PLUS
University

Fiduciary Liability Insurance

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Background of Fiduciary Law & ERISA

Fiduciary Law - ERISA

- ERISA is the Employee Retirement Income Security Act of 1974
  - You are not required to issue benefit plans, but must follow ERISA if you do.
- The goal of ERISA was to ensure that employers keep their promises
  - It was enacted in response to the failure of certain corporate pensions
  - Lays out **fiduciary duties** – **what to do**
  - Also, **what not to do:** establishes **prohibited transactions** – regulates certain transactions unless exempted
- Covers private sector employer-provided health and retirement plans
- Preemption of state law – intended to create a uniform, national standard
- Non-ERISA plans, like local and state governmental plans, are typically subject to state fiduciary standards that mimic ERISA

Plan Fiduciaries and Their Duties

Who is a Plan Fiduciary?

Under ERISA, a fiduciary is a person who:

(1) is the “named fiduciary,” as formally designated by the plan;

(2) exercises discretion with respect to management or administration of the plan;

(3) Exercises discretion with respect to the management or disposition of plan assets; or

(4) Provides investment advice for a fee.

The test of whether someone is a fiduciary is <u>functional</u>, focused on those with actual authority and control over a plan. You do not need a formal appointment to be a fiduciary – based on function.

Who is a Plan Fiduciary? (cont.)

- Certain identified parties [named fiduciary; administrator; trustee]
- Functional fiduciaries
  - Plan management, administration
  - Investment advice
- But **Settlor** activities are not fiduciary activities
  - Settlor = business decisions relating to plan establishment and design.
  - Settlor decisions cannot be paid out of plan assets.
  - Amending a plan is a settlor activity, and not subject to ERISA requirements governing fiduciary activities.

What is a Fiduciary Function?

Fiduciary Functions: a person is only a fiduciary when performing a fiduciary function (i.e., exercising authority and control over the plan). Fiduciaries will frequently be employees of the company, so it is vital to recognize when such a person is wearing their employee hat as opposed to when wearing the fiduciary hat.

Fiduciary Functions are activities that give rise to fiduciary status, and include:

- Being a plan sponsor;
- Appointing other plan fiduciaries;
- Selecting and monitoring third-party service providers;
- Interpreting plan provisions;
- Exercising discretion in denying or approving plan benefit claims; and
- Providing investment advice for a fee.

What is an Administrative Function?

Conversely, some plan-related activities are purely administrative (i.e. ministerial or clerical in nature) and do not give rise to fiduciary status, including:

- Application of rules determining eligibility for participation or benefits where the application of such rules does not include the exercise of discretion;
- Calculation of service and compensation credits for benefits;
- Preparation of employee communications materials;
- Maintenance of participants' service and employment records;
- Preparation of reports required by government agencies;
- Orientation of new participants and advising participants of their rights and options under the plan;
- Collection of contributions and application of contributions as provided in the plan;
- Preparation of reports concerning participants;
- Processing of claims; and
- Making recommendations to others for decisions of plan administration.

These actions do not involve exercising authority or control over the plan. Members of the human resources department are typically not fiduciaries unless they are also plan committee members.

Typical Fiducial Functions

Administrative

- Selection and monitoring of plan service providers, insurers [TPA, counsel, auditor, actuary]
- Reporting and disclosure
- Eligibility and benefit processing of appeals
- Plan asset and participant recordkeeping
- Ensuring tax compliance
- Approval of administrative expenses

Investment

- Selection and monitoring of investment vehicles or managers
- Establishment and monitoring of investment allocation and policies
- Approval of investment-related expenses

Settlor versus Fiduciary Functions

A third category of actions with respect to an employee benefit plan are known as **settlor functions**.

Settlor functions include business decisions about the plan that are not subject to ERISA's fiduciary requirements. Some examples of settlor functions include:

- **Establishing a plan;**
- **Amending or terminating a plan;**
- **Deciding which benefits to offer; and**
- **Deciding which groups of employees will be covered under a plan.**

The same party may perform fiduciary, administrative, and settlor functions. This is particularly the case in multiemployer plans.

