Here’s the scene: You are a newly seated trustee for a jointly trusted benefit fund. You are attending your first board meeting and the plan administrator is summarizing the renewal of the fiduciary liability insurance policy and the fidelity bond. While you are, of course, familiar with the concept of insurance and purchase some insurance yourself, you have never had to purchase any type of corporate (commercial) and benefit plan insurance. So, you start to wonder: What types of insurance protection does a benefit plan and the board of trustees need? How much protection is appropriate? And, even more basic: How does an Employee Retirement Income Security Act (ERISA) benefit plan go about purchasing insurance?

This article addresses these and other questions as an introduction to (or a review of) this complex but vitally important subject for all trustees, especially those who are new to the job:

• The place to start is with the very basic question: What is insurance? (See the sidebar, “Insurance Defined.”)
• The second step is to understand the most important insurance protection needed to cover the board of trustees and the benefit plan—the fidelity bond and the fiduciary liability insurance policy.1
• Trustees must also consider other property and casualty coverages, such as property, general liability, auto, workers’ compensation and umbrella policies.
• Last, trustees need to understand how benefit plans use an insurance broker to secure this protection. (See the sidebar, “The Role of the Broker.”)
A multiemployer fund trustee soon learns that fiduciary liability insurance and a fidelity bond are necessary but may not fully understand this complex topic. This article explains the types of insurance—and how much insurance—a trustee must have, and other types he or she may need.
What Is the Fidelity Bond?

The purchase of a fidelity bond is mandated by ERISA for any ERISA plan with plan assets. Fidelity bond is a generic term covering many types of insurance contracts where an insurer agrees to cover a loss arising from a breach of honesty by covered individuals. ERISA requires that fiduciaries and all persons who handle plan assets (plan officials) be bonded. For ERISA compliance, it is a first-party insurance policy that protects the plan from fraud or dishonest acts by any plan official in handling plan assets (money, securities or other property). Handling and fraud or dishonest acts are broadly defined terms.

More than one bond can be used for compliance, but the plan must be a named insured within each bond. An exception is available for certain large regulated financial service companies that maintain fidelity bonds under other federal or state laws.

The amount of the fidelity bond must be 10% of the plan assets, subject to a $1,000 minimum and a $500,000 maximum. If the plan owns securities of any of the employers that make contributions to the plan on behalf of covered employees, the required maximum increases to $1 million. Larger amounts can be purchased at the discretion of the trustees. So, for example, a plan with $100 million in assets would be required to buy a bond with at least $500,000 of coverage, if employer securities are involved, $1 million. However, given the size of the plan assets, the trustees may want to consider a higher coverage limit. The plan official is responsible for having a compliant bond—it is not the insurance carrier's responsibility to assure that all required terms are part of the contract.

More than one benefit plan (e.g., companion pension and health benefits funds) can be insured under a single fidelity bond, but the bond's limit of liability must be at least equal to the sum of the amount that each plan would be required to buy individually. For example, if three plans are required to buy a maximum of $500,000 of coverage, the fidelity bond's limit of liability needs to be a minimum of $1.5 million.

Discovery of a loss event triggers coverage, permits the plan to immediately file a claim notice with the insurance carrier and sets in motion very specific time lines that are detailed in the bond and must be met in order to obtain reimbursement. For example, generally within 120 days, the insured must file with the insurance carrier a proof of loss with sufficient details to identify the person who committed the fraud or dishonesty, the amount of money involved and how the loss was accomplished. Unlike the fiduciary liability insurance policy, which is discussed below, the fidelity bond's limit of liability generally resets, so it is fully available for each discovered loss. However, for any and all losses caused by an individual, the limit of liability is an aggregate amount.

What Is Fiduciary Liability Coverage?

Fiduciary liability insurance, while not required by ERISA, is generally considered a “must” purchase. ERISA establishes and holds trustees to an “expert” prudent man standard of care and a personal liability standard of performance.

