Fiduciary Liability Insurance: *An Organization's Most Vital Safety Net*

By Sean Dauber, *Senior Vice President*, Medical Arts Insurance

Picture this ... An executive dies unexpectedly, leaving behind a loving family, including his second wife and three children who are still in grade school. He modified his life insurance when he remarried making his new wife the beneficiary of his policy – a benefit provided by the company where he was employed. However, due to an administrative oversight at the busy company, the beneficiary change form was misplaced and never mailed to the insurance carrier. As a result, the death benefit was paid to the executive's ex-wife, leaving his new family without financial means. This article briefly examines fiduciary liability and possible ways to handle the exposure.

What Is Fiduciary Liability Insurance?

Fiduciary Liability protects entities, their officers, directors, stockholders, partners and partnerships, as well as employees who are authorized to act in the administration of any plan, in the event of a claim against them by former, present, or future employees, their beneficiaries, or legal representatives. The damages, if covered, depend in part on negligent acts, errors or omissions in the administration of various benefit plans.

Fiduciary liability coverage, although not mandated by the Employee Retirement Income Security Act of 1974 (ERISA), is designed to cover losses caused by administrators, trustees, and other fiduciaries as a result of their wrongful acts committed while handling covered employee benefit programs.

What Types of Employer Plans Are Covered?

ERISA's definition of an employee benefit plan is very broad and can include any plan, fund, or program established or maintained for the purpose of providing employee benefits to its participants or their beneficiaries.

The rules and regulations of ERISA include very strict guidelines for fiduciaries of plans that fall under ERISA control. Some of the plans that are subject to ERISA regulations include the following:

- 401k plans, Pension plans, Profit-sharing plans and Employee Stock Ownership plans (ESOPs)
  - *Employers are fiduciaries in the choice of investment options offered, regardless of how the plans perform*
- Disability Insurance
- Group Health
- Group Life

Today, most employers have one or more plans for their employees that fall under ERISA guidelines.

Why is Fiduciary Liability Insurance Needed?

The passage of ERISA substantially increased the liabilities of fiduciaries in the United States. It also better defined some of the responsibilities and associated liabilities of fiduciaries. As its name suggests, ERISA was created to help protect the interests of pension and employee benefit plan beneficiaries.

Fiduciary liability insurance gives financial protection to fiduciaries of employee benefit plans against legal liability arising out of their role as fiduciaries, including the cost of defending those claims that seek to establish such liability.

Are You a Fiduciary?

According to ERISA, a fiduciary is an individual (or organization) if that person (or entity) exercises any discretionary authority or control over the management of any type of employee benefit plan. ERISA broadly defines employee benefit plans as "any one plan, fund or program established or maintained for the purpose of providing to its participants or beneficiaries employee benefits."

Fiduciaries include any individuals included in plan documents by name or title, or anyone who has discretionary authority over the administration or management of plans, such as:

- Human resources employees
- Appointed or implied fiduciaries
- Plan administrators

Are You Subject to Lawsuits, Fines and Penalties?

Strict standards are in place for fiduciaries and any breach of their responsibilities can result in lawsuits and statutory penalties. A lawsuit against a fiduciary can be filed by the Secretary of Labor, a plan participant or beneficiary, or by another plan fiduciary. The Treasury Department and the Department of Labor can also impose penalties or bring lawsuits against plan fiduciaries.

continued on other side

Under the law, fiduciaries can also be held liable for the acts of co-fiduciaries or outside entities. This means that the plan sponsor and individual fiduciaries can be subject to claims that arise out of the actions of various organizations that provide services to the plan. These can include consulting firms, professional administration firms, investment management companies, accounting firms, law firms, etc.

Are Your Personal Assets at Risk?

The plan sponsor (normally the employer of the plan participants) has a major financial risk if found liable, but is not the only one at risk. Individual fiduciaries are held personally liable for plan losses resulting from their breach of duties which can result in serious personal financial consequences.

You Had Me At Fiduciary!

Enter bonds, EBL and CGL, and it is not surprising that a lot of confusion exists regarding the differences among the fidelity bond that is required by ERISA, fiduciary liability insurance, and employee benefits liability insurance.

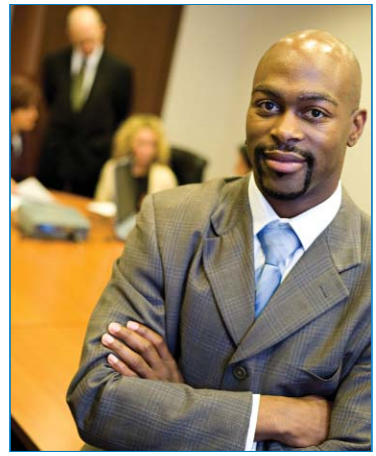
First, fidelity bonds are required by ERISA law. This is a form of insurance when dishonest administrators or trustees have financially harmed an employee benefit plan. These bonds may be used, but only for the benefit of the plan and the plan's beneficiaries. This bonding insurance will not protect the trustees themselves from liability claims and is thus completely distinct from fiduciary liability insurance.

A second related coverage is employee benefit liability (EBL) insurance. These insurance policies cover many claims arising out of errors or omissions in the administration of a benefit plan. Coverage is intended for the "administration" of these plans, including counseling employees, interpreting employee benefits programs, handling records, and enrolling, terminating, or canceling employees in specified plans on a timely basis. The coverage is provided either under a separate policy or as an endorsement to the employer's commercial general liability (CGL) policy.

EBL insurance does not cover all situations of fiduciary responsibility, especially those regarding imprudent investment of funds. EBL insurance normally only applies to claims rising out of administrative errors, thus it is very limited. Many clients believe that by having EBL coverage, they do not need fiduciary liability coverage, which is not true.

This article is for informational purposes only and does not constitute a legal opinion. Contact your legal representative for information specific to your needs.

How Can You Protect Your Company and Your Fiduciaries?



First, make certain your company has proper and adequate protection from one of the many A-rated insurance companies offering this coverage. While fiduciary liability insurance is one answer to limiting the liability risks of the plan sponsors and fiduciaries, risks of lawsuits can be significantly reduced by following these best practices:

1. Gather all materials related to specific benefit plans into a binder, including renewal letters from vendors and materials distributed to employees
2. Pay special attention to keeping benefits descriptions up to date. By law, all employees must have access to the plan document and be notified in writing of any alterations.
3. As a routine practice, make sure changes in your benefit policies are also written into any formal plan documents.
4. Perform a yearly self-audit, checking to see if plan document wording matches your current policies.
5. Use experienced firms to establish and administer employee benefit plans. Have a law firm with experience in ERISA regulations review the plans on a regular basis to make sure they are in compliance with ERISA. Use established investment firms for decisions regarding the investment and handling of plan assets. And finally, choose plan fiduciaries and administrators carefully.

Conclusion

A private company can help mitigate the personal liability of its fiduciaries by following the advice of outside experts and by selecting diverse, financially sound investments. However, it cannot entirely eliminate their personal liability. When faced with claims by current or former employees that seek wrongfully withheld benefits, companies will turn to insurers that have issued liability policies for the defense and indemnification of such claims.

Sources: Travelers Insurance Company, Rough Notes and ISO.

For more information about this brief, please contact **Sean Dauber,** Senior Vice President of Medical Arts Insurance, at **630-967-3806** or via e-mail at **sean.dauber@medicalartsins.com**.