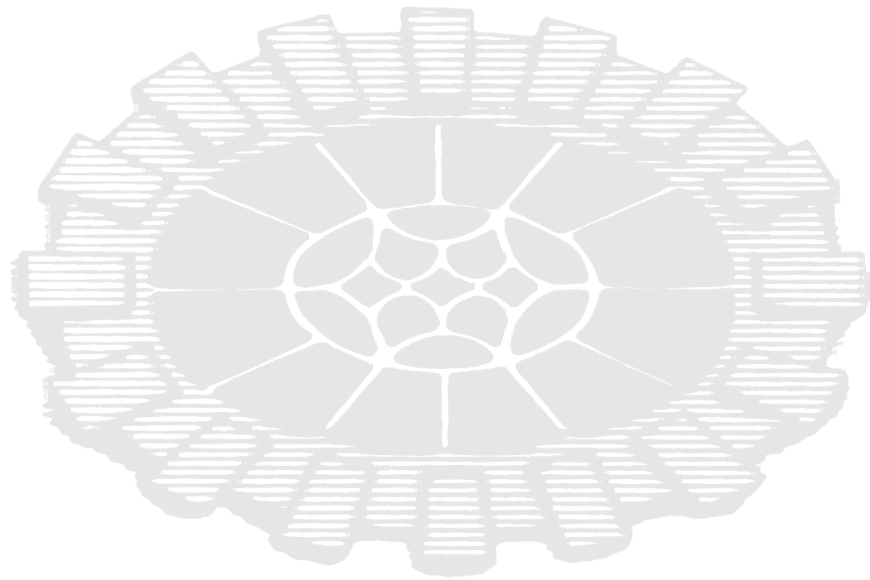


Fiduciary Liability



Presented by

The McLaughlin Company

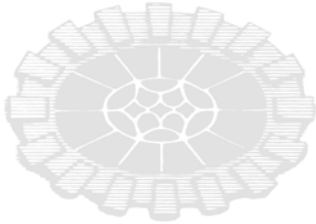
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Fiduciary Liability



The McLaughlin Company

The Fiduciary Marketplace

- ⌘ Ulico Casualty Company
- ⌘ Travelers
- ⌘ XL
- ⌘ AIG
- ⌘ Chubb
- ⌘ New Entrants



How Much is Enough?



- ⌘ Policy Limits?
- ⌘ Deductible/Retention Levels?

Who Is Insured?

- ⌘ The specific plan designated in the policy
- ⌘ The plan sponsor
- ⌘ Any individual serving as a trustee, director, officer or employee of the plan
- ⌘ Any other person or organization specified in the policy

What other protection might the fiduciary have?

- ⌘ Advancement or reimbursement of litigation cost by the plan itself
- ⌘ Indemnification by the plan sponsor (union or management).
- ⌘ Exculpatory Provisions
- ⌘ Indemnity by Third Parties

Checklist for Fiduciary Liability Insurance

- | | |
|-------------------------------|-----------------------------------|
| ⌘ Employee benefits liability | ⌘ Coverage trigger |
| ⌘ Covered plans | ⌘ Cancellation |
| ⌘ Retroactive date | ⌘ Punitive damages |
| ⌘ Named insured | ⌘ Managed care |
| ⌘ Waiver of recourse | ⌘ Cancellation nonrenewal |
| ⌘ Duty to defend | ⌘ Contractual liability exclusion |
| ⌘ Defense costs | ⌘ Severability |
| ⌘ Discovery clause | |

Employee Benefits Liability

- ⌘ Fiduciary liability policy including employee benefits coverage
- ⌘ Endorse fiduciary liability policy to cover employee benefits exposures
- ⌘ Purchase employee benefits endorsement to CGL policy and Umbrella