Core Fiduciary Liabilities

ERISA has no business judgment rule – no presumption that you are acting in good faith. Instead, under ERISA, a plan fiduciary has **four core affirmative fiduciary duties**, plus two additional key duties:

(1) **Duty of Loyalty:** The duty of loyalty requires fiduciaries to act **"solely in the interest"** of participants and beneficiaries with the exclusive purpose of providing benefits to those participants and beneficiaries.

(2) **Duty to act prudently:** This requires fiduciaries to discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity would use in similar circumstances. This duty focused on conduct, and emphasizes process over conduct.

(3) **Duty to diversify the assets of the plan:** The duty to diversify is intended to minimize the risk of large losses. This duty requires the fiduciary to refrain from investing disproportionately large amounts in a single security or in a single type or security or securities dependent on one locality or industry. Section 404(c) is supposed to relieve plan fiduciaries of liability for investment performance in participant-directed plans.

Core Fiduciary Duties (cont.)

(4) Duty to Comply with the provisions of the plan [Follow Plan Documents]: This requires fiduciaries to discharge their duties in accordance with the documents and instruments governing the plan to the extent consistent with ERISA. Documents include the plan document, summary plan description, trust agreement, investment management agreements, and investment policies.

PLUS:

(5) Duty not to engage in certain prohibited transactions [Avoid non-exempt prohibited transactions]: ERISA and the Internal Revenue Code prohibit transactions between employer sponsored retirement plans and "parties in interest."

(6) Duty to pay only reasonable plan expenses: ERISA allows plan assets to be used for two purposes: paying benefits and paying reasonable expenses of administering the plan.

Statute of Limitations

Section 413 of ERISA provides that "[n]o action may be commenced . . . with respect to a fiduciary's breach of any responsibility, duty, or obligation" after the earlier of the following:

- Six years after (A) the date of the last action which constituted a part of the breach, or (B) in the case of an omission the latest date on which the fiduciary could have cured the breach or violation, or
- Three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation.
- Thus, the statute of limitation is six years, unless the plaintiff has "actual knowledge" of the breach, in which the statute of limitations is shortened by half [but this has been interpreted as not applying to the continuing duty to monitor investments]
- There is also no statute of limitations – or look back – for benefits.

Prohibited Transactions

Prohibitions: Everything prohibited unless specifically permitted

- “Party-in-interest” transactions
- Self-dealing
- Kick-backs

Prohibited transaction exemptions – class and individual exemptions

- e.g., provision of services for “reasonable compensation”

Fiduciary Liability

Fiduciaries may have personal liability for:

- Plan losses caused by a breach of duty;
- Disgorging profits; and
- Other appropriate equitable relief.

ERISA Section 409: Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

Co-Fiduciary Liability [ERISA section 405]: a fiduciary may be liable for another fiduciary's breach of fiduciary duty.

Fiduciary Exposures & Claim Examples

Who Might Pursue a Plan and its Fiduciaries?

- Plan participants and their beneficiaries
  - ➢ Single plaintiff or class actions
  - ➢ Written demands
- Government regulator - Department of Labor
  - ➢ Investigations
  - ➢ Enforcement actions
  - ➢ Recommend criminal charges

DOL/EBSA 2023 Enforcement Statistics

Total Recovery

Recovered $1.4B

Criminal Actions

Closed 196 criminal investigations with almost 140 indictments/guilty pleas/convictions

Voluntary Corrections

20,147 filings received

Civil Investigations

Closed 731 civil investigations with almost 70% resulting in monetary recovery/corrective action

Inquiries

197,173 employee inquiries/complaints with $444M in informal complaint resolutions

Retirement Plan Claim Examples

Claim 1

Plan fiduciaries hired a third-party investment manager for its 401(k) plan and later found he was "skimming" money from the employees' accounts. Employees claims over $1M in missing funds.

