EUCLID SPECIALTY MANAGERS, LLC
Labor Affinity and Commercial Programs

THE EUCLID PERSPECTIVE

An electronic newsletter from Euclid Specialty Managers
September 12, 2012

Fiduciary Insurance Coverage for Plan Amendments and Other Non-Fiduciary Functions

Two recent cases underscore a recurring fiduciary liability insurance gap for trustees of multiemployer benefit plans: they perform many functions in their capacities as trustees that, like plan amendments, are normally handled by a plan sponsor. But these settlor functions may not be covered under standard fiduciary policies. Indeed, the standard fiduciary liability insurance policy only covers fiduciary actions. Trustees thus need insurance coverage for more than just claims relating to fiduciary activities.

Amending a Plan is not a Fiduciary Function

An August 27, 2012 decision from the Second Circuit Court of Appeals in *Janese v. Fay,* Case 11-5369-cv (2nd Cir. Aug. 27, 2012), addressed the question of whether trustees of multiemployer plans act as fiduciaries when they amend a pension plan. The case was a derivative action of present and former beneficiaries of the former Niagara-Genesee & Vicinity Carpenters Local 280 Pension and Welfare Funds alleging that current and former trustees had improperly depleted plan assets through a series of plan amendments. The trustees defended the action by arguing that they have no liability under ERISA because amending a plan is not a fiduciary function.

While it has been resolved for years under Supreme Court precedent that amending a single employer plan is not a fiduciary function, courts have reached conflicting conclusions with respect to multiemployer plans. Indeed, prior to the decision, the Second Circuit had a split of opinion as to whether plan amendments in multiemployer plans are fiduciary functions. For example, in *Chambless v. Masters*, 772 F. 2d 1032 (2d Cir. 1985) and *Siskind v. Sperry*, 47 F.3d 498 (2d Cir. 1995), the Second Circuit held that trustees of multiemployer pension plans act as fiduciaries when they amend a plan. The court reasoned that multiemployer plans were different than single employers plans, because "[i]n the multi-employer setting, trustees amending a pension plan 'affect the allocation of finite plan asset pool' to which each participating employer has contributed." But more recent decisions in the Circuit, relying on Supreme Court decisions in *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73 (1995), *Lockheed Corp v. Spink*, 517 U.S. 882 (1996), and *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999), had ruled to the contrary that multiemployer plans are no different than single employer plans with respect to plan amendments. These cases reasoned that plan sponsors who alter plans do not fall into the category of fiduciaries, because employers or other plan sponsors are free under ERISA for any reason and at any time to adopt, modify or terminate benefit plans.

After reviewing cases from three other federal circuits and courts within its own circuit, the Second Circuit joined the weight of authority holding that amending a multiemployer plan is not a fiduciary function. The decision effectively eliminates any distinction between single and multiemployer plans concerning plan amendments.

No Coverage for Settlor Functions under a Fiduciary Liability Policy

Earlier this year, the Court of Appeals in New York (New York's highest court) held that a fiduciary liability insurance policy does not cover actions undertaken in a settlor capacity of an employee benefit plan. *See Federal Insurance Co. v. International Business Machines Corp.*, 965 N.E.2d 934 (N.Y. 2012).

In the underlying action, beneficiaries of the International Business Machines Corporation Personal Pension Plan ("IBM" or "IBM Plan") filed a class action alleging that IBM had violated the age discrimination provisions of ERISA when it amended its pension plan. Although the complaint alleged violations of ERISA, it did not allege that IBM had breached any fiduciary duties. Indeed, the record was undisputed that IBM was acting not as a fiduciary, but in a settlor capacity in amending the plan benefits. The only question was whether a settlor function was covered under the fiduciary liability insurance program issued to IBM. After protracted litigation in federal courts, including a denial of certiorari by the U.S. Supreme Court, the parties reached a settlement that exceeded $300 million, including over $88 million in attorneys' fees and costs to plaintiffs' counsel.

Federal Insurance Company ("Chubb") subsequently filed an insurance coverage action seeking a declaration that it had no duty to indemnify the IBM Plan under its fiduciary liability excess policy (the underlying $25 million Zurich policy had been exhausted). As a following form excess policy, the Chubb Policy specified coverage for "wrongful acts," defined in relevant part as "any breach of the responsibilities, obligations or duties by an Insured which are imposed upon a fiduciary of a Benefit Program by ERISA, or by the common or statutory law of the United States, or ERISA equivalent laws in any jurisdiction anywhere in the world." IBM argued that it qualified for coverage because it was a plan fiduciary and was accused of violating ERISA, regardless of whether the underlying claims were based on acts undertaken in a settlor rather than a fiduciary capacity. In other words, IBM argued that there was no requirement that it must as an insured have been acting in its capacity as an ERISA fiduciary in order for an act to be considered a "wrongful act" under the policy. Chubb argued that the term "fiduciary" limited coverage to cases in which the alleged wrongful acts an insured engaged in were alleged to be in breach of ERISA's fiduciary duties. Chubb therefore disclaimed coverage because IBM was sued for amending a plan, which is a non-fiduciary settlor function.