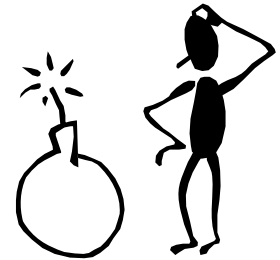
Covered Plans

- ⌘ ERISA and non-ERISA plans
- ⌘ COBRA?
- ⌘ Non-qualified plans
- ⌘ JATC's

Plans Subject to ERISA

- ⌘ Profit-Sharing
- ⌘ Thrift and Savings (401(k))
- ⌘ ESOP (Employee Stock Ownership Plan)
- ⌘ TRASOP (Tax Reform Act Stock Ownership Plan)
- ⌘ Life insurance
- ⌘ Hospital-surgical-medical insurance
- ⌘ Dental and vision care insurance
- ⌘ Accident insurance
- ⌘ Disability income
- ⌘ Scholarship plans (which are funded)
- ⌘ Supplemental unemployment
- ⌘ Prepaid legal services
- ⌘ Some severance pay plans

Retroactive Dates



Named Insured

Name as insureds:

- ⌘ All applicable plans
- ⌘ Sponsor of plans
- ⌘ All individuals with fiduciary duties
- ⌘ All other persons/organizations required to be insureds
- ⌘ Include "omnibus" insured wording

Recourse Provision

As is required by the provisions of the Employee Retirement Income Security Act of 1974, in the event of any payment by the Company under this policy by reason of a breach of fiduciary obligation by an insured, the Company shall have the right of recourse against such insured to the extent of such payment.

Deletion of Recourse Provision

In consideration of the additional premium shown, it is understood and agreed that the [recourse provision] is deleted as respects all insured(s) as defined herein.

It is warranted by the individual insured(s) that such additional premium shall not be paid out of Plan assets.

Duty to Defend

An insurer's duty to defend is generally construed as being broader than its duty to indemnify.

Defense Costs

Are defense costs....

- ⌘ Outside the policy limits?
- ⌘ Included in the policy limits?
- ⌘ Calculated by some other formula?

Discovery Clause

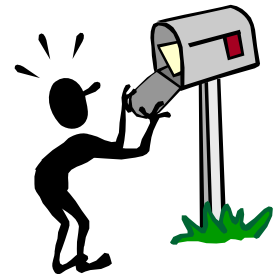
- ⌘ One-way or two-way extended reporting period?
- ⌘ Duration of extended reporting period?
- ⌘ Premium for extended reporting period?
- ⌘ Time required to purchase extended reporting period?

Coverage Trigger

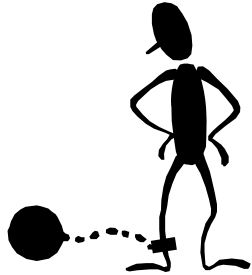
- ⌘ Claims-made and reported policy
- ⌘ "Pure" claims-made policy

Cancellation

- ⌘ Is the policy non-cancellable by the insurer once the premium is paid?
- ⌘ Is the insurer required to give at least 90 days' notice of its intention not to renew the policy?



Punitive Damages



Managed Care

Does this policy contain standard or manuscript language that provides coverage for managed care liability claims?

Contractual Liability Exclusion

Modify contractual liability exclusion or waive for specific contracts

Severability

- ⌘ Application
- ⌘ Exclusions
- ⌘ Conditions

QPAM Endorsement

It is understood and agreed that coverage shall apply to an investment by the Fund in real estate and/or mortgages that is:

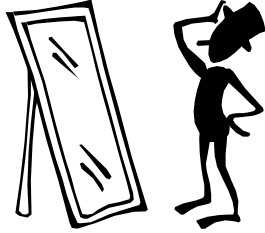
- ⌘ *In or by way of a separate account...which holds real estate and/or mortgages and which is sponsored by an insurance company...*
- ⌘ **Specifically directed or approved by and managed by a Qualified Professional Asset Manager ("QPAM")....**
- ⌘ *In or by way of a separate account...which holds real estate and/or mortgages and which is managed by a Qualified Professional Asset Manager ...*
- ⌘ *In or by way of a guaranteed governmental mortgage pool including GNMA, FNMA and FHLMC mortgage pools or an account, fund, pool or trust that consists primarily of Certificates issued by a guaranteed mortgage pool.*

Dilution of Coverage

Service providers should have their own insurance.

