ERISA Fiduciary Insurance

A Lexis Practice Advisor® Practice Note by
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This practice note discusses the use of fiduciary insurance in protecting fiduciaries from liability when governing or providing services for employee benefit plans subject to the Employee Retirement Income Security Act (ERISA). Fiduciary liability insurance is an important, but often overlooked, aspect of a company's risk management plan. This type of insurance covers liabilities resulting from fiduciary errors or omissions when operating employee benefit plans. The insurance is optional and not a permissible substitute for a fidelity bond nor is it typically covered in a corporation's director and officer (D&O) liability insurance policy.

The practice note is organized around the following topics:

- ERISA Fiduciary Duties Generally
- ERISA Fiduciary Insurance
- Fiduciary Liability Policy Provisions
- Indemnification of ERISA Fiduciaries

See Employee Benefits Law § 12.07, Section 3(b)(ii)(B) for a further discussion of these issues.

ERISA FIDUCIARY DUTIES GENERALLY

ERISA imposes personal liability on fiduciaries who are determined to have breached their fiduciary duties, requiring them to make the plan whole for any losses incurred by such breach or to restore any profits the fiduciary gained by the use of plan assets. See ERISA § 409 (29 U.S.C. § 1109). ERISA also imposes joint and several liability among multiple fiduciaries who are responsible for a breach and, in some cases, on a non-breaching co-fiduciary for the breach of another co-fiduciary. ERISA § 405 (29 U.S.C. § 1105).

Fiduciary liability can arise from a host of reasons related to a fiduciary's activities. These can include:

- The selection or retention of imprudent investments
- Engaging in transactions that present a conflict of interest
- Failing to pay a participant the benefit amount due under the plan –or–
- Participating in an act of self-dealing

See ERISA § 404 and § 406 (29 U.S.C. § 1104 and § 1106). A fiduciary will also be liable for the acts of any agent it hires and must be prudent when selecting any plan vendor. ERISA § 409(a) (29 U.S.C. § 1109(a)). For example, an ERISA fiduciary may be challenged in its choice of an insurer that will satisfy plan liabilities in a terminated plan or the investment manager it selects to manage all or a portion of plan assets. Furthermore, the duty does not end at the selection process. There is a continuing duty to monitor service providers after the selection process. Tibble v. Edison, 135 S. Ct. 1823, 1829 (2015) ("This continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting . . . at the outset").

ERISA defines the term fiduciary for purposes of applying the ERISA statutory fiduciary duties and obligations. ERISA § 3(21) (29 U.S.C. § 1002(21)). ERISA § 402(a)(1) (29 U.S.C. § 1102(a)(1)) provides that any person (including any entity) is a plan fiduciary to the extent such person is identified in the plan as a named fiduciary or, under ERISA 3(21) (29 U.S.C. § 1002(21)), performs the following activities:

- **Manages or invests plan assets.** The individual or entity exercises any discretionary authority or control over the management of the plan or exercises any authority or control, whether or not discretionary, over the management or disposition of the plan's assets
- **Provides investment advice.** The individual or entity renders (or has the authority or responsibility to render) investment advice regarding the plan's assets for a fee or other compensation, whether direct or indirect –or–
- **Administers the plan.** The individual or entity has any discretionary authority or responsibility in the plan's administration

ERISA §§ 3(21)(A), 402(a) (29 U.S.C. §§ 1002(21)(A), 1102(a)). See also I.R.C. § 4975(e)(3). Even if a fiduciary is not identified as such in the governing documents, an individual or entity may still be a fiduciary based on functional terms of control and authority over plan assets. E.g., Martin v. Feilen, 965 F.2d 660 (8th Cir. 1992). ERISA fiduciaries are increasingly exposed to liability in making decisions relative to ERISA employee benefit plans and, given the risk of personal liability, require financial protection in the event they incur liability under ERISA. Unique issues exist both with respect to the types and extent of that protection.

To learn more about ERISA fiduciary duties, see ERISA Fiduciary Duties. Also see Prohibited Transaction and Parties in Interest Checklist (ERISA Rules) for identification of various prohibited transactions which, if violated, may lead to fiduciary liability. For a discussion about various cases alleging breaches in a fiduciary's duty, particularly in defined contribution plans, see 401(k) Plan Fee Regulation and Litigation.

ERISA FIDUCIARY INSURANCE

A fiduciary insurance policy protects employers and their plan fiduciaries from fiduciary-related claims for the alleged mismanagement of plan assets or failure to follow ERISA rules in the control or management of plan assets and payment of benefits. The coverage is not required but is highly recommended.

