Fiduciary Insurance—Understanding Your Exposure
First Party vs. Third Party

**ERISA Plan**

**First Party**

- Named plan fiduciaries or anyone acting in the capacity as a fiduciary
- Has direct relationship to the plan as an owner, employee, or trustee

**Third Party**

- Provide services to the first party, plan, and/or trustees
- Can include Investment Advisor, Plan Consultant, Accountant or Third-party Administrator
- May still act in a “fiduciary” capacity
Overview

- Who is a Fiduciary
- Plans Subject to ERISA
- Claim Exposure
- Fiduciary Insurance
- FAQs
- Conclusion
ERISA fiduciaries are either **named in the plan document** or are **identified by the function they perform for the plan**. Since fiduciary status may be based on a person’s responsibilities rather than title, it is possible to be a fiduciary **without** being aware of it.

Regardless of whether a person has knowledge of his/her status, an ERISA fiduciary must:

1. Act for the exclusive purpose of providing retirement benefits to plan participants
2. Fulfill a duty of loyalty to the participants
3. Act prudently
4. Avoid conflicts of interest and acts of self-dealing, known as prohibited transactions
Plans Subject to ERISA

**Pension Plans**
- Profit Sharing
- Thrift and Savings (401k)
- Employee Stock Ownership (ESOP)
- Tax Reform Act Stock Ownership Plans (TRASOP)

**Welfare Plans**
- Life Insurance
- Hospital/Surgical/Medical Insurance
- Dental and Vision Care Insurance
- Accident Insurance
- Disability Insurance
- Scholarship Plans (funded)
- Supplemental Unemployment
- Prepaid Legal Services
- Some Severance Pay Plans
Fiduciary Responsibilities

• ERISA requires that a **fiduciary** of an Employee Benefit plan acts solely in the best interests of participants and beneficiaries

• Fiduciaries can be held **personally liable** for any breach of their responsibilities

• Recent studies indicate significant **increases in claims severity and frequency** against fiduciaries over the past several years
Claim Statistics

Fiduciary claims are filed at a higher rate than EPLI or Sexual Harassment claims.

- **$800,000** average cost of a Fiduciary claim
- **$125,000** average defense costs of Fiduciary claims

50% of Fiduciary claims stem from benefit disputes, with the remainder of claims the result of administrative errors or miscommunication.

Plan participants file the majority of claims.
Claim Examples

Scenario 1

A Health Plan sponsor allegedly did not monitor the performance of its Third-Party Administrator (TPA) and retained the company despite its inadequate performance.

**Loss:** $230,000

**Loss Lesson:** Use of a Third-Party Administrator does not eliminate your liability as a fiduciary. In fact, it is your duty to ensure that all third parties have sufficient experience and carry Errors & Omissions insurance that would cover *their* act as a fiduciary.

Scenario 2

Plan sponsors of a Pension Plan were accused of failing to inform the employees of the penalties for withdrawing from the Annuity Plan or the excessive surrender charge on the Life Insurance policy.

**Loss:** $72,000

**Loss Lesson:** Understanding your roles as a Fiduciary is crucial. It is important to ensure that the plan participants are well educated on their decisions, prior to making them. Be sure to utilize your resources (i.e. TPA, Advisor, Investment Committee, etc.) prior to making a decision or offering advice that you are uncertain about.
What is Fiduciary Insurance?

**Fiduciary Liability Insurance:**

- Pays the legal liability arising from claims for alleged failure to prudently act within the meaning of the Pension Reform Act of 1974

- Protects the personal assets of a plan fiduciary from allegations of breach of fiduciary duties

- ERISA explicitly allows for the purchase of Fiduciary Liability Insurance

- Failure to purchase Fiduciary Insurance could potentially be a breach of fiduciary duty if a claim arises and no insurance is in place that was readily available
What Can Fiduciary Insurance Cover?