Professional Liability Exclusions

- ⌘ What happens when a fiduciary wears more than one hat?
- ⌘ When is fund attorney a fiduciary?



Types of Claims Made Against Fiduciaries

- ⌘ Claims Produced by Mergers/Termination of Plans
- ⌘ Claims Involving Some Form of Negligence
- ⌘ Claims Alleging Imprudent Investment of Assets
- ⌘ Claims Alleging Failure To Pursue Delinquent Contributions
- ⌘ Losses Arising From Administrative Errors

When Is a Claim "Made"

- ⌘ "Claim" is a demand for money or services
- ⌘ "Claim" is a written demand for money and services
- ⌘ "Claim" is a notice given to the insurer of an incident that could give rise to a claim.
- ⌘ "Claim" is not defined

Is the Loss Covered?

- ⌘ Was policy in effect for responsible party?
- ⌘ Does the allegation "trigger" coverage?
- ⌘ Is the entity that is being asked to pay an "insured" under the policy?
- ⌘ Is the loss excluded for this insured?

Good news.....Loss covered!

Loss Control Recommendations

- ⌘ Conduct Periodic, Independent ERISA Compliance Audits
- ⌘ Use "Experts" To Design Benefit Plans
- ⌘ Fund Plans Adequately
- ⌘ Invest Plan Assets Prudently
- ⌘ Avoid Prohibited Transactions by Seeking Outside Advice
- ⌘ Report and Disclose Plan Information as Required
- ⌘ Select Fiduciaries Carefully
- ⌘ Avoid Conflicts of Interest
- ⌘ Monitor your Vendors

Are You Fully Covered?

- ⌘ General Liability
- ⌘ Automobile
- ⌘ Bonding
- ⌘ Employment Related Liability Coverage
- ⌘ Pollution Liability
- ⌘ JATC Coverage
- ⌘ Professional Liability



Fiduciary Liability

How Do You Pick a Fiduciary Carrier?

- Financial Strength and Claims Paying Ability
- Pricing
- Limits and Deductibles
- Terms
- Coverage Extensions
- Exclusions
- Intangibles

How Much is Enough?

The manner in which insurers treat coverage of defense costs is an important point to consider in selecting policy limits. For example, assume that defense costs are roughly equal to settlement amounts. It could therefore be said that a \$500,000 policy covering defense "within limits" is equivalent to a \$250,000 policy providing defense "in addition to" limits. Nevertheless, such a conclusion would be based on averages only, which will vary significantly on a claim-to-claim basis. Accordingly, selecting adequate but affordable fiduciary liability limits is a difficult decision and one that is complicated by the fact that the costs of defending such claims have increased markedly during the past decade.

Who is a Fiduciary?

According to ERISA, an individual is considered a fiduciary if that person or entity does any of the following.

1. Exercises any discretionary authority or discretionary control in managing the plan or exercises any authority or control in managing or disposing of its assets.
2. Renders investment advice for a fee or other compensation, with respect to any monies or other property belonging to the plan.
3. Has any discretionary authority or responsibility in administering the plan.

Fiduciary Liability

Employee Benefits Liability

Endorsing a CGL policy to cover employee benefits poses several disadvantages. First, it creates problems because it combines a claims-made form of coverage (employee benefits) with an occurrence coverage (CGL) under the same policy. As a result, it exposes insureds to potential coverage gaps from the retroactive date and extended reporting provisions that are part of employee benefits endorsements. Another disadvantage associated with employee benefits endorsements is that, unlike other types of claims-made coverages, they do not generally contain "discovery," "awareness," or "notice of potential claim" provisions.

Fiduciary liability policies that also cover employee benefits liability exposures cost little if any more than those that do not. Therefore, if possible, insureds should attempt to purchase a fiduciary liability form that also covers employee benefits. In reality, the only reason for a company to purchase an employee benefits endorsement to a CGL policy is if it is unable to obtain fiduciary liability coverage that also covers the firm's employee benefits liability exposure. This is normally the optimal approach to covering the exposures presented by pension and benefit plan administration.

