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TRUSTEE LIABILITY INSURANCE UNDER ERISA

Marc Gertner*

Until 1974, federal regulation of private noninsured pension plans was minimal and indirect,¹ but as the scope of these plans underwent enormous expansion in recent years,² the need to protect the interest of employees in employee benefit plans became more apparent, and Congress responded by enacting the Employee Retirement Income Security Act of 1974 (ERISA).³ Because the unknowns of this legislation currently far outnumber the knowns, lawyers and other professionals operating in the pension field still are attempting to clarify the changes created by ERISA. Clearly, though, the expansion of duties and obligations of trustees has increased the risks trustees bear, the possibility of litigation, the types of redress, and the potential for liability.⁴ These changes require fiduciaries of employee benefit plans to take a new look at trustee liability insurance, more frequently called "errors and omissions insurance." In response to these expanded obligations and liabilities, this Article will set forth guidelines for use by the fiduciary in procuring errors and omissions insurance in compliance with section 410 of ERISA.⁵

Consideration of errors and omissions insurance under ERISA demands a brief review of pre-ERISA trustee liability insurance law for

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1. Congressional attempts to regulate these plans consisted primarily of awarding tax benefits to those plans that met minimum standards. See INT. REV. CODE OF 1954, §§ 401(a), 402(a), 404(a), 501(a). The only sanction for failure to comply, however, was the withdrawal of tax-exempt status. Id. § 503. This shortcoming, coupled with the utter inadequacy of prior congressional regulatory efforts, made the need for reform apparent. See Landau, Merholtz & Perkins, Protecting a Potential Pensioner's Pension—An Overview of Present and Proposed Law on Trustees' Fiduciary Obligations and Vesting, 40 BROOKLYN L. REV. 521 (1974).

2. Estimates of the number of employees covered by such plans range from 23 to 30 million, as compared to 4 million in 1940 and 9.8 million in 1950. It is predicted that by 1980 some 42 million employees will be covered by these plans. Moreover, book value of plan assets soared from $12.1 billion in 1940 to $150 billion in 1972, and is expected to reach $225 billion by 1980. H.R. REP. No. 807, 93d Cong., 2d Sess. 3 (1974).


4. The increasing vulnerability of professional fiduciaries and the need for "errors and omissions insurance" is examined in Hume, Errors and Omissions Liability as Affecting Insurance Agents and Brokers, 40 INS. COUNSEL J. 379 (1973).

historical and practical perspective. Ten to fifteen years ago this subject received scant consideration by trustees and their advisors, as only rarely were legal actions commenced by employee benefit plan participants or their beneficiaries. Also, very few carriers wrote errors and omissions policies, and those with available policies made little effort to market them. Finally, and perhaps most importantly, trustees, in almost every instance, had wrapped themselves in the secure blanket of a broadly and deftly drawn exculpatory clause.

The five years preceding the enactment of ERISA witnessed increased fiduciary interest in the acquisition of errors and omissions insurance. This interest was sparked by the sudden demise of exculpatory provisions in trust agreements and an increase in the number of actions brought by participants and their beneficiaries against trustees. Then, in 1972, Congress gave the first indication of an intent to exert extensive control over private pension plans with the introduction of the proposed Retirement Income Security for Employees Act. This bill severely limited the availability of protection by exculpatory clauses, causing trustees to look for other means of protection, principally insurance.

Counsel whose clients asked for an opinion as to the legality of the purchase of errors and omissions insurance prior to ERISA had two major concerns. First, the propriety of the purchase of insurance to protect trustees from acts of negligence was called into question. If exculpatory clauses were unenforceable because of public policy considerations, the purchase of insurance might be improper for the same reasons; no primary authority was to be found on point, however.


7. See Hume, supra note 4.


10. Most lawyers believed that it was not illegal or improper for the trustees to purchase this protection. Their primary contention was that though both the insurance policy and the exculpatory clause represent attempts to protect the trustees from the natural consequences of their own errors, a policy of insurance does not deprive the
second concern with pre-ERISA trustee liability insurance was the legality of paying premiums from the trust fund.\(^{11}\) This question was most frequently resolved simply by inserting express language in the trust agreements authorizing the payment of insurance premiums from the trust fund for the benefit of the trustees.