Because ERISA requires that plan

Takeaways

- ERISA requires that fiduciaries and all plan officials be bonded.
- Fiduciary liability insurance protects a plan’s assets, trustees and employees against a third-party claim that a wrongful act caused a loss.
- How a policy is written can vary between carriers and can mean the difference between coverage and no coverage.
- Trustees should evaluate and understand a fiduciary policy’s scope of coverage rather than focusing solely on premium cost.
- The plan’s attorney and insurance broker can help identify additional risks to determine what other types of insurance are needed.
assets can be used only to provide benefits and to defray reasonable administrative costs and, also, prohibits plan fiduciaries from engaging in transactions for their own benefit, plan assets cannot be used to indemnify (i.e., protect) the trustees (or other fiduciaries) for any actual breaches of fiduciary duty that cause the plan a financial loss. Fiduciary liability insurance is designed to provide protection for the plan arising from any alleged or actual breaches of fiduciary duty. These policies will also provide coverage for the trustees with respect to claims made against them individually for a nominal additional charge, called a waiver of recourse premium, which the covered fiduciary must pay. Without adequate fiduciary insurance that covers the plan and its fiduciaries, the trustees will confront thorny questions about when plan assets may be used to defend claims made against both the plan and the trustees, such as a benefit claim, and how to proceed without breaching a fiduciary duty by paying defense costs without allocating costs to the trustees.

Fiduciary liability insurance is designed to protect the assets of the plan, its trustees and its employees against a third-party claim made against the insured during the policy period, alleging a loss caused by a wrongful act. The specific words—claim, loss, policy period, insured and wrongful act—are defined terms with specific contractual meanings. They are contained within the insurance contract, and whether a suit brought against the plan and its trustees fits within their definitions will determine whether an insurance carrier will cover the claim. This, in turn, triggers the carrier’s contractual defense obligation.

ERISA’s personal liability standard makes fiduciary liability insurance and its scope of coverage critical for each trustee. While a fiduciary policy’s general format is fairly standardized, specific language, especially its insuring clause, definitions and exclusions, can differ substantially from carrier to carrier and even within the same carrier. These variations in contract language can mean the difference between coverage and no coverage. While it is the insurance broker’s responsibility to negotiate, recommend, explain and service this policy, trustees would be well-advised to ask the following questions:

- Are the trustees’ spouses/domestic partners and estates protected?
- What coverage is provided for fines and penalties imposed by the Department of Labor, the Internal Revenue Service, the Pension Benefit Guaranty Corporation, the Department of Health and Human Services and other regulators?
- What “settlor” coverage and/or investigation monitoring coverage is provided? Unless specifically stated, any settlor functions performed by the trustees will not be covered by a policy that insures only fiduciary acts.
- Is defense provided on a “duty-to-defend” or “pay-on-behalf-of” basis and is there any policy provision that may convert the policy from the former to the latter?
- Under a duty-to-defend policy, the insurance carrier has the obligation to defend and pay the defense costs for all allegations in a covered claim. In contrast, under a pay-on-behalf-of policy, the insurer may pay only the defense costs related to the covered claims.

A fiduciary policy is not an off-the-shelf product. Trustees should carefully evaluate and understand the scope of coverage rather than focusing solely and narrowly on the premium cost.

What Other Coverage Should Be Considered?

Although fidelity bonds and fiduciary coverage are the two most discussed policies among fiduciaries, trustees must also consider other types of insurance protection for the board of trustees and for the proper administration of

Education

Trustees and Administrators Institutes
June 24-26, San Francisco, California
For more information, visit www.ifebp.org/trusteesadministrators.

59th Annual Employee Benefits Conference
October 20-23, Las Vegas, Nevada
For more information, visit www.ifebp.org/usannual.

From the Bookstore

For more information, visit www.ifebp.org/books.asp?7068.
The Role of the Broker

While a plan’s legal counsel will be able to provide guidance on the prudent process for vetting plan vendors, he or she is unlikely to have particular knowledge about the carriers in the marketplace and the latest policy features that have evolved in each class of insurance agreement.

Rather, counsel is likely to recommend the use of one or more insurance brokers. Such brokers would have the expertise to help trustees

- Identify plan risks
- Determine whether and what type of insurance coverages and policies can be used to transfer any risks that cannot be eliminated or mitigated
- Identify the appropriate insurance carriers for that purpose.