Plans Subject to ERISA

Pension Plans

- Profit-Sharing
- Thrift and Savings (401(k))
- ESOP (Employee Stock Ownership Plan)
- TRASOP (Tax Reform Act Stock Ownership Plan)

Welfare Plans

- Life insurance
- Hospital-surgical-medical insurance
- Dental and vision care insurance
- Accident insurance
- Disability income
- Scholarship plans (which are funded)
- Supplemental unemployment
- Prepaid legal services
- Some severance pay plans

Fiduciary Liability

Retroactive Dates

Retroactive dates in fiduciary liability policies preclude coverage for claims caused by acts, errors, or omissions that took place before the retroactive date—despite the fact that the claim is made during the policy period. The rationales underlying retroactive dates are (1) to eliminate coverage for possible errors or omissions committed in connection with some known (i.e., to the insured) event that took place prior to the retroactive date, and (2) to restrict coverage for stale claims caused by errors or omissions that took place far in the past, even if they are unknown to the insured. The vast majority of fiduciary liability policy forms provide full prior acts coverage with no restrictions

Recourse Provisions

Despite recourse provisions, most fiduciary liability policies also indicate that by payment of a specified additional premium, the insurer will waive its right of recourse. This is favorable for the insured because it prevents an insurer from subrogating against an insured whose non-willful error causes a loss. Therefore, it is usually a good idea to purchase such an endorsement, especially since the additional premium is generally \$25 per covered fiduciary.

If fiduciary liability premiums are NOT paid from plan assets, insurers will not subrogate against insureds, thus making waiver of subrogation endorsements unnecessary. However, because multiemployer plans do pay fiduciary liability premiums from plan assets, the possibility of subrogation against insureds does exist. Accordingly, waiver of recourse endorsements are recommended

Can Sponsor or Union Pay the Elimination of Recourse Premium? Yes.

Fiduciary Liability

Duty to Defend

Does the insurer have a duty to provide legal defense against claims that may be covered under the policy?

A “duty to defend” is normally part of the policy, but is sometimes removed in exchange for a higher limit or reduction in premium.

An insurer's duty to defend is generally construed as being broader than its duty to indemnify. In practice, insurers typically provide coverage of defense costs as long as allegedly dishonest acts are not yet proven to be true.

The policy provides defense coverage against allegations of dishonesty only in civil claims as opposed to criminal court cases.

Important point. Can the fund select counsel?

Extended Reporting Period

Extended reporting periods (ERPs), also known as extended discovery or "tail" provisions, that are found in fiduciary liability policies, give an insured the right to present claims after a policy has expired or been canceled. They do not, however, increase or reinstate the policy's limit of liability. Thus, coverage during an extended reporting period is always subject to available remaining limits.

For coverage to apply under an extended reporting period, the alleged wrongful act giving rise to the claim must have taken place on or after the retroactive date, if any, of the policy and before the policy's termination date. Thus, there is never coverage for an act or omission that took place during the extended reporting period itself, in spite of the fact that such a claim is reported during the extended reporting period.

Fiduciary Liability

Cancellation

This is important. It would normally take 90 days to thoroughly search for insurers to replace a policy that was not renewed.

Depending on size of fund and problems associated, it may take longer than 90 days to replace coverage.

Punitive Damages

Does the policy provide coverage for punitive damages except where prohibited by law? Even where an individual state may prohibit punitive damage coverage, a policy may provide coverage in another jurisdiction. It is always advantageous for an insured to have this coverage.

Managed Care Liability

Does this policy contain standard or manuscript language that provides coverage for managed care liability claims?

Such coverage is increasingly important as Congress and state legislatures expand the scope of liability .

Contractual Liability

As a general rule, it is a sound practice for a fiduciary to avoid holding other parties harmless for services that outside parties render in conjunction with benefit and pension plans. However, if an insured fiduciary must hold another entity harmless, the underwriter should be advised prior to policy inception. This allows the insurer time to evaluate the exposure and assess an appropriate additional premium if the underwriter is willing to cover such an agreement.