Civil action can be brought by the following claimants:

- Plan participants and beneficiaries
- Plan fiduciaries –and–
- The Department of Labor (DOL)

ERISA § 502(a) (29 U.S.C. § 1132(a)). The DOL may also work with the Internal Revenue Service (IRS) and, for most defined benefit plans, the Pension Benefit Guaranty Corporation (PBGC). On limited occasion, the U.S. Securities and Exchange Commission, the Department of Justice or State Attorneys General may initiate lawsuits against the plan or plan sponsor under statutes separate from ERISA.

Coordinating D&O and Fiduciary Insurance Coverage

At first glance, employers may believe that their D&O insurance policies extend coverage to claims against ERISA fiduciaries. However, most D&O policies do not protect against ERISA claims due to a common ERISA exclusion. Some do provide ERISA coverage by endorsement. As a first step to evaluating the adequacy of fiduciary liability coverage, review the client's D&O policy to confirm whether it covers fiduciary claims. If it does not, you will need to assist the client in adopting a fiduciary insurance policy or will want to review an existing, separate fiduciary insurance policy for the adequacy of fiduciary protection.

Many D&O policies set forth an explicit ERISA exclusion. The exclusion may be absolute or provide partial coverage. If you identify this provision, coordinate the scope of coverage afforded under the fiduciary policy as closely as possible with the scope of the D&O policy's ERISA exclusion. Do this with an eye to eliminating any coverage gap between the two policies. To minimize the risk of overlap, you can solicit and evaluate fiduciary insurance policies that do not set forth an ERISA exclusion.

Where the plan sponsor or its ERISA fiduciaries already have fiduciary insurance, evaluate the sufficiency of that coverage, gaining insight from the plan sponsor's risk management group, if possible. Consider that fiduciary liability exposure may have grown since the plan sponsor last purchased or assessed fiduciary liability or D&O insurance policy coverage. Advise the plan sponsor about the general need to reevaluate coverage periodically. For example, if the client is a publicly traded company that added an employer stock investment to its 401(k) plan, the policy should have coverage limits sufficient to address a possible "stock drop" challenge.

For a further discussion on D&O coverage, see Director and Officer (D&O) Insurance.

Other Insurance

While fiduciary liability insurance protects plan sponsors and their ERISA fiduciaries (officers, directors, and other individuals), plan sponsors may need to control other risks related to their employee benefit plans. The following sections also discuss other types of insurance that you may wish your client to consider that are similar to, but provide coverage distinct from, fiduciary liability insurance.

Employee Benefits Liability Insurance

While fiduciary liability insurance covers claims alleging breach of ERISA fiduciary duties, employee benefits liability insurance covers claims involving administrative errors that are not treated as breaches of fiduciary duty. For example, a failure on the part of plan personnel to name a beneficiary on a life insurance policy is an administrative act normally not covered under fiduciary liability insurance. Advise the plan sponsor on how best to coordinate these two types of coverage. Some fiduciary liability policies automatically include employee benefits liability coverage, or make it available as an endorsement. On the other hand, stand-alone employee benefits liability policies generally do not cover fiduciary liability exposures. Explore whether the fiduciary insurance coverage extends to administrative errors and fill any gaps in coverage.

IRS Liability Insurance

Under the Employee Plans Audit Closing Agreement Program (audit CAP), which is part of the Employee Plans Compliance Resolution System (EPCRS) for correcting qualified plan errors (see EPCRS Correction Rules and Procedures), the IRS can impose monetary penalties on trustees for failing to operate a retirement plan following IRS qualification requirements. Rev. Proc. 2016-51, 2016-2 C.B. 466, Part VI, § 13, 14. The IRS may impose penalties for not following the terms of plan documents even if plan operation complies with IRS qualification requirements.

Civil penalties, like audit CAP monetary sanctions, are not covered under a standard fiduciary or employee benefits liability policy. And most standard fiduciary liability policies do not cover the costs of correcting disqualifying defects for which a plan fiduciary is responsible. In both instances, plan sponsors bear the liability. Even if a fiduciary liability insurance policy does include audit CAP coverage, the coverage typically cannot exceed a nominal amount (e.g., $100,000). Plan sponsors may want to consider purchasing a separate IRS fiduciary liability insurance product to protect itself and its internal fiduciaries against any liability arising from a disqualifying plan operational failure. Some carriers offer enhanced audit CAP coverage as well as coverage for the cost of IRS corrections required resulting from an audit.

Cyber Insurance

Fiduciaries may wish to explore the possibility of purchasing insurance policies explicitly covering cybersecurity and privacy risks. The risk may extend to employee benefit plans. The likelihood is that existing fiduciary liability insurance coverage will not cover risks relating to liability related from state law causes of action (that are not preempted), for data breaches as opposed to liability resulting from a breach of an ERISA fiduciary duty relating to a privacy or security breach. Importantly, cybersecurity insurance may provide coverage not only for liability resulting from a security breach, but may also help cover the costs of any required notifications and other recovery steps associated with a privacy or security breach, even if the breach has not, and may never, trigger a liability claim by an injured party. For a further discussion on a plan sponsor's exposure for cyber-security risks, see Privacy Risks for Retirement and Other Non-Health Benefit Plans.

