

The Fid Guru Blog

Insights from Euclid Specialty on fiduciary liability and other risk exposures of employee benefit plans

Employee Benefit Plan Liability Versus Fiduciary Liability Insurance

By Daniel Aronowitz | February 6, 2020 | EBL Insurance | Fiduciary Liability

As a leading underwriter for fiduciary liability insurance, we are often asked about the difference between a Fiduciary Liability Insurance policy and an Employee Benefits Liability (EBL) insurance policy. Namely, some plan sponsors believe that they do not need to spend additional premium dollars to purchase fiduciary liability insurance when they have EBL coverage as part of their commercial package general liability insurance policy. As discussed more fully below, including an analysis of a recent court case, a fiduciary liability insurance policy provides significantly broader coverage than the limited administration coverage in a standard EBL policy to protect employee benefit plans and its fiduciaries. Even the defense of routine benefit claims can be excluded from coverage under an EBL policy, which is why plan sponsors need to protect their plans and plan fiduciaries with quality fiduciary liability insurance coverage.

EBL Insurance Coverage

The standard Employee Benefits Liability Insuring Agreement¹ provides that the Insurer “will pay those sums the insured becomes legally obligated to pay as damages because of acts, errors, or omissions arising out of the ‘administration’ of your ‘employee benefit program.’ “Administration” is defined to mean: “(a) Counseling employees, including their dependents and beneficiaries with respect to the ‘employee benefit program’; (b) Handling records in connection with the ‘employee benefit program’; (c) Effecting or terminating any employee’s participation in a plan included in the ‘employee’s participation in a plan included in the ‘employee benefit program,’; or (d) interpreting the ‘employee benefit program.’ Administration does not mean the selection process of your ‘employee benefit program.’” “Employee Benefit Program” is defined to “include only the following: (a) group life, disability or dental, group accident or health insurance; unemployment insurance, social security benefits, workers’ compensation and disability benefits; (b) unemployment insurance, social security benefits, workers’ compensation and disability benefits; (c) The following plans but only if they are self-directed by the employee: (1) IRS qualified pensions; (2) 401K plans; (3) profit sharing plans only those plans that are IRS qualified and equally available to all full-time employees; and (4) stock subscription plans but only those plans that are IRS qualified and equally available to all full-time employees.”

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The Insurance Services Office (ISO) EBL policy contains exclusions that limit the available coverage:

This insurance does not apply to:

- a) **Dishonest, Fraudulent, Criminal or Malicious Act.** Damages arising directly or indirectly out of any intentional, dishonest, fraudulent, criminal or malicious act, error or omission, committed by any insured, including the willful or reckless violation of any statute . . .
- b) **Insufficiency of Funds.** Damages arising directly or indirectly out of failure of performance of contract by an insured.
- c) **Inadequacy of Performance of Investment/Advice Given With Respect to Participation.** Any “claim” arising directly or indirectly out of: (1) the failure of any investment to perform; (2) errors in providing information on past performance of investment vehicles; or (3) advice given to any person with respect to that person’s decision to participate or not to participate in any plan included in the “employee benefit program.”
- d) **ERISA.** Damages for which any insured is liable because of liability imposed on a fiduciary by the Employee Retirement Income Security Act of 1974, as now or hereafter amended, or by any similar federal, state or local laws.
- e) **Available Benefits.** Any “claim” for benefits to the extent that such benefits are available, with reasonable effort and cooperation of the insured, for the applicable funds accrued or other collectible insurance.
- f) **Taxes, Fines or Penalties.** Taxes, fines or penalties, including those imposed under the Internal Revenue Code or any similar state or local law.

