

# Fiduciary Liability Insurance

## In General

Fiduciary liability insurance is protection for the plan fiduciaries (plan administrator or a single-employer plan or trustees of a Taft-Hartley fund or trustees of a VEBA) against losses which result from their breaching their fiduciary duties.

ERISA fiduciaries will often contemplate insurance to protect themselves against a breach of fiduciary trust. Such contemplation may be made by the following:

- Investment advisor
- Plan supervisor of single employer plan
- Administrative firm in a jointly managed plan.

Fiduciary liability insurance does not include any of these three commonly found insurance forms:

- Fidelity bonds required by ERISA § 412 for employer in single employee plans which have plan assets. Fidelity bonds are also often required by states under their Plan Supervisor's registration statutes.
- Surety bond which is a performance bond and may be distinguished from a fidelity bond. The fidelity bond relates only to dishonesty, embezzlement, etc. and is required by several states as part of their Plan Supervisors registration statutes.
- Plan Supervisor or employer *errors and omissions* coverage.

With ERISA plans, plan fiduciaries are personally liable for breaches. Plan assets, per ERISA, may not be used to make up losses for fiduciary breaches. Plan assets, however, may be used to purchase fiduciary liability coverage for an insurer. There is significant legal exposure for ERISA fiduciaries and for this reason, such coverage is popular; fiduciary insurance is more popular with deferred compensation plans than with health care plans, however. Reason: the health care plan will typically have little or no plan assets, thereby reducing the fiduciary's liability to a small amount.

## Legal Considerations

### Legal Decisions

One of the earlier of the court decisions which indicated that fiduciary liability was prudent was *Dawes Mining Company v Callahan*. In this case, the employer was held liable for the negligent administration of a health care plan. The employer failed to

tell Callahan that if the plan switched to a new carrier, there was not to be any no loss-no gain provision.

In *Woodman Company, Inc. v Adair*, the employer failed to properly inform Adair of his rights on continuation and conversion.

In *Gediman v Anheiser-Busch*, the employer was held liable for \$78,356 plus interest for failing to notify the participant of a benefit reduction.

In *Sur v. Glidden-Durkee*, employer's representative told Sur that the conversion policy would be as good as the plan's major medical policy. When it was not as good, Sur suffered; the court held the employer to be liable.

## **Responsibilities for Actions of a Co-fiduciary**

Any fiduciary (named or implied) is responsible for the actions and conduct of any other fiduciary (named or implied). This rule is especially important with jointly trustee plans. The rule is also significant in single employer plans where the claims administrator, acting as a co-fiduciary, knows the plan administrator (employer) is doing something which is not proper even if such act is not directly related to claims. Such co-fiduciary involvement may take on several forms:

- Such co-fiduciary knows of the breach of another fiduciary and does nothing.
- Such fiduciary acts, knowingly, in a way to cause a co-fiduciary to commit a breach.
- With knowledge of a breach, such co-fiduciary does nothing.

These rules put each fiduciary on notice to know what the other fiduciaries are doing.

## **Due Diligence With Service Providers**

Prudence demands that service providers be most carefully selected; once selected that they be carefully monitored. Thus, the employer in a single employer plan, using a Plan Supervisor, is obligated to carefully select and monitor the claims practices of such Plan Supervisor.

## **Practical Aspects of Errors and Omissions Coverage For Fiduciary**

The various fiduciaries have this interest in E&O coverage for fiduciary breaches:

**Employers.** Most single employer plans name the plan administrator to be the company, as opposed to a particular person, thereby putting the peril on the employer and not on the named officer who is actually managing the plan.

**Trustees of Jointly-Managed Plans.** These persons do have an active and legitimate interest in obtaining E&O coverage for fiduciary breaches.

**Service Providers.** These persons have a great interest in fiduciary breaches but generally believe that their professional E&O coverage is sufficient to protect them. They reason any claim for a breach would likely be covered as a professional malpractice claim. While not correct, this is the general practice. In truth there are some instances

where a Plan Supervisor, e.g., may have breached his fiduciary duties, been held personally liable but for which his professional E&O coverage will not pay.

## **Errors and Omissions Fiduciary Liability Insurance**

As laws, regulations and court decisions multiply, interest in fiduciary liability insurance increases.

The insurance industry is fearful – their liability is so uncertain, the perils so great, the future so confused.