- Breach of fiduciary duties
- Negligent errors and omissions
- Improper disclosures to plan participants
- Remiss investment advice
- Imprudent choice of outside service provider (OSP)
- Faulty advice of counsel
- Improper amendments to plan documents
Why Purchase Fiduciary Insurance?

- To avoid personal liability
- To avoid loss of plan assets
- There is no immunity against Fiduciary liability
- Conflict of interest between D&O duties to the company and to the plan
- Protection in the event of Merger or Acquisition
- Many Directors & Officers do not realize they are fiduciaries
Cost of Fiduciary Insurance

Premium for Defined Contribution Plans is subject to underwriting review and is based on plan assets.

<table>
<thead>
<tr>
<th>Plan Assets</th>
<th>Avg. Premium*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000,000</td>
<td>$800</td>
</tr>
<tr>
<td>$3,000,000</td>
<td>$1,200</td>
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<tr>
<td>$5,000,000</td>
<td>$1,200 - $1,500</td>
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*Premium based on $1,000,000 coverage limit, and are averages used for demonstrative purpose only. Actual premium determination is subject to review of completed application.
Frequently Asked Questions

Q: What are a fiduciary’s liabilities under ERISA?
A: Fiduciary liability is personal, absolute and unlimited. ERISA made fiduciaries personally liable for their actions.

Q: What are some common mistakes made by employers under ERISA?
A: "Promised" coverage, benefits or promised performance are at the core of most ERISA lawsuits. In recent years, there has been an increase in the number of lawsuits involving the management and misuse of plan assets.

Q: Does my fiduciary bond cover my fiduciary exposure?
A: Although nearly 50% of fiduciaries think their ERISA-mandated fidelity bond protects their personal assets, it does not. The fidelity bond protects the plan from loss due to dishonest acts of those who handle the plan assets.
Q: Is there a difference between an ERISA bond and Fiduciary Liability policy?

A: Yes. You are required by ERISA to bond, or insure, your plans from employee dishonesty in the lesser of $500,000 or 10% percent of all plan assets. The U.S. Department of Labor has the authority to prescribe a bond in excess of $500,000, up to 10% of the value of all plan assets at the beginning of the plan year. Fiduciary liability coverage is not required by ERISA.

Q: We have turned all of our investment decisions over to our bank, insurance company agent or other professionals. Is this a good business practice?

A: Plan fiduciaries can never completely insulate themselves from liability. Plan fiduciaries can take steps to reduce their personal liability, however, they are ultimately responsible for the management and administration of the benefit plan.

Q: Isn’t Fiduciary Liability insurance coverage included in our Directors & Officers Insurance policy or Employment Practices liability Insurance?

A: Review all of your insurance policies carefully. Most other types of insurance policies exclude fiduciary liability exposures as well as exposures pertaining to ERISA.
Key Points

• The exposure as a fiduciary is **very broad** and **claim frequency is increasing**

• ERISA allows for the purchase of Fiduciary Insurance and is a prudent step to take to **protect the company**, the **plan**, and your **personal assets**

• Fiduciary Insurance is **readily available** and **affordable**
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- National programs serviced by licensed professionals

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affinity group programs

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individual accounts

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million in premium placed

160+
associates

11 Years
average tenure
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OVERVIEW

This PowerPoint presentation is intended as a general overview to educate a client about potential fiduciary exposure and the availability of Fiduciary Liability Insurance. It is by no means a comprehensive explanation on the subject and only an actual insurance policy can provide actual policy conditions, provisions, and exclusions.

TUTORIAL

The following are talking points to assist with the presentation of the PowerPoint.

Cover Slide

Slide 2 – First Party vs. Third Party

The intent of this slide is to provide a brief explanation of the difference between First Party and Third Party in insurance terms. Fiduciary Liability Insurance is First Party coverage. It protects plan fiduciaries that have a direct relationship to the plan. An Investment Advisor or Third Party Administrator (TPA) is a Third Party who is providing services to the First Party.