ERISA Fidelity Bonding Insurance

A fidelity bond involves a contract with an insurance company or other issuer agreeing to reimburse a benefit plan for losses resulting from dishonest acts (e.g., theft and fraud) by persons who handle plan assets. ERISA requires all plan trustees and employees who handle plan funds to be bonded. Generally, unless an exception applies, ERISA plan officials **must** be bonded for at least 10% of the amount of funds they handle, subject to a minimum threshold and maximum amount of $500,000 per person. ERISA § 412 (29 U.S.C. § 1112). The maximum may be higher in circumstances involving employer securities. An exception to the bonding requirement exists for corporate trustees and insurance companies that have a combined capital and surplus of at least $1 million. Other exceptions apply where:

- The only assets from which benefits are paid are from the employer's general assets or union funds –or–
- The entity is a registered broker dealer and subject to bonding requirements under 15 U.S.C. § 78c(a)(26)

ERISA § 412(a)(3) (29 U.S.C. § 1112(a)(3)). Other exceptions apply. See ERISA § 412(a)(1), (2) (29 U.S.C. § 1112(a)(1), (2)). For further discussion of the ERISA bonding requirement, see Bonding Requirements under ERISA.

FIDUCIARY LIABILITY POLICY PROVISIONS

Fiduciary liability insurance protects benefit plans and plan fiduciaries from losses caused by the unintended acts or omissions of fiduciaries. While fidelity bonds, discussed above, are mandatory under ERISA § 412 and cover intentional wrongdoings, like embezzlement, fiduciary liability insurance covers unintentional acts and coverage is optional and discretionary.

Fiduciary liability policies generally:

- Pay for the cost of defending a plan and plan sponsor (or other fiduciary) when there are allegations of a fiduciary breach –and–
- Indemnify (compensate) the fiduciary for monetary liabilities that result from a legal settlement or adverse judgment

As plan or plan sponsor counsel, consider the following issues when evaluating fiduciary liability insurance.

Insureds under ERISA Fiduciary Insurance Policies

The insured protected by a fiduciary liability policy are the benefit plan and specific persons affiliated with the plan, like the employer.

The Benefit Plan

All fiduciary liability insurance policies include the benefit plan as an insured. Such coverage is critical because ERISA specifically provides that an "employee benefit plan may sue or be sued as an entity." ERISA § 502(d) (29 U.S.C. § 1132(d)). In most suits filed under ERISA, common practice is to sue not only the plan sponsor and other fiduciaries, but also the plan itself.

In some cases, an employer sponsoring multiple plans may purchase one policy to cover more than one plan. Although this arrangement may result in some premium savings compared with insuring each plan separately, whatever limit of liability is selected applies to all plans combined and not to each plan individually. Consequently, if there is a major claim against one of the plans resulting in substantial defense and/or settlement costs, it may leave the other plans with little protection left for the remainder of the policy period. Most carriers do not permit restoration of the liability limit during the policy period, even with the payment of an additional premium.

Another problem with multiple-plan coverage is that policy cancellation can result when a carrier experiences a significant loss on behalf of any one of the plans. Since that result leaves all the plans without coverage, this is another risk of covering multiple plans under one policy.

Specific Persons as Insureds

Past, present, and future directors, executives, or employees of the plan sponsor or the plan in their capacity as plan fiduciaries are typically protected from claims filed during the insurance policy period. Normally, the coverage does not include the specific name of each fiduciary for coverage to be in effect. Consequently, new fiduciaries contemplated by the terms of the policy are automatically covered if fiduciary changes occur during the policy period.

The initial application form, however, usually asks for the names of the present fiduciaries and sometimes the names of all fiduciaries who have served the preceding five or six years. This information may become a factor when a carrier is determining whether to underwrite coverage, especially if any of the trustees have been involved in prior litigation or wrongdoing.