Plans face a dilemma: to not have the coverage puts the fiduciaries at risk; to pay huge premiums for uncertain coverage puts the plan assets at risk. DOL will look carefully at any fiduciary liability insurance during their compliance audit. The travesty of an insurer's \$1,000,000 policy for a \$970,000 premium and its results clearly show DOL's interest in self-dealing with plan assets, particularly as regards fiduciary liability insurance.

## **Solutions to the Problem**

The trustees should be very careful that they obtain fair value from their premiums when buying fiduciary liability insurance. To obtain best terms, the plan and/or its fiduciaries may engage an independent firm (accounting, legal, actuarial, e.g.) to do an audit). The auditor must be independent and not a party-in-interest. Often the underwriter of the fiduciary liability insurance will do its own audit – or hire someone to do it. The point is, that a good compliance audit will result in a best terms offer of fiduciary liability insurance.

The employer was made to suffer financially in *Corey v. Binkley Company*, when he lost coverage due to a position change and was not informed. When he was hospitalized and realized he was not covered, there was a definable liability.

Sheller could have converted his group coverage but did not do so because he was led to believe that it was still in force. When it wasn't and he suffered a loss, the court held the employer to be liable. See *Sheller-Globe Corporation v. Sheller*.

There are numerous other miscellaneous court cases which essentially have held as the earlier cited cases. If the employer, or trustees, fail in their duties they may be held liable.

## **Recent Legislation**

The reader is alerted to the fact that the recent legislation enacted by Congress adds to the employer's perils. Example:

- Discrimination self-funded plans.
- COBRA
- Americans with Disabilities Act.

## **Fiduciary Liability Insurance**

### ***Demand***

The demand continues because the pressures by the courts and the regulators and the statutes is ever increasing.

The insurers are frightened by the open-endedness of the of the peril and the ever-escalating demands of the laws and regulations. The risk, from the insurer's point of view, is not assessable. Insurers have been increasing rates and decreasing protection.

The vast majority of Taft-Hartley funds have fiduciary liability coverage in plan; the premiums are in many instances quite high, the *Catch-22* to the trustees is this: is it prudent to buy insurance which is believed to be *overpriced* or should the fund save its money and run the risk of a possible loss? The Department of Labor looks favorably on fiduciary liability coverage.

### ***Who Sells Fiduciary Liability***

Property and casualty companies generally offer this coverage as an extension of their regular product line. These insurers are familiar with ERISA, labor law, investment risks, etc.

In underwriting the fiduciary liability coverage, the insurer may ask for this information:

- Plan financials, audited.
- Plan papers (document, trust agreements, booklets, union contracts, administrative agreements, minutes, etc.)
- Special items of concern (asset management agreements, role of parties at interest, resumes of persons involved, details on assets, funding practices, etc.)

The insurer may request what is called an *operational review* which is really a critique of the plan and its performance.

### ***Purchasing the Coverage***

Employee benefit fiduciary liability coverage is desirable for many organizations. The employer can obtain the coverage from any of three sources: purchasing a separate policy, adding an endorsement to the general liability coverage of the employer or purchasing a fiduciary liability policy that defines coverage acts broadly enough to include errors and omissions coverage.

An employer that decides it needs employee benefits program liability insurance and that carries fiduciary liability coverage should examine the scope of its fiduciary liability insurance. Some fiduciary liability policies are broad enough to cover employee benefits program liability. Fiduciary liability policies that provide coverage on a *per wrongful act* basis may contain wording broad enough to provide employee benefit liability coverage as well.

## ***Living with Fiduciary Liability Coverage***

The plan's fiduciary should have the coverage periodically reviewed by its attorney. The reviewing attorney should be independent and knowledgeable. Such reviewing attorney should submit a report in writing as to the status and effectiveness of the coverage. The plan's fiduciaries should act on the recommendation of the reviewing attorney.

## ***Fiduciary Insurance Company Problem Areas***

These are areas of concern with such coverage:

- *What actions and costs are covered?*  
Will coverage defend against even groundless or false claims? Are all defense costs covered?
- *What is Definition of Wrongful Act?*  
Does it extend to alleged or actual fiduciary breaches, either jointly or severally? Does the coverage extend to errors and/or omissions by the fiduciaries, even if there is no allegations of a fiduciary breach?
- *What is Definition of Damages?*  
Do damages extend to compensatory, punitive damages and attorney's fees?
- *Is the Coverage Claim Made?*  
That is, the determinant is not when the breach was made but when restitution is sought. This gives the fiduciary *retroactive coverage*.