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Fiduciary Liability Insurance: How Much Is Enough?

By
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In 2006, the Employees Retirement System of the City of St. Louis (SLERS) decided to scrap its reliance on a city-administered "self-insurance" pool and get its own fiduciary liability insurance policy. The question for the $600 million fund was how much coverage should it get? After hiring a broker and sorting through myriad options and exclusions, SLERS ultimately settled on a policy that provided $5 million in coverage with a $10,000 deductible.

"We were approximately a $600 million plan, but we knew we couldn't afford $600 million in coverage," says Scott Harper, SLERS in-house counsel. "So we did the best we could. When it comes to [fiduciary liability insurance], a plan can't buy enough and a plan can't afford to cover all its assets. You figure out how much the plan can pay, and what would be reasonable, and you go from there."

As SLERS and other public funds know, however, determining the proper amount of fiduciary liability insurance can be a headache. It's hard enough figuring out how much the plan can afford. Throw in the myriad of other factors, including the current funding environment and the often confusing exclusionary language in the policy contracts, and it's easy to see why many plan attorneys and administrators are often tempted to throw up their hands.

The bottom line is that there is no right or wrong answer to the question of how much fiduciary liability coverage is appropriate. It depends, among other factors, on the total assets in the plan, the unique circumstances surrounding the plan, and the level of risk tolerance of trustees. Indeed, a random sampling of U.S. public plans shows a wide range of differences in the amounts of coverage even among systems at similar asset levels (see Chart 1).

That being said, there are some guidelines a plan can use to help it determine the right amount of coverage for the money. But before we get to that process, it's helpful to review what is fiduciary liability insurance and how it has come to be such an important – and thorny – issue for public plans.

Fiduciary liability insurance is a special type of insurance that protects the assets of the plan from being used to pay judgments against the plan or its trustees for, primarily, allegations of breaches of fiduciary duty. It also protects the personal assets of the trustees, a key consideration since most public funds provide that trustees who breach their fiduciary duties can be held personally liable.[2] While many states and local governments do provide some layer of indemnification or "sovereign immunity" for its public plan trustees or employees[3], the provisions regarding indemnification for breach of fiduciary duty are limited. [4] Hence, fiduciary liability insurance provides the extra protection that is often needed.

Until recently, many retirement systems might have figured they didn't need fiduciary liability insurance. Not anymore. With the troubled economy leading to a dramatic increase in lawsuits and severe funding issues, public funds are now taking a second look.

"We've had more public funds secure [fiduciary liability insurance] in the past two years than we've ever had before," says Craig Goesel, an insurance broker for Mesirow Financial Services in Chicago which counts dozens of public funds among its client base. "Everybody is nervous about funding levels. They want to know, if there are problems down the road, who's going to protect the fund and its trustees?"

In determining the proper amount of coverage for his public fund clients, Goesel advises them to consider more than just the plan's asset size. The system's level of funding, the number of participants in the plan, the number of past claims and/or litigations it has faced, and the simple matter of how much the plan can afford, are other key factors, he says. "The political nature of the fund is also a big factor right now," he says. "The more high profile, the greater the scrutiny will be on a fund and its trustees."

With so many public funds strapped for cash, however, trustees and administrators need to make sure they are getting the most for their money when it comes to purchasing fiduciary liability insurance. Here are some key factors, gleaned from interviews with insurance brokers and NAPPA attorneys around the country, for plans to consider as they go about performing the cost/benefit analysis:

- **Find out the applicable governmental indemnity**

  Many public funds have some level of indemnification by statute. But, as mentioned above, even in those cases there are limits. For example, the Los Angeles City Employees Retirement System discontinued its fiduciary liability coverage in '03 after determining that it was adequately covered by the City of Los Angeles. However, the City policy did not cover Board members in the event of a conflict-of-interest with the City. Furthermore, as Chris Waddell, former general counsel to two large California public funds, notes, it is vital to find out if these "provisions are mandatory or discretionary, and who controls the indemnification/defense decisions if discretionary." [5]

Chart 1*

Public Pension Fund**	Apx Total Fund Assets	Fiduciary Liability Levels
Municipal Pension Fund (5)	$5,000,000	$1,000,000
Municipal Pension Fund	$7,500,000	$2,000,000
Municipal Pension Fund (4)	$10,000,000	$1,000,000
Municipal Pension Fund	$10,000,000	$2,000,000
Municipal Pension Fund (2)	$12,500,000	$1,000,000
Municipal Pension Fund	$15,000,000	$2,000,000
Municipal Pension Fund	$15,000,000	$5,000,000
Municipal Pension Fund	$25,000,000	$2,000,000
Municipal Pension Fund (2)	$30,000,000	$3,000,000
Municipal Pension Fund	$50,000,000	$3,000,000
Municipal Pension Fund	$100,000,000	$5,000,000
St. Louis City Employees	$500,000,000	$5,000,000
Tulare Co. (Cal.) Employees	$800,000,000	$5,000,000
Laborers LABF	$1,000,000,000	$15,000,000
Chicago Firefighters	$1,000,000,000	$15,000,000
Municipal Pension Fund (2)	$1,500,000,000	$10,000,000
Municipal Pension Fund	$1,500,000,000	$15,000,000
Cincinnati Retirement System	$1,800,000,000	$7,000,000
Municipal Pension Fund	$2,500,000,000	$10,000,000
Dallas Police & Fire	$2,500,000,000	$50,000,000
Municipal Pension Fund	$3,500,000,000	$10,000,000
San Diego City Employees	$3,800,000,000	$25,000,000
District of Columbia Employees	$4,000,000,000	$10,000,000
Chicago Municipal Employees	$5,000,000,000	$10,000,000
Municipal Pension Fund	$5,000,000,000	$10,000,000
Municipal Pension Fund	$8,000,000,000	$10,000,000
Cook Co. Workers/Forest Pres.	$9,500,000,000	$10,000,000
Kentucky Retirement System	$11,500,000,000	$5,000,000
CALSTRS	$125,000,000,000	$75,000,000