The broker’s role also involves making and explaining recommendations, binding and processing the policy, answering questions and assisting in the reporting of any claims. Moreover, a broker may also have market clout to secure appropriate levels of coverage and negotiate or modify terms of the insurance agreement.

Conclusion

ERISA funds have risk exposure because of the many functions they perform. One of the mechanisms to help manage the risk is the purchase of insurance protection that permits the transfer of fund and trustee risk to an insurance carrier. The various insurance policies that cover the funds are complicated. Because of the vital protection they offer, trustees would be well-served to hire the appropriate advisors (e.g., an insurance broker and attorney) who can help them identify, understand, purchase and explain the various property and casualty coverages plans should consider.

Ultimately, the trustees’ objective is to design a portfolio of insurance policies that protects the assets of the plan, the trustees and the plan’s employees. Trustees who understand this basic framework will be better equipped to help their benefits plan secure the proper insurance protection.

Endnotes

1. This article focuses on the sometimes neglected subject of insurance protection for a benefits plan and boards of trustees. This article does not address insurance coverage for a trust fund’s participants, such as health, life, accident, dental, vision, etc.

2. See ERISA §412. There is an exception. A single employer-sponsored health and welfare plan with no plan assets (“completely unfunded”) would not be subject to this ERISA mandate. See the Department of Labor’s (DOL’s) 2008–04 Field Assistance Bulletin (FAB) Q&A #12.

3. ERISA defines a plan official to be every fiduciary and every person who handles funds or other property. See ERISA §412. As defined, plan official may include the plan’s trustees, its employees and the employees of certain plan vendors, such as any investment manager and, in some instances, any third-party administrator (TPA).

4. Depending on how responsibilities for han-
When plan assets are allocated, the covered individuals under a bond may be any natural person, including officers, employees or other persons performing functions for the plan normally performed by administrators, officers or employees of a plan. These can include persons indirectly employed or otherwise delegated to perform such work (such as consultants or attorneys), handling plan assets. Note, however, not all ERISA fidelity bonds provide this full scope of coverage. See 29 CFR §2580.412-3.

5. A first-party policy is one obtained by an insured for payment to the insured in the event of a loss, whether it is caused by the insured or a third party.

6. For these definitions, see ERISA §412, the DOL regulations §2580.412-1 to 36 and FAB 2008-04.

7. See FAB Q&A #25 and 31.

8. See FAB Q&A #36.

9. See FAB Q&A #5 and 6.

10. See FAB Q&A #23.

11. See ERISA §§404(a) and 409. This is referred to as an “expert” standard because it is benchmarked to the care exercised by a “person familiar with such matters.”

12. See ERISA §410(b)(2) and (3) to see who can pay for this waiver of recourse premium.

13. For a further discussion of these topics, see ERISA §§409 and 410. In the case of an alleged breach of fiduciary duty where plan assets might be used in the defense, legal counsel may advise the board that it needs to require from the individual named in the suit or investigation either an undertaking agreement (which is an agreement that guarantees repayment by such individual if the breach of fiduciary duty is established), or collateral or both to secure repayment of any advanced costs of defense where the board, after its own investigation, concludes that there was no breach. A more complete discussion of this situation is beyond the scope of this article.

14. Any plan amendment will generally be a settlor function.

15. This article does not focus on insurance protection for plan participants, such as health, life, disability, accidental death and dismemberment, dental and vision coverage. With respect to coverage for these areas, a board of trustees must typically works with its regular advisors: plan administrator, attorney and an actuary or employee benefits consultant. If a plan is self-administered and employs a staff, some of these coverages may also be needed and will often be coordinated with the coverage for plan participants.

16. The plan might be sued even if the “slip and fall” occurs at a nonplan meeting site (e.g., a hotel or plan vendor’s office).


18. The Health Information Technology for Economic and Clinical Health provisions of the Health Insurance Portability and Accountability Act of 1996 establish a federal breach notification requirement for health and welfare plans upon nonpermitted disclosure of PHI. Also, at least 46 states have privacy breach notification laws. Legal counsel should be consulted to determine whether ERISAs’ preemption would excuse any nonexempt ERISA plan from the state law.