

The Department of Labor Increases Civil Monetary Penalties

Without much fanfare and little notice last Fall, Congress directed all federal agencies by July 1, 2016 to begin increasing civil penalties annually with inflation adjustments. On November 2, 2015, Congress passed the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (2015 Inflation Adjustment Act) as part of the Bipartisan Budget Act of 2015. The new law directs each government agency to adjust their civil monetary penalties for inflation every year. Agencies across the federal government must determine the last time their penalties were increased and publish interim final rules to adjust their penalties for inflation from that date.

The Department of Labor published two interim final rules on July 1, 2016 to adjust its penalties for inflation:

- (1) one DOL-only rule covering the vast majority of penalties assessed by the Department’s Employee Benefits Security Administration, Mine Safety & Health Administration, Occupational Safety and Health Administration, Office of Workers’ Compensation Programs, and Wage and Hour Division; and
- (2) a second rule jointly with Department of Homeland Security to adjust the penalties associated with the H-2B temporary guest worker program.

The stated purpose of the 2015 Inflation Adjustment Act is to modernize penalties that have lost ground to inflation since first enacted. The Department of Labor claimed in its press release that “[t]hese penalty increases will also deter violations, which will provide a significant benefit not only for workers but also for responsible employers who will have a more level playing field when competing with employers who are not following the law.”

New Penalty Amounts Adjusted for Inflation

The table below shows the current penalty amounts enforceable by EBSA and the inflation-adjusted penalty that will go into effect for penalties assessed after August 1, 2016, whose associated violations occurred after November 2, 2015 (the date of the enactment of the Inflation Adjustment Act).

ERISA Penalty Statute and Description of ERISA Violations Subject to Penalty	Current Penalty Amount	New Penalty Amount
ERISA § 209(b) Failure to furnish reports (e.g. pension benefit statements) to certain former participants and beneficiaries or maintain records.	Up to \$11 per employee	Up to \$28 per employee
ERISA § 502(c)(2) <ul style="list-style-type: none"> • Failure or refusal to file annual report (Form 5500) required by ERISA § 104; and • Failure of a multiemployer plan to certify endangered or critical status under ERISA § 305 (b)(3)(C) treated as failure to file annual report. 	Up to \$1,100 per day	Up to \$2,063 per day

<p>ERISA § 502(c)(4)</p> <ul style="list-style-type: none"> • Failure to notify participants under ERISA § 101(j) of certain benefit restrictions and/or limitations arising under Internal Revenue Code § 436; • Failure to furnish certain multiemployer plan financial and actuarial reports upon request under ERISA § 101(k); • Failure to furnish estimate of withdrawal liability upon request under ERISA § 101(l); and • Failure to furnish automatic contribution arrangement notice under ERISA § 514(e)(3). 	Up to \$1,100 per day	Up to \$1,632 per day
<p>ERISA § 502(c)(5) Failure of a multiple employer welfare arrangement to file report required by regulations issued under ERISA § 101(g).</p>	Up to \$1,100 per day	Up to \$1,502 per day
<p>ERISA § 502(c)(6) Failure to furnish information requested by Secretary of Labor under ERISA § 104(a)(6).</p>	Up to \$110 per day not to exceed \$1,100 per request	Up to \$147 per day not to exceed \$1,472 per request
<p>ERISA § 502(c)(7) Failure to furnish a blackout notice under section 101(i) of ERISA or notice of the right to divest employer securities under section 101(m) of ERISA.</p>	Up to \$100 per day	Up to \$131 per day
<p>ERISA § 502(c)(8) Failure by a plan sponsor of a multiemployer plan in endangered status to adopt a funding improvement plan or a multiemployer plan in critical status to adopt a rehabilitation plan. Penalty also applies to a plan sponsor of an endangered status plan (other than a seriously endangered plan) that fails to meet its benchmark by the end of the funding improvement period.</p>	Up to \$1,100 per day	Up to \$1,296 per day
<p>ERISA § 502(c)(9)(A) Failure by an employer to inform employees of CHIP coverage opportunities under ERISA § 701(f)(3)(B)(i)(I) – each employee a separate violation.</p>	Up to \$100 per day	Up to \$110 per day
<p>ERISA § 502(c)(9)(B) Failure by a plan administrator to timely provide to any State the information required to be disclosed under ERISA § 701(f)(3)(B)(ii), regarding coverage coordination – each participant beneficiary a separate violation.</p>	Up to \$100 per day	Up to \$110 per day
<p>ERISA § 502(c)(10)(B)(i) Failure by any plan sponsor of a group health plan, or any health insurance issuer offering health insurance coverage in connection with the plan, to meet the requirements of ERISA §§ 702(a)(1)(F), (b)(3),(c) or (d); or § 701; or § 702(b)(10) with respect to genetic information.</p>	\$100 per day during non-compliance period	\$110 per day during non-compliance period
<p>ERISA § 502(c)(10)(C)(i) Minimum penalty for de minimis failures to meet genetic information requirements not corrected prior to notice from the Secretary of Labor.</p>	\$2,500 minimum	\$2,745 minimum
<p>ERISA § 502(c)(10)(C)(ii) Minimum penalty for failures to meet genetic information requirements which are not corrected prior to notice from Secretary of Labor and are not de minimis.</p>	\$15,000 minimum	\$16,473 minimum
<p>ERISA § 502(c)(10)(D)(iii)(II) Cap on unintentional failures to meet genetic information requirements.</p>	\$500,000 maximum	\$549,095 maximum
<p>ERISA § 502(c)(12) Failure of CSEC plan sponsor to establish or update a funding restoration plan.</p>	Up to \$100 per day	Up to \$100 per day