Fiduciary Liability

Severability

Provisions that enforce the concept of severability of coverage are included in virtually all fiduciary liability policies. These clauses note that coverage applies separately to each insured under the policy. There are three significant implications of such clauses. First, severability provisions indicate that if the actions of one insured void coverage under the policy, such coverage is not invalidated for other individuals insured by the policy. For example, assume that one fiduciary commits an act which would be subject to the policy's dishonesty exclusion (e.g., a plan trustee profits when, in return for a kickback, he allows his brother-in-law to manage the assets of a covered plan). Further, assume that as a result of this action, all fiduciaries insured by the policy are named in a lawsuit. In this situation, the severability provision of the policy will afford defense coverage to the other "innocent" fiduciaries—despite the fact that no coverage would be available to defend the culpable individual.

Dilution of Coverage

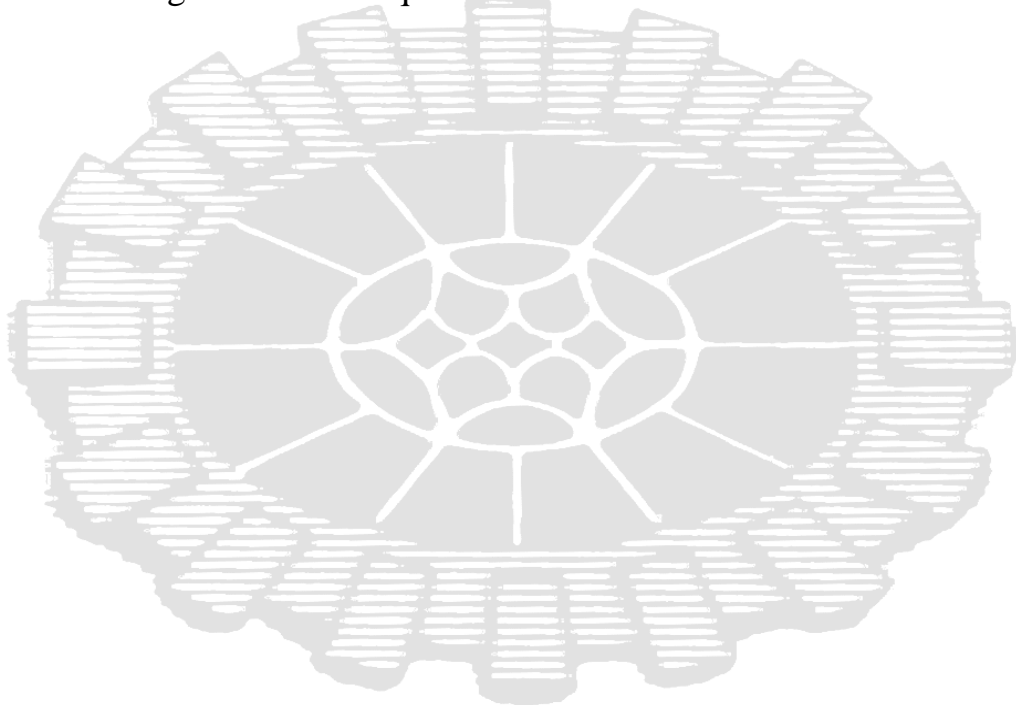
Fiduciaries frequently delegate a number of duties to outside organizations and individuals. Should any of them commit errors or omissions that cause a loss to the beneficiaries of the covered plans, or act in contravention of ERISA, the fiduciary sponsoring the plan can be held liable for their acts. Outside service providers should rightfully maintain professional liability coverage of their own.

Fiduciary Liability

Consider the Entire Cost of a Claim

Even if an organization maintains fiduciary liability insurance, it will nevertheless sustain a number of unreimbursed losses in the event of a claim. These include the following.

- Absorption of deductibles and retentions
- Increased premiums in future policies given prior adverse loss experience
- The possibility of cancellation or nonrenewal by the incumbent insurer in light of poor claim experience
- Loss of management time required to defend the claim



The mission of THE MCLAUGHLIN COMPANY is to provide a service oriented organization dedicated to providing high quality insurance and risk management services -- and thus security -- to our clients. To achieve our goal we endeavor to provide our clients with timely and creative solutions to all their insurance and risk management problems.

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