Although many companies modify the ISO language, the core EBL coverage is usually very similar. EBL provides coverage for “administration” of a company’s employee benefit plans. Administration is broadly defined to cover advice to participants, including interpretations of the plan as to whether something is covered, enrollment of employees in a plan, and handling plan records. The limitations of EBL coverage, however, are found in its multiple broad exclusions. For example, EBL coverage excludes any breach of fiduciary duty claim under ERISA or any fiduciary law. This excludes most claims against employee benefit fiduciaries, as even the most generic denial of benefit claims are usually styled as breaches of fiduciary duties against the plan administrator and its fiduciaries or trustees. The ISO form goes further to exclude any claim for “available benefits,” which excludes both defense and indemnity under the policy. While this benefits exclusion is not contained in every insurer’s EBL coverage, the ERISA exclusion is universal. Finally, the EBL policy excludes claims for funding of the plans, claims of dishonesty or malfeasance, and regulatory penalties are also excluded – all crucial liability risks faced by modern employee benefit plans.



Fiduciary Liability Insurance

Fiduciary liability insurance is designed to protect plan trustees, other fiduciaries and the plan itself against claims alleging breach of fiduciary duties to the plan or claims alleging that they committed an error in the administration of the plan. The modern fiduciary policy has explicit insuring agreements for breach of fiduciary duty under ERISA and other fiduciary law and negligence in the administration of the plan, with a similar broad definition of “administration” to the EBL policy. A quality fiduciary policy goes even further than breach of fiduciary duty and negligence in the administration of the plan, however, as it will also cover first-party claims to the plan in reimbursing the costs to use the Internal Revenue Service and Department of Labor voluntary compliance programs to correct mistakes. Finally, the modern fiduciary policy will cover certain specified regulatory penalties, like penalties under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) as amended by the Health Information Technology for Economic and Clinical Health Act (HITECH), the Patient Protection and Affordable Care Act (ACA) and common Department of Labor and Internal Revenue Service reporting and penalty provisions. A fiduciary policy will contain certain exclusions, but will not exclude claims under ERISA like the EBL policy, and provides a defense for benefit claims (and only excludes the contractual indemnity for a benefit claim) – again, unlike the total benefit exclusion in the EBL policy.

Recent Case Law

An April 10, 2019 decision from the United States District Court for the Southern District of California illustrates the limits of EBL coverage. See *By Referral Only, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2019 WL 1559145 (S.D. Cal Apr. 10, 2019). The insured, a professional services company, offered disability and life insurance plans to its employees. One employee who contributed to the plan was diagnosed with cancer and collected long-term disability until her death. After her death, her beneficiary submitted a life insurance claim. The life insurer denied coverage, asserting that the employee’s coverage had terminated prior to her death, despite her continued payments. The employee’s beneficiary filed suit against the employer, asserting that the employer breached its fiduciary duties by failing to advise the employee that her eligibility for life insurance coverage had expired and the employer had a duty to explain the plan, such that the employee could elect to continue coverage. The beneficiary’s first cause of action was for recovery of benefits asserted that the insurer’s denial of benefits was improper under the plan; and the second cause of action sought equitable relief and breach of fiduciary duty for failure of the plan to notify the participant of her rights under the plan. The plan sponsor’s liability insurer denied coverage for the lawsuit under the employee benefits liability (EBL) coverage of the policy. Specifically, the EBL insurer argued that it has no duty to defend or indemnify the lawsuit because the EBL policy only covers negligence in plan administration, and not an insured’s fiduciary acts, and the policy’s ERISA exclusion otherwise barred coverage.

The district court first found that the failure to advise the participant of her rights under the plan “fits squarely within the definition of administration as defined by the [EBL] policy.” Nevertheless, the ERISA exclusion excluded the claims for breach of fiduciary duty in denying life insurance benefits to the participants. The court rejected the beneficiary’s argument that ERISA exclusion was somehow ambiguous because fiduciary was not defined in the policy. Finally, the court held that the EBL insurer had no duty to defend because all of the alleged negligent conduct in administering the plan arose out of alleged breach of fiduciary duties imposed upon it by ERISA, including the claims of equitable relief.



The Limitation of EBL Coverage Based on Claim Examples

As the EBL decision discussed above demonstrates, the administration coverage in an EBL policy is so limited that it will not protect against garden-variety benefit claims, which are the most common claims against employee benefit plans. The following is a list of common claim examples in which EBL coverage is deficient, but would more likely be covered by a quality fiduciary liability insurance policy.

