

Fiduciary FAQ

Fiduciary or Pension Trust Liability and Insurance Frequently Asked Questions

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1. What's a Fiduciary liability policy intended to do?

The policy is intended to protect against allegations of breach of fiduciary duty under ERISA (the Employee Retirement Income Security Act of 1974, as amended) or similar common or statutory law, as well as errors or omissions in plan administration.

2. When does the wrongful conduct have to occur to be covered by the Fiduciary policy?

The basic answer is that the conduct complained of has to have taken place prior to or during the policy period. But not all prior acts are covered.

For a more complete answer, note that this insurance is not intended to cover wrongful acts clearly known prior to the start of the policy. So the insurance application will ask if the insureds are aware of anything that could reasonably lead to a covered claim during the policy period (if so, report it then and there under any current coverage, or forego insurance in the next policy period). You are also asked about prior claims and previous litigation which is similarly excluded from the future policy.

3. Who is insured under a Fiduciary policy?

There are many insureds under a Fiduciary policy. This usually includes company-sponsored employee benefit plans, the company itself, those at the company alleged to be plan fiduciaries and those working in plan administration. Those who are not insured include outside and institutional fiduciaries such as bank trustee and those working at a third-party administrator.

4. Who can bring the types of claims typically covered by a Fiduciary policy?

ERISA and state trust law generally limit those who can bring claims against fiduciaries in their official capacity to: potential plan participants and beneficiaries, and government enforcement/regulatory groups. This last group includes the Internal Revenue Service (IRS), the Department of Labor (DOL), possibly the Pension Benefit Guarantee Corporation, on occasion the Securities and Exchange Commission and State Attorneys General.

5. Why don't companies simply indemnify their employees and directors and officers when they are alleged to be ERISA fiduciaries?

Indemnification would first have to be possible under ERISA and then under the relevant state law (as a federal statute, ERISA trumps state law). In addition to creating personal liability for fiduciaries, ERISA strongly limits the ability to indemnify fiduciaries while firmly stating that fiduciary liability cannot be waived. Indemnification is possible and permitted, but cannot resemble or function as a holdharmless agreement. If it appears to be an exculpation provision, then it is void under ERISA as against public policy.

After passing through ERISA's narrow indemnification provisions, one then examines state indemnification provisions. Similar to the concerns of company directors and officers, there will be situations where the company is unable or unwilling to indemnify (or pay for) costs incurred in fending off claims. With ERISA's personal liability for fiduciaries, most companies choose to purchase Fiduciary Liability coverage to fill any potential gaps.

ERISA counsel can inform the directors and officers of specifically which situations this is likely to occur.

6. How does the policy's limit of liability apply?

There is a single aggregate limit of liability that applies for all claims that fall within the terms of the policy. Once this limit is exhausted, there is no more coverage available under the policy for any current or future claims.

Defense costs apply first to the deductible or retention of the policy, and then serve to exhaust the available limit of coverage. It is possible that the entire policy could be spent in the defense of a claim, with no coverage remaining for any possible settlement or court award.

7. When does the dreaded issue of "allocation" arise?

Allocation is generally not the issue for fiduciaries that it is under Fiduciary insurance, as there is typically coverage for the company and the insuring agreement is very broad. (The standard wording is "duty to defend").

Allocation can still raise its ugly head whenever there is a claim that is made against both insureds and uninsured parties as defendants. (Third parties in the claim could include: the plan's accountants, attorneys, bank trustee, etc.). In this situation, the insurance carrier will look to allocate the costs associated with the defense, settlement and investigation of the claim made against the insureds from those same expenses generated on behalf of the non-insureds.

There may also be coverage coordination issues that may arise, where more than one insurance policy may apply. This may occur with claims alleging errors or omissions in plan administration (with potential additional coverage found under an Employee Benefit Liability extension to a General Liability policy), or with age discrimination claims (that might also be covered under an Employment Practices Liability policy).

8. What is typically excluded under a Fiduciary Liability policy?

Standard exclusions include fraud, illegal personal profiting, bodily injury/property damage, the failure to collect or the return of contributions, pending and prior litigation, prior (late) claim notices and pollution.