The passage of ERISA, and in particular of section 410 of the Act, was intended to remove some of the uncertainty surrounding the propriety of trustee liability insurance. However, though the Act does regulate the purchase of the insurance and the payment of premiums, it leaves other questions to be resolved. Much of the consternation surrounding the propriety of trustee liability insurance was occasioned by the insertion of section 410(b)\(^{12}\) by the joint conference committee without any notice or publication.\(^{13}\) Perhaps the greatest disservice done by the last minute insertion of this section and the early effective date of subtitle B, part 4,\(^{14}\) was to leave the insurance industry without available ERISA-form policies of trustee liability insurance. There are still only a few carriers in the field, and they generally were unprepared for the added provisions of the Act.\(^{15}\) At present, therefore, trustees are forced to take policies not wholly satisfactory; better policies are expected to be forthcoming soon.

Before discussing the specifics of errors and omissions insurance that must be considered by the trustees and their advisors, several threshold matters must be mentioned. Questions arose concerning the propriety of the use of fund assets by trustees to procure errors and omissions insurance covering their personal acts. It was feared that purchase of the insurance would be considered an imprudent expenditure of fund assets, an aggrieved party of a solvent party against whom to seek economic redress for the damages suffered.

\(^{11}\) Indeed, the two leading trust scholars, George Bogert and Austin Scott, reached different conclusions on this question. Compare G. Bogert, Law of Trusts, § 126 (5th ed. 1973), with A. Scott, Abridgment of the Law of Trusts §§ 222.1-.4 (1960).

\(^{12}\) ERISA § 410(b), 29 U.S.C.A. § 1110(b) (1975).


\(^{15}\) One carrier announced a new policy form and within days after its debut started proliferating contract amendments. Another well publicized policy was in fact a standard pre-ERISA policy with several amendatory riders.
would be condemned as an indirect payment of something of value to the trustees at the expense of the fund, or would be deemed improper in light of the required right of recourse by the insurer against the fiduciaries. Although these problems have been resolved for the present, the longterm solutions have yet to be established.

Of more immediate concern is the status of pre-ERISA policies that are currently in force. Terminating existing policies would cause the fund to receive only a short rate refund, and post-ERISA policies constitute more expensive, albeit less concise, replacements. The pre-


17. The conference committee report accompanying section 410(b)(1), 29 U.S.C.A. § 1110 (1975), states that plan funds may be used to purchase insurance for fiduciaries of the plan only if the insurance permits recourse by the insurer against the fiduciary upon breach of fiduciary responsibility. It should be noted, however, that the fiduciary himself or his employer or union may purchase the insurance without providing for recourse. H.R. REP. No. 1280, 93d Cong., 2d Sess. 320-21 (1974).

18. Fortunately, the Department of Labor responded promptly with the March 4, 1975 press release of Assistant Secretary of Labor Paul J. Fasser, including the legal determination of Solicitor of Labor William J. Kilberg. The last paragraph of the release, however, gave notice that this may change in the future "as experience data" develop subject to Department of Labor monitoring "of the operation of the policies and the reasonableness of premium rates."

19. Trustee advisors who would delay in the purchase of new policies predicate their action upon two communications of the Department of Labor. First, they cite the fact that many of the trustees have applied for or received a six-month stay under regulations issued by the Department on November 21, 1974. 29 C.F.R. § 2550.414b-1 (1975). However, these regulations allowed an extension for the provisions of sections 402, 403 (except (c)), 405 (except (a) and (d)), 29 U.S.C.A. §§ 1102, 1103, 1105 (1975), through December 31, 1975, and for section 410(a), 29 U.S.C.A. § 1110(a) (1975), through June 30, 1975. Thus, the extension, if granted, defers the effective date of those sections, but does not stay the requirements of section 410(b), 29 U.S.C.A. § 1110(b) (1975). 29 C.F.R. § 2550.414b-1 (1975).

A second line of defense urged by those seeking to retain the existing liability insurance is based on Department of Labor ERISA Interp. Bull. 75-1, 40 Fed. Reg. 39598 (1975). It is argued that the Department granted up to a three-year stay of ERISA if three conditions precedent were met: (a) the fiduciary services are provided under a binding contract in effect on July 1, 1974, or pursuant to a renewal of such a contract; (b) the services provided under the contract are upon terms at least as favorable to the plan as would be terms of a newly negotiated contract on a freely negotiated transaction with an unrelated party; and (c) the services were not a prohibited transaction under section 503(b) of the Internal Revenue Code, INT. REV. CODE OF 1954, § 503(b).