- 1) **Breach of fiduciary for failure to pay claims:** As noted, failure to pay benefits under the plan is the most common claim against employee benefit plans and plan fiduciaries. The typical claim is that a benefit was not paid properly. We have seen a significant rise in denial of duty disability benefit appeals, particularly against governmental plans. Many plans have changed their plan eligibility for disability, or are enforcing their plans terms more rigorously, leading to an increase in benefit lawsuits against plans. We are seeing more direct claims by providers against health plans based on an assignment from plan participants. A typical example is when a plan participant needs to medevac to the hospital, and the provider that is not approved by the plan requires the participant to assign rights to seek reimbursement from the plan. As the EBL decision discussed above demonstrates, any claim for breach of fiduciary duty in denying benefits under the plan will likely be excluded from EBL coverage, but the plan would likely get reimbursement of defense costs from a fiduciary liability insurance policy.
- 2) **Funding claims – failure to fund plans:** A key risk for defined benefit plans, particularly for multiemployer and governmental plans, is failure to fund the plan to ensure the long-term solvency of the plan. This high-exposure claim would be excluded by EBL coverage, but potentially covered by fiduciary liability insurance.
- 3) **Imprudent Investment Claims:** The highest exposure claim against defined benefit plans is that the plan trustees or fiduciaries imprudently selected an investment that has experienced poor returns. The damages model can be the loss in the investment with interest. This would only be covered under fiduciary liability insurance.
- 4) **Participant claims – *pro se* whistleblowers:** A participant or concerned citizen can sue employee benefit plans claiming that they are improperly managed or that investments are improper. This would only be covered under fiduciary liability insurance.
- 5) **Challenges to Plan Amendments or benefit changes:** When a plan sponsor makes changes to the terms of benefits under the plan, participants sometimes file class actions challenging the benefit change. This is very common for governmental plans, such as when early retirement benefits have been eliminated or reduced. The ISO EBL policy form excludes from the definition of “administration” the selection process of any employee benefit plan, and thus would not cover any settlor or business function in determining what plan terms should be provided. A quality fiduciary policy, by contrast, will provide settlor coverage to protect the plan for benefit changes or amendments to the plan that are not considered fiduciary functions.
- 6) **Conflicts of Interests or Prohibited Transactions:** Fiduciaries of benefit plans must act in the best interests of plan participants, and participants or regulator can bring claims that a fiduciary acted in its own self-interest, such as taking improper gratuities from a plan investment advisor. This is expressly excluded from EBL coverage, but the fiduciary carrier would provide a defense until a finding of guilt by the individual fiduciary.



- 7) **Excessive Fees:** A new trend for defined contribution plans is participant class actions accusing plans of excessive investment fees and not ensuring that investment expenses for mutual funds are the lowest possible. These lawsuits are expensive to defend and can carry high exposure. This is another exposure that would only be covered under fiduciary liability insurance.
- 8) **Poor investment selections in defined contribution plans:** Related to excessive fee exposure, participant class actions have been filed alleging that investment choices are not diversified or have underperformed the market. The damage models can be significant in these cases. Again, this is likely only covered under fiduciary liability insurance.
- 9) **Failure to remit contributions to defined contribution plans:** Regulators have been enforcing the requirement that all participant deferrals to defined contribution plans must be moved immediately into participant funds. This exposure is not covered by EBL.
- 10) **Penalties Assessed by the Department of Labor or Internal Revenue Service:** If the plan is audited, or fails to file required forms with the DOL, or the IRS, both regulators can assess penalties that cannot be paid out of plan assets. Plans also face potential penalties for non-compliance with HIPAA, the ACA, and other laws. Some of the penalties can be paid by the fiduciary policy, but are excluded completely by EBL coverage.
- 11) **Voluntary Compliance Program Claims:** If the plan makes a mistake, like failing to file its Form 5500 on time, it can use the DOL voluntary compliance program to avoid future regulatory issues. The defense expenses and filing fees will be paid by fiduciary insurance, but excluded by limited EBL coverage.