Fiduciary Liability Insurance does not provide coverage for Third Parties. It is our opinion that if coverage for a Third Party was offered under Fiduciary Liability a conflict of interest is created. The First Party would be paying the Third Party for their services as an expert, while at the same time paying for insurance coverage to protect them from liability from breach of their duties. Third Parties should obtain coverage through their Errors & Omissions (Professional Liability) Insurance.

Slide 3 - Overview

The key items which will be addressed within the presentation

- Who is a Fiduciary and what plans are subject to ERISA
- Claim exposures
- Fiduciary Insurance (what, why, and cost)
- Frequently Asked Questions
- Conclusion

Slide 4 – Who is a Fiduciary under ERISA

“ERISA fiduciaries are either named in the plan document or are identified by the function they perform for the plan. Since fiduciary status may be based on a person’s conduct rather than his title, it is possible to be a fiduciary without being aware of it.”
There is a clear message here that a person may be a fiduciary without being aware of their status. A consistent example of this is a Human Resources individual who by their function is acting in a fiduciary capacity. And, regardless of their knowledge they are held to the fiduciary responsibility of acting in the best interest of the plan participants, not the company.

Slide 5 – Plans subject to ERISA

Companies may not realize that ERISA pertain not just solely to investment related plans, but also encompasses health and welfare plans including simple medical and dental plans. In fact, there are as many claims from welfare plans as there are from Pension plans.

Slide 6 – Fiduciary Responsibilities

At this point we are reiterating that a fiduciary must act solely in the best interests of plan participants. However, the key point of this slide is to communicate that as a fiduciary you can be held personally responsible. There is no corporate protection or immunity under ERISA.

In addition, it is important to explain that even if a company utilizes a third party to administrate their plans, they still hold a fiduciary responsibility. There are clear statistics that show an increase in claims against plan fiduciaries. These may be generated as the baby boomer generation looks to retire and determine that they do not have the sufficient funds to do so.

Slide 7 – Claim Statistics

A slide outlining some statistics regarding claims against fiduciaries.
- Clear confirmation of the increase in fiduciary claims is the fact that there are now more claims against fiduciaries than sexual harassment claims
- The average claim cost is $800,000. In addition, it is estimated that the cost to defend a fiduciary claim is over $125,000. This is defense only and does not include damages.
- The vast majority of claims are made by plan participants
- 50% of claims arise out of benefit disputes and 50% from simple administrative errors and deficiencies in communication.

Slide 8 – Claim Examples

The first claim example is intended to emphasize that utilizing a third-party administrator does not eliminate a fiduciaries liability. The fiduciary still owes a responsibility to the participants to review the TPA’s experience, confirm that they carry Errors & Omissions insurance, and continuously monitor their progress.

The second claim example highlights how neglecting to communicate important plan policies to participants may lead to a potential claim. It may help to point out that this clearly was not an intentional or malicious act, but that does not eliminate the responsibility nor the liability.
Slide 9 – What is Fiduciary Insurance

The good news is that there is an insurance policy readily available that protects a plan, and it’s fiduciaries against all of the issues mentioned to this point in the presentation. In addition, Fiduciary Insurance is a very affordable solution.

A Fiduciary Liability policy protects the personal assets of a plan Fiduciary due to allegations of breach of fiduciary duties. And, ERISA explicitly allows for the purchase of fiduciary liability insurance. Although, the cost for fiduciary insurance should come not from plan funds, but from corporate funds.

Slide 10 – What can Fiduciary Insurance Cover?

A list of potential exposures faced by plan fiduciaries that may be covered by Fiduciary Liability Insurance. Most of these items were discussed in some format throughout this presentation.

Slide 11 – Why Purchase Fiduciary Insurance?

To Avoid Personal Liability - ERISA sets forth personal liability for fiduciaries. In other words, the fiduciary’s personal assets (house, bank accounts, etc.) are at risk. (In the case of Barker v. American Mobil Power Corporation, the court held an individual to be 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.