Claim 2

Employee requested a change in how is 401(k) account was invested. Fiduciaries took over a week to honor the request, but there was a market downturn in the interim. Claimed $150K in investment losses.

Claim 3

Department of Labor alleged that plan fiduciaries retained an unqualified professional third-party trustee who whose gross negligence and misuse of plan assets resulted in significant plan losses. Resulted in >$1M in defense costs & removal of fiduciaries.

Health & Welfare Plan Claim Examples

Claim 1

Defendant failed to enroll an employee's newborn child in a healthcare plan, resulting in denial of coverage for child's healthcare costs. Resolved by payment of over $100K.

Claim 2

HR erroneously advised terminally ill employee that he was eligible for additional life insurance benefits. His widow's claim for life insurance proceeds was later denied. Resolved by payment of over $400K.

Claim 3

TPA who was hired by a church to review medical claims under its plan refused to pay to airlift an infant. (It was later learned that TPA's reviewing doctor had his medical license suspended.) Recovered $2M, including $60K for airlift.

Class Action/Severe Claim Trends

- Retirement Plans:
  - Paying excessive fees and using underperforming investments
  - Using forfeitures to offset plan expenses
  - Using outdated mortality data/interest rates to determine annuity payments
  - Over/undervaluing company stock in an ESOP transaction
- Medical Plans:
  - Imposing nicotine surcharges in context of smoking cessation program
  - Refusing to cover certain behavioral/mental health treatments (MHPAEA)
  - Paying excessive fees (PBMs)?

Fiduciary Liability Insurance

What is Fiduciary Liability Insurance?

With respect to employee benefit plans, it protects companies, plans, D&Os & employees against:*

3rd Party Claims for:

- Breach of fiduciary duty: Poor judgement / mismanagement
- Errors in administration/ clerical acts

1st Party Voluntary Correction Programs:

- DOL, IRS, PBGC
- Usually subject to a sublimit

*Subject to policy terms

Fiduciary Liability Insurance, ERISA Bonds and EBL Coverage

Fiduciary Liability Insurance

- Not required
- 3d party
- 1st party voluntary correction
- Administrative errors & breach of duty
- Claims brought by anyone, including DOL

