

Encore (Formerly Euclid) Fiduciary's policy is a complex insurance contract with many valuable coverage enhancements not offered by other insurance companies. This glossary is intended to explain these coverage enhancements so that policyholders can better understand the scope of their insurance policy. For a full understanding of fiduciary liability insurance, please request a copy of Encore's Fiduciary Liability Insurance Handbook at [fiduciaryliabilityhandbook.com](http://fiduciaryliabilityhandbook.com).

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## What Is Fiduciary Liability Insurance?

A fiduciary liability insurance policy is a contract designed to protect plan trustees, other fiduciaries and the employee benefit plan against claims alleging breach of their fiduciary duties to the plan or alleging they committed an error in the administration of the plan. The insurance company issues the insurance contract to the plan itself or to an employer that sponsors an employee benefit plan. The policy provides two important basic benefits, defense and indemnity: (1) the policy pays for the expense of defending fiduciaries accused of violating their duties to the benefit fund [i.e., providing a lawyer to defend you]; and (2) the policy also indemnifies trustees for their alleged violations of duty and negligent administrative acts or omissions in the event of a settlement or judgment of liability [i.e., payment of anything you owe to the complaining party]. While the policy now provides coverage to the plan itself, as discussed more fully below, the primary purpose of the fiduciary liability insurance policy is to protect against the individual liability of plan fiduciaries. The modern fiduciary liability insurance policy will offer four basic coverage grants: (1) claims by beneficiaries or other third-parties of breach of fiduciary duty; (2) negligence in the administration of the plan; (3) voluntary compliance programs; and (4) regulatory penalties.

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## What Is the Difference Between Fiduciary Liability Insurance and a Fidelity Bond?

A fidelity bond is a contract under which the issuer of the bond, typically a surety company or an insurance company, agrees to reimburse a benefit fund for losses caused by theft, fraud, or other dishonest acts covered by the bond. The primary insuring agreement is coverage for employee theft. A fidelity bond covers losses due to intentional acts to deprive a benefit fund of fund assets. By contrast, a fiduciary insurance policy covers losses caused by negligence or other acts or omissions not intended to cause the benefit fund to lose assets. A fidelity bond is required for any plan covered by ERISA, whereas a fiduciary liability policy is not mandatory.

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## What Is Settlor Coverage?

The term "settlor" refers to the plan sponsor who establishes an employee benefit plan. Settlor functions are the business decisions when creating, amending or terminating a plan that are not considered under ERISA fiduciary law as acting in a fiduciary capacity. Settlor functions include decisions to: choose the type of plan, or options in a plan; amending a plan, including changing or eliminating plan options; requiring employee contributions or changing the level of employee contributions; or terminating a plan, or part of a plan. Settlor coverage in a fiduciary liability policy is designed to cover these settlor business decisions of the plan sponsor that are not considered fiduciary duties and would otherwise not be covered under a fiduciary policy covering breach of fiduciary duty or negligence in plan administration. Settlor coverage is critical given the frequency of challenges to benefit design changes in a plan.

## What Is Trustee Claims Expenses Coverage?

**Trustee Claims Expense Coverage** is defense coverage for non-fiduciary claims. The typical policy language expands defense coverage to “any negligent act, error or omission by an Insured solely in such Insured’s capacity as a trustee of a Plan”. The purpose of non-fiduciary coverage is a catch-all for the fiduciary policy to defend any unanticipated claim that could be asserted against a plan fiduciary, but that does not allege breach of fiduciary duty or negligence in the administration plan. While claims are rare, non-fiduciary coverage would theoretically cover claims such as a challenge to the fund’s property lease or other non-plan function; or could cover an employment practices claim in which a plan trustee is named as an additional defendant. For these reasons, such coverage, while broader in scope, is typically restricted to a defense sublimit within the overall limit of liability.

