Fiduciary Liability Insurance a "Must Have" for Plan Sponsors

ERISA creates personal liability for fiduciaries, which places the fiduciary's personal assets (house, bank accounts, etc.) at risk. In Barker v. American Mobil Power Corporation,[2] the court held an individual personally liable for losses to a plan, and stated, "While we are not unsympathetic to his burden, we note that fiduciaries may be insured for this type of liability. It would appear that prudent fiduciaries would have their plan or employers secure such insurance."

The Employee Retirement Security Act (ERISA) of 1974 imposes one of the strictest standards of care on fiduciaries responsible for management and administration of employee benefit plans. A fiduciary who fails to comply with the standard of conduct under ERISA may be personally liable for resulting losses. The Department of Labor (DOL), the plan administrator, participants, and their beneficiaries are all entitled by law to bring an action against a fiduciary.

ERISA defines a fiduciary as an individual or entity that exercises discretionary authority over the management and administration of a plan or plan assets and/or renders investment advice [ERISA Sec. 1002 (21)(a)]. Under ERISA, fiduciaries are bound by certain duties which include: to act solely in the interest of the plan's participants and beneficiaries, to act for the exclusive purpose of providing benefits to participants and beneficiaries, to act with prudence and diligence, and to diversify plan investments to minimize risk, and to act in accordance with documents governing the ERISA plan [ERISA 404(a)(1)]. Any organization that offers employee pension or welfare benefits faces a fiduciary liability exposure.

Claims made against fiduciaries can include allegations of a variety of mistakes in judgment. The most frequently alleged claims include:[1]

- Administrative error
- Cash balance plan conversions
- Civil rights denial or discrimination
- Denial or change of benefits
- Failure to adequately fund a benefit program
- Improper advice or counsel
- Imprudent investment
- Inappropriate selection of advisors or service providers
- Incorrect benefit calculation
- Lack of investment diversity
- Misleading representation
- Wrongful termination of plan

Good loss prevention practices, such as relying on the advice of independent experts and selecting diverse, financially sound investments, can reduce fiduciaries' liability exposures. However, it is impossible to completely eliminate a fiduciary's exposure to loss. This is why quality Fiduciary Liability insurance is essential to a comprehensive insurance portfolio.

The costs of defending a lawsuit alleging breach of fiduciary duty could be devastating to an individual fiduciary, and out-of-pocket settlement costs would only compound the damage. These costs, when borne by an organization sponsoring a pension plan, would be unwelcome. When borne by an individual, they can be ruinous.

Many organizations believe their ERISA Fidelity Bond[3] adequately protects the interests of fiduciaries. This is a dangerous miscalculation, as the ERISA Fidelity Bond protects the plan, not the fiduciaries themselves. Coverage under the Bond is limited to theft or fraud losses suffered by the plan.

Recent Cases with Implications for Fiduciary Liability

- Doctor Pleads Guilty to Converting Employee Pension Funds, *April 28, 2009*
- Former Pension Plan Administrator Pleads Guilty to Embezzlement from Employee Retirement Fund, *April 14, 2009*
- Former Corporate Benefits Manager of Hitachi America Pleads Guilty to Defrauding Health Care Plan of More Than Six Million Dollars, *March 11, 2009*
- Newark Man Pleads Guilty to Stealing Retirement Funds from 401(k) Accounts and Laundering the Proceeds, *February 20, 2009*

Source: U.S. Department of Labor[4]

[1] *Fiduciary Liability Loss Prevention*, Dan A. Bailey, Bailey Cavalieri LLC, Chubb & Son, a division of Federal Insurance Company, 2006

[2] *Barker v. American Mobile Power Corp.*, 64F.3d 1397, 1403 (9th Cir. 1995)

[3] ERISA requires fiduciaries of pension or profit sharing plans to post a bond for 10 percent of the assets in the plan. As an example, a 401(k) Plan with $5 million in funds must post a bond of $500,000. ERISA-required Fidelity Bond coverage is limited to protection against loss through fraud or dishonesty. For plan years beginning after January 1, 2007, the Pension Protection Act of 2006 (PPA) increases the maximum fidelity bond amount to $1,000,000 for plans that hold company stock.

[4] Criminal Enforcement News Releases 2009, U.S. Department of Labor (http://www.dol.gov/ebsa/newsroom/criminal/main.html)

Unlike the ERISA Fidelity Bond, Fiduciary Liability insurance is tailor made to protect individual fiduciaries against personal liability. A Fiduciary Liability policy is designed to protect fiduciaries against liability for their decisions and actions in two areas:

- Employee Benefit Liability protects plan fiduciaries from their liability arising out of errors or omissions in employee benefit program administration.
- Breach of fiduciary duty applies to a fiduciary acting in a reasonable and prudent manner in accordance with the standards outlined in ERISA or state laws.

A Fiduciary Liability policy generally protects fiduciaries, employee benefit plans, and plan sponsors against claims alleging wrongful acts. The policy covers settlements, judgments, and defense costs. There is no "standard" Fiduciary Liability policy language, so it is imperative to review available policies and select one that provides the broad coverage required by this exposure.

Fiduciary Liability insurance is essential to protect against claims arising out fiduciary responsibilities, duties and obligations imposed upon you by ERISA. According to ERISA, plan fiduciaries must act solely in the interest of the participants and beneficiaries of the plan. ERISA also mandates fiduciaries may be personally liable for breach of certain responsibilities imposed on them under the law. The rising number of ERISA civil cases highlights the importance of Fiduciary Liability insurance coverage in a well-structured insurance portfolio.

Kibble & Prentice not only places Fiduciary Liability insurance on behalf of employers, but also serves as a risk management resource, helping design non-insurance solutions to minimize exposures.

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