



Benefit Plan Protection: What Insurance Policies Are Needed?

Experience has shown that benefit plans can face a wide range of potential legal claims and that comprehensive protection requires more than one type of insurance coverage. This publication discusses some common claims involving three insurance policies that can protect benefit plans, their trustees, fund office staff and, by endorsement, agreed-upon people or entities: fidelity bonds, fiduciary liability insurance and employment practice liability insurance.

Examples of Legal Claims Against Benefit Plans

For these insurance policies, benefit plan claims, as defined within each policy,¹ can generally be grouped into the following broad categories:

- **Noncompliance** Examples of noncompliance may include inconsistency between a plan document and a summary plan description, or between these documents and the Employee Retirement Income Security Act (ERISA), agency regulations and/or actual plan administration.
- **Negligence** From a legal perspective, there are various levels of negligence: simple, willful, wanton or gross. Examples of negligence may include improperly calculated benefits, improper expenditures, breaches of loyalty, lack of adequate decision evaluation, lack of adequate documentation and failure to monitor.
- **Employment Issues** Examples of employment-related lawsuits that a fund office might face from fund office employees include discrimination, harassment, retaliation and wrongful termination.
- **Investments** Investment-related lawsuits typically involve investment decisions or asset allocation. Recent cases related to investments with Bernard L. Madoff Investment Securities LLC, an admitted Ponzi scheme, are an extreme example. Smaller scale losses related to alleged poor investment or asset-allocation decisions are more common.
- **Fraud or Dishonesty** Theft of plan assets by a plan trustee or fund office employee is the type of claim typically associated with fraud or dishonesty. Other, less well-known scenarios may involve a third party fraudulently cashing a stolen benefit payment check or causing a loss by hacking into the benefit plan's claims payment system.

This is the first issue of *The Fiduciary Shield*, a publication prepared by The Segal Company's National Fiduciary Liability Insurance Practice (NFLIP). This publication, which replaces NFLIP's *Fidelity Bond Update*, will focus on insurance matters for plan sponsors. By identifying and discussing potential liability issues, its goal is to demonstrate how they may be reduced or eliminated. We hope you find the information in *The Fiduciary Shield* informative and useful. Comments and suggestions are welcome. Contact information appears near the bottom of the next page.

Such claims might involve fund office staff, trustees and/or service providers, such as fund investment and benefits professionals. They may also involve known or unknown third parties, such as a plan participant or any other person who may have interaction with a plan trustee or employee when acting in that capacity. Coverage may be triggered by the discovery of the act by the existing auditing and security mechanisms, or by some type of formal demand, such as a lawsuit or investigation by a regulatory agency, like the Internal Revenue Service or the Department of Labor. At the point of a claim, or in anticipation of one, one of the most significant questions plan sponsors ask is: Are we covered? The answer to this question will be dependent upon the timely purchase of the proper type of insurance containing the appropriate scope of coverage.

Insurance Coverage for Benefit Plans

To protect the assets of the plans and its fiduciaries (i.e., trustees, administrators and employees), the following types of insurance are available:

- **Fidelity Bond** ERISA requires that every person who handles plan assets be covered by a fidelity bond. This may include the plan's trustees, its employees and certain plan service providers. To be ERISA-compliant, fidelity bonds must provide protection from fraud and dishonesty as opposed to other standards, such as "theft" or "employee dishonesty," which are terms defined in many commercial and financial service industry fidelity bonds.
- **Fiduciary Liability Insurance** As the name suggests, fiduciary liability insurance provides protection for trustees and employees of benefit plans in the event of a claim alleging a breach of fiduciary responsibility or an administrative error or omission. In addition to providing coverage for defense costs associated with such a claim, the policy limits are also available to cover settlements or judgments.

¹This article refers to "claims" rather than "lawsuits" because many insurance policies will define a claim to include more than a lawsuit.

