Trends in Fiduciary Liability Insurance:

What New Coverages Does Your Employee Benefit Plan Need?

by | Daniel Aronowitz

The primary purpose of a fiduciary liability insurance policy is to protect against personal liability for trustees. But fiduciary responsibility law is complex and ever-evolving, and the liability against fiduciaries does not fit into convenient labels. Consequently, the standard fiduciary liability insurance policy for employee benefit plans has changed dramatically in the last several years to handle these modern risks.

State-of-the-art fiduciary policies now cover more than just breaches of fiduciary duty and administrative errors and omissions. The best policies now cover voluntary compliance programs, settlor and other nonfiduciary claims, and regulatory penalties not previously covered by insurance. Other policies have expanded to cover liability from recent privacy and health care legislation as well as evolving cyberrisks that all plans now face. With so many recent policy changes, insurance professionals and benefit funds need to evaluate what new coverages are right for their plans.

Pre-Claim Investigation Coverage

The Department of Labor (DOL) has primary responsibility for regulating employee benefit plans. DOL typically exercises this authority by conducting routine and targeted audits of plans, and it has increased its number of audits in recent years. Most insurance policies have not treated DOL investigations as a covered claim under a fiduciary policy until DOL issues any findings at the conclusion of the investigation. The reason is that fiduciary liability insurance policies are issued on a claims-made basis. This means that the policy will cover “claims” that are made during the policy period. The definition of claim is standard in most fiduciary policy and requires a notice of charges or a written notice that alleges a “wrongful act” or some
Employee benefit plan fiduciaries face modern risks that call for newer types of fiduciary liability insurance.
Generally, employee benefit plans can benefit from a separate cyberliability policy, especially when the benefit plan itself has been harmed by a data breach. Any defense costs for responding to most regulatory investigations, therefore, are not covered under a standard fiduciary policy.

In recent years, however, many DOL audits have become more extensive. DOL auditors often interview plan officials and request a large volume of documents. Many plans want an attorney to protect their rights during the DOL audit. For insurance purposes, another concern is that audits often take more than one year and extend beyond any one individual insurance policy period. Plans face some uncertainty as to which policy should cover any ultimate liability assessed by DOL—the policy in force when the audit began or the policy when the notice of findings is issued at the conclusion of the audit.

To address these more intensive DOL audits, fiduciary liability insurance carriers have responded by offering pre-claim investigation coverage. This is typically handled by expanding the definition of claim to include a pre-claim investigation, defined as “a fact-finding investigation which does not contain an allegation of a wrongful act in writing” commenced by DOL. With pre-claim investigation coverage, insurers will reimburse for the expense of an attorney to represent the plan during the investigation. This gives the plan access to an advocate to address concerns by the investigator. For investigations by other regulatory authorities, such as the Department of Justice, the Securities and Exchange Commission or a state attorney general, carriers may grant interview coverage. This provides reimbursement for defense costs when an enforcement unit is conducting an investigation.

While insurance carriers will charge additional premium for adding pre-claim investigation or interview coverage to a plan's fiduciary policy, this enhancement can provide valuable coverage for a regulatory investigation or audit of an employee benefit plan.

Nonfiduciary Claims

Fiduciary liability policies primarily are designed to cover breaches of fiduciary responsibility. Policies originally were not designed to cover business expenses. Fiduciary policies, for example, would cover a claim for breach of fiduciary duty but not a challenge to a settlor function, such as establishing or terminating a plan, choosing the plan design and features, or amending the plan, including changes in benefits.

But over time, the fiduciary-versus-settlor distinction has blurred. Indeed, a challenge to a plan amendment—a classic settlor function—nearly always includes a breach-of-fiduciary-duty claim against trustees. And the settlor role is more problematic for multiemployer plans in which the same trustees wear “two hats” to handle both fiduciary and settlor functions.

The solution is to seek defense coverage for settlor functions in a plan’s fiduciary liability insurance policy. Settlor coverage is now being offered in two different ways. First, some carriers expand their definition of wrongful act to provide defense costs for claims in which a trustee is sued in the capacity as a trustee (as opposed to his or her capacity as just a fiduciary). One leading policy, for example, expands defense coverage to “any negligent act, error or omission by an Insured solely in such Insured's capacity as a trustee of a Plan.” This is the broadest way to expand coverage for settlor claims, because it does not limit the type of function that could be covered. This approach, however, could be restricted to a sublimit of the overall limit of liability.