Please note that the "conduct" exclusions (fraud, dishonesty, personal profiting) are generally limited by requiring either a final adjudication or "in fact" determination. A mere allegation of wrongdoing is not enough to trigger the exclusion.

9. Wouldn't an exclusion for fraud or personal profiting exclude most claims?

Fortunately, while a large percentage of Fiduciary claims include allegations of fraud or illegal personal profiting (or both) the simple allegation is not sufficient to trigger the exclusion. Most exclusions require something like a court determination of

guilt or an admission of guilt before the exclusion can apply. Either the words “final adjudication” or “in fact” will be used in the exclusion to indicate how high the hurdle is for the carrier to apply these exclusions.

Defense costs incurred for such a claim are covered until such time as the wrongful conduct is determined to have “in fact” occurred, or until there is a final adjudication. It is important to note that those insureds who are not found guilty, admitted guilt or participated in a per se violation, continue to be covered even after the “evil doers” have confessed or been adjudged guilty.

10. Why is the Insuring Agreement thought of as broad? What does the duty-to-defend entail?

Most Fiduciary policies are written on a duty-to-defend basis, which is very significant in terms of the breadth of coverage. In terms of defending claims, it usually means that so long as there is a single coverable allegation against an insured, the carrier must defend the entire claim made against that insured (and cannot allocate between covered and uncovered counts for that insured). It may also serve to limit the application of the policy's exclusions.

This is generally viewed as a broadening feature, especially when compared with most public company D&O policies where the carrier has the obligation to pay for the defense of the claim, but not the actual duty to defend. However, like all good things, there may be drawbacks to the duty-to-defend (see Question 16).

11. When does a claim have to be reported to one's Fiduciary carrier?

It varies, but typically, as noted above (see Question 2) the claim has to be first asserted or “made” against you during the policy period and then reported to the carrier as soon as you can (as soon as practicable) during this same policy period. This is referred to as a “claims made/claims-reported” requirement.

12. What happens if a claim is not reported in a timely fashion?

Bad things can happen if what is otherwise a covered Fiduciary claim is not reported in a timely manner. An otherwise covered claim can become uncovered if the reporting provisions of the policy are not strictly adhered to.

You want to be familiar with the reporting provision of your Fiduciary policy, including the terms of any post-policy reporting period that may exist or any extended reporting requirement (ERP) (see Question 19).

13. What precisely is a “claim” under a Fiduciary policy?

The definition of claim varies widely from policy to policy, and some do not define it at all. Generally, a claim includes any written demand alleging a wrongful act by an insured in his or her capacity as a plan fiduciary or in the administration of a plan seeking monetary or non-monetary damages. This includes law suits and may be expanded to include formal investigations.

14. What exactly does a Fiduciary policy cover in terms of expenses?

A Fiduciary policy will generally pay the costs associated with the defense, investigation, negotiation and settlement (by way of a court determination or otherwise) of a covered claim made against the plan, the company and/or its in-house fiduciaries or those working in plan administration. This may include certain accounting and actuarial expenses in addition to legal costs.

Because ERISA provides for some cost shifting, you and your carrier may also be liable for the legal costs of the plaintiffs (especially if they win).

15. What will a Fiduciary policy usually not cover as expenses?

Covered loss will usually specifically exclude civil, criminal or punitive fines or penalties, exemplary or multiplied damages, amounts that are without legal recourse to an insured or amounts that are uninsurable under the law. As with many other things on Fiduciary policies, this can be modified by insurers, with many now agreeing to pick up certain fines and penalties. Those fines/penalties that you would expect to find covered include: the IRS's 5 percent 502(i) penalty and the DOL's 20 percent 502(l) penalty. Today, a number of carriers may also add the penalties that may be assessed under the IRS's voluntary Closing Agreement Program (CAP), and at least one carrier may include the costs associated with the DOL's voluntary correction program.