➤ **Employment Practice Liability Insurance (EPLI)** This coverage protects a self-administered benefit plan, its trustees and employees if a plan employee, or possibly, a third party, alleges a violation of any one of a host of federal or state laws involving discrimination or harassment.²

The Importance of Customization

When purchasing or renewing insurance, especially if a change in carriers is involved, it is important to keep in mind that not all coverages — even of the same type — are equal. The amount and scope of coverage are key considerations. For example, as previously mentioned, many fidelity bonds insure against “theft” or “employee dishonesty,” neither of which equals the “fraud or dishonesty standard” required by ERISA. Moreover, as discussed in the June 2009 issue of NFLIP’s *Fidelity Bond Update*, fidelity bonds provide different scopes of coverage: narrow, moderate or broad.³ It also discusses administrative procedures trustees may need to establish to assure that service providers have purchased compliant ERISA fidelity bonds. Similarly, the scope of fiduciary liability insurance coverage can vary significantly because there is no standardized or mandated policy form. Any fiduciary liability insurance policy may include several endorsements, which may broaden or diminish coverage. Moreover, the coverage evolves over time, as new endorsements become available.

Examples of customization include the following:

- Fiduciary liability policies generally exclude all fines and penalties, yet specific coverage can be added back through one or more endorsements.
- Some fidelity bonds can be endorsed to cover scheduled entities or people who are neither trustees nor employees but, nonetheless, handle plan assets (e.g., investment managers). Other fidelity bonds, for a larger premium, may

include coverage, on a blanket (automatic) basis, for “any natural person” required to be bonded. Alternatively, to save premium costs, trustees may want narrower coverage for just the plan’s trustees and employees. Whichever approach is selected, trustees need to assure plan compliance with ERISA’s bonding requirements. Likewise, fidelity bonds can be endorsed to cover losses by forgery, computer fraud and wire transfer fraud by a non-insured third party. For example, a maintenance worker might steal a plan check, forge and cash it. An organized criminal ring might hack into the computer system to steal cash via fraudulent wire transfer instructions.

- Not all EPLI policies automatically provide coverage for claims initiated by a third party. Yet, most can and will offer this coverage via an endorsement.

All policies should be carefully reviewed periodically to understand the scope of coverage provided, to determine whether the right coverage is still being purchased or provided, to identify the availability of any coverage changes or enhancements, and to consider whether any additional coverage may be appropriate.

Conclusion

This issue of *The Fiduciary Shield* outlines some of the liability risks facing benefit plans and points out the importance of having three types of coverage — a fidelity bond, fiduciary liability coverage and, for self-administered plans, EPLI — as protection against possible liability. The next few issues of *The Fiduciary Shield* will discuss these three types of benefit plan insurance in more detail.



If you have questions about the types of claims discussed or the insurance coverage needed to provide adequate protection, or you would like to request a complimentary policy review, contact one of the following experts or any other member of NFLIP: Brian L. Smith (212.251.5333 or bsmith@segalco.com) or Robert Piccini (212.251.5051 or rpiccini@segalco.com).

² These include, in order of enactment, the Equal Pay Act of 1963 (EPA), Title VII of the Civil Rights Act of 1964 (Title VII), the Age Discrimination in Employment Act of 1967 (ADEA), Sections 501 and 505 of the Rehabilitation Act of 1973, Title I and Title V of the Americans with Disabilities Act of 1990 (ADA) and the Civil Rights Act of 1991.

³ That issue is available on the following page of Segal’s Web site: http://www.segalco.com/publications/fidelitybondupdate/june_2009.pdf

Trustees of multiemployer plans should always rely on their fund counsel for authoritative advice on all issues involving the interpretation or application of laws and regulations. *The Fiduciary Shield* does not provide legal advice or a binding interpretation of coverage.

Test Your Knowledge: NFLIP has created a brief online test that allows you to find out how well you know which type of coverage would apply in various scenarios. Your results will be kept confidential. You can [take the test here](#).