Fiduciary Insurance Purchaser

Fiduciary insurance is usually procured by:

- A plan sponsor for itself and/or its committees, directors, officers, or employees acting in a fiduciary capacity for any of its benefit plans
- A plan, for the same purpose –or–
- By third parties that act as fiduciaries as part of the services they perform on behalf of employee benefit plans

While employers want to protect their fiduciaries in fulfilling their fiduciary responsibilities, recognize that ERISA generally prohibits a benefit plan (and not the employer) from:

- Excusing a fiduciary from liability for a breach of duty or using plan assets to pay such a liability, even if the breach was unintentional or resulted from good faith actions –or–
- Paying for the defense of fiduciaries who breach their duties to their plan

ERISA § 410(a) (29 U.S.C. § 1110(a)). ERISA does allow fiduciaries to use plan assets when purchasing fiduciary liability insurance to cover losses resulting from plan fiduciaries' acts or omissions. Thus, the plan may be the insured. For a fiduciary to use plan assets for the payment of premiums:

- The plan must explicitly permit the use of plan assets for the purpose of paying fiduciary insurance premiums –and–
- The insurance policy must have a recourse provision

ERISA § 410(b)(1) (29 U.S.C. § 1110(b)(1)). The recourse provision gives the insurance carrier the right to seek reimbursement directly from a breaching fiduciary for costs incurred by the carrier arising from the breach. This requirement stems from congressional concern that trustees covered by non-recourse policies would otherwise have no incentive to take reasonable care in the performance of their fiduciary duties.

Waiver of Recourse Provision

While insurance carriers must comply with the ERISA requirement, they recognize that recourse provisions permitting them to seek reimbursement for paid claims significantly undermine the value of such coverage. Most carriers permit benefit plans to buy a waiver of the recourse provision. A waiver of recourse provision restricts the insurance company from recovering a covered loss from a fiduciary. The provision is either a part of the basic policy or an endorsement (i.e., an amendment or addition) to it. Normally, the insurer charges a nominal amount for the waiver, usually no more than \$100–\$200 a year for each fiduciary or other insured party. Notably, the extra charge cannot be paid out of plan assets; each fiduciary must pay for it individually. More commonly, the employer pays for it from its corporate assets.

Scope of Coverage

The beginning of a fiduciary liability policy typically sets forth a primary insuring clause. This clause reflects the carrier's basic intent about what actions, omissions, and losses will be covered by the policy and describes coverage limitations. A typical primary insuring clause states that the carrier will cover damages, settlements, judgments, and defense costs up to the policy limit of liability for any claim provided the claim meets three criteria:

- The claimant alleges the insured has committed a wrongful act
- The claimant seeks monetary damages –and–
- The claimant filed during the policy period (typically, renewable one-year periods)

Defense costs are usually included in the limit of liability; they involve the costs of investigating, defending, and settling claims. These items include attorney fees, adjuster services, court costs, bonds, and related expenses required as part of the claim settlement process. Generally, policies do not cover fines and penalties imposed by law, taxes, and punitive damages. Increasingly though, particularly in view of the IRS correction program (particularly EPCRS) and the DOL's Voluntary Fiduciary Correction Program (VFCP), insurers may be willing to issue policies that cover certain penalties that can be assessed under those agency programs. See 71 Fed. Reg. 20,262 (April 19, 2006), updated DOL VFCP. In addition, policies can and have covered DOL civil penalties under ERISA §§ 502(i), 502(l), and 502(c) (29 U.S.C. §§ 1132(c), (i) and (l)).

Remind the plan sponsor that outside organizations, such as service providers to the plan, are not insured under its fiduciary policy; these policies cover only plan and fiduciary liability for the acts of inside entities. Accordingly, plan sponsors should seek to include a requirement in its service provider agreements with outside fiduciaries requiring that entity to maintain its own fiduciary liability coverage for its activities and errors in dealing with the sponsor's plans.

Wrongful Acts

The key to determining what is covered by a fiduciary liability policy is understanding what the insurance carrier considers a wrongful act. Generally, a wrongful act is "any alleged or actual violation by the insured of any of the responsibilities, obligations or duties imposed on fiduciaries pursuant to employee benefit law." Some policies extend this language to include "any alleged or actual errors, omissions, or negligence on the part of the insured in the administration of the plan." This additional language provides coverage for mistakes in the day-to-day operations of the plan (such as recordkeeping) even if there is no allegation of a fiduciary breach. This is the type of omission discussed in "Employee Benefits Liability Insurance" in the section ERISA Fiduciary Insurance, above.

Filing a Claim

The policyholder should file a claim as soon as possible after it becomes aware of a cause of action. A claim under the policy may arise from any of the following:

- A written demand or a civil, criminal, or arbitration proceeding for monetary, non-monetary or injunctive relief
- A formal agency or regulatory adjudicative proceeding
- A fact-finding investigation by the Department of Labor –or–
- A written request to toll the statute of limitations relating to an ERISA violation

In addition, most fiduciary policies cover any actual or alleged act, error or omission by an insured while acting in a settlor capacity with respect to a plan. A settlor act is an act done in a corporate capacity, not a fiduciary capacity, such as establishing, amending, or terminating a plan. See ERISA Fiduciary Duties — Duties and Obligations of ERISA Fiduciaries for a further discussion of settlor versus fiduciary duties.