Employee Benefit Liability Insurance

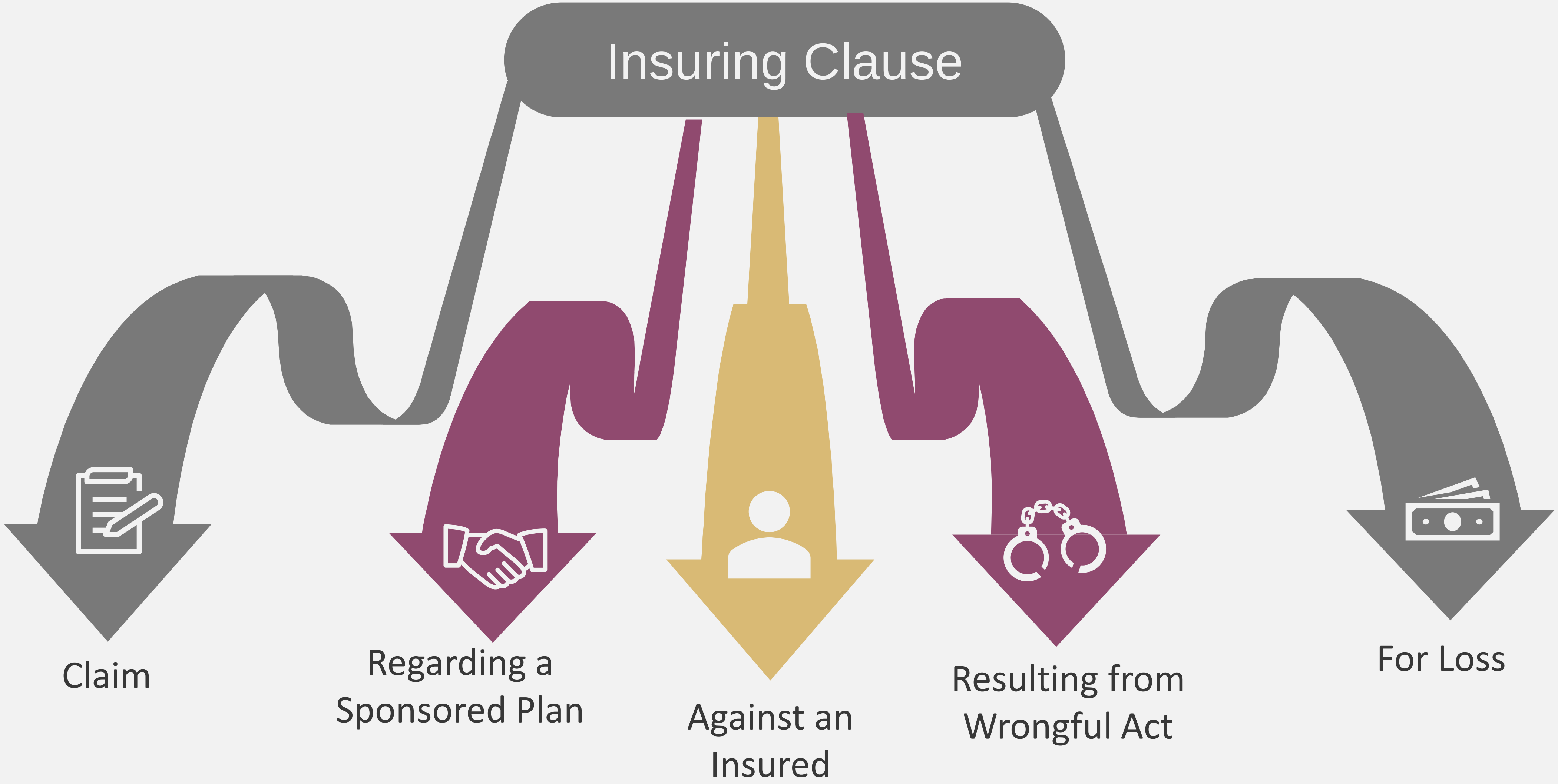
- Not required
- 3rd party only
- Administrative errors only
- Claims by employees

ERISA Fidelity Bond

- Legally required
- 1st party only
- Fraud/dishonesty of plan officials

Note:
D&O policies cover a different type of fiduciary duty and exclude ERISA claims