Alternatively, the fiduciary policy can be amended to offer express coverage for settlor functions. Some carriers amend the definition of administration to include settlorlike activities, such as “choosing, changing or eliminating the Trust or Plan options.” By contrast, the definition of wrongful act can be expanded to include acts “solely in such

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<th>takeaways &gt;&gt;</th>
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<td>A standard fiduciary policy does not cover defense costs for responding to most regulatory investigations. Pre-claim investigation coverage and interview coverage fill the gap.</td>
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<td>A plan’s fiduciary liability insurance policy can be expanded to cover settlor functions.</td>
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<td>Coverage is now available to pay the expenses involved in correcting some violations by using voluntary compliance programs. Benefit plans should be sure their policy has an adequate voluntary compliance sublimit.</td>
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<td>Health plan fiduciaries should make sure they are covered against penalties for Affordable Care Act violations.</td>
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<td>Plans should be sure they are adequately covered in the event of HIPAA/HITECH violations, for which HHS can assess annual maximum fines of $1.5 million.</td>
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Insured’s settlor capacity with respect to establishing, amending, terminating or funding a Trust or Plan.” Policyholders should be careful to ensure that the language does not limit possible claims that can be brought against the trustees.

Finally, a word of caution is appropriate. Settlor coverage represents expanded coverage for the plan sponsor under the same policy as the coverage for the individual trustees. The possibility exists that a settlor claim could exhaust the limit of liability, leaving nothing to protect individual trustees, many of whom are serving as volunteers with their personal assets at risk. Adding settlor coverage is not without risk, therefore, and trustees should consult with their professional broker or insurance advisor to ensure that they have adequate policy limits if opting for settlor coverage.

Voluntary Compliance Programs

Historically, fiduciary liability insurance policies would not cover claims when no third party was alleging some type of wrongdoing. Insurers wanted to avoid moral hazard claims, which might occur if policy coverage created an incentive for plan representatives to take unusual risks, knowing they’d be covered. But that has changed in recent years with regulatory agencies encouraging employee benefit plans to proactively remedy fiduciary violations under the Employee Retirement Income Security Act (ERISA) by taking prescribed remedial actions.

Both the Internal Revenue Service (IRS) and DOL now have vibrant voluntary compliance programs.

When mistakes are made with respect to a plan, for example, the IRS Employee Plans Compliance Resolution System (EPCRS) encourages plans to remedy mistakes and avoid the consequences of plan disqualification. Similarly, the DOL Voluntary Fiduciary Correction (VFC) Program allows those potentially liable for certain specified fiduciary violations under ERISA to voluntarily apply for relief from enforcement actions and certain penalties.

Plan assets may not be used to pay the cost of correcting many of the violations specified in a voluntary compliance application unless such cost would otherwise have been paid from the plan (and assuming the plan document permits such payment of reasonable and necessary expenses to be paid from the trust). Cutting-edge fiduciary liability insurance policies solve this problem by providing coverage for voluntary compliance program expenditures. These expenditures are subject to a policy sublimit that is part of the aggregate limit of the policy, ranging from $50,000 to $250,000. Under this sublimit of coverage, the insurance company essentially allows the insured to make a claim against itself and seek reimbursement from the insurer. The voluntary compliance coverage should cover both the expenses of attorneys and accountants to evaluate and investigate the possible regulatory noncompliance as well as the fees, penalties or sanctions paid to the governmental authority under an authorized voluntary compliance program. This coverage has become the most utilized fiduciary liability insurance feature in recent years. An employee benefit plan should consult its broker or insurance advisor to ensure that its fiduciary liability policy has an adequate voluntary compliance sublimit.

502(c) Reporting Violations

Like the first-party claims discussed above, professional liability policies are not designed to cover penalties. Most professional liability will define loss or damages to exclude any taxes, fines or penalties that are not affirmatively covered in the policy. The problem for individual fiduciaries of employee benefit plans is that they face individual liability from penalties under ERISA and several recent statutes, and these penalties cannot be paid out of plan assets. Once again, cutting-edge fiduciary liability insurers have begun to fill that void by providing coverage for certain penalties faced by employee benefit plans.

The most important penalty coverage is under ERISA Section 502(c) for alleged failures to respond to written requests for plan information. Section 502(c) provides for penalties for an administrator’s refusal or failure to supply required information. DOL is authorized to assess penalties of $100 a day from the date of refusal or failure, and every violation is treated separately for purposes of calculating the penalty. Section 502(c) claims are common claims because many benefit claims contain a tag-along reporting allegation. Section 502(c) has become even more valuable with the new reporting requirements of the Pension Protection Act of 2006, as these penalties are codified to be enforced under ERISA Section 502(c). Some carriers label this coverage “Pension Protection Act” coverage, but ensuring that a plan has a sublimit of coverage for 502(c) penalties will provide the necessary cover.

