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Insurance: A Necessity for Every Fiduciary

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The world of insurance is often confusing, with many different types of products and services. This is especially true for the fiduciary of an employee benefit plan. Some questions that might be raised in this context - why is insurance needed? what are the different types of insurance, and what do they cover? what is insurance designed to protect? This brief will attempt to answer these questions.

When the Employee Retirement Income Security Act (ERISA) became law in 1974, it exposed the fiduciaries of employee benefit plans to personal liability for any loss to the plan, or any loss suffered by a participant for lapses in communication, failure to follow the plan document, or other errors or omissions. This means that a fiduciary can potentially lose his or her entire net worth if found liable for a breach of fiduciary duty. This risk of loss can be reduced by conscientious management and following a prudent investment process, but it can never be totally eliminated. Insurance is often the best way to fill the gap.

Many plan sponsors, trustees, and other fiduciaries assume that they are covered for this by their Directors & Officers (D&O) insurance or by a fidelity bond. This is not true. D&O insurance policies often exclude fiduciary liability exposure as well as anything pertaining to ERISA. These policies need to be reviewed carefully to see just what is included and excluded. Also, fidelity bonds do not protect fiduciaries from breach-of-duty liability. This form of insurance is to protect the plan and its participants from acts of dishonesty; it does not protect the fiduciary at all.

So where can a fiduciary turn for insurance protection? Two types of policies are typically used: Fiduciary Liability Insurance and Employee Benefits Liability Insurance. Fiduciary Liability Insurance, as the name implies, pays for liability arising from claims for breaches of fiduciary duty under ERISA, either the fiduciary's own acts or the acts of a co-fiduciary (another trustee, plan administrator, investment manager, consultant, custodian, etc.), for which a fiduciary can also be liable. Some examples of such breaches include: inappropriate selection of advisors or service providers; imprudent investments; lack of investment diversity; or conflict of interest with regard to investments.

The other type of policy is Employee Benefits Liability Insurance. This first got its start after the 1962 court case of *Gediman v. Anheuser Busch*, in which an employer was

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held accountable to the estate of a former employee for providing incorrect information.[1] This insurance protects fiduciaries and employees from damages resulting from errors, omissions, or negligent acts in the administration of a benefit plan. Two examples of this are typical:

- Providing an incorrect pension benefit calculation that influences an employee to retire earlier than he might have if given correct information;
- Neglecting to enroll an employee in the health insurance plan, and the employee finds out about the omission after a serious illness.

Both of these examples could expose the company and/or plan fiduciary to liability even though they result from action or inaction by employees (e.g., the HR Department).

Fiduciary Liability Insurance and Employee Benefits Liability Insurance are very useful forms of protection, and necessary in this day and age. They are distinct from fidelity bonds as well as D&O insurance. But the two are sometimes confused with each other, and often are sold as part of one policy with a single limit. This can be a big disadvantage. Fiduciary liability cases are infrequent, but judgments may be severe. Employee benefits liability claims tend to be more common, and frequent claims can result in the erosion of the protection available under the fiduciary liability policy. All policies should therefore be approached with caution, and given careful scrutiny before signing on the dotted line. High deductibles should be considered to reduce cost.

[1] Source: InsureCast, a division of Gaston & Associates, Inc.

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