Fiduciary Liability
The Unseen Risk

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WHAT IS ERISA?

The Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide uniform rules for plans subject to its jurisdiction. Indicating its complexity, the Supreme Court has itself referred to ERISA as a “comprehensive and reticulated statute.”

WHO MAY BE A FIDUCIARY?

Although some fiduciary positions are obvious (e.g., trustees, investments managers, advisors, and plan administrators), anyone can be fiduciary without regard to his designation or lack thereof if he exercises discretionary authority or control respecting management or disposition of plan assets, renders investment advice for a fee or other compensation with respect to plan assets or property, or has responsibility to do so (even if he does not actually render advice), or if he has discretionary authority or responsibility in the administration of the plan.

Because a person is a fiduciary to the extent that he exercises this type of authority, a person may be a fiduciary for some purposes and not for others. ERISA explicitly permits a person to serve in dual capacities, in what may be a clear conflict of interest. That is, the same person may be the employer, or an agent of the employer, and a fiduciary. Some individuals may even have conflicting but equally binding fiduciary duties, for example as a director of a corporation and as a trustee or plan administrator of a plan. In fact, since the board of directors is ultimately responsible for supervising other fiduciaries, this will frequently be the case.

WHAT TYPES OF PLANS ARE SUBJECT TO ERISA?

ERISA recognizes two general types of plans: pension plans and welfare plans. Pension plans provide fora deferral of compensation or payment of retirement benefits. These plans include profit sharing plans, 401(k) plans and ESOPs. Welfare plans include medical benefit, disability, life insurance and severance pay plans. These plans are subject to some or all of the fiduciary duty rules whether they are funded through a trust or insurance or paid from general assets of the employer (unfunded), although the degree of coverage by ERISA otherwise varies.

One or more of these plans is sponsored by most employers. As such, almost every employer is subject to ERISA with respect to its benefit programs.

WHAT ARE ERISA’S FIDUCIARY DUTIES?

ERISA imposes four basic fiduciary duties.

1. A fiduciary must discharge his duties solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.
2. The fiduciaries must act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in a conduct of an enterprise-like character and with like aims. That is, a fiduciary will be judged as having expert skill even if he does not.

3. The fiduciaries in charge of investments must diversify investments so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so. The fiduciaries must discharge their duties in accordance with the documents and instruments governing the plan unless those documents and instruments are inconsistent with ERISA.

WHAT LIABILITY MAY A FIDUCIARY INCUR?

Fiduciaries who are found to have violated their duties are subject to various sanctions which are intended to make the participants or the plan whole or to prevent further violations.

Fiduciaries must reimburse plan for any losses, including lost earnings. Any profits made by the fiduciary must be disgorged to the plan, even if the plan not damaged by the fiduciary's act or received a full return on its investment. In some jurisdictions, a fiduciary's benefit may be attached (offset) in order to reimburse the plan for its losses.

Even if there is no loss to the plan, a fiduciary may be required to pay damages required to restore a participant to the position he would have enjoyed if the fiduciary had not breached his duties (restitution). Some cases have allowed recovery of monetary damages flowing from the breach of fiduciary duties (consequential damages), such as loss of favorable tax treatment.

Attorneys' fees, costs and interest may be awarded. In some cases, these may be more important that the potential recovery itself since the latter would be paid by the plan. Non-fiduciaries may also be liable if they knowingly participate in a breach or benefit from the breach.

CAN THESE RISKS BE COVERED BY INSURANCE?

ERISA prohibits any provision which would waive compliance with it's fiduciary standards. But plans and employers may purchase insurance to cover these risks. If plan assets are used to pay premiums, the insurer must have a right of recourse against the fiduciary. If premiums are paid by employer assets, no right of recourse against the fiduciary is required.

FIDUCIARY LIABILITY VS. EMPLOYEE BENEFITS LIABILITY

There is often confusion over the similarities between Bond's policy for Pension and Welfare Fund Fiduciary Responsibility Insurance and the Employee Benefits Liability Endorsement for the Commercial General Liability Coverage Part. Although some coverage duplication exists in the area of administrative errors and omissions, the thrust of the two forms is different. The EBL endorsement was designed primarily to provide coverage for administrative errors and omissions for a large variety of benefit plans. Bond's policy form was designed to cover ERISA (Employee Retirement Income Security Act) exposures of fiduciaries for specifically designed plans to the extent that they are caused by a "wrongful act."

COMMON EXCUSES

"I have a fidelity bond to cover my fiduciary exposure."

Although nearly 50% of fiduciaries think their ERISA-mandated fidelity bond protects their personal assets, it doesn't! The ERISA Fidelity Bond protects the Plan from loss due to dishonest acts of trustees. The fiduciary liability policy protects the personal assets of a plan fiduciary due to allegations of breach of fiduciary duties.

"We have turned over all investment activities for our plans to a bank, insurance company, professional investment firm or TPA. We are not involved in handling the plan, so we are not at risk."

Plan fiduciaries can never fully insulate themselves from liability, nor transfer the responsibilities for compliance to another party. Plan fiduciaries can take steps to reduce their personal liability by hiring a competent team of experts, but the fiduciary remains ultimately responsible for the management and administration of the benefit plan. Delegating management or administration of a benefit plan to a bank, insurance company, professional investment firm or TPA does not mean delegating fiduciary responsibilities.

"We have a 401(k) plan and our employees make their own investment decision, thus eliminating our " exposure."

The Department of Labor investigates how fiduciaries educate employees regarding available investment options. Plan fiduciaries are also ultimately responsible for determining what investment options will be available to participants and have a duty to monitor those investment vehicles to ensure performance measures.

"This coverage is included in our D&O (or other) policy."

Look carefully! Most policies exclude fiduciary liability exposures as well as those exposures pertaining to the Employee Retirement Income Security Act (ERISA).

"My attorney or accountant said I don't need this coverage."

You may want to get that in writing. ERISA was designed to hold fiduciaries accountable and personally liability for a breach of their fiduciary duties imposed upon them under the law. Remember fiduciaries' personal assets are at risk!

"My employees would never sue me."

While employees (plan participants), are the parties most likely to bring suit against the plan fiduciaries and sponsoring company for a breach of their duties, many times the Department of Labor will bring a class action suit against the plan fiduciaries on behalf of the employee participants.