*Based upon responses received to NAPPA list serve inquiry dated November 5, 2009, information obtained from independent insurance broker, and publicly available information confirmed from fund websites.

**Numbers in parentheses represent total number of funds that share asset/liability levels.

- **Factor in the times**

  With funding levels a concern across the country, public fund trustees and administrators have reason to be concerned. One insurance firm study suggests that the number of claims against fiduciaries (in both public and private plans) has increased threefold since the 1990s, and that plan fiduciaries now surpass the medical profession as a target for litigation.[6] While much of that increase likely can be attributed to ERISA plans that featured compulsory investment in company stock, public funds have not been spared. A prime public fund example of multiple fiduciary claims would be the San Diego City Employees Retirement System litigation, in which several former trustees and administrators were forced to undergo lengthy and costly trials after being indicted on charges related to their fiduciary responsibilities. A fiduciary liability insurance policy will obviously not pay to improve the funding level of an underfunded pension system. However, if there is a catastrophic event or insolvency situation, the policy may be the first line of defense for the trustees in the event that a lawsuit is filed.

- **Figure out who needs coverage**

  Higher-profile public plans with bigger staffs must take into account the accompanying greater likelihood of claims. When the Dallas Police and Fire Pension System (DPF) was considering how much coverage to buy a few years ago, it contemplated worst-case scenarios such as those that befell San Diego. "We figured that nasty litigation like San Diego would cost each [named trustee or staff member] north of

$2 million," plan attorney Everard Davenport said. Partly as a result of this analysis, DPF settled on a policy that provides $50 million in coverage.

- **Know what the policies cover**

  In general, most fiduciary liability policies will cover the plan and all past, present and future trustees, directors, officers and employees (including spouses and legal estate representatives), for breach of fiduciary duties and any act or error of omission along those lines. It will extend to written demand for monetary or injunctive relief, and to criminal or civil proceedings commenced by service of complaint, return of indictment, or regulatory proceeding. The policy will cover damages (judgments, settlements, pre-trial and post-trial interest) and defense costs, and be administered on a claims-made basis (providing coverage for claims arising from prior acts).

  What might the typical fiduciary liability policy NOT cover?

  Most policies will not protect fiduciaries against criminal or fraudulent acts or in cases of conflict-of-interest; nor will they cover claims of libel, slander, defamation or bodily injury. Coverage usually will not extend to outside service vendors, benefits due participants or failure to collect contributions. Most fiduciary liability insurance plans also require that any previous or pending claims be disclosed before the policy is purchased.

  In analyzing the exclusions in a fiduciary liability policy, plan trustees and counsel need to pay close attention to the language. For example, they should look carefully at the fraud exclusion to see if coverage of allegations extends up to "final adjudication." They should check severability (or "black cat") provisions to make sure guilt of one trustee does not preclude coverage of the other trustees against charges that they failed to monitor or supervise the guilty party. As stated above, trustees also want to make sure they get a clear reading on whether they will be covered for investigations (in addition to litigation) and for suits seeking injunctive relief as well as those seeking monetary damages. This requires a thorough examination of the policy's definition of a "claim."

  Another key issue in any policy is who will litigate any such claim if one is tendered? While many carriers prefer to retain control over this decision, it is an issue that may be negotiated. As Deirdre McGrath, Assistant County Counsel for the Stanislaus (Calif.) County Employees' Retirement Association, notes: "Do you want the insurance company's attorney or an attorney who is knowledgeable in the area of retirement/pension law [to represent your fund]?" [7]

- **Consider a lower deductible**

  In many cases it might not make sense for a public fund to buy a fiduciary liability policy with a significant deductible. If there is a $1 million claim, including defense and settlement or judgment, a $250,000 deductible might have a small impact on the overall cost of the fiduciary liability policy, but it could have a huge impact on the public's perception of the plan. The "headline risk" to the plan of having used even a relatively small amount of plan assets to pay for legal fees or to satisfy a claim against trustees may be the same as if there were no insurance in place. It might be more rational in many cases to pay a little more for the policy and seek a nominal deductible or none at all.