Duty to Defend

Most fiduciary policies are written to provide for a duty to defend. This provision means typically that as long as there exists a single coverable allegation against an insured, the carrier must defend the entire claim. However, the duty to defend may be a point that you wish to explore as a policy provision. Some fiduciary insurance policies provide that the insurer has the right to defend any covered claim. This can lead to awkward results and you may wish to negotiate a choice of who is to defend. One such example is where the insurer selects defense counsel for fiduciaries in an ERISA stock drop class action while those defendants select their own counsel in the tandem securities class action. Conflicts may result! When evaluating a policy, consider advising the plan sponsor or its fiduciaries either to seek to:

- Eliminate the insurer's right to defend covered claims –or–
- Provide the insured with a consultation and consent right when selecting defense counsel

The latter provision may exist but be subject to restrictions. For example, the insured may be required to choose from a list of law firms, particularly in case of a class action.

Tie-in Limits

ERISA "stock drop" class actions arise out of and allege essentially the same wrongdoing as alleged in securities class actions. Since D&O insurance policies insure against losses in those class actions, some insurers require coordinated (i.e., tied-in) limits when they issue both types of policy to the same company. Advise plan sponsors to weigh the advantages and disadvantages of placing their D&O insurance and fiduciary insurance policies with different insurers against using a single insurer that subjects the coverage to tie-in limits.

Consider two particular issues if the insurer attaches a tie-in of limits endorsement:

- Whether the tie-in applies only to a single claim covered under both policies or to all claims covered under one or both policies
- Whether the excess policy coverage (i.e., the liability coverage limit of the primary policy has been paid) in the D&O and fiduciary policies drops down if the underlying policies are exhausted by reason of the tie-in limit

Even if the insurer does not require a tie-in limits endorsement, the insurer may require an allocation of loss between the two types of policies, which may lead to insufficient coverage. These limits, and the potentiality for insufficient coverage, further recommend that the plan sponsor have two insurers, not one.

Losses

For a claim to be covered under a fiduciary liability policy, carriers generally require that the claimant be seeking to restore losses. Losses typically include: damages, settlements, judgments, defense costs, and certain covered penalties. Claims that do not meet this definition include benefit claims, wages, taxes, and nonpecuniary claims.

Benefit Claims

Benefit claims are participant disputes limited to whether the participant is owed a benefit and the nature of that benefit. See ERISA § 502(a)(1)(B) (29 U.S.C. § 1132(a)(1)(B)). Normally, the dispute is limited to issues like eligibility, benefit amounts, type of benefit payable, or interpretation of plan provisions. Benefit claims generally do not include claims for damages. The claimants merely seek payment of a benefit and if they win, the plan simply pays the amount it is deemed legally obligated to pay.

While a fiduciary insurance policy will not cover benefit claims, the policy will cover requests by a claimant for damages and/or attorney fees appended to a benefit claim. For example, where a claimant contends he was entitled to a higher monthly pension benefit, and wins in court, the plan will be responsible for that increase in monthly payment, not the insurance policy. However, the policy will provide coverage for defending that claim.

Nonpecuniary relief

Fiduciary liability losses generally do not include claims for nonpecuniary relief. This includes actions under ERISA § 502 (29 U.S.C. § 1132) which section specifically authorizes participants, beneficiaries, the DOL, and fiduciaries to take civil action to enforce or clarify a participant's rights or obtain equitable relief for an ERISA violation. An example would be a situation where the DOL prohibits fiduciaries from making certain real estate investments considered imprudent or a court order removing a fiduciary and prohibiting that person from acting in any future fiduciary capacity.

Claims Made

Fiduciary liability policies are usually claims-made policies, under which claims are covered for conduct taking place prior to or during the policy period. Under ERISA, the statute of limitations period is six years for a fiduciary breach, unless the claimant had actual knowledge, which will reduce the limitations period to three years. ERISA. § 413 (29 U.S.C. § 1113). Thus, a viable claim can potentially arise five years after the alleged breach of fiduciary act occurred. The submission of such claim in the current year would be covered under the current policy. In effect, fiduciaries have retroactive coverage, a comforting thought for fiduciaries who may be relatively new and may not be fully aware of earlier fiduciaries' or co-fiduciaries' decisions.

Reporting a Claim

As indicated above, a claim has to be first asserted against during the policy period. The covered party must then report the claim to the carrier as soon as practicable during this same policy period. An otherwise covered fiduciary claim not reported in a timely manner and in accordance with the policy's reporting provisions may not be covered. Instruct your clients accordingly. Consult the policy for the terms of any post-policy or extended reporting period. Where an opportunity is missed, the client may have to purchase extended coverage, although this may exclude known omissions.

