policy has its own particular terms, conditions, limitations and definitions. In the case of fiduciary liability insurance, this caveat remains true. Simply put, the purpose of fiduciary liability insurance is to protect insureds against claims alleging a breach in fiduciary duties or an error in plan administration. When reviewing a fiduciary liability policy, there are six important questions to ask:

1. What constitutes a claim? Generally, coverage is triggered when a claimant accuses an insured of doing something wrong with regard to the plan and demands some form of relief. A claim can take many different forms, such as:
   - A written demand for monetary damages or injunctive relief
   - A civil complaint
   - A formal administrative or regulatory proceeding due to the filing of a notice of charges or formal investigative order
   - A written notice by the Department of Labor (DOL) or the Pension Benefit Guaranty Corporation of an investigation against an insured for a wrongful act

EBL coverage is generally limited to administrative errors and omissions. Plan administration includes handling records in connection with enrollment, termination or cancellation of employees and interpreting benefits of the plan. These types of claims are frequent, but not severe. In contrast to EBL coverage, a fiduciary liability policy not only covers errors and omissions, but also the personal liability for a breach of fiduciary duty in connection with an employee benefit plan.

Many policies include an option for a voluntary settlement provision (usually a sublimit) which provides for regulatory supervised corrections in benefit plans. However, this coverage usually does not cover the actual costs of bringing the plan into compliance.

2. Who is an insured? Insureds may include the plan sponsor, officers, directors and employees acting as fiduciaries. The plan itself is also an insured. A company may have many types of employee benefit plans, including non-qualified plans, so it’s important to ensure the policy covers all employee benefit plans of the company.

Third party service providers who are hired by the plan or plan sponsor are typically not insured by fiduciary liability policies purchased by the plan or plan sponsor.

3. What is a wrongful act? Fiduciary liability insurance generally has two components: 1) coverage for administrative mistakes; and 2) liability arising out of ERISA. A review of actual claims and class-action lawsuits is the best way to understand what results in damages.

4. What is a loss? Most fiduciary liability policies exclude coverage for benefits due as a result of a wrongful act. A major insurance company underwriter recently acknowledged that perhaps the biggest misconception about fiduciary liability insurance is that it restores losses to an employee benefit plan when a plan sponsor or employer discovers that they have made an error. Fiduciary liability insurance is third party coverage, meaning someone must make a claim against an insured for a wrongful act. In turn, the fiduciary liability insurance policy will provide a defense against the claim (assuming the policy includes a duty-to-defend provision) and then pay for any covered award entered against the insured up to the policy’s limit of liability. Fiduciary liability insurance is not first party coverage; therefore, the insured cannot draw on the policy to restore losses to the plan.

5. Is there a duty to defend? Fiduciary liability insurance pays claims on behalf of the insured for failure to prudently act as a fiduciary. A policy that has a duty-to-defend provision means the insurer has the right and duty to defend against claims and the right to select expert defense counsel. If the insurer does not retain the duty to defend, policies often require the insured to choose from pre-approved defense counsel rather than retaining their own counsel of choice.

6. Does a different insurance policy respond? Fiduciary liability insurance helps protect the personal assets of company fiduciaries, as well as the financial assets of the company and employee benefit plans against lawsuits. Group life and medical expense plans as well as pension and retirement plans are within the scope of ERISA.

Insurance to the Rescue!
Things are not always what they seem; the first appearance

Fiduciary duty, only covering activities performed in the capacity of the interest of the participants and their beneficiaries, and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and diversify plan assets, subject to the terms of the plan and in compliance with ERISA. Fiduciaries in breach of their responsibilities may be personally liable to restore any losses to the plan or any profits made through improper use of plan assets. A person is a fiduciary to the extent that he or she: 1) exercises discretionary authority / control over plan management; 2) exercises any authority or control over plan assets; 3) has any discretionary authority over plan administration; or 4) gives investment advice for a fee.

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Beyond Insurance
In addition to fiduciary liability insurance, a comprehensive risk management plan must encompass a well-designed, strategically executed and thoughtfully administered employee benefit plan. Being a fiduciary is rarely a singular job, and most mistakes made by fiduciaries are not malicious in intent, but rather the result of human error. Many advisors now offer a co-fiduciary partnership to ensure all persons who are named or deemed as fiduciaries fully understand and appreciate their responsibilities. This allows internal stakeholders to get outside assistance to better understand and co-manage this risk.

Fiduciary training, at a minimum, should include several areas of focus, including:
- The role of a plan steward
- Precepts every steward must know
- Applying the fiduciary precepts
- Trends in the evolving legal and regulatory environment

Help Is Here
Exposed for plan fiduciaries are growing in number and complexity. Rather than relying on insurance to address this risk, it is important that employers seek the help of knowledgeable advisors to help manage their employee-sponsored retirement plans. The right set of professionals can help companies comply with the many regulations that govern retirement plan management while keeping the best interests of the plan participants in mind. For more information on risk reduction strategies and plan administration guidance, contact the investment and risk management professionals at SilverStone Group.

We hope this overview sheds light on the importance of fiduciary liability insurance to help protect the interests of the plan participants and the company.

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