ERISA § 502(m) Distribution prohibited by ERISA § 206(e) of ERISA.	Up to \$10,000 per distribution	Up to \$15,909 per distribution
ERISA § 715 Failure to provide Summary of Benefits Coverage under Public Health Services Act section 2715(f), as incorporated into ERISA section § 715 and 29 CFR 2590.715-2715(e).	Up to \$1,000 per failure	Up to \$1,087 per failure

Insurance Coverage for Department of Labor Penalties

Most professional liability insurance policies are not designed to cover penalties. The typical policy will define “loss” or “damages” to exclude any taxes, fines or penalties that are not affirmatively covered in the policy. The problem for fiduciaries of employee benefit plans, however, is that they face individual liability from penalties under ERISA and several recent statutes, and these penalties cannot be paid out of plan assets.

Cutting-edge fiduciary liability insurance companies have filled that void by providing coverage for certain penalties faced by employee benefit plans. Whereas the traditional fiduciary policy covered only claims brought by third-party, the modern fiduciary liability insurance policy has evolved by adding many “first-party” coverages – policy benefits sought by the policyholder. For example, fiduciary policies now cover expenditures for voluntary compliance programs in which the policyholder seeks coverage even when a third-party has not asserted any wrongdoing.

The key questions for trustees of employee benefit plans is *what* penalty coverages do you need and *how much* coverage do you need.

A. **What Penalty Coverages Do You Need?**

The typical fiduciary policy will provide a coverage for (1) voluntary compliance programs; (2) section 502(i) penalties; (3) section 502(l) penalties; (4) 502(c) coverage; (5) HIPAA (including HITECH amendments); (6) PPACA (health care reform); and (5) IRC section 4975.

1. **Voluntary Compliance Programs:** The most valuable first-party coverage feature of the modern fiduciary liability insurance policy is coverage for voluntary compliance programs, which involve costs associated with a fund’s voluntary effort to bring its plan into compliance with ERISA and Internal Revenue Code requirement. When mistakes are made with respect to a plan, the IRS Employee Plans Compliance Resolution System (EPCRS) encourages plans to remedy mistakes and avoid the consequences of plan disqualification. Similarly, the DOL Voluntary Fiduciary Correction Program (VFCP) allows those potentially liable for certain specified fiduciary violations under ERISA to voluntarily apply for relief from enforcement actions and certain penalties. Plan assets may not be used to pay the cost of correcting many of the violations specified in a voluntary compliance application unless such cost could otherwise have been paid from the plan (and assuming the plan document permits such payment of reasonable and necessary expenses to be paid from the trust). Fiduciary policies solve this problem by providing coverage for voluntary compliance expenditures. This coverage allows an insured to file a first-party claim without any third-party claiming breach of any duty or loss to the plan. Such correction programs typically carry a filing fee that operates essentially like a penalty. The general IRS Voluntary Correction Program (VCP) fees, which are subject to exceptions, including a higher fee for egregious failures, are based on the number of fund participants:

# of Participants	VCP Fees
20 or fewer	\$500
21-50	\$750
51-100	\$1,500
101-1,000	\$5,000
1,001-10,000	\$10,000
more than 10,000	\$15,000

2. **Section 502(i):** Section 502(i) of ERISA permits the DOL to assess a five (5) percent civil penalty against a party in interest who engages in a prohibited transaction with respect to an employee benefit plan.
3. **Section 502(l):** Section 502(l) of ERISA requires that, in the event of a fiduciary breach, the DOL assess a civil penalty of twenty (20) percent of the amount of settlements or courts orders against a breaching fiduciary or any other person who participated in the breach. The DOL has interpreted Section 502(l) as a provision that gives it no discretion not to impose the penalty when its investigation reveals that there may have been a breach of fiduciary duty.
4. **Section 502(c):** Section 502(c) imposes penalties for alleged failures by the plan or administrator to respond to written requests for plan information. Many of the reporting requirements and related penalties of the Pension Protection Act were codified in Section 502(c).
5. **HIPAA:** In 2008, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) privacy and security rules were broadened by the enactment of the Health Information Technology for Economic and Clinical Health Act (HITECH). One of significant changes in the final rule is the expanded scope of HHS enforcement authority, including civil monetary penalties up to an annual maximum for identical violations of \$1.5 million.
6. **PPACA:** The Patient Protection and Affordable Care Act (ACA) amended and expanded ERISA and the Public Health Service Act (PHSA) by incorporating ACA coverage mandates for individual, group, self-insured and fully insured employer-sponsored health plans into Section 715 of ERISA. Various regulatory agencies have implemented penalties for ACA violations. For example, the IRS may assess excise taxes upon group health plans (and church plans) that do not comply with ACA insurance market reforms. The Department of Health and Human Services (HHS) also enforces ACA insurance market reforms against non-federal governmental plans and may assess penalties.
7. **IRC Section 4975:** IRC Code Section 4975 gives authority to the IRS to assess excise taxes for prohibited transactions, such as the failure to remit contributions within the prescribed time frame.