Health Care Reform

The Patient Protection and Affordable Care Act (ACA) amended and expanded ERISA and the Public Health Service
Act (PHSA) by incorporating ACA coverage mandates for individual, group, self-insured and fully insured employer-sponsored health plans into Section 715 of ERISA. To enforce these new coverage mandates, health plan participants can file direct actions under ERISA Sections 502(a)(1)(B) and 502(a)(3), the sections under which beneficiaries have long brought benefit claims. And, separate from beneficiary litigation, DOL already is implementing ACA requirements in its health plan audit process. ACA-related litigation is also likely under Section 510 of ERISA, which prohibits interfering with employee benefits and protects employees’ rights to present and future entitlements.

These new causes of action under ACA should be covered under the breach-of-fiduciary-duty coverage of the fiduciary policy. But what would not be covered automatically are the new penalties from various regulatory agencies for ACA violations. ACA penalties will not be covered under fiduciary insurance unless penalty coverage is expressly carved back from the general penalty exclusion. For example, IRS may assess excise taxes upon group health plans (and church plans) that do not comply with ACA insurance market reforms. For group health plans, the penalty on a non-complying plan sponsor is $100 per day of noncompliance per affected individual, and such violation must be self-reported to IRS on IRS Form 8928. The Department of Health and Human Services (HHS) enforces ACA insurance market reforms against health insurers and nonfederal governmental plans (such as state and municipal employee health plans) and may assess penalties of up to $100 per day, per affected individual, for each day of noncompliance. PHSA, which was incorporated into ERISA by reference, provides additional penalties, including fines up to $1,000 per day for failure to provide participants or beneficiaries with a summary of benefits and coverage explanations.

Like with Section 502(c) penalties, employee benefit plans must review their policies to ensure that they have a sublimit of insurance coverage for penalties related to health care reform.

HIPAA/HITECH

In 2008, Health Insurance Portability and Accountability Act of 1996 (HIPAA) privacy and security rules were broadened by the enactment of the Health Information Technology for Economic and Clinical Health Act (HITECH). HITECH enhanced patient privacy rights, provided individuals with new rights to obtain copies of their health information and fortified the government’s ability to enforce the law. In January 2013, the Office for Civil Rights (OCR) of HHS issued a final rule under HITECH with significant amendments to the HIPAA privacy, information security and breach notification rules.

One of the significant changes in the final rule is the expanded scope of HHS enforcement authority. HHS expanded liability by: (1) subjecting the HITECH Act and implementing regulation violations to a civil monetary penalty (CMP); (2) subjecting business associates and all downstream contractors to direct liability for certain HIPAA violations; and (3) increasing the monetary penalties for such violations. HHS detailed in the final rule that it will establish penalties based on the degree of culpability for each violation of a given provision. The precise fine will depend on factors set forth in 45 C.F.R. Section 160.408, such as the nature and extent of the violation, including the number of persons affected and time period during which the violation occurred, the nature and extent of the resulting harm, the history of prior compliance with the provision, the financial condition of the covered entity or business associate, and “such other matters as justice may require.” The annual maximum for identical violations is $1.5 million.

Fiduciary liability insurance carriers
have responded with penalty endorsements that are intended to reimburse employee benefit plans faced with HIPAA penalties. The key issue is whether the limit of the HIPAA coverage in a plan’s policy is sufficient to meet HHS CMP authority. HIPAA sublimits range from a low of $25,000 to the statutory maximum of $1.5 million.

**IRS 4975 Penalties**

A common problem for employee benefit plans is the failure to remit contributions within the prescribed time frame. Failure to remit contributions within the prescribed time frame results in a prohibited transaction subject to an excise tax under Code Section 4975. In addition, failure to timely remit elective contributions may give rise to civil penalties under ERISA and, if the failure is willful, may give rise to criminal penalties under ERISA. DOL’s VFC Program allows employers to voluntarily correct late deposits of employee deferrals. Like the other penalties discussed above, Section 4975 penalties or excise taxes will not be covered unless affirmatively covered under the policy. Cutting-edge fiduciary liability insurance policies will generally add Section 4975 coverage to the policy.

**Cyberinsurance**

Because they depend on modern technology, benefit funds face data breach and cyberloss risks, including threats from hackers, thieves, third-party contractors and employees. Moreover, benefit funds can also be affected by inadvertent misuse or loss of data. The fund’s computer systems may also need to be shut down and operations interrupted. Most insurance professionals recommend that a fund purchase a separate cyberliability insurance policy.

When evaluating cyberexposure, the difference between third- and first-party claims is crucial. Third-party claims involve claims from participants, regulators or other third parties relating to alleged losses from a broad range of wrongdoing by a plan in connection with a computer system or breach of privacy due to theft, loss or misuse of data. By contrast, first-party claims relate to injury incurred by the policyholder itself. First-party cyberclaims can include paying for the cost of providing notice to individuals whose identifying information was compromised and other expenses related to investigating a breach.