Allocations

On occasion, a claim may be made against both the insureds and uninsured parties such as third-party administrators or other plan vendors. Here, the insurance carrier may seek to allocate defense costs related to the claim made against the insureds and non-insureds. The policy may also include a coverage coordination clause which operates where more than one insurance policy applies. Thus, different insurers may have to allocate defense costs between or among them. An employer who has employee benefits liability insurance (see "Employee Benefits Liability Insurance" in ERISA Fiduciary Insurance, above) may also have to allocate defense costs between its policies (for example, where an omission in plan administration occurs in tandem with a claim alleging fiduciary breach).

Another time where there may be an allocation is when an ERISA § 510 claim is made. ERISA § 510 (29 U.S.C. § 1140). ERISA § 510 makes it unlawful to take an adverse action (i.e., discharge, discriminate) against a participant for:

- **Retaliation:** Exercising their rights under an employee benefit plan
- **Interference:** For the purpose of interfering with the attainment of a right the participant may become entitled to –or–
- **Whistleblowing:** Where the participant has given information or is about to testify in a proceeding

An ERISA § 510 claim may also include claims under other statutes such as the Age Discrimination in Employment Act, Family Medical Leave Act, American with Disabilities Act, Fair Labor Standards Act, or Pregnancy Discrimination Act. These other claims will be excluded under the fiduciary liability policy but may be covered under another policy such as an Employment Practices Liability Policy (a policy covering claims made by employees alleging (1) discrimination based on sex, race, age or disability, (2) wrongful termination, (3) harassment, or (4) other employment-related issues).

For a discussion regarding ERISA § 510 claims, see Discrimination, Retaliation, and Whistleblower Claims (ERISA § 510).

Other Fiduciary Liability Insurance Exclusions

The policy may specify certain exposures that are excluded from coverage. Exclusions specified in policies may result from:

- Definitions of terms
- Specific exclusions in the basic policy –or–
- Endorsements attached to the basic policy

Regardless of how and where they are presented, exclusions can have a significant impact on the scope of coverage and require careful examination.

Exclusions by Definition

Some policy exclusions are expressed via policy definitions. For instance, fiduciary policies usually define loss as not including:

- As discussed above, (i) damages for routine benefit claims unless the claimant seeks compensatory damages and/or the fiduciaries are held personally liable and (ii) nonpecuniary claims based on ERISA § 502 (e.g., DOL injunction)
- Taxes or tax penalties (other than covered penalties)
- Punitive or exemplary damages
- Matters which may be deemed uninsurable under the law

Exclusions by Enumeration or Endorsement

Typically, fiduciary liability policies specifically exclude certain coverages. Under those exclusions, the insurer will not pay for the claim regardless of whether a court requires the fiduciary to pay the claimant. Frequent policy exclusions apply for:

- Contractual liabilities, such as hold harmless clauses
- Benefits payable to participants
- Fraud, illegal personal profiting, criminal or malicious act, if such conduct was determined in a final, non-appealable judgment or adjudication
- Any violation of any of the securities laws
- Violation of the Racketeer Influenced and Corrupt Organizations Act or "RICO"
- Acts arising out of the insured's employment of any individual (including wrongful dismissal, discrimination, harassment, or other employment-related claim)
- Claim brought by or on behalf of an insured (also known as the "insured v. insured" exclusion)
- Claims that fall under the purview of commercial general liability insurance, such as bodily injury, property damage, libel, or slander
- Failure to collect employee benefit plan contributions from the sponsor or other participating employer
- Failure to fund the plan in accordance with ERISA
- Liability where the fiduciary receives a personal financial benefit and the facts establish that the fiduciary personally profited from that benefit
- Obligations stemming from workers' compensation, unemployment insurance, or disability statutes
- Willful or reckless violation of any statute, rule, or law
- Pending or prior litigation

The exclusion for willfully or recklessly violating a statute is troublesome. Lawsuits frequently allege that fiduciaries have not only breached a fiduciary duty but that the violation of law is willful or reckless. Some policies are not clear whether the mere allegation of willful or reckless conduct is sufficient for a carrier to exclude defense costs or whether defense costs will be covered until the guilt or innocence of the trustees has been determined by the court (i.e., a final adjudication). A mere allegation is not a sufficient trigger for the exclusion to apply. Clarify this matter with the carrier when reviewing the insurance policy.

