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What is Fiduciary Liability, and Does My Organization Need It?

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Fiduciary liability insurance is a common source of confusion for many commercial insurance buyers. In fact, many insurance industry personnel are often unable to explain what it covers and why it's necessary.

When I talk to clients about fiduciary liability, many assume that I am referring to their ERISA bond, which is actually crime coverage protecting a plan from fraudulent activities and theft of assets, and a requirement of ERISA plans. A fiduciary liability policy provides much different coverage than an ERISA bond without any overlap in coverage.

WHAT DOES FIDUCIARY LIABILITY INSURANCE COVER?

Fiduciary liability insurance policies (FLIPs) will provide a legal defense for an insured fiduciary and restore any damages for which the fiduciary is responsible. It's a bit like a malpractice policy for fiduciaries. Directors' and officers' policies generally contain exclusions for fiduciary liability claims.

Another coverage, employee benefits liability, sounds appropriate for liability related to an ERISA plan, but this coverage alone may be inadequate. Employee benefits liability is often provided through an endorsement on a general liability policy; it functions as an errors and omissions policy for the administration of employee benefit programs, but it does not provide liability coverage for exposures of fiduciaries.

WHO IS CONSIDERED A FIDUCIARY?

While all employee benefit plans provide for one or more "named fiduciaries," according to Fidelity Investments, "ERISA also defines investment manager, plan administer, discretionary trustee, and investment advisor as fiduciary roles." Anybody exerting control or authority over plan management may also be considered fiduciaries, as well as individuals who provide investment advice for a fee.

While fiduciaries often hire others to conduct their designated duties, a fiduciary cannot simply hire others and pass along their fiduciary liabilities. They remain

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responsible for selecting those hired and are required to monitor the activities of those individuals to ensure that plan recordkeeping, investments, and expenses are reasonable.

FLIPS AND ERISA

ERISA is said to impose "the highest duty known to law" upon fiduciaries, and section 409 of ERISA also imposes personal liability upon fiduciaries. To make matters worse, the employer may be legally prevented from reimbursing the fiduciary for their personal liability. As such, purchasing a fiduciary liability policy becomes critically important to providing both a defense and the necessary indemnification to those liable fiduciaries.

Unlike an ERISA bond that addresses theft and fraudulent activities, a FLIP guards against claims of breach of fiduciary duty and/or plan mismanagement. FLIPs provide coverage against lawsuits alleging poor investment decisions and negligence when selecting plan service providers or handling plan records. The plans themselves may include retirement plans (e.g., 401ks, 403bs, stock purchase plans, profit-sharing plans, and employee stock ownership plans) and welfare plans (e.g., medical, dental, life, and disability insurance plans).

RECENT CLAIM TRENDS

Fiduciary claims arising from ERISA violation allegations aren't a common type of claim that insurance brokers handle each year. Historically, attorneys focusing on specialized areas of litigation would bring suits against very large plans. However, the number of class-action lawsuits has been increasing dramatically in recent years. According to Amwins, a national insurance wholesaler that places fiduciary liability coverage, "Since 2015, carriers have paid an estimated $1 billion+ in settlements and well over $250 million in attorney fees." The annual number of lawsuits jumped 80% in 2019 and doubled in 2020 compared to the 2018 total.

One barrier to filing such lawsuits was the difficulty in obtaining information to allege improper or excessive fees. However, this information is becoming more accessible, so there are greater numbers of suits, and smaller companies with fewer than 1,000 employees are becoming targets of such litigation. According to Forbes, "It is important to focus on the fee structure of a retirement plan, especially the expense ratio. The ideal expense ratio is 0.20% or less, while anything above 1% is indefensible…"

Currently, excessive fee claims are the fastest growing segment of allegations. Numerous actions can be taken to reduce the likelihood of becoming a target for ERISA litigation:

- Creating and documenting a prudent process.
- Soliciting services through RFPs.
- Benchmarking fees against appropriate standards.
- Maintaining both diverse and low-cost investment options.

While lawsuits are not inevitable, even the most attentive fiduciaries could be accused of wrongdoing. These types of lawsuits, while often resolved out of court, are very expensive to defend and settle; FLIPs are critically important for fiduciaries of retirement and welfare plans. If you would like to learn more, reach out to **Parker, Smith & Feek's Commercial Department**.

References and Resources

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