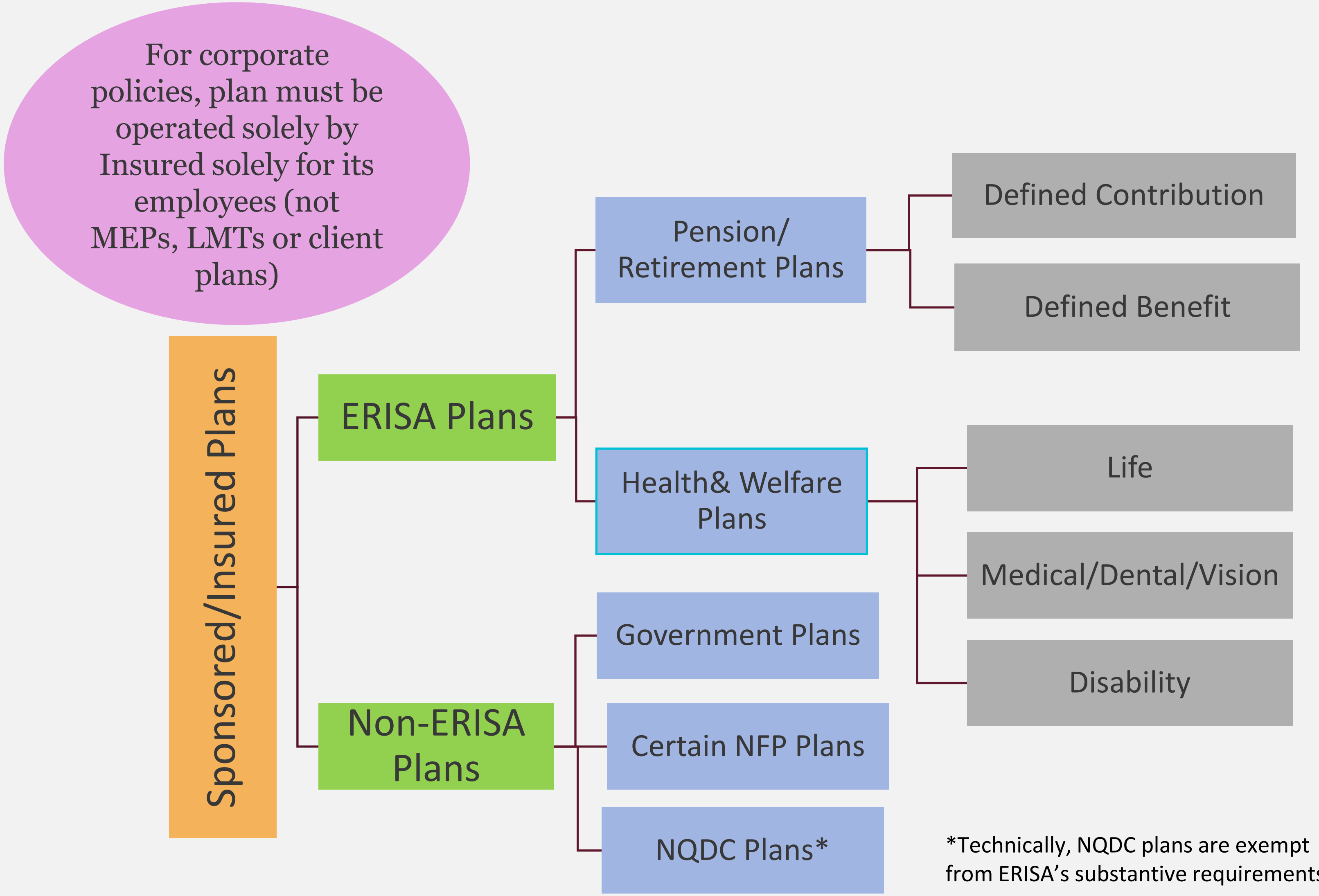
Making it Through the Insuring Clause



What is a Claim, Matter, Etc.

- Written demand for monetary or injunctive relief
- Civil or criminal proceeding
- Formal DOL investigation
- Pre-Claim Investigations
- Request to toll statute of limitations
- Benefit Claim Denials
- Interviews
- Voluntary Compliance

What Is A Sponsored Plan?



*Technically, NQDC plans are exempt from ERISA's substantive requirements.

Who is an Insured?

Sponsor/ Organization	Plan	Executives
Employees	Plan Committee?	NOT 3rd Party Service Providers

What are Wrongful Acts?