The trial court held that IBM was entitled to coverage under the policy because the plaintiffs' lawsuit alleged breaches of fiduciary duty. The intermediate appellate court reversed and ruled for Chubb. The New York Court of Appeals affirmed the decision in favor of Chubb, holding that the policy "constitutes a clear expression of the parameters of coverage, easily understandable to the average insured." Specifically, the policy's definition of "wrongful act" limits coverage to acts of an insured undertaken in its capacity as an ERISA fiduciary. The policy does not cover every violation of ERISA as IBM argued; only violations that involve fiduciary responsibilities under the law. Since IBM was sued in the underlying action as a plan sponsor and settlor of the plan, it was not acting as a fiduciary under ERISA. Consequently, Chubb had no duty to indemnify IBM for settlement of the class action.

The Euclid Perspective

The *Federal v. IBM* decision reflects the basic proposition that standard fiduciary liability insurance policies are primarily designed to protect against individual liability. Nevertheless, this causes misunderstandings when policyholders often believe that their fiduciary liability policy should cover any violation of ERISA, as IBM argued here. Typical fiduciary liability insurance policies do not cover settlor functions, such as establishing or terminating a plan, choosing the plan design and plan features, and amending the plan, including changes in benefits. Three considerations are noteworthy.

First, the coverage gap for settlor claims is largely limited to payment of defense costs because the damages recoverable in pure settlor cases are likely to involve a core claim for benefits that would have been due but for the allegedly improper conduct.

Second, the coverage gap should be rare, because most claims involving plan amendments involve both settlor and fiduciary functions, and thus the policy would provide a duty to defend the action to the extent a covered claim is alleged. For example, most objections to a plan amendment, such as a violation of ERISA's anti-cutback or anti-discrimination rules (settlor functions), usually also allege a disclosure violation relating to the

plan amendment (fiduciary or covered administrative functions). But on the occasions like the IBM case in which only settlor functions are challenged, the decision serves as a reminder of the potential coverage gap.

Third, and more importantly, this coverage gap is more problematic for multiemployer plans. The August *Janese* decision demonstrates the prevailing trend that, with respect to plan amendments, multiemployer plans are being treated like single employer plans. For single employer plans like the IBM pension plan, the company can pay the costs, although potentially significant, of defending and settling the claim. But paying the litigation expenses in a settlor claim involving a multiemployer plan is more challenging. No individual employer exists that is able or likely willing to pay the claim that is not covered by standard fiduciary insurance policies.

The solution is to seek defense coverage for settlor functions in a plan's fiduciary liability insurance policy. In an evolving trend, several insurance carriers committed to the multiemployer market now expand their definition of "wrongful act" in fiduciary liability policies issued to multiemployer plans to provide defense costs for claims in which a trustee is sued in the capacity as a trustee (as opposed to their capacity as a fiduciary). The policy issued by Euclid Specialty Managers expands coverage in the policy form to "any negligent act, error or omission by an Insured solely in such Insured's capacity as a trustee of a Plan." This expansion of coverage provides a defense to a purely settlor claim and avoids the coverage gap presented in the recent IBM coverage action for multiemployer plans.

The Euclid Perspective is an occasional commentary from Euclid Specialty Managers on fiduciary liability and other liability events relevant to our affinity insurance programs.

About Euclid

Founded in 1952, Euclid Insurance Services, Inc. is a family-owned, managing general agent and underwriting manager and claims administrator. The firm offers a wide range of professional liability, property, casualty, life, accident and health insurance products through agents and brokers nationwide. Euclid Specialty Managers is a division of the company that specializes in fiduciary liability and other insurance programs for the labor affinity market.

Euclid Specialty Managers
Labor Affinity and Commercial Programs
2701 Prosperity Avenue, Suite 220, Fairfax VA 22031
Phone 571.730.4810 | Fax 571.730.4813
Contact us: Daniel Aronowitz – daronowitz@euclidmanagers.com or
Doug Dvorak – ddvorak@euclidmanagers.com
Send submissions to: Mike Saa – msaa@euclidmanagers.com
Marketing inquiries to: John O'Brien – jobrien@euclidmanagers.com
Website: www.euclidspecialtymanagers.com