16. Who selects defense counsel for a covered Fiduciary claim?

In most cases, the Fiduciary insurance carrier has the right and duty to defend the claim made against you; this includes the inherent right to select defense counsel. Most major Fiduciary carriers have what they call "panel counsel" lists of pre-approved defense firms from which you can select defense counsel. Some policies require the use of this list only for class actions and major claims, otherwise letting you pick your own defense firm.

You want to know in advance who gets to select counsel under your Fiduciary policy. If there is a list of firms that you must use, you might want to review this list.

17. What happens to coverage if the company is bought or merges into another?

Nearly all Fiduciary policies have what are generally referred to as "change in control" provisions. Most, but not all, policies state that in the event a change in control, the policy will remain in force for the remainder of the policy period, but, and this is a big caveat: coverage will only be provided for claims involving wrongful acts occurring prior to the change in control.

Conversely, if you make an acquisition during the policy period, most policies provide some level of automatic coverage that might kick in. The threshold for this automatic coverage is usually set as a percentage of plan assets ("so long as the newly acquired plan's assets don't exceed the current plans by more than 10 percent, the new plan is covered..."). Coverage would apply to acts occurring after the date that you acquired or became sponsor of the new plan. Acts prior to this date might be covered either under a separate run-off policy or under the prior sponsor's ongoing program of insurance.

Please note that some policies actually terminate coverage altogether at the time of the change in control. It is very important to know precisely how your specific policy would respond in such a situation.

18. Can a Fiduciary policy be cancelled by the insurance carrier during the policy?

Historically, all Fiduciary policies could be readily canceled by either the insurer or the insured. Many state insurance commissioners believed that this ability presented a significant hazard to the insured. As a result, many states limit the situations under which an insurance carrier can cancel a Fiduciary policy and require these specific situations to be clearly identified and detailed in each policy. Today, Fiduciary carriers are often willing to make their policies non-cancelable as long as you have paid the premium for the coverage. In this way, the insured does not need to worry that when things look their worst, their insurer is not going to desert them. This is a good policy provision to be familiar with.

19. If my Fiduciary carrier cancels or non-renews my policy, do I have any rights?

In addition to setting out the specific circumstances and timeframes in which an insurance carrier can cancel or non-renew a Fiduciary policy, most states provide the insureds with special protected rights in these situations. These rights can often be found in the Fiduciary policy itself.

One such provision is to purchase an extended period in which to report claims that would have been covered by the policy before it was cancelled or non-renewed. When these claims are first discovered and reported to the policy during this extended period, they are then covered under the policy terms and limits in effect prior to the policy's termination. This extended reporting period (ERP) is often referred to as a "discovery" period. Some Fiduciary insurers make discovery available when either the insurer or the insured either cancels or non-renews (bi-lateral discovery), and most will pre-set both the price and the term of the discovery period.

20. What's the "hammer clause"?

Most if not all Fiduciary policies have a provision that states that the insureds are not permitted to settle a claim without the carrier's approval (it is, after all, their money). So settlements generally have to be mutually agreed upon by the insureds and the insurer.

Concerned that some insureds may view their policies as assets to spend, many Fiduciary policies further state that if there is a settlement offer on the table that the carrier believes is the best that can be achieved, and you disagree, the insurance carrier can limit its liability (or bring down the hammer so to speak) at claims expenses to date plus this settlement amount on the table. Theoretically, if the ultimate settlement amount or court award is less than this earlier settlement amount, the insureds get to keep the "profits". But this is pure speculation.

For more information, contact a Willis Fiduciary specialist about these related Willis materials:

- Fiduciary Definitions
- Fiduciary Liability – Considering Limits Generally
- Fiduciary Large Loss Survey
- The Need for Fiduciary Liability Insurance
- The Need for Fiduciary Liability Insurance (Canada)
- The Need for Fiduciary Liability Run-Off Insurance

- Fiduciary Liability Insurance and Waivers of Recourse
- Fiduciary Liability Insurance versus Fidelity Bonding
- Fiduciary Liability Insurance versus the GL's EBL Extension
- Fiduciary Liability: M&A Concerns
- Fiduciary Liability: Cash Balance Concerns
- Fiduciary Liability: Company Stock
- Fiduciary Liability: Bodily Injury and ERISA