- **Be careful with waivers of recourse**

  Over the years, many fiduciary liability carriers of public funds have followed the lead of their ERISA counterparts and added waivers of recourse, an extra layer that indemnifies trustees from being held individually liable for breach of fiduciary duties. These provisions typically require each trustee to pay about $25 annually and are paid by the trustees out of their own pockets. In most cases, however, these waivers are unnecessary for public fund trustees.[8]

- **Shop around**

  With the rise in demand for fiduciary liability insurance has come a similar increase in premiums. Once a relatively inexpensive item, a typical policy for a small public fund seeking $1 million in coverage now might go for around $5,000 per year. A large fund seeking $10 million in coverage might find the cost of premiums to run anywhere from $100,000-150,000.[9] As with most any other purchase, however, it pays to shop around and compare rates among carriers.

- **Hire a qualified and trusted broker**

  Another way to get a range of prices, and to help sort through the myriad exclusions listed above, is to hire a qualified or trusted broker. Take the time to research candidates and get references. "Find an agent who has sold this kind of product to other pension funds," advises Gary Lawson of the Dallas law firm of Strasburger & Price. "We have seen some policies that fail to cover the right risk and then what you are left with is a claim against the inept agent." [10]

Once again, there really is no right or wrong answer to the question of how much fiduciary liability insurance coverage is appropriate. Goesel, for example, says $5 million plans generally may feel adequately protected with $1 million in limits. For a $5 billion plan, the limits typically top out in the $10 to $15 million range. But even he admits such benchmark figures are of limited value without knowing all the relevant circumstances surrounding the particular plan.

While it might seem that working through the fiduciary liability insurance cost-benefit thicket would be expensive and time-consuming, the effort to determine the right amount of coverage will be worth it. It certainly proved to be for SLERS. Last year, the members of its Board of Trustees found themselves sued by two employers over allegations that the trustees breached their fiduciary duties by not granting separate employer contribution rates (instead of a uniform cost sharing employer contribution rate) and operating the fund in a manner that was not in accordance with state enabling legislation and the Missouri constitution.

At first the insurance carrier balked at paying the legal fees, claiming that the suit was seeking injunctive relief – not monetary damages. Since there were no monetary damages, they argued, there was no duty to indemnify or provide a defense. After the second employer joined the initial suit, the carrier agreed to pay future defense costs, subject to a reservation of rights.

"I think it is very important to have fiduciary insurance coverage," Harper says.

No doubt SLERS is happy to have every penny of that policy right now.

Endnotes

1. This article explores the issue of how much fiduciary liability insurance coverage is adequate for a public pension plan but does not attempt to offer advice as to whether fiduciary liability coverage is advisable for any specific plan or what such insurance should cover.
2. By way of example, the Illinois Pension Code, 40 ILCS 5/1-114(a), provides that "any person who is a fiduciary with respect to a retirement system or pension fund established under this Code who breaches any duty imposed upon fiduciaries by this Code shall be personally liable to make good to such retirement system or pension fund any losses to it resulting from each such breach, and to restore to such retirement system or pension fund any profits of such fiduciary which have been made through use of assets of the retirement system or pension fund by the fiduciary, and shall be subject to such equitable or remedial relief as the court may deem appropriate, including the removal of such fiduciary." Based upon this, the public interest in protecting trustees is obvious. Without adequate protection for trustees against claims for personal assets, few reasonable persons would agree to serve in such capacity.
3. For an example of an indemnification provision, see Illinois Pension Code, 40 ILCS 5/1-107.
4. According to a 2009 report by Patton Boggs LLP/Ullico Casualty, sovereign immunity may not apply to actions that are "inconsistent with statutory duties or commands, potentially including fiduciary duties, on the grounds that such actions are 'beyond [the fiduciary's] authority' or 'outside the scope of employment.' More generally, sovereign immunity does not render an employee immune from 'liability for willful and wanton negligence,' and exposes plan fiduciaries to potential risk and costs in connection with such claims." Hence, many states and governments mandate some form of additional coverage for its plan trustees. According to the Boggs/Ullico report, approximately 20 states require the purchase of fiduciary liability insurance for their state retirement systems. ("Government Plans: Exposure to Fiduciary Liability," Feb. 2009, by Patton Boggs LLP/Ullico Casualty).
5. Response to NAPPA list serve query, Nov. 5, 2009
6. North American Professional Liability Insurance Agency, "Is Liability Insurance Important for ERISA plan administrators?," www.fiduciaryinsurance.com
7. Response to NAPPA list serve query, Nov. 5, 2009
8. Unlike ERISA plans, public plans are generally allowed by statute to purchase insurance for trustees. Thus, in many cases, public fund trustees may be covered by the fund's fiduciary liability policy and do not need individual coverage.
9. Though Goesel says rates for fiduciary liability insurance policies have stabilized over the past few years, he says those rates may skyrocket in coming years if the funding crisis worsens and more carriers opt to get out of the fiduciary liability insurance market for public funds.
10. Response to NAPPA list serve query, Nov. 5, 2009