

Special Interdisciplinary Advisory Committee on Fiduciary Issues

Insuring ESOP Fiduciaries

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What are the most important considerations when purchasing or renewing insurance for ESOP fiduciaries? What should you look for in your company's existing policy to make sure you are getting the proper coverage? This article highlights significant areas of concern, but due to publication space limitations, is not a comprehensive review of the topic.

Type of Insurance Policy

Standard form "multi-risk" policies generally do *not* cover ESOP fiduciaries - such policies often exclude claims relating to ERISA. While standard form "Directors and Officers" (D&O) policies cover *corporate* fiduciaries, they generally do *not* cover ERISA/ESOP fiduciaries, unless there is a special ERISA/ESOP endorsement.

A "Fiduciary Liability" form of insurance policy (sometimes but not always with the term "ERISA" in the title) is designed specifically to protect the personal assets of fiduciaries of ERISA plans, including ESOPs, as well as the assets of the company sponsoring the plan ("Company").

It is not uncommon to find Fiduciary Liability coverage bundled with other insurance, such as D&O, Employment Practices Liability ("EPL") and Crime policies. When reading a Fiduciary Liability policy, make sure to read the "general terms and conditions" that apply to that policy and the others bundled with it.

Fiduciary Liability Insurance Coverages and Exclusions

Make sure the policy covers claims brought against present, past and future ESOP fiduciaries by plan participants, beneficiaries, successor trustees, independent fiduciaries, and government agencies (such as the Department of Labor or Internal Revenue Service), for breaches of fiduciary duty under ERISA as well as errors and omissions that are not breaches of fiduciary duty under ERISA.

The policy should cover claims relating to transactions, valuations, investments, loans, employer contributions, as well as allegations of conflict of interest and misrepresentation. Confirm that claims are covered for the imposition of a "constructive trust" and other claims that are portrayed as "equitable" or for "injunctive relief" but actually seek recovery of money or property. *The policy should cover defense costs for all claims covered by the policy.*

Be aware that the following types of claims, among others, may be excluded from coverage under Fiduciary Liability policies:

- Claims of the Company against directors, officers, and ERISA fiduciaries
- Claims of directors, officers, and ERISA fiduciaries against one another
- Liabilities covered in other insurance policies
- Financial loss for personal services

It may be possible to obtain custom policies or endorsements to waive certain of these exclusions and provide coverage for claims that otherwise would be excluded. Certain exclusions are unavoidable, however, such as damages for criminal or fraudulent acts, persons taking actions for their own personal profit, and benefit claims.

Fines (civil or criminal) are typically excluded except for fines under ERISA Section 502(i) (civil penalty of 5% for prohibited transactions) or ERISA Section 502(l) (civil penalty of 20% for fiduciary violations). Confirm that these ERISA penalties are covered.

Non-Indemnifiable Loss

Fiduciary Liability policies generally are silent on "non-indemnifiable loss." The presumption had been that the Company could indemnify ESOP fiduciaries. Because courts in the Ninth Circuit recently have ruled that companies with ESOPs may not advance legal defense costs or indemnify ESOP fiduciaries under certain circumstances, Fiduciary Liability policies should be written to expressly cover non-indemnifiable loss.

"Recourse" or "Non-Recourse" Insurance

Under ERISA it is permissible for the Company (but not the ESOP itself) to purchase insurance for a fiduciary on a "non-recourse" basis, meaning that the fiduciary is not obligated to reimburse the insurance company for payments made on behalf of the fiduciary. However, some forms of Fiduciary Liability policies provide that the insurance company has a right of recourse and subrogation against a fiduciary, thus giving the insurance company a right to recover from the fiduciary any payment made by the insurer. *Policies with such provisions should be avoided except in limited circumstances.*

Coverage Depends on When Act Occurred and When Claim was Asserted

Fiduciary Liability policies generally are written on a "claims made" form, meaning that only claims asserted during the policy term are covered and if an insured does not notify the insurer of such a claim before the end of the term, the insurer may have grounds to deny coverage.

If a policy is to end without renewal, the insured should determine whether notice of any claims should be given to the insurer prior to the termination of the policy, and confirm that coverage for any claims made during the policy term will survive the expiration of the policy. It is possible to purchase an extended reporting period or a "tail" to lengthen the time

during which a claim will be covered.