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## Voluntary Compliance Coverage Expenditures

The Internal Revenue Service and the Department of Labor have established compliance programs in which plans can remedy mistakes to avoid plan disqualification or higher penalties. Some states have established their own compliance or settlement programs. For example, the plan could discover that employer matching contributions were not made to all appropriate employees; or the plan failed the 401(k) ADP nondiscrimination tests. The IRS Employee Plans Compliance Resolution System (EPCRS) encourages plans to remedy mistakes and avoid the consequences of plan disqualification. Similarly, the DOL’s Voluntary Fiduciary Correction Program allows those potentially liable for certain specified fiduciary violations under ERISA to voluntarily apply for relief from enforcement actions and certain penalties. Although not “voluntary,” the IRS also offers correction of mistakes that are discovered during an audit. This is known as the IRS Audit Closing Program (Audit CAP), which allows a plan to enter into a Closing Agreement with the IRS, which involves the plan correcting identified issues and paying a sanction negotiated with the IRS. The cost of correction of many of the violations specified in a voluntary compliance application or pursuant to an Audit Closing Program may not be paid with plan assets, unless such cost would have otherwise been paid from the plan (and assuming the plan document permits such payment of reasonable and necessary expenses to be paid from the trust). The Encore Fiduciary policy solves this problem by providing coverage for voluntary compliance program expenditures. These expenditures are subject to a policy sublimit that is part of the aggregate limit of the policy, typically ranging from \$50,000 to \$250,000. Under this sublimit of coverage, the insurance company essentially allows the insured to make a claim against themselves and seek reimbursement from the insurer. The sublimit provides coverage for the filing fee, any required penalty, and the expenses of your attorney to handle the program application.

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## What Is the Reinstatement of Sublimit for Voluntary Compliance Program Expenditures?

As noted above, the Encore fiduciary policy provides a sublimit of coverage to cover the plan’s costs and penalties in voluntary compliance programs. If a plan seeks reimbursement for a voluntary compliance filing under the policy and exhausts the available coverage, the reinstatement provision kicks in, and the sublimit of coverage is replenished. This reinstatement provides a new sublimit of voluntary compliance coverage for a new claim that might arise during the same policy period. Given that voluntary compliance program claims have become one of the most prevalent claims under fiduciary policies in recent years, the reinstatement provides valuable protection in the event of a subsequent claim.

## What Is Coverage for Estoppel and Surcharge Claims?

Plan beneficiaries often bring claims against the plan alleging that they did not receive a benefit due under the policy. The defense of that claim is expressly covered under a fiduciary policy. But a beneficiary could claim that a plan should cover a benefit even if it is not provided under the terms of the plan document. For example, a participant could seek advice from the plan administrator that a surgery is covered, but then the administrator denies the claim once it is submitted based on the plan document. The benefit is properly denied, but the participant may bring a claim of equitable estoppel, claiming that the plan should be estopped from denying the claim. This claim could also be brought under the equitable “surcharge” doctrine. The policy coverage for estoppel will provide coverage to the plan for this indemnity amount that cannot be paid out of plan assets.

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## ERISA 502(c) Civil Penalties - Reporting Violations

ERISA Section 502(c) imposes penalties for alleged failures by the plan or administrator to respond to written requests for plan information. Section 502(c) provides for penalties for an administrator’s refusal or failure to supply required information. The DOL is authorized to assess penalties of at least \$100 a day [now indexed for inflation every year] from the date of refusal or failure, and every violation is treated separately for purposes of calculating the penalty. 502(c) claims are common claims because many benefit claims contain a tag-along reporting allegation. Section 502(c) coverage becomes even more valuable with the reporting requirements of the Pension Protection Act of 2006, as these penalties are codified to be enforced under ERISA section 502(c). For governmental and other plans not subject to ERISA, Encore’s 502(c) coverage will apply to any state or local statute or regulation involving reporting requirements.

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## Department of Labor Penalties

The Department of Labor utilizes authority under ERISA to assess two types of penalties for alleged violations. 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. Section 502(i) 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. These penalties are covered under the fiduciary policy under the definition of “Damages.”

These penalties should not apply to governmental plans, but the coverage is broad enough to include penalties from a comparable state labor commission or department that has jurisdiction over the plan.

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## Health Care Reform - Patient Protection and Affordable Care Act (ACA) Coverage

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.