Comparison of EBL and Basic Provisions of Fiduciary Liability Insurance*

Feature	Employee Benefit Liability Coverage	Fiduciary Liability Insurance
Administration of Employee Benefit Plan Coverage	<p>Yes.</p> <p>EBL includes unemployment insurance, social security benefits, workers' compensation and disability benefits in the definition of Employee Benefit Plan. This is arguably broader than a fiduciary policy, but the EBL policy nevertheless contains an exclusion for failure to comply with these laws. Also, ISO form only covers participant-directed 401k plans, which limits coverage to when employees can make their own investment choices.</p>	<p>Yes</p>
Breach of Fiduciary Coverage	<p>No. Expressly excluded under the ERISA exclusion of the EBL policy.</p>	<p>YES: Any breach of the responsibilities, obligations or duties imposed upon fiduciaries of a Plan by an Employee Benefit Law.</p> <p>Claim Examples: Employee sues when plan eliminates early retirement benefit; employee sues for denial of disability early pension benefit; participants sue for investment losses in the plan due to alleged imprudent investment.</p>
Defense for Benefit Claims	<p>No</p>	<p>Yes</p>
Settlor Coverage	<p>No</p>	<p>Yes. Settlor coverage is available in most fiduciary policies. Coverage would include settlor responsibilities in establishing, amending, terminating or funding a plan. EBL policy would not cover any claim alleging that the plan was underfunded; or any claim challenging a reduction in benefits – this is the single most frequent claims against employee benefit plans.</p>
Defense of non-fiduciary Coverage	<p>No</p>	<p>Yes</p>



Feature	Employee Benefit Liability Coverage	Fiduciary Liability Insurance
Voluntary Compliance Program Coverage	No	<ul style="list-style-type: none"> • Voluntary compliance programs: <ul style="list-style-type: none"> - Provides coverage for the filing fee, fines, any required penalty or sanctions, and the costs, charges and expenses of your attorney - Responds to programs administered by the IRS and DOL including but not limited to: the EPCRS; Audit Closing Agreement Program; Voluntary Compliance Resolution Program; Walk-in Closing Agreement Program; the Administrative Policy Regarding Self-Correction; the Tax-Sheltered Annuity Voluntary Correction Program; the Delinquent Filer Voluntary Correction Program; and the Voluntary Fiduciary Correction Program. <p>Claim Example: governmental plan discovers that it has failed to withhold income taxes from annuity distribution payments to retirees and uses the IRS Voluntary Compliance Resolution Program to avoid loss of qualified tax status.</p>
ERISA Section 502(c) & PPA Reporting Violation Coverage	No	<ul style="list-style-type: none"> • 502(c) & Pension Protection Act – loss in the form of civil penalties or any excise tax imposed pursuant to 502(c) of ERISA and the Pension Protection Act of 2006 or comparable state reporting laws. This coverage relates to claims from participants that the plan did not provide annual or other required disclosures.
HIPAA/HITECH Coverage	No	<ul style="list-style-type: none"> • HIPAA/HITECH - violations of HIPAA’s privacy and security rules are covered under a fiduciary policy.
PPACA Coverage	No	<ul style="list-style-type: none"> • PPACA Fines and Penalties – coverage for violations of health care reform laws.
IRC Section 4975	No	<ul style="list-style-type: none"> • Section 4975 of the Internal Revenue Code – coverage for prohibited transactions from the IRS to avoid plan tax disqualification.

* Note that fiduciary liability insurance can provide additional coverage provisions, and this chart only addresses the core administration, breach of fiduciary duty, voluntary compliance and penalty coverage provisions of the policy.



The Euclid Perspective

We understand why many plan sponsors want to save money by avoiding the purchase of another insurance policy. But with the rising liability risks of maintaining retirement and health benefits for employees, the investment in fiduciary liability insurance is necessary. EBL coverage is severely limited in scope and will not cover even the most common claims facing today's employee benefit plans.

For a more complete understanding of the scope of fiduciary liability insurance, please request a copy of Euclid's Fiduciary Liability Handbook from www.fiduciaryliabilityhandbook.com.

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¹ ISO Form U058-0310 (2000)

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