This interpretation is incorrect. The ruling attempted to clarify section 414(c)(4) of ERISA, 29 U.S.C. § 1114(c)(4) (1975), dealing with prohibited transactions. It related expressly to the effective date of sections 406 and 407(a), 29 U.S.C.A. §§ 1106, 107(a) (1975), not section 410(b), 29 U.S.C.A. § 1110(b) (1975). The bulletin stated:
ERISA policies, however, were not designed to cover the broad range of liability imposed by the Act, and may fall short of compliance with section 410(b). Therefore, though short rate refund losses are as a general rule to be avoided and though the currently available trustee liability policies that comply with section 410(b) contain inherent uncertainties, a new policy is often the best choice.

This inquiry examines the risks and exposures imposed by ERISA on trustees of employee benefit plans and the means by which trustees may structure a policy of liability insurance to protect against those risks. Although a detailed discussion of fiduciary responsibility under ERISA and exposure for breaches of this responsibility is beyond the scope of this Article, an understanding of the scope of potential trustee liability requires an examination of the provisions of ERISA that increase a fiduciary's exposure.

The Act applies to both employee welfare benefit plans and employee benefit pension plans, though certain enumerated plans are beyond the scope of the Act. The fiduciary is charged with the establishment of a plan, and must administer plan assets to provide benefits to the participants and beneficiaries and to defray costs of administration of the plan. A fiduciary must invest plan assets in conformity with the prudent man rule and diversify the investments so as to minimize the

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21. ERISA §§ 3(1), 401, 29 U.S.C.A. §§ 1002(1), 1101 (1975). These include any plan that provides medical benefits, accident, disability or unemployment compensation, vacation benefits, training programs, scholarship funds, or prepaid legal services.

22. Id. §§ 3(2), 401, 29 U.S.C.A. §§ 1002(2), 1101. These include any plans that provide for retirement income or deferred income.


26. The fiduciary must act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar
risk of large losses. A fiduciary may incur liability if he engages in enumerated prohibited transactions, or if a cofiduciary is guilty of a breach of trust. A plan fiduciary who breaches any of the responsibilities, obligations, or duties becomes personally liable to the plan for any losses resulting from the breach, must restore to the plan any profits made through the use of plan assets, and may be subject to other equitable or remedial relief, including removal, deemed appropriate by the court. In addition to being subject to actions for breach of fiduciary duty, a trustee may face a civil action brought by a participant or beneficiary to recover benefits due under the plan or to enforce a right to benefits under the plan; further, a participant or beneficiary may seek a declaratory judgment to clarify rights to future benefits.

The fiduciary faces additional potential liability as a result of a five-percent nondeductible excise tax on transactions prohibited by the Act.
This tax rises to 100 percent of the amount involved if the transaction is not corrected within a reasonable time after notice is received from the Internal Revenue Service that the initial tax is due.\textsuperscript{34} A daily penalty of \$100 is imposed for failure to furnish in a timely manner the information that the reporting and disclosure provisions of ERISA require the plan administrator to furnish to a participant or beneficiary upon request.\textsuperscript{35} In any action brought under section 502, the courts are granted discretion to allow reasonable attorney’s fees and costs to either party in an action;\textsuperscript{36} before the enactment of ERISA, the substantial cost of maintaining an action against fiduciaries discouraged bringing such a suit.

To insulate himself from these wide ranging liabilities, a trustee may still procure errors and omissions insurance on the terms set forth in the Act. Section 410(b) regulates the purchase of insurance to cover liability or losses occurring by reason of an act or omission of a fund fiduciary, providing that such insurance may be purchased by the fund, by the trustees themselves, or by the participating employers and unions. However, when the insurance is purchased with fund assets and purports to protect the trustee for a breach of a fiduciary obligation, the policy must provide the insurance carrier with a right of recourse.\textsuperscript{37} This requirement gives individual fiduciaries very little protection against liability for a breach of duty under an errors and omissions policy purchased by

\textsuperscript{34} ERISA § 2003(a), Int. Rev. Code of 1954, § 4975(b). The time for correcting the prohibited transaction is referred to as the “correction period,” and is defined in section 2003(f)(6), Int. Rev. Code of 1954, § 4975(f)(6). It should be noted that this section provides that the time may be expanded by the Secretary or his delegate if expansion is reasonably necessary to bring about the correction of the prohibited transaction.

Technical Information Release No. 1329, issued by the Internal Revenue Service on December 31, 1974, 9 P-H 1975 Fed. Taxes ¶ 6316, clarified the application of the excise tax to advisor-consultants, whom the Act renders as liable as fiduciaries for engaging in any of the prohibited transactions. If such services were rendered on a regular basis on or before June 30, 1974, and the requirements of section 2003(c)(2)(D), Int. Rev. Code of 1954, § 4975(c)(2)(D), are otherwise met, the excise tax will not apply to commissions earned and received prior to July 1, 1977. See Rock, Fiduciary Responsibility Under the Employment Retirement Income Security Act of 1974, 11 Ga. Sr. B.J. 162, 166 (1975).

\textsuperscript{35} ERISA § 502(c), 29 U.S.C.A. § 1132(c) (1975).

\textsuperscript{36} Id. § 502(g), 29 U.S.C.A. § 1132(g).

\textsuperscript{37} Id. § 410(b)(1), 29 U.S.C.A. § 1110(b)(1). The requirement for recourse under the subsection is at best ambiguous. The term “recourse” was apparently used to identify the reservation of a right to the carrier against an insured, as distinguished from the carrier’s right of subrogation against third parties. Section 410(b), 29 U.S.C.A. § 1110(b)(1) (1975), suggests that the right of recourse need only be reserved by the carrier against the individual fiduciary who breached the fiduciary obligation and not against all fiduciaries of the fund.
the fund. In response to this requirement, insurance companies have designed a policy aimed at both adequately protecting the fiduciary and meeting the requirements of ERISA. First, a "basic policy" is purchased by the fund to cover liability or losses from claims resulting from improper acts or omissions by fiduciaries. Compliance with ERISA requires the basic policy to contain a provision giving the insurance carrier the right of recourse against a trustee who breaches a fiduciary duty and causes a loss covered by the policy. The insurer next offers to the fiduciaries a "recourse policy" in a separate instrument or a rider attached to the basic policy. Under the recourse policy the carrier either agrees to protect the fiduciary against any liability arising under the recourse provision in the basic policy or waives its right against the fiduciary under the provision. To comply with ERISA, the premium for the recourse policy cannot be paid by the fund, but only by the trustees individually, by an employer, or by a union. Combining the coverages under the basic policy and the recourse policy offers fiduciaries protection similar to that available prior to the enactment of ERISA.

**Proposals for Errors and Omissions Insurance**

In contemplating the purchase of errors and omissions insurance, several factors must be considered by the fiduciary or his attorney.

**Persons Insured**

In addition to the regular trustees and employees of the plan, it is important that alternate trustees be covered as well. Predecessors and successors of the trustees or plan employees should be specifically insured under the policy. The insurance coverage also should protect the estates, heirs, and personal representatives of these persons. The extension of coverage to corporate fiduciaries particularly is significant if the professional administrator or investment manager has a small net worth in comparison to the total assets administered or managed by the corporate entity.

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39. If the definition of insured under the policy does not refer to former trustees or employees, then coverage for claims made against such persons during the policy period but after they leave office should be discussed with the carrier prior to the purchase of the policy.
40. For example, an investment manager, other than a bank, may manage $50 million of assets for various plans while having a net worth of $1 million and an errors and omissions policy with a $1 million limit. If a plan entrusts that manager with $5 million
Because the fund can be sued as an entity, the policy should include the trust fund as an insured under the policy. Benefit-related actions probably will name the fiduciary and the fund as defendants in the same suit so as to enable the claimant to obtain relief from the fund if the fiduciary is exonerated from individual liability.

**Insured Risks**

Traditionally, fiduciary errors and omissions insurance was considered to be "all-risk" insurance as distinguished from "named-peril" insurance. Although under an all-risk policy the carrier will insure all errors and omissions of insureds except those specifically excluded, named-peril insurance covers only those risks enumerated or otherwise specified in the policy. The type of policy is crucially important in allocating the burden of proof in disputes between the fiduciary and the insurer. Under an all-risk policy, the carrier must pay unless it can establish the applicability of an exclusion. If the coverage is named-peril, the insured must demonstrate that the loss was in fact one of the specific risks covered. Several of the policies currently available provide quasi-all-risk coverage as to all losses resulting from a breach of fiduciary duty.

Of plan assets, it may be prudent for the trustees to insure that there is an errors-and-omissions policy that will cover specifically a claim relating to assets of the plan rather than relying on the investment manager's policy, which would be responsive to the claims of all client plans affected by an improper investment decision. Since an investment manager generally follows the same pattern of investment for all client plans, an imprudent investment policy could affect all of its client plans, and the net worth and insurance maintained by the investment manager could be inadequate to cover the loss fully. It should be noted that carriers are reluctant to add an investment manager as an insured under the policy.

Most of the policies specifically exclude as insureds any professional administrators and other professionals and independent entities providing services to the plan. There are, however, carriers that will include the professional administrator as an insured for an additional premium.

41. ERISA § 502(d), 29 U.S.C.A. § 1132(d) (1975), provides that a fund can be sued under Title I, id. §§ 2 to 514 (codified in scattered sections of 5, 18, 29 U.S.C.A.), as an entity; any money judgment against the fund is enforceable only against the fund unless the liability of another person, such as a fiduciary, is established in his individual capacity.


To provide adequate coverage, a policy must anticipate and protect against acts or omissions most likely to arise during the tenure of the fiduciary; it not only should insure against losses to the fund incurred by a direct breach of a fiduciary duty, but also should safeguard acts or omissions of a fiduciary who acts prudently, but incorrectly. Claims against an insured fiduciary for acts or omissions of noninsured fiduciaries and other persons for whose acts the insured fiduciary is responsible should be included in the coverage. If this coverage is not available and the investment manager is not an insured under the policy, it may be found that coverage for investment decisions has been diluted substantially.

**Defense Costs Covered**

Under many of the available policies, the insurer has exclusive control over litigations against the insured and the correlative duty to defend the insured in all actions brought against the insured alleging breaches covered by the policy. As a corollary to the right of exclusive control, it should be noted that defense costs incurred by an insured are only covered by the policy if prior consent is obtained from the carrier. Under these policies, the carrier retains the right to select the defense counsel, a choice that the trustees may wish to retain for themselves. The trustees should determine also the extent of control the carrier intends to exert over the litigation of a claim.

44. This would include situations in which the trustees take all reasonable steps to verify eligibility but still make an erroneous benefit payment. A loss results to the fund notwithstanding the absence of a breach of duty. Other situations in which errors that would not necessarily constitute a breach of fiduciary duty could occur include counseling participants regarding their rights under the plan, interpreting the plan, and verifying eligibility and pension credits.


47. There are some policies available under which the carrier has no duty to defend, but the carrier agrees to indemnify the insured for the expenses of litigation incurred with the prior consent of the carrier. Under this type of policy, the fiduciaries retain some discretion with respect to the defense of the claim and the appointment of defense counsel.
Suits for nonpecuniary relief as well as monetary damages should be covered. The risk in such suits is not monetary damages but rather the costs of defense, which could be significant in an action for an injunction or a declaratory judgment. In evaluating the scope of coverage under the policy, the trustee should determine whether defense costs in claims for benefits lawfully paid or payable from the plan are excluded from coverage, for, if such an exclusion is present, a substantial portion of the types of nonpecuniary relief provided under section 502 is excluded from coverage.\footnote{48} Further, the trustee should ascertain whether coverage extends to a suit for a declaration of rights concerning pension credit or other plan provisions that relate to eligibility. If all nonpecuniary relief suits are excluded from coverage, the extent of coverage for a claim involving both monetary damages and nonpecuniary relief should be determined.

*Application of Deductible*

The deductible under the policies is applied to each claim or loss. Since the deductible becomes a personal liability of the fiduciary if an alleged breach of fiduciary duty is sustained, it is recommended that it be kept as low as possible. It should be cautioned, however, that the payment of an exorbitant premium for a nondeductible policy may be considered an unreasonable expenditure of plan assets by the Department of Labor.\footnote{49}

The policy should be studied to determine whether claims or losses arising out of the same or related acts of one or more insureds will be considered a single claim or loss for purposes of applying the deductible. Without such a provision, a suit against a multimember board of trustees for action taken by the board could impose liability on each trustee for the full amount of the deductible instead of merely a pro rata portion of a single deductible. Further, it is important to determine whether the deductible will be applied to litigation expenses. Several policies specifically provide that the deductible will not apply to the costs and expenses of litigation covered by the policy. Trustees exonerated of an alleged wrongdoing would be indemnified against potentially significant defense costs by a policy that would provide first-dollar coverage in any case covered by the insurance contract.

\footnote{48} See notes 31-32 supra & accompanying text.\footnote{49} Cf. ERISA § 404(a) (1), 29 U.S.C.A. § 1104(a)(1) (1975); note 17 supra.
Policy Limits

Generally, policy limits apply to all claims against the insured during a policy year; liability in excess of the limit is not covered. When determining the appropriate policy limits, the trustees should consider especially whether defense costs are covered and whether the policy covers more than one plan or fiduciary.50

Period of Coverage

The policy should cover all claims filed during the policy period even though the act or omission giving rise to the claim occurred before coverage was purchased.51 Generally, policies provide for coverage of such past acts but do not apply if the insured at the inception of the policy "knew or could reasonably expect" that the act might result in a claim.52

Subrogation Provisions

Errors and omissions policies generally provide that in the event of payment under the policy, the carrier is subrogated to all of the insureds' rights of recovery against third persons. It should be assured, however, that the carrier is not subrogated to any rights of recovery that the fiduciary may have against the fund itself by virtue of the trust agreement or other provisions.53

50. Some carriers permit several plans to be covered under the same policy at a lower premium than that which would be charged if a separate policy were to be purchased for each plan. In these cases, the policy limit under such an arrangement is not applied on a per-plan basis. Therefore, the claims of all the covered plans during the policy year are aggregated to determine if the limit has been exceeded.

51. The available errors and omissions policies are "claims made" policies under which the carrier will pay a loss only if the claim against the insured is made during the policy period. For purposes of determining coverage, the policies consider the time of the claim, rather than the time of the wrongdoing. An exception to this general rule is the "claims made extension" provision, which should be included in all policies. It provides that if the carrier is notified of a potential claim prior to the policy termination, the claim is to be considered as being made within the policy period despite the fact that it was actually made after the policy ended.

The standard extended discovery period is 12 months and is generally available only when the policy is terminated or cancelled by the carrier. If the carrier will agree, an extended discovery period should also be applicable when the insured terminates the policy. Generally, the policy will provide a time limitation on the election of this option, though addition of the extended discovery period option may result in an additional premium ranging from 25 percent to 30 percent of the cost of the policy.


53. This situation could arise if the policy extends coverage to acts or omissions other than breaches of fiduciary duty and the liability of the fund is not covered under the policy.
Recourse Provisions

The policy should permit recourse only against an insured fiduciary to the extent required by section 410(b).\textsuperscript{54} If the provision permits recovery of any payments made under the policy because of any act or omission by an insured fiduciary, the recourse provision is too broad; on the other hand, if recourse is permitted only if the fiduciary failed to act prudently, the provision may be too narrow to comply with the Act. For example, there could be a breach of a fiduciary duty in which the prudence of the fiduciary is not in issue, yet section 410(b) would require the insurance policy to permit recourse against the fiduciary.

After a fiduciary leaves office, the recourse coverage should continue to protect him against subsequent claims resulting from actions taken while he was a fiduciary.\textsuperscript{55} This extended coverage is significant because the fiduciary may be liable for a breach of fiduciary duty for six years after a breach occurred, or for three years after the plaintiff had either actual knowledge or constructive notice of the breach arising from a report of the breach by the Secretary of Labor.\textsuperscript{56} In cases of fraud or concealment, however, the period of jeopardy is six years from either the violation or its discovery.\textsuperscript{57} This potential exposure after a fiduciary has left office mandates continuation of the recourse coverage for the insured fiduciary at least until the applicable statutes of limitation have run.

The recourse policy should provide protection against any payment or expenditure made by the carrier under the basic policy. Recourse provisions limiting protection to damages paid by the carrier are not sufficient since the carrier may be able to proceed against the insured fiduciary for litigation expenses.

Exclusions from Coverage

All errors and omissions policies contain exclusions from coverage that substantially limit the types of claims to which the policy is responsive.\textsuperscript{58}

\textsuperscript{54} ERISA § 401(b), 29 U.S.C.A. § 1110(b) (1975).
\textsuperscript{55} For example, if a trustee resigned and a suit were commenced two years later attacking a prior action by the trustees, the recourse protection should be applied to any payments made by the carrier under the basic policy notwithstanding the fact that the trustee did not renew the recourse policy after the date he resigned as trustee.
\textsuperscript{56} ERISA § 413(a) (1), (2), 29 U.S.C.A. § 1113(a) (1), (2) (1975).
\textsuperscript{57} Id. § 413(a), 29 U.S.C.A. § 1113(a).
\textsuperscript{58} Such exclusions limit the otherwise “all-risk” coverage under the policy. Some policies, for example, offer coverage for any act or omission by an insured causing a loss to the fund, though this protection is diluted by an exclusion from coverage of
In reviewing a policy, it is important to distinguish between an exclusion applying only to payment of certain damages, such as fines and penalties, and one disallowing any claim arising from an excluded act. Under the former type of exclusion, defense costs will be covered and only the expenses of the specific exclusion will be denied coverage. If the exclusion refers to any claim based on a certain act, then the policy will not cover defense costs, and the trustees should require the carrier to assure coverage of defense costs in the event the insured fiduciary is not held liable for the act.

Although it is impracticable to discuss all possible exclusions in the context of this Article, several of the more controversial major exclusions warrant consideration.

1. **Fines and Penalties.** This exclusion would deny coverage for claims relating to the $100 daily penalty under section 502(c)\textsuperscript{59} for failure to furnish plan information to a participant or a beneficiary in a timely manner, the five-percent excise tax on prohibited transactions,\textsuperscript{60} and other penalties imposed by the Act. It is important to ascertain whether this exclusion would preclude payment by the insurer of compensatory damages if fines and penalties also are imposed upon the fiduciary, for if it does, the fiduciary would be well advised either to negotiate for the inclusion of such protection or to seek insurance from another carrier.

2. **Criminal Acts.** If the policy contains an exclusion concerning criminal acts or a willful violation of a criminal statute, this exclusion should be limited to a conviction involving fraudulent or dishonest intent. Without this limitation, coverage could be denied to a trustee of the fund who merely accepts contributions from an employer and fails to set forth a detailed basis for the contributions in a written agreement.\textsuperscript{61}

3. **Willful or Reckless Statutory Violations.** Several policies exclude coverage of willful or reckless violations of a statutory duty. Presumably, the term "reckless" is intended to refer to wanton conduct as dis-

\textsuperscript{59} ERISA § 502(c), 29 U.S.C.A. § 1132(c) (1975).
\textsuperscript{60} See notes 33-35 supra & accompanying text.
When considering the potential scope of this exclusion, it should be noted that courts generally apply a standard that holds fiduciary conduct to be reckless if done arbitrarily, capriciously, or in bad faith. The distinction between negligence and willful or reckless misconduct is, however, a nebulous one, and a clarification of what the carrier means by reckless conduct should be obtained prior to purchase of a policy containing this exclusion.

4. Discrimination. Some policies specifically exclude claims alleging discrimination on the basis of race, creed, age, or sex. An increasing number of cases involve sex and age discrimination under pension plans on the basis of allegedly discriminatory vesting formulas and retirement ages. This coverage is particularly significant from the standpoint of defense costs since courts generally award a successful plaintiff the costs of maintaining the suit. It should be determined whether other exclusions under the policy would act to exclude claims based on discrimination. For example, many policies exclude from coverage any prior act that the fiduciaries, at the time the policy was issued, could reasonably expect to result in a claim. If at the time the policy commenced, the plan set forth an eligibility rule precluding the payment of benefits for pregnancy-related disability, a claim arising during the policy period alleging that such an eligibility rule violated the guidelines of the Equal Employment Opportunity Commission might be excluded. The carrier,
in these circumstances, could argue that at the time the policy commenced the trustees reasonably could have anticipated that a claim would result.

5. **Claims for Benefit Payments.** The policy should provide coverage to trustees for defense costs arising from claims for benefits under the plan, if in the actions the court finds a breach of fiduciary duty and precludes indemnification by the fund for defense costs incurred by the trustees. Trustees should be concerned with a blanket exclusion of all claims for benefits payable under the plan. As noted earlier, a test based on arbitrary and capricious conduct generally is applied in reviewing actions by trustees with respect to the payments of benefit claims; unless there are unequivocal regulations or court decisions holding that arbitrary and capricious conduct is not a breach of the fiduciary obligations imposed by ERISA, the policy should provide coverage of such actions.

6. **Dishonesty.** The dishonesty exclusion should apply only to fiduciaries on an individual basis, and only when a final adjudication of active or deliberate dishonesty is made and is material to the claim in issue. To apply the dishonesty exclusion indiscriminately to the trustees as a group would negate coverage for a trustee who merely had negligently failed to take proper steps to prevent a dishonest act by a co-fiduciary.

7. **Uninsurable Acts.** Any policy excluding acts uninsurable under law should specifically limit application of the exclusion to acts upon which a final decision concerning insurability has been made by a court of competent jurisdiction. The determination should not be left to the carrier.

8. **Misrepresentation and Fraud with Respect to the Application for Insurance or Claim Under the Policy.** As a general rule, the insurer can avoid liability under a policy before a loss is incurred if the insured procured the policy by fraud or material misrepresentation. The insurance contract should emphasize that misrepresentations by the insured will not negate the policy unless they are material and intentional. In

66. See note 63 supra & accompanying text.
addition, fraud or misrepresentation by one fiduciary should not in any way abrogate the protection of the policy as to innocent co-fiduciaries.

9. **Imputed Acts or Knowledge.** The policy should provide that in applying any exclusion, the wrongful act or knowledge of any one fiduciary will not be imputed to a co-fiduciary for the purpose of denying coverage to the co-fiduciary.

**Exculpatory Clauses and Indemnification**

In considering the alternatives available for the protection of the fiduciary under ERISA, the fiduciary is not limited merely to the purchase of errors and omissions insurance. The insertion of exculpatory or indemnification clauses into the trust agreement can provide broad protection, and must not be overlooked. Although ERISA provides that any clause that purports to relieve a fiduciary from any duty imposed upon him under the Act shall be void as against public policy, two points should be noted concerning this statutory elimination of the exculpatory clause protection. First, the Act does not void all exculpatory clauses, but only those that purport to relieve a fiduciary from responsibility or liability for his fiduciary obligations. Therefore, such clauses are still valid and effective as to non-fiduciary responsibilities. Secondly, section 410 became operative on January 1, 1975 (or July 1, 1975, if a six month stay was obtained), and any breaches of fiduciary duty committed prior to those dates still would be protected under exculpatory clauses then in effect.

Closely related to exculpatory clauses are indemnification agreements, which provide that if the trust cannot relieve the trustee of liability or responsibility, someone else—the fund, the employer, or the union—will agree to hold him harmless for his liabilities. The validity of these provisions has been sustained to a limited degree by the Department of Labor.

68. ERISA § 410(a), 29 U.S.C.A. § 1110(a) (1975). This does not, however, extend to agreements among co-fiduciaries that allocate specific duties or responsibilities among themselves. Id. § 405(b)(1), 29 U.S.C.A. § 1105(b)(1). Nor does it prevent a trustee from avoiding liability by assigning his investment duties and responsibilities to an investment manager, id. § 405(d), 29 U.S.C.A. § 1105(d), as long as the fiduciary acts prudently in choosing the manager. See H.R. REP. No. 1280, 93d Cong., 2d Sess. 301 (1974).


70. Department of Labor ERISA Interp. Bull. 75-4, 40 Fed. Reg. 31599 (1975) provides in part:
Conclusion—A Word of Caution

The purchase of trustee errors and omission insurance or the use of other protective devices by no means will provide absolute insulation from liability, for there are still many important and, as yet, unresolved questions concerning the scope of coverage and its limitations. Unfortunately, answers to these questions may come painfully to a particular board of trustees, if the questions are to be resolved by litigation against the board. Therefore, the purchase of insurance should not lull a fiduciary into a false sense of security. The most effective protective device employee benefit plans and their trustees have is an honest, concerned, hard-working board backed up by a well-coordinated team of competent professionals.

The Department of Labor interprets this section [ERISA 410(a), 29 U.S.C.A. § 1110(a) (1975)] to permit indemnification agreements which do not relieve a fiduciary of responsibility or liability under Part 4 of Title I. Indemnification provisions which leave the fiduciary fully responsible and liable, but merely permit another party to satisfy any liability incurred by the fiduciary in the same manner as insurance purchased under Section 410 (b) (3), are therefore not void under Section 410(a).