The insurer may add other exclusions to the policy, such as:

- Liability of any insured to any other insured
- The rendering or failure to render services contracted for with any service provider
- Any professional services (e.g., legal, accounting, actuarial, investment counseling, or fund managing) rendered or that should have been rendered by an insured or third party

- Any wrongful act alleged by the PBGC, or a person or entity against whom PBGC has asserted any claim or demand
- Defects and potential defects in the operation of a plan that were identified in a fiduciary audit operational review conducted at the insured's request for the purpose of obtaining enhanced IRS liability insurance coverage

Not all exclusions are in the basic policy; some may be attached to the basic policy as endorsements or riders. For example, an insurance rider may exclude coverage for real estate in which the plan invests unless the investment is directed or managed by a qualified professional asset manager (QPAM) (i.e., under Prohibited Transaction Exemption (PTE) 84-14; 49 Fed. Reg. 9494 (Mar. 13, 1984)). Discuss any specific exclusions with the plan sponsor to determine whether the exclusions are unduly restrictive and assist the plan sponsor in negotiating a revised policy to include any coverage that otherwise would be excluded.

Policy Cancellations

Plan fiduciaries should contact plan counsel as soon as possible after receiving a cancellation notice. This meeting should occur prior to the cancellation date (usually a period of 30 days or less from the date of notice) to identify any wrongful acts that may have been committed prior to the cancellation date requiring reporting to the insurer.

Ask the insurer how much detail will ensure these potential claims are covered if eventually made. Since a claims-made extension results in more comprehensive future coverage for the plan, assist the plan sponsor in communicating with the insurer as quickly as possible.

Extended Coverage

Most fiduciary liability insurance policies permit plans to purchase extended coverage for another 6 or 12 months after a policy period ends, often for a premium 25% to 75% higher than the premium charged for the most recent policy period. Such coverage extends to wrongful acts occurring prior to, but not discovered until after, the policy's cancellation. Extended coverage provides fiduciaries and plan sponsors with some additional protection in the event an unanticipated claim arises. No coverage is provided, however, for a claim based on a wrongful act committed after the cancellation date.

Policies vary widely in terms of the time allowed to purchase extended coverage. In some cases, the plan sponsor must exercise the option prior to the effective date of cancellation. In other cases, the extended coverage must be purchased no later than 10 or 30 days after cancellation. Consequently, if the insurer cancels a policy, fiduciaries and plan sponsors should ask plan counsel to check immediately on this time limit.

Whether or not extended coverage is worth the increased premium is a decision fiduciaries and plan sponsors, in consultation with their plan counsel, will have to make based on individual circumstances. If coverage is picked up immediately from a new carrier, then there may be limited value to purchasing the extension unless the new policy has coverage limits for prior wrongful acts. If it will take some time before a new insurer processes an application for coverage, purchase of extended coverage may be essential. This is paramount if the sponsor or fiduciaries fear a major claim will be filed based on a wrongful act allegedly committed prior to the policy cancellation.

Change of Control Provisions

Most ERISA Fiduciary Insurance policies contain a "change in control" provision, the purpose of which is to address risks, and coverage limitations, occurring if the insured is a party to a change in control. Most policies provide that the policy remains in force for the remainder of the policy period, but typically limit coverage to claims for wrongful acts committed prior to the change in control. This means you should visit and review the policy where your client is contemplating a purchase or is the subject of an acquisition, to understand the nature of the change in control provision. You may need to suggest provisional coverage or be sure that the acquirer's policy embraces wrongful acts related to your client's benefit plans. In the case of an acquisition during the policy period, many policies provide some level of automatic coverage for the target's plans. Often the added risk is subject to a limitation such as a fixed percentage of the insured's plan assets (e.g., additional coverage cannot exceed 10% of the insured's gross plan assets) for wrongful acts on and after the acquisition date.

Settlement Clauses

Since the insurance carrier is providing all or part of the moneys should the parties wish to settle a suit, a common policy provision requires that settlements generally have to be mutually agreed upon by the insured and the insurer. Problems can easily arise in the context of a suit. For example, the carrier may wish to settle and the insured does not. Policies often include provisions which limit the carrier's liability in this case to the amount of the settlement offered. These are typically referred to as "hammer clauses." It's important to be alert to this provision for any claims filed.

INDEMNIFICATION OF ERISA FIDUCIARIES

Plan sponsors and their ERISA fiduciaries should evaluate not only the adequacy of ERISA Fiduciary Insurance coverage, but also the extent to which the plan sponsor will indemnify ERISA fiduciaries. This is especially true in light of the increased liability exposure of ERISA fiduciaries resulting from the rising number of ERISA class action lawsuits.

