Segale Consulting Services , LLC

Fiduciary Liability

Most employers today provide some form of employee benefits for their employees; group health insurance, dental insurance, pension, retirement or profit sharing programs. The existing economic conditions have not reduced the need for employers to attract and retain the highest skilled employees and benefit programs are an integral part of most companies. However, by doing so, the company has also put themselves at increased risk of litigation arising out of those benefits. In addition, these employers are also struggling to understand the provisions enacted by the Healthcare Reform Law and the new regulations that are being promulgated now as a result of the new law. Non-compliance with any of these regulations can result in litigation not only from the employee or dependents, but a federal or state agency as well. On top of this, many highly skilled lawyers have entered the benefits field in recent years and employees are becoming more sophisticated and aggressive in using these litigators to address real or perceived wrongs committed by their employer.

The legal guidelines that govern the current majority of litigation was established in 1974 after the U. S. Congress passed the Employee Retirement and Income Security Protection Act of 1974 (ERISA). The law and resulting regulations was properly described by the U. S. Supreme Court as “comprehensive and reticulated’ (meaning forming a network). In addition to the potential litigation costs, ERISA contains a provision that allows the losing defendant to pay attorney’s fees for the plaintiff (the reverse is not true) which also provides an incentive for employees to sue and attorneys to take all cases with a good potential for a win.

From the “plan sponsor” employer, the board of directors and executive officers to the human resources supervisor (or manager), all have a significant legal liability exposure that cannot be removed by hiring a third party administrator. All of these persons have put their **personal assets** (ERISA Section 409) at risk to pay for defense and damages should they lose the case to plaintiffs.

All employers, large, small and everywhere in between face this expensive litigation and part of the insurance producer's job is to make sure their client understands these risks and offers the proper solution.

This article will not tackle the finer distinctions in the law, such as whether a party holds statutorily imposed liability or fiduciary liability, but suffice it to say that many parties have a personal liability exposure, whether imposed by express statute, fiduciary obligations or by common law decisions in tort and many of those parties may be unaware of that personal risk.

Potential Defendants

- The plan sponsor (employing company)
- The plan administrator
- Named fiduciaries
- The plan trustee
- HR administrator/manager
- Investment committees
- The company management: Executive officers or managing employees, such as general partners, managing members, etc.
- Board of directors
- Investment manager(s)
- Consultants, including Accountants and Attorneys

ERISA defines fiduciary in terms of function and conduct can make a party a "fiduciary" if that party (1) exercises discretionary authority or control over the plan management or (2) over plan assets (3) has discretionary authority over plan administration or (4) gives investment advice for a fee.

ERISA statute applies to both welfare and pension benefit plans. Welfare benefit plan is defined to include medical plans, disability benefit plans, vacation plans. Pension benefit plan is defined to include any type of plan that provides retirement income to employees or that defers income to periods beyond termination.

Contrary to popular belief, the most common claim brought by employees is not under the pension benefit section of the law, it is under the welfare benefit section and involves denial of benefit or was improperly reimbursed. Now, you might think that is covered under the Employee Benefit Liability insurance policy, but that policy has extremely restrictive language (hence the extremely low cost) and requires that the insured is negligent in plan administration. The policy also excludes legal liability arising from ERISA. The other frequent claim involves the pension benefit plan the typical claim is that the benefits were miscalculated or a surviving spouse did not properly receive the entitled benefits. Most of the claims are settled short of an appearance in court and are generally brought by an individual employee. Class action suit are less frequent, but involve a much great degree of potential loss and those claims are increasing.

Typical claims for pension benefit plans include:

- Stock-drop actions under ESOP, 401(k) plans and the like allege that plan fiduciaries acted imprudently by either offering employer stock or misrepresented the risks of investment in that stock.
- Fees and expenses actions allege that the fiduciaries charged or allowed excessive plan service fees to be charged
- Other types of allegations include improper investments, promised benefits were cut by management or violated statutory obligations
- Typical claims for welfare benefit plans include:
- Change in post-retirement medical benefits
- Premiums charged for insurance were excess
- Fiduciaries failed to scrutinize cost vs. benefit ratio properly

There are obviously many more allegations that can be brought against fiduciaries. So, all of this is by way of explaining the need for a carefully crafted administrative loss control program in conjunction with a broadly written Fiduciary Liability policy.

Look at your agency's overall book of business. What is the percentage of client's who have purchased Fiduciary Liability insurance? Next – how many of your client's have been offered this coverage (discounting those that provide absolutely no benefits at all)? Last – if your agency does not provide employee benefits coverage, do you ask about them for this purpose and document your files accordingly?

Many insurance companies offer Fiduciary Liability coverage; all forms are not created equally, however.

Since the plan sponsor may not have the funds to do this for the fiduciaries or even that the state of domicile may preclude the plan sponsor from protecting the fiduciaries, it will be up to each party to fund their own defense and pay damages with insurance to do this for them. Make sure that this is stressed as many clients, including the executives and the human resource manager may not know this. The coverage is designed to protect the defined insureds against claims that allege a breach of fiduciary duties. Note that the majority of Fiduciary Liability policies do NOT include coverage for other legal liability that may be imposed, whether by tort, contract, ERISA or any other statute. The suit must typically allege "fiduciary" liability.

Check the policy definition of "insured". It certainly should include the plan sponsor(s), officers, directors, trustees, employees (acting as fiduciaries), members of benefit committees as well as the employee plan trustee. The plan itself should also be included as an insured.

The policy will typically not include consultants, advisors or third party administrators. The insured should be advised to receive evidence that these parties carry professional liability insurance to cover their own activities.

One last, but very significant point is that Fiduciary Liability covers exactly that – fiduciary liability. The policy does NOT include coverage for settlor duties. What does this mean? Let's look at this recent case: *Federal Ins. Co. v. International Business Machines Corp.*, 2010 WL 4540585 (N.Y. App. Div. Nov. 9, 2010), The insurance company asked the court to provide a legal interpretation of their excess Fiduciary Liability policy and rule on whether or not coverage applied to this case. The court ruled that the insurer was correct and owed no indemnity for costs or damages. The finding was that the insured was acting in a settlor capacity, not a fiduciary capacity when the alleged age discrimination according to the ERISA provisions. Settlor capacity refers to the plan sponsor responsibilities that include the creation of the plan, amendments to the plan as well as termination of the plan. These functions are not subject to imposition of fiduciary liability, but as the above case illustrates, the plan sponsor can still be held liable under the law, in this case, age discrimination provisions of ERISA.

So, do your due diligence and offer this coverage, in writing, to your clients, even if the only benefit they provide is a fully insured health plan.