The typical fiduciary policy will cover section 502(i) and (l) penalties for the entire statutory penalty assessed by the DOL. Voluntary compliance fees and penalties under 502(c), HIPAA, PPACA and IRC Section 4975 will usually be subject to a sublimit of coverage ranging from \$25,000 to \$250,000, or higher when excess carriers provide additional drop-down excess sublimit coverage. HIPAA penalty coverage can vary from as low as \$25,000 to the full policy limit, depending on the carrier.

As the types of penalties have increased, the approach of adding penalty coverages to the policy when the need becomes apparent can leave a plan exposed to a new penalty. For example, the Department's chart explaining increased penalties starts with ERISA section 209(b) penalties, which arguably would not be covered under existing fiduciary penalty coverage grants. Similarly, a new penalty was created under the Bipartisan Budget Act of 2013 regarding improper disclosure or misuse of information in the Social Security Administration Death Master File computer database – yet another penalty that would be excluded from coverage without an affirmative coverage grant.

Euclid Specialty responded to this void by offering the **Miscellaneous/Other Penalties Endorsement** as a safety net to cover any other penalty that can be assessed against an employee benefit plan, and other leading insurance markets have followed suit. This new coverage covers any penalty assessed against a plan that is insurable under applicable law and not already covered under the policy.

B. How Much Penalty Coverage Do You Need?

The appropriate level of penalty coverage is complex and requires professional advice from an experienced fiduciary liability insurance broker. The Department of Labor states that the purpose of the penalties is deterrence of improper conduct. But any experienced ERISA lawyer will tell you that the Department has not required individual contributions beyond the sublimit of penalty coverage in the fiduciary policy. Indeed, the Department typically assesses a penalty no higher than the amount of the penalty coverage. Consequently, if the Department continues to respect the amount of penalty insurance coverage, then the risk of carrying too low of a limit is reduced for trustees facing personal liability. For this reason, \$100,000 to \$250,000 should be sufficient penalty coverage for most funds, and \$500,000 should be sufficient for large funds (with assets over \$1 billion).¹

Euclid Specialty offers higher limits by offering our Penalty Box Umbrella Endorsement. Instead of requiring policyholders to pay for increased limits for each type of penalty coverage, Euclid Specialty offers an umbrella of penalty coverage that sits on top of each penalty sublimit and provides additional excess coverage – ranging from \$100,000 to \$250,000 – when additional limits are necessary. The Penalty Box Umbrella Endorsement applies to voluntary compliance program expenditures, and 502(c), PPACA, and IRC Section 4975 penalties. As noted above, Euclid Specialty also offers its Miscellaneous/Other Penalties Endorsement as a safety net to cover any other penalty that can be assessed against an employee benefit plan that

¹ As a practice pointer, we urge defense counsel to defend the insurance limit vigorously before offering the whole limit to the regulator. Based on our experience, the DOL typically asks for the penalty coverage sublimit before issuing the penalty amount. We urge defense counsel to attempt to define an appropriate penalty that is not based solely on the available coverage limit. Otherwise, we will face an arms race for higher and higher penalties. While the recent insurance market has been favorable to policyholders, higher limits may not be available at affordable premiums if the market cycle changes.

is not already covered under the policy.

Conclusion

The Department of Labor has increased civil monetary penalties, and penalties will now increase annually at the rate of inflation. Employee benefit plans are subject to a broad array of statutory penalties, which likely cannot be paid out of plan assets. Leading fiduciary insurance carriers have responded with insurance coverages that will pay penalties to reduce an individual trustee's risk of personal liability. Fiduciaries should review their fiduciary policies to ensure the broadest scope of coverage possible for potential penalties.

About Euclid Specialty Managers, LLC

Euclid Specialty is a leading provider of fiduciary liability insurance for multiemployer, governmental and other non-profit employee benefit funds. Euclid Specialty is part of the Euclid Program Managers family of underwriting companies that specialize in liability niches that require superior expertise. Professional liability brokers come to Euclid Specialty to protect their employee benefit plan clients, because our underwriters and claims professionals are all experienced ERISA and fiduciary liability insurance experts. For more information, contact John O'Brien at jobrien@euclidspecialty.com or 440-714-5832.



EUCLID SPECIALTY

Euclid Specialty Managers, LLC

380 Maple Avenue West, Suite 302, Vienna, VA 22180

Main: 571.730.4810 | Fax: 571.730.4813

Website: www.euclidspecialty.com

Submissions to: mail@euclidspecialty.com

Note: This newsletter is provided for informational purposes only and does not contain legal advice. We recommend that you consult with legal counsel prior to acting on any information contained in this material.