Most policies contain a Pending and Prior Litigation Date and provide that the policy will not cover a claim or litigation that was initiated before that date. In renewing with the same carrier or moving to a different insurance carrier, make sure the renewal or new policy has the same Pending and Prior Litigation Date as the previous policy. The Pending and Prior Litigation Date should be the date the first policy was issued and should not change when the policy is renewed or the coverage moved to other insurers.

Applications for Insurance

Special care should be taken in completing an application. Be aware that the way in which certain questions are answered on the insurance application can affect coverage or cause certain claims to be excluded from coverage. For a policy renewal, ask the insurer to accept an application that does not include warranty questions. It is frequently the case that the policy or governing law may provide that the application is part of the policy. Either warranting that there are no prior or pending claims/litigation, or listing prior or pending claims/litigation, may result in claims being excluded from coverage under the policy. Failing to answer questions in the application accurately and completely may give the insurer a basis to deny coverage.

Coverage of Legal Fees and Expenses

When a claim is brought, the fiduciary's reputation and assets are at stake. It is of the utmost importance that the Fiduciary Liability policy be designed to permit the fiduciaries to obtain an adequate defense. Defending ERISA litigation is expensive - it is not uncommon for the litigation costs to exceed the actual liability. In larger policies, it may be possible to obtain a provision that permits each fiduciary to choose counsel.

It is also important that the insurance company begin to pay the attorneys' fees and expenses for defending the fiduciary as soon as a claim is asserted or a lawsuit filed, rather than requiring the Company or fiduciary to pay the fees and expenses up to a deductible (or "retention") amount. Insurance is of little comfort if a fiduciary does not have the financial wherewithal to pay attorneys' fees and expenses before the policy "steps in." Some policies will not pay legal fees directly, but will reimburse the insured for the fees paid. The latter is not optimal for the same reason - the fiduciary may not have the wherewithal to front these costs.

The coverage limits of certain forms of policy may be reduced or "eroded" by the amount of attorneys' fees and expenses paid by the insurance company to defend claims. It is possible and desirable to obtain a policy with separate or additional defense cost limits.

In some cases, claims which are covered by the Fiduciary Liability insurance policy are asserted along with claims that are not covered. Generally, a Fiduciary Liability policy will not pay defense costs for excluded claims, although an insurer may agree to advance such costs until the case is resolved, on the condition that if the fiduciary is found to be liable on an excluded claim, the Company or fiduciary may be called upon to reimburse the insurer for the applicable defense costs. Certain state laws and court decisions require insurers to pay defense costs for uncovered claims where they are brought along with covered claims.

Policy Limits and Deductibles

In these litigious times, it is advisable to purchase the highest affordable coverage limit and, where possible, to write separate insurance policies for ERISA Fiduciary Liability that do not share coverages with D&O or EPL insurance. In choosing a policy limit, keep in mind that the same insurance policy may be called upon to cover multiple claims or lawsuits and a number of different fiduciaries, as well as the Company and the ESOP. Beware of policies that are written so that a single coverage limit applies to the defense costs and indemnification for all such claims and insured persons and entities.

Think twice before accepting a deductible, or if the insurance cannot be obtained without a deductible, choose the lowest available deductible amount. A deductible usually will apply to defense costs and settlements as well as payment of damages. A deductible generally applies only to indemnified claims - if there is no indemnification by the Company, there generally will not be a deductible.

Conclusion

When obtaining or renewing insurance for ESOP fiduciaries, it is essential to carefully review the application, the sample form policy, and any proposed endorsements, because insurers craft the language in their policies to benefit the insurer more often than not. Also, inquire into the financial condition of the insurance company and make sure premiums are timely paid - it is important that the insurance company and policy be there if and when a claim is made! Be sure to ask your insurance broker to help determine if your insurance coverages and policy terms are adequate to the task.

The author of this article is a member of The ESOP Association Legislative & Regulatory Advisory Committee. The author reviewed this article with and editing assistance was provided by Susan Lenczewski of Gray Plant Mooty, Minneapolis, MN; Legislative & Regulatory Advisory Committee Chair Laurence A. Goldberg, Sheppard, Mullin, Richter & Hampton, San Francisco, CA; Interdisciplinary Advisory Committee on Fiduciary Issues Chair Alexander P. Moss, Praxis Consulting Group, Philadelphia, PA; and Jeffrey S. Gelburd, Murray Risk Management and Insurance, Lancaster, PA.

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