While a plan cannot relieve a fiduciary from liability arising from an alleged or actual breach, ERISA does not preclude a person other than the plan or its trust, like the employer, from indemnifying a plan fiduciary. ERISA § 410(a) (29 U.S.C. § 1110(a)). The Department of Labor has permitted indemnification agreements that do not relieve a fiduciary of responsibility or liability under ERISA. See 29 C.F.R. § 2509.75-4 (Interpretative Bulletin 2509.75-4). The regulations state that "[i]ndemnification provisions which leave the fiduciary fully responsible and liable, but merely permit another party to satisfy any liability incurred by the fiduciary in the same manner as insurance purchased under ERISA 410(b)(3), are . . . not void under ERISA 410(a)." Harris v. Greatbanc Trust Co., 2013 U.S. Dist. LEXIS 43888. Thus, ERISA permits an employer plan sponsor to indemnify a plan fiduciary. ERISA limits the ability to indemnify. However, while indemnification is possible and permitted, it cannot function to hold fiduciaries harmless or exculpate them from liability.

Limits on ERISA Indemnification Provisions

The availability of an employer indemnification of plan fiduciaries may be limited by law. While Interpretative Bulletin 2509.75-4 indicates that the DOL accepts employer indemnification provisions, courts have questioned indemnification provisions that encourage undesirable fiduciary behavior, such as when an indemnification right by its terms could encourage undesirable fiduciary behavior. E.g., Leigh v. Engle, 619 F. Supp. 154 (D.C. Ill. 1985), aff'd, 858 F.2d 361 (7th Cir. 1988) (holding that ERISA does not allow indemnification of legal expenses when a breach of trust had been established).

Impact of State Indemnification Statutes

State corporate indemnification statutes typically permit a companies to indemnify their directors, officers, employees, and agents for losses incurred on account of claims against such persons acting in such capacity. These same indemnification statutes also permit a corporation to indemnify any person who serves at the request of the corporation as a director, trustee, officer, employee, or agent of another entity or other enterprise.

For example, in Delaware the statute authorizes permissive indemnification by the corporation provided that the officer or director acted (i) in good faith and (ii) in a manner reasonably believed to be in the best interests of the corporation. 8 Del. C. § 145. The statute mandates indemnification when an officer or director has been "successful on the merits or otherwise in defense" of any action. 8 Del. C. § 145(c). It also authorizes Delaware corporations to advance their litigation expenses, including attorneys' fees (subject to repayment if unsuccessful). 8 Del. C. § 145(e).

Some states expressly authorize a corporation to indemnify its employee benefit plans fiduciaries. For example, Texas permits indemnification of plan fiduciaries whether or not the fiduciaries serve at the corporation's request. Such indemnification, though, is merely permissive unless mandated by the corporation's bylaws or certificate of incorporation. E.g., Tex. Business Organizations Code § 8.101(b).

RELATED CONTENT

Practice Notes

- ERISA Bonding Requirements
- Director and Officer (D&O) Insurance
- ERISA Fiduciary Duties
- ERISA § 404(c) and QDIA Safe Harbors
- Investment Committee Issues for Defined Contribution Plans

Analytical Materials

- Employee Benefits Law § 12.07, section [3][b][ii][B]
- Liability of Corporate Officers and Directors § 9.16

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José Jara has over 20 years of Employment, ERISA, and employee benefits law experience and is a partner and the ERISA and Employee Benefits Practice Group Leader at CKR Law. José is a frequent speaker at employee benefit seminars. In the field of employee benefits law, he provides innovative solutions to his clients by incorporating into his guidance a business and practical perspective.

José has extensive experience in:

- Guiding plan sponsors and fiduciaries through U.S. Department of Labor (DOL), Employee Benefits Security Administration (EBSA) – audits and investigations; and Office of the Solicitor – lawsuits;
- Defending fiduciaries and boards of directors against ERISA class action litigation alleging breach of fiduciary duty (imprudent investments, employer stock, cash balance, excessive fees, delinquent employee contributions, ESOPS);
- Advising on fiduciary responsibilities, plan fees and expenses, plan asset regulations, and ERISA prohibited transactions and exemptions;
- Correcting retirement plan errors under: the Internal Revenue Service, Employee Plans Compliance Resolution System (EPCRS), fiduciary violations under the DOL Voluntary Fiduciary Correction Program (VFCP), Annual Reporting failures under the DOL Delinquent Filer Voluntary Compliance Program (DFVCP); and
- Handling Withdrawal Liability Arbitrations and advising on Controlled Group and Affiliated Service Group, Plan Funding, and PBGC issues.

In the professional liability insurance arena, José advises on D&O, Fiduciary, and EPL insurance issues. As a former claims director at a major insurance carrier, he fully understands the triad relationship between the law firm, the client, and the insurance carrier and in litigation matters manages the relationships to produce optimal results for the trio involved. He has also acted as monitoring counsel and coverage counsel. José has provided advice to underwriters on a variety of provisions of the insurance policy and taught underwriters on spotting red flags and mitigating risks.

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