Employee benefit plans clearly have cyberliability exposure. The key question, however, is whether they need a separate cyberliability policy. Employee benefit funds could benefit from separate cyberliability coverage, but it is not always necessary. The reason is because many third-party claims are already covered under a plan’s fiduciary liability insurance policy. The definition of wrongful act in fiduciary liability insurance policies can be quite broad and, arguably, could cover many third-party data breach claims if alleged in the context of a breach of fiduciary duty or negligence in the administration of an employee benefit plan. Indeed, the best example is the express coverage in many fiduciary liability insurance policies for CMPs under HIPAA, which mandates that employers protect the privacy of employee medical and health-related information. But while certain third-party claims could already be covered under a plan’s fiduciary liability policy, or even its crime insurance policy, most first-party claims would not. Funds still have exposure for notification and contention restoration expenses even if, as often happens, no third-party claim is asserted. Consequently, to the extent any additional cybercoverage is needed, funds need first-party coverage, which can sometimes be provided as an additional coverage to a fiduciary policy.

**Benefit Overpayment Claims**

Fund administrators of defined benefit plans have the primary responsibility to correctly calculate and pay each participant’s retirement benefit on a monthly basis during the participant’s lifetime. But mistakes are commonplace, and a fund often is in a quandary when it discovers that a participant or beneficiary’s pension was calculated incorrectly or was otherwise paid incorrectly under the terms of the plan document. The problem for fiduciaries is that fund trustees and plan administrators are required to fix incorrect pension calculations under ERISA Section 404(a) in order to comply with plan documents. This correction must result in both the participant or beneficiary receiving the correct amount going forward and the fund recouping all past overpayments (or paying all past underpayments), with interest.

The fund has limited options to correct an overpayment of plan benefits. The fund can attempt to reduce the affected individual’s future pension payment or ask the participant to pay the money back. But these options are not always workable, particularly for a deceased participant. The plan sponsor can make the fund whole. But this option does not work for multiemployer plans in which the plan sponsor is effectively the board of trustees, which does not have assets to make the necessary contribution.
Whether the fiduciary liability insurance policy applies for benefit overpayment claims is murky at best, and fiduciary carriers historically have been reluctant to document a written position on the issue. The primary coverage problem is that a benefit overpayment issue rarely involves a third-party claim because no participant is going to complain about receiving too much money. So a fiduciary liability policy is likely not triggered by a benefit overpayment, unless a third party like DOL comes in and asserts a breach of fiduciary duty. Without a claim, many fiduciary liability carriers likely would not respond to the problem. In other words, carriers will correctly assert that they provide third-party coverage for benefit overpayments, but that does not mean they provide coverage for a first-party situation in which an overpayment occurs but no claim has been made. At least one carrier has responded to this trustee dilemma by providing first-party voluntary overpayment coverage with a small sub-limit of coverage. But very few insurance professionals have recognized the nuance between first- and third-party coverage for benefit overpayments, and many trustees remain uninsured for the most frequent iteration of this type of claim.

502(a)(3) Equitable Relief (Amara Surcharges)

Three years ago, the U.S. Supreme Court issued a landmark ERISA decision in CIGNA Corp. v. Amara. While the decision involved a challenge to CIGNA’s conversion of its traditional defined benefit pension plan to a hybrid cash balance plan, the case’s significance is proving to be much broader in regard to future equitable relief claims. With Amara, the Court declared that a form of monetary compensation is available under the equitable relief provisions in ERISA Section 502(a)(3), including a “surcharge” remedy upon a showing of “actual harm.”

Since the Amara decision, courts continue to wrestle with equitable relief under Section 502(a)(3). And although it will take time to sort out, the recent case law demonstrates that some courts will provide equitable relief to beneficiaries whose benefit claim is foreclosed under the normal 502(a)(1) avenue of relief. The question then becomes whether equitable relief is covered under a fiduciary liability insurance policy.

The vast majority of fiduciary liability insurance policies do not expressly address whether Amara-type equitable relief is covered, leaving policyholders with potential uncertainty. The uncertainty stems from the fact that a finding of equitable relief under Amara technically is not a benefit under the plan. A fiduciary carrier would likely defend the case under a claim for breach of fiduciary duty, but would the policy pay indemnity? This novel type of coverage issue must be addressed by fiduciary liability insurers to remove uncertainty for employee benefit plan fiduciaries. Indeed, at least one leading fiduciary carrier offers affirmative Amara indemnity coverage for equitable relief that would not be covered under a plan document.

Conclusion

Many new coverage enhancements are now available for fiduciary liability insurance protection. As liability and insurance policies become more complex, policyholders need the advice of a sophisticated insurance broker with fiduciary liability insurance experience to ensure quality coverage.

Endnote

1. 131 S.Ct. 1866 (2011).