Breach of Fiduciary Duty

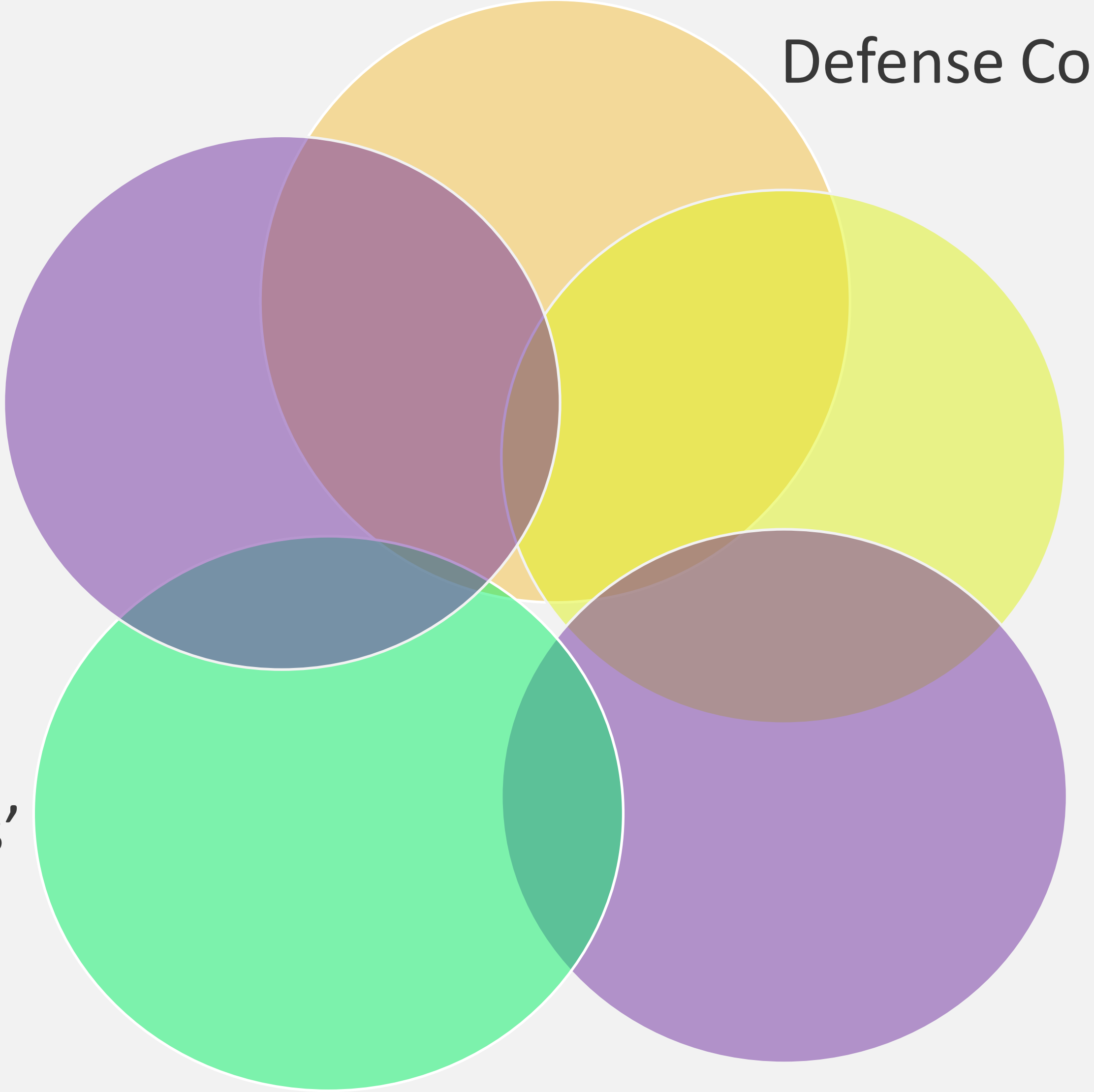
Errors in Administration

Settlor Functions?

What Constitutes Loss?

Defense Costs (Within LOL)

Not Benefits Due (could be in Loss or In an exclusion)



Damages

Plaintiff’s Attorneys’ 502(g) Fee Awards

Fines & Penalties (Sublimits)

Policy Endorsements

- Might be used to address exposure trends
  - Plan fees and investments
  - ESOPs and company stock
- May impose special retentions, sub-limits, co-insurance or exclusions for certain types of exposures or specific plans

Takeaways

- Distinguish Fiduciary Policy from Fidelity Bond
- Confirm applicant’s plans qualify as sponsored plans
- Know who qualifies as an insured
- Understand what constitutes a Claim and the notice requirements – timely reporting of claims
- Be prepared for questions pertinent to exposure trends (depending on the account)
- Review endorsements

Questions?

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Thank you!