## HIPAA/HITECH Penalties

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) establishes national standards for electronic health care transactions and code sets, unique health identifiers, and security. Congress further incorporated into HIPAA provisions that mandated the adoption of federal privacy protections for identifiable health information. The HIPAA Privacy Rule sets national standards for the protection of individually identifiable health information by health plans and other covered entities. The HIPAA Security Rule sets national standards for protecting the confidentiality, integrity, and availability of electronic protected health information. The privacy and security rules were strengthened and broadened by the enactment of the Health Information Technology for Economic and Clinical Health Act (HITECH) in 2009. 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 [now indexed for inflation]. The HIPAA coverage in the Encore Fiduciary policy provides coverages for the fines and penalties of HIPAA/HITECH privacy and security violations that are being enforced by the federal Department of Health and Human Services.

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## IRC Section 4975 Penalties

IRC Code Section 4975 gives authority to the IRS to assess excise taxes for prohibited transactions. A “prohibited transaction” under fiduciary law refers to any plan transaction or dealing with a disqualified person. Prohibited transactions are broadly construed and intend to prevent insider dealings with plan assets. The most common prohibited transaction is the failure to remit contributions within the prescribed time frame. Section 4975 penalty coverage is becoming more important with the increased enforcement of contribution deadlines.

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## Death Master File Penalties

Section 203 of the Bipartisan Budget Act of 2013 established penalties of \$1,000 to \$250,000 per person for improper disclosure of confidential social security and other information in the Social Security Death Master File. The Encore Fiduciary policy covers these penalties up to the aggregate limit of the policy.

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## Miscellaneous/Other Penalties

Fiduciary liability policies typically only cover specifically defined penalties, often defined as “Covered Penalties” or a similar nomenclature. As regulation has increased, however, so have the types of penalties that can be imposed. The “band-aid” approach of adding penalty coverages to the policy when new penalties are developed can leave a plan exposed to a new penalty. The Encore Fiduciary policy fills this void by offering the Miscellaneous/Other Penalties coverage as a safety net to cover any other penalty that can be assessed against an employee benefit plan. The covers any penalty assessed against a plan that is insurable under applicable law and not already covered under the policy.

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## Retainer Fees and Expenses of an Independent Fiduciary

In certain lawsuits against the plan, such as an imprudent investment challenge, plan fiduciaries may have a conflict in recommending a settlement of the lawsuit, particularly when plan fiduciaries are members of the participant class. When a potential settlement is proposed, the plan may need an independent fiduciary to decide whether to accept the settlement and release parties from liability. The Encore Fiduciary policy will cover the costs of the independent fiduciary to provide the necessary valuation and advice to the plan or participants.

## Benefit Overpayment (Benefit Miscalculations)

Fund administrators of defined benefit plans have the primary responsibility to correctly calculate and pay each participant's retirement benefit on a monthly basis during the participant's lifetime. When the plan discovers that it has overpaid a participant, or improperly paid a participant, the Encore fiduciary policy has limited coverage available even when no claim by a participant or third-party is presented to the plan. The benefit overpayment coverage provides coverage for benefit miscalculations made by the plan (as opposed to a third-party administrator) that result in overpayment that would otherwise not be covered by the plan and cannot be recovered after reasonable effort. Even though no claim needs to be brought against the plan, the coverage is not a blank check. To recover against the sublimit, it must involve a miscalculation by the plan that cannot be recovered by the plan. The plan must attempt, for example, to seek reimbursement or offset the overpayment against future benefit payments to a participant or beneficiary. The coverage is also not designed to cover interest or other lost opportunity costs a plan may seek from a participant, or benefit overpayments that date back before the applicable statute of limitations.

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## What Is the Hammer Clause, and What Does it Mean to Have No Hammer Clause?

Most policy forms require the insurer's consent for the settlement of claims, with the caveat that such consent shall not be unreasonably withheld. Many fiduciary policies also contain language giving the insurer the right to recommend settlement, with refusal by the insured to settle resulting in restrictions on the amounts recoverable under the policy. These **consent to settle provisions** are commonly referred to as **"hammer" clauses**, and provide that if the insured rejects the insurer's recommendation to settle a claim and instead chooses to continue to litigate, the insurer's liability is "capped" at the amount for which the claim could have been settled, including defense costs incurred prior to the date such a settlement is refused. Some policies, for example, will cap the insurer's liability at seventy or eighty percent of potential liability. The idea is to encourage the insured to settle when the opportunity is presented.