For fear of personal liability, many D’s&O’s won’t sit on a company’s board of directors or take on responsibility for the company’s plans unless there is insurance in place.

To Avoid Loss of Corporate Assets – Without fiduciary liability insurance, a company will have to pay defense costs and possibly damages in the event of any ERISA litigation – a waste of corporate assets when fiduciary liability insurance is so readily available and at such reasonable rates. In theory, such misuse of corporate assets could trigger a D&O lawsuit.

To Avoid Loss of Plan Assets – Using plan assets to defend ERISA litigation is a very questionable use of plan assets, and potentially a breach of fiduciary duty. Another potential breach is for the plan to lose money that could have been paid by a fiduciary liability policy, had one been in place. ERISA explicitly allows for the purchase of fiduciary liability insurance.

Because There is an Inherent Conflict of Interest Between the D’s&O’s Duties to the Company and to the Plan – The people running the company are almost always the same people who are responsible for running the plans. And what’s good for the company (e.g. selling company stock to a plan or reducing retiree medical benefits) isn’t always good for the plans or their participants.

For Protection in the Event of Merger or Acquisition – M&A activity is one of the most frequent triggers of ERISA lawsuits. Plan participants sue to obtain severance benefits, to access the excess cash in defined benefit plans, because they feel that their plan distributions were incorrectly calculated, because they feel that their new benefits aren’t as generous as their old benefits, because not enough money was transferred to their new employers’ plans, or for myriad other reasons. And often companies don’t anticipate these suits – employee benefit plans are often given little consideration in a merger or acquisition negotiation.
Because Many Directors and Officers Don't Realize that they are Fiduciaries - While many directors and officers know that they are fiduciaries, because they sit on plan investment or administration committees, many others don't recognize that they are fiduciaries, and do not act appropriately.[4] “Fiduciary” is a functional title - in other words, if you are performing fiduciary functions, then you are a fiduciary, regardless of your title. Therefore, if an officer without the title of “fiduciary” does something that has an effect on a plan, then that officer may be considered a fiduciary of that plan and become personally liable for any damage he may have caused to the plan.

Slide 12 – Cost of Fiduciary Insurance

Fiduciary Insurance is relatively inexpensive in comparison to other insurance products. The premium is based on the amount of plan assets. We have included some ranges of cost based on Defined Contribution Plans, and at a $1,000,000 policy limit. Actual premiums are always subject to underwriting review, but these ranges should be accurate.

Slides 13 and 14— Frequently Asked Questions

Some frequently asked questions or misconceptions regarding ERISA and Fiduciary Insurance.

In the presentation we tend to highlight the third question on this page. An ERISA Bond (Fiduciary Bond) is required by ERISA in the lesser $500,000 or 10% of all plan assets. This bond protects plan assets from dishonest acts (theft) of those who handle plan assets. It does not provide protection for breach of fiduciary duties, nor defense costs for such claims.

Question 2 reiterates that hiring a TPA does not eliminate your exposure, and Question 3 points out that most other professional insurance policies have specific exclusions to prevent them from responding to fiduciary and/or ERISA related claims.

Slide 15 – Conclusion

A summary of the key points of the presentation:
1. Fiduciary exposure is extremely broad and is an increasing target in litigation.
   a. There is no immunity from this exposure and it still exists even if a third party is utilized for their professional experience
2. Fiduciary insurance is readily available and affordable.
3. As a fiduciary it is a prudent decision to protect the company and the plan with a fiduciary liability policy. In addition, it protects the individual’s personal assets that may be at stake.

Slide 16 - Resources

Lockton Affinity wants to be a free resource for you clients. We offer a 100% no obligation, educational approach to all of our insurance products.

You may direct your clients to our attention and be confident that they are receiving the same level of professional service that you provide them yourself.