Common Misconceptions and Myths of Fiduciary Liability

Presented by:
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Goals

• Basic Concepts Underlying Fiduciary Liability Insurance
• Claims Scenarios
• NCPERS Solution
What is Fiduciary Liability?

• Responsibility of trustees, employers, fiduciaries, professional administrators, and the plan itself with respect to the errors and omissions and proper management in the administration of employee benefit programs

There is no reduction in fiduciary liability in the event of significant outsourcing of the management of your benefit plans as those officers selecting the outsource firm will be held liable for their decision to outsource, their selections of that particular firm and any claims arising from that firm’s activities on behalf of the client. The fiduciary (public entity/board) remains ultimately responsible for the management and administration of the benefit plans.
“Spirit of” ERISA

What Is ERISA?

• A federal law that sets minimum standards for the administration of pension and welfare benefit plans in private industry
“Spirit of” ERISA

Why Was ERISA Enacted?

• End the raiding of employee benefit plans by insolvent companies and dishonest corporate executives
• Protect participants and beneficiaries
• Establish strict minimum standards of conduct
• Eliminate exculpatory provisions
• Ensure financial soundness
• Provide access to Federal Courts
Who is a “Fiduciary”?*

A Fiduciary is:

• Any person who is named as a fiduciary in the plan
• Any person who exercises discretionary authority or control over plan assets or administration, or gives investment advice
• Plan administrators, trustees and investment managers are almost always considered fiduciaries under ERISA

*Excerpted from the Employee Retirement Income Security Act (ERISA)
Who is a “Fiduciary”? 

Who isn’t a Fiduciary? 

• Generally, plan attorneys, plan accountants, plan actuaries, those engaged in settlor functions and those engaged in ministerial acts are not considered fiduciaries
Fiduciary Duties

Basic Fiduciary Duties:

• Duty of loyalty
  – Exclusive benefit rule
• Duty of prudence
• Duty to diversify investments
• Duty to adhere to plan documents
Fiduciary Duties

“Self-dealing” Prohibited Transactions:

A Fiduciary must not:

- Deal with plan assets for its own account;
- Act on behalf of a party whose interests are adverse to the plan or its participants; or
- Receive anything of value from any party in connection with a transaction involving the assets of a plan.
Fiduciary Duties

“Party-in-Interest” Prohibited Transactions:
A fiduciary shall not cause the plan to engage in a transaction that constitutes a direct or indirect:

– Sale or exchange of property
– Loan
– Furnishing goods/services

between the plan and a party in interest.

Further....

– No transfer of plan assets to Party in Interest
– Acquisition of employer stock or real property in excess of limits set by law.
Fiduciary Duties

What are the consequences if a plan fiduciary breaches a fiduciary duty?

Personal Liability for Breach of Fiduciary Duty

Fiduciaries shall be personally liable to:

(1) restore to the plan any losses resulting from a breach of fiduciary duty and

(2) restore to such plan any profits made by the fiduciary through the use of plan assets

(3) and subject to such other equitable or remedial relief as the court may deem appropriate
Why Fiduciary Coverage is Needed

• Governmental trustees are increasingly a target of fiduciary claims:
  – Imprudent investments, including real estate and alternative investments
  – Breaches of fiduciary duty in selecting and monitoring a service provider
  – Self Dealing
  – Insufficient funding
  – Dishonesty claims/Pay to Play
Why Fiduciary Coverage is Needed

• Governmental plan trustees often have two dangerous misconceptions:
  – That ERISA fiduciary standards do not apply to them; and
  – That they are protected by sovereign immunity

• The reality:
  – Governmental trustees are held to high fiduciary standards similar to the federal ERISA duties; and
  – State law contains significant limits on indemnification protections for governmental fiduciaries
Why Fiduciary Coverage is Needed

• Limited Liability
  – Most states provide some form of protection to government plan fiduciaries, either through the statute governing the retirement system or generally through the state’s sovereign immunity law.
  – But most state statutes have gaps in fiduciary liability protection.
    1. Express Limits on Indemnification
    2. The Scope of Indemnification
    3. State Agent Immunity
    4. Express Denials of Indemnification
Exposures: Who Can Sue for Breach of Duty?

- Participants or beneficiaries
- Department of Labor
- Fiduciaries
Exposures: How do Fiduciaries get into trouble?

- False or misleading statements
- Imprudent investments
- Diversification
- Non-compliance with Plan documents
- Errors in the administration of Plans
- Failure to properly disclose administrative fees
Exposures Specific to Plans

Defined Benefit Plans:

- Actuarial Insolvency
- Conversion to Cash Balance Plans
- Mergers/Termination of Plans
- Plan Disclosures
- Imprudent Investment of Assets
- Failure to pursue delinquent contributions
- Negligence not involving discretionary activities
Who’s Covered?

- Benefit Plans
- Merged/Terminated/Sold Plans
- Fiduciaries/Trustees of the Plans (Directors & Officers and employees)
- Spousal & Domestic Partner Extension
Claim Scenarios

Employees Sue Oregon Pension for Risky Investments
April 27, 2012 - Two Oregon state employees sued one of the outside money managers most favored by Oregon’s state pension fund for fraud.

Retirees Sue San Francisco Pension System to Change Strategy
(August 17, 2012) San Francisco retirees are suing the San Francisco city government and its pension fund, alleging that the city’s new investment strategy is inadequate to meet retirement needs.

Health Benefits and Pension Reform Wording
San Jose Employees Sue City Over Pension Reform Wording
March 19, 2012 - City workers are suing over pension reform wording, arguing that the ballot measure is an illegal breach of their vested pension rights.

San Francisco Employees Sue N.C. for Changing Health Plan for Breach of Contract
March 19, 2012 - City workers are suing North Carolina’s employee health plan for breach of contract, arguing that the pension fund is insufficient to meet retirement needs.
Claims

Tillinghast Fiduciary Liability Survey Report
Average settlement/court award:
$994,000

Average defense costs:
$365,000
Definitions

Claim: A request for payment or other benefit under a plan.

Benefits: The compensation or advantage promised or provided under a plan.

Plan: A scheme or arrangement for providing benefits to a group of people, typically employers and employees.

Survey Report: A document that presents the results of a survey, typically in the form of a report or presentation.

Distribution: The act of allocating resources or rewards in a particular way, often referring to the allocation of benefits or resources.

Claim Count: The number of claims that are filed or processed, typically referring to the number of claims that are made under a plan.

Tillinghast Fiduciary Liability Survey Report Distribution Claim Count

- Denial of benefits – 32%
- Misleading representations – 10%
- Administrative error in benefit plan – 9%
- Communication of plan benefits – 9%
- Imprudent investment – 2%
- Civil rights/human rights, including discrimination – 2%
- Inadequacy of plan assets – 2%
- Full or partial termination of a plan – 2%
- Reduction of plan benefits or failure to fund benefits program – 2%
National Issues

• Fees/Excessive Foreign Currency Charges - BNY Mellon and State Street Corp. are both under investigation by federal regulators and have been hit with lawsuits claiming the financial giants overcharged certain pension funds
  
  – 2009 – the California attorney general’s office has charged the State Street Corporation (company that owns Currenex) with fraud, accusing the company of cheating the state’s two largest pension funds of at least $56.6 million by overcharging them for a series of foreign exchange trades.

  – October 2010 – The Washington State Investment Board reached an $11.7 million agreement with State Street, without filing a lawsuit. Other states such as California, Virginia and Florida are taking legal action against custodial banks on behalf of their retirement funds.


  – June 2011 – Massachusetts calculates that it was overcharged over $30 million by BNY Mellon.

  – No excessive currency charge-type lawsuits or investigations have targeted plans themselves or their boards of trustees, but something to continue to monitor.
National Issues

• **Pay to Play** –
  – April 15, 2011 Former New York state Comptroller Alan Hevesi was sentenced after pleading guilty to a felony charge of receiving rewards for official misconduct in a pay-to-play scandal involving the NY State’s pension fund.
  – May 6, 2010 - California Attorney General Jerry Brown has sued two former officials of CalPERS, the nation's largest public pension fund, on civil charges of fraud.

• **Risky Investments**
  – State and local plans reported gradually changing their asset portfolios over many years by increasing their allocations in higher risk investments partly in pursuit of higher returns but also for diversification following well-accepted techniques of portfolio management given their long investment horizon.
National Issues

• Improper Funding/Bankruptcy
  – Since Chapter 9, the governmental version of Chapter 11 bankruptcy, was enacted in 1937, about 600 governmental units have used it. Most of them were small boards or agencies, such as water or sewer districts. Because so few municipalities have filed for bankruptcy — most of the current law for it now is drawn from two California cases, Orange County in 1994 and the City of Vallejo in 2008 — each new filing creates new precedents that the rest of the nation’s governments will use when they try to figure out how to cope with their own fiscal crises.
  – So far, several courts have ruled that under some circumstances, financially strapped governments may reduce cost-of-living increases in pensions, but no court has ruled definitely whether cuts can be made in the base pensions being paid.
  – Article: DeKalb County Educators April 2011
  – Article: Baltimore Police & Firefighters Union – June 2010
National Issues

• Actuarial Negligence
  – **June 2010** JUNEAU, Alaska - Alaska's attorney general said Friday that the state has settled a breach of contract and professional malpractice lawsuit against its former actuary for $500 million.

  – **June 2011** Court of Appeals of Maryland has held the former actuary firm of the state’s retirement system is liable for damages of $73 million. According to an announcement from Maryland Attorney General Douglas F. Gansler and State Treasurer Nancy K. Kopp, the Court of Appeals of Maryland granted the award to the Maryland State Retirement and Pension System (MSRPS) for damages resulting from what was described as “the firm's repeated errors in performing actuarial valuations for the State Police Retirement System, Law Enforcement Officers' Pension System, and Judges' Retirement System over a 22 year period.” The appellate court held that Milliman, Inc., the Maryland system's actuary from 1982 until 2006, was liable for failing to include in its calculations benefits payable to the surviving spouses of participants in these systems.
National Issues

• Disclosure Lawsuits
  – Fury Over Public Pensions Sparks Disclosure Lawsuits. Several state and local retirement funds have balked at disclosing the pensions of individual government workers, triggering lawsuits that claim taxpayers have the right to such information. The showdown comes amid growing scrutiny of public-sector pensions as voters, many struggling amid the recession, increasingly question how tax dollars are spent in states and cities facing budget shortfalls and service cutbacks.

• Constitutional Issues and Benefit Reductions
  – 2010 Lawmakers in Colorado, Minnesota and South Dakota voted earlier this year to limit cost-of-living increases they previously had promised to thousands of current and future retirees, who courts historically have protected from benefit reductions. Retirees in each state have filed lawsuits asking judges to restore their annual benefit increases to what they were previously.
Constitutional Issues and Benefit Reductions (continued)

- June 2011 - The Denver Post reports that a group of retirees sued, alleging the state had abrogated a contract by lowering the inflationary increases. However, District Judge Robert Hyatt disagreed. "While plaintiffs unarguably have a contractual right to their PERA pension itself," Hyatt wrote, according to the Post, "they do not have a contractual right to the specific COLA formula in place at their respective retirement, for life without change."

- Minnesota Case decided similarly
- South Dakota Retirees’ Suit on COLA – June 2011
- New Hampshire Fire Fighters – June 2011
- Rhode Island Public Sector Unions Suit – June 2011
- Cincinnati Retirement System Suit- June 2011
- New Jersey Suit – September 2011
NCPERS Solution

• NCPERS Fiduciary Liability Insurance Program is offered by Arthur J. Gallagher Risk Management Services, Inc. and is underwritten by Ullico Casualty Group, Inc. as a managing general underwriter for Alterra America Insurance Company (AM Best “A” XV).

• NCPERS Board saw the need to provide a fiduciary program to public pension funds because of:
  – Increased scrutiny for trustee decisions
  – Subject to lawsuits with groundless claims
  – Payment of Defense Costs
  – Protect members against risk fund assets and their own personal liability
Benefits and Features of Program

• Available to NCPERS members and non NCPERS public pension funds that apply
• Alterra America Insurance Company (AM Best “A” XV) may offer coverage options even to those members with funding levels below underwriting requirements
• We will keep improving benefits as more NCPERS members obtain quotes
• Defense Costs inside the Limits and Retention
• Duty to Defend coverage form and member can select counsel (work with own defense attorneys)
• Policy is non-cancellable during policy term except for non-payment of premium
• Trustees are not required to pay the Waiver of Recourse Premium, and this is included by endorsement
Benefits and Features of Program

- Voluntary Compliance Programs
- HIPAA, PPACA, COBRA, and amendments to such
- Benefits Due Defense Coverage
- Final Adjudication language for Personal Conduct
- Consent to settle clause 80/20
- Definition of Insured to include Past and Present Trustees, and Employees
- Spousal Definition to include Domestic Partners
- Severability of application and exclusions
- Trustees are not required to pay the Waiver of Recourse Premium, and this is included by endorsement
Benefits and Features of Program

• Alterra America Insurance Company (AM Best “A” XV) Ability to offer up to a $25,000,000 tower of insurance on primary or excess basis
• Enhanced coverages provided through NCPERS endorsement
• Renewal guarantee (subject to criteria)
• Amendment of Employee Benefit Law
• Retentions—based on asset size
How to Access the Program?

• Quoting Process
  – Required: Application (or existing carrier application), Audited financial statements for pension fund

• Underwriting considerations:
  - Claim history
  - Funding status
  - Limits purchased
  - Plan size
  - Number of Participants
  - Net Assets
  - Contributions/Investments
  - Changes

• Questions on program and how to access the program:
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