 [Download PDF of the Fiduciary Liability Handbook: encorefiduciary.com/fiduciary-handbook](https://encorefiduciary.com/fiduciary-handbook)

Although the rationale for refusing to settle is often asserted as wanting to avoid "copycat" claims or to achieve "vindication" at trial, such rationale is misplaced. "Copycat" suits are almost always a non-issue, and trials come with the risk of placing the outcome of the matter into the hands of a jury, where the outcome is unknown and is public record when a judgment is entered. In contrast, settlement provides finality, and can be achieved with confidentiality provisions drafted into the settlement agreement. Nevertheless, hammer clauses can be problematic in benefit claims, because a benefit plan may have an interest in litigating an individual benefit claim beyond the value of the claim to set helpful precedent and to avoid other participants from pursuing a similar claim.

The Encore Fiduciary policy contains no consent to settlement or hammer clause. This unique feature gives the policyholder more control of a lawsuit, and the ability to fight certain claims that could be settled, but the plan may want to litigate to conclusion if it has precedential value that could affect other participants.

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## Pre-Claim Investigation Coverage

Fiduciary liability insurance policies are claims-made policies in which coverage is triggered when a claim is made during the policy period. The standard definition of claims requires a "wrongful act" or some allegation of wrongdoing. The issue for employee benefit plans is what happens when the Department of Labor, IRS, or state regulatory body audits or starts an investigation of the fund, because the initial audit or investigation does not typically allege any wrongdoing. The fiduciary policy will typically not cover the audit or investigation until findings are issued, but that can take months or years, and after considerable expense to the plan. The Encore Fiduciary policy eliminates this coverage gap and provides pre-claim investigation coverage for any regulatory audit, investigation, or request for an interview of plan officials. Whereas some fiduciary policies have started to provide pre-claim coverage for Department of Labor investigations, the Encore Fiduciary policy is broader, allowing coverage for any regulatory audit or investigation.

## What Is Coverage for Claims of Equitable Relief and Surcharges - 502(a)(3) Coverage?

This coverage provides affirmative coverage for indemnity under a fiduciary policy (defense coverage would typically be provided) under a claim involving equitable relief imposed pursuant to Section 502 (a)(3) of ERISA. In the Cigna v. Amara Supreme Court case, the Court declared a form of monetary compensation is available under the equitable relief provisions in ERISA Section 502 (a)(3) but fiduciary policies typically do not respond to provide this coverage.

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## What Is Indemnifiable and Non-Indemnifiable Claims Coverage?

Most fiduciary liability coverage for governmental plans is limited to non-indemnifiable claims (where governmental immunity or indemnification is not permitted or applicable) without clear disclosure to the policyholder. This leaves many claims uncovered. Encore offers options for coverage of non-indemnifiable and also indemnifiable claims that most carriers will not provide. This full coverage approach responds to claims irrespective of governmental indemnification or sovereign immunity.

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## Payment Instruction Fraud

A growing threat to businesses is the rise of “social engineering fraud” or “payment instruction fraud.” In these schemes, scammers use official-seeming email communications to induce company employees to transfer company funds to the imposters’ account. Most crime insurers have taken the position that payment instruction fraud is not covered under commercial crime policies because the schemes do not involve a “hacking” of the company’s systems and because the actual fund transfers are voluntary. Payment Instruction Fraud coverage is nevertheless crucial because of the growing number of social engineering schemes to trick plan officials into sending plan assets. This coverage will usually be sublimited on a crime policy and may require additional application disclosures to confirm plan controls to guard against social engineering scams. This coverage is not available on the fiduciary policy but is an option available if the plan purchases Encore’s crime policy for employee benefit plans.

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## Employee Benefit Law

The definition of “**employee benefit law**” will define the scope of potential coverage for alleged fiduciary breaches. The Encore Fiduciary policy provides a comprehensive