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Risk Management Tools for the Design Professional

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Managing Employee Benefits: A Three-Legged Stool of Protection

by Dan Knise and Frances Railey

For many design firms, the ability to offer and maintain competitive employee benefit programs continues to be one of the keys to attracting and retaining the best available talent. Yet, the regulatory and legal environment within which these benefit plans are being designed and administered is more complex than ever. Not only are there ERISA issues, but there is a literal alphabet soup of COBRA, FMLA, HIPAA, etc. With this greater complexity and heightened scrutiny comes risk: risk for the company itself, and the executives and administrators responsible for overseeing and administering the benefit plans.

The good news is that the risks are manageable and design firms with employee benefit programs can take advantage of a three-legged stool of insurance protection – Employee Benefits Liability Insurance, ERISA Bonds, and Fiduciary Liability Insurance. Many executives and administrators are confused about what each of these covers and whether or not they need them. This article will explain how each coverage evolved and what specific exposures they address. We also examine some risk scenarios based on actual litigation.

Employee Benefits Liability Insurance

Employee Benefits Liability insurance (EBL) very simply provides protection against claims arising from errors in the administration of employee benefit plans. This coverage was developed in the mid-1970s largely in response to exposures that arose from the 1962 court decision in *Gediman v. Anheuser Busch.* In this case, an employer was held accountable to the estate of a former employee for providing incorrect information to the health insurance company, which then in turn

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Mr. Knise joined Ames & Gough in 2005. Prior to that, he was working with an investment/consulting group to form new insurance entities. Notable activities included formation of Restaurant Insurance Corp., a reinsurance company and underwriting manager, and consulting services for Palmer & Cay (now Wells Fargo). From 1998 through 2002, he led the region-wide effort to win the right to host the 2012 Olympic and Paralympic Games in Washington, D.C., Virginia, and Maryland. Prior to that, he held various senior management positions for Marsh & McLennan and its predecessor firm, Johnson & Higgins. Previously, he also had senior roles for SJ Groves & Sons, a Minneapolis-based general contractor, and for the Associated General Contractors of America in Washington, D.C. Long active in risk management and insurance affairs, Mr. Knise is a frequent speaker at ACEC and other A/E events. He is a 1977 graduate of Cornell University.

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denied the employee's claim. Thus, EBL insurance addresses claims arising out of errors or omissions in the administration of benefit plans. Three typical exposure scenarios covered by EBL insurance include:

1. An employer failing to properly enroll an employee for health insurance coverage, resulting in a denial of coverage.
2. An employer not providing an employee with the appropriate COBRA information after termination, resulting in the ex-employee being unable to continue participating in the health insurance plan as required by law.
3. An employer incorrectly calculating the amount of an employee's pension benefit so that the employee decides to retire early only to find that the amount is much less.

Typically, Employee Benefits Liability insurance is written as an endorsement to a Commercial General Liability (CGL) insurance policy. While the CGL policy is usually written on an occurrence basis, the EBL coverage is almost always claims-made. Therefore, in order for a claim to be covered the firm must continue to renew its CGL policy with the EBL coverage part intact.

Fortunately, there are very few significant claims. While administrative errors do happen, the impact is typically not severe and this coverage is not expensive. Minimum premium charges can be as low as $50 to $100 per year with a $1 million limit being typical. Deductibles are often $1,000 or there may even be no deductible.

EBL is not meant to cover critical discretional judgment exposure (see Fiduciary Liability section below). Instead, it is geared toward damages arising out of the administration of employee benefit plans. The coverage benefits beneficiaries, the firm, and plan administrators, alike. Beneficiaries are made whole for any lost benefits caused by administrative errors and the firm and its executives and administrators are protected from the costs of litigation and claims.

ERISA Bond

An ERISA bond (also known as a "fidelity" bond or employee dishonesty insurance) is required by federal law for every pension or 401(k) plan. The law states that the bond "shall be not less than 10% of the amount of funds handled" and that "in no case shall such bond be less than $1,000 nor more than $500,000." (However, if the plan invests in employer securities, such as company shares, the maximum bond amount is $1 million.)

The ERISA bond protects participants in pension or 401(k) plans from embezzlement, theft, or loss of funds that trustees or administrators might undertake. Unlike Fiduciary Liability Insurance, which provides liability coverage, the purpose of the so-called bond is to put money back into an employee's

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retirement account. There is no coverage for any personal liability of a plan trustee or administrator (see Fiduciary Liability Insurance below).

ERISA bonds are not expensive; annual premiums average $200 or less. While not as comprehensive as insurance, ERISA bonds do provide important protection against fraud and theft. For many firms, the ERISA bond coverage will actually be a part of their Employee Dishonesty or Crime Insurance policy. These insurance policies, which provide broader theft protection, include either an endorsement or a separate insuring agreement extending coverage for the ERISA bond obligation.

Additional ERISA Liabilities

With the demise of Studebaker, a well-known automobile manufacturer in South Bend, Indiana in 1963, thousands of Studebaker employees (many of whom were life-long employees) lost not only their jobs, but their promised pensions when the pension plan defaulted on its obligations. The devastating situation of the Studebaker employees became a symbol of the need for pension reform and a focal point for a push to gain broad-based federal legislation to address the issue.

Yet, because pension reform was highly controversial, almost a decade went by before Congress passed the Employee Retirement Income Security Act of 1974 (ERISA). This comprehensive legislation addresses virtually **all** employee benefit plans, not just retirement and profit-sharing plans; however, its impact on retirement, profit-sharing and 401(k) plans has been most notable to many.

ERISA created a framework of responsibilities and liabilities for plan sponsors (typically companies or organizations employing workers) and the trustees, administrators, and service providers who offer and oversee such plans. Specifically, Section 410 (a) creates direct personal liability for any individual considered a “fiduciary” under the Act’s broad definition. To paraphrase, a fiduciary can be any person or entity designated in the plan as having control over the plan’s operation. Fiduciaries can include the trustees, investment advisers, individuals administering the plan, those serving on its administrative committee, and even those responsible for selecting committee officials. Interestingly, this provision goes on to provide that the liability is not only personal, but cannot be indemnified under corporate bylaw provisions.

Importantly, ERISA’s Section 410(b), does allow an affected “fiduciary” to purchase liability insurance for this specific exposure, which, in turn, led to the creation of Fiduciary Liability Insurance.

Fiduciary Liability Insurance, a Critical Third Leg of Protection

The additional liability imposed on plan sponsors, trustees, and administrators isn’t covered by either an ERISA bond or Employee Benefits Liability insurance. The

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only way to protect against this exposure from an insurance perspective is to purchase a Fiduciary Liability Insurance policy.

Even though many firms have out-sourced their pension or 401(k) plans to banks, investment companies, or Third-Party Administrators, plan fiduciaries are never completely insulated from personal liability under ERISA. Working with professional outside advisors and administrators can only **reduce** their personal liability, not eliminate it.

ERISA specifically prevents any individuals responsible for running employee benefit plans from transferring their personal liability to a third party by contract. In addition, plan fiduciaries are held responsible for the selection and monitoring of Third-Party Administrators (TPAs) to ensure the plan's best interests are served.

Fiduciary Liability Insurance is written on a claims-made basis and typically covers:

- Breach of fiduciary responsibilities imposed by ERISA.
- Errors and omissions in plan administration (there may, as a result, be some overlap with Employee Benefits Liability insurance, but this ensures full protection).
- Imprudent selection of investment advisors or third party administrators.
- Lack of investment diversity or offering inappropriate investment options.
- Mishandling of records.
- Faulty advice to plan participants.
- Improper amendments to plan documents.

Coverage is often provided on an optional basis for "voluntary settlement procedures" involving the Internal Revenue Service.

The best insurance policy will cover any conceivable discretionary judgment actions (subject to policy exclusions) and ideally will provide coverage for acts occurring prior to the policy's inception (so-called "prior acts" coverage). Additional coverage features you should try to obtain with these policies include:

- A HIPAA (Health Insurance Portability and Accountability Act) extension, which will provide protection for civil penalties assessed under HIPAA.
- A broad definition of "Insured," which includes the company, its benefit plans and its fiduciaries.
- Coverage for punitive damages where allowable by law.
- Coverage for defense costs outside the limits as defense costs are often a significant portion of any claim and this feature will help preserve the policy limit for indemnity payment.
- A *severability* clause to prevent the dishonesty of one fiduciary on an application form from negating coverage for all insureds on the policy.

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Purchasing Fiduciary Liability Insurance

Obtaining quotes for Fiduciary Liability Insurance is not difficult; numerous insurance companies provide this coverage and pricing is competitive.

Premiums are based on a firm's benefit plan assets, annual contributions, past loss experience, and funding practices (if a defined benefit plan).

Often, Fiduciary Liability coverage is combined with Management Liability (Directors & Officers) and Employment Practices Liability Insurance. It may even be paired with Crime insurance. In these instances, limits may either be shared (typically for a cost-savings) or apply separately to each coverage part.

Fiduciary Liability Claims Statistics

A valuable source of fiduciary liability exposure information is the periodic survey conducted by Tillinghast Towers Perrin, a well-known consulting firm. In the 2004 survey, the average defense cost per fiduciary claim was $365,000, with average non-defense indemnity costs just under $1 million. The cause of claims most frequently cited in the survey was "denial of benefits," followed by "misleading representations" and "communication of plan benefits." In recent years there has been an increase in suits being brought in regard to plan fees and/or investment options.

Fiduciary Liability Claim Examples

Fiduciary exposures are real and need to be taken seriously by plan trustees and administrators. Among some recent claims examples are:

A) Employees sued the plan fiduciaries alleging that they breached their fiduciary duties by providing an option to invest in a guaranteed investment option backed by a poorly performing insurance company (eventually leaving the plan with a loss). They further alleged that plan fiduciaries breached their duty of disclosure by providing misleading or incomplete communications to participants. The case eventually settled for $250,000.

B) Legal action brought by employees alleged the wrongful elimination of a profitable investment option, improper selection of another, and failure to monitor the actions of the outside investment manager. Defense costs were $358,000 and the jury awarded the plaintiffs $500,000 in damages.

C) Plan participants alleged that the fiduciaries of a 401(k) plan failed to divest the plan of an investment option that underperformed versus a comparable index and resulted in poor returns. The case settled for $250,000 after $150,000 was spent in legal fees.

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D) Employees alleged that the new outside plan administrator improperly delayed transferring fund balances in the plan from one investment option to another, as directed by the participants. Subsequently, the employees sued the plan trustees to recover more than $1 million in lost investment income. Defense expenses were $250,000.

Conclusion: Protecting Your Firm and Its Plan Administrators

Design firms are constantly assessing and fine-tuning their employee benefits offerings to address cost considerations, satisfy evolving needs and expectations of employees and address ever-changing regulatory and legal requirements. With these actions comes risk and executives, trustees, and administrators need to recognize these risks and work to minimize them. Insurance can play a key role and should be re-evaluated from time to time. The three-legged stool of Employee Benefits Liability insurance, an ERISA bond, and Fiduciary Liability Insurance can go a long way to helping address benefits-related exposures.

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ProNet Practice Notes

Building Information Modeling

Building Information Modeling (BIM) is the process of developing a virtual, three-dimensional, information-rich model to design, construct, and maintain a building project. BIM is much more than software used to produce a pretty 3D graphic. Because a variety of information can be embedded into the model, BIM can also be used to manage the project's construction schedule (4D); to track project costs (5D); and, once constructed, facility management (6D).

Guest Essays

Stirring the Pot: Workplace Drug Policy Implementation in the Era of Legalized Medicinal and Recreational Marijuana

In a wave of change that children of the 1960s only dreamed, debated and theorized about, almost half of the states in the United States have now passed laws legalizing the controlled distribution of medicinal marijuana, and two states have even legalized the sale of recreational marijuana… These new laws raise a variety of questions for employers who have drug screening programs or any type of drug-free workplace policy.

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Podcast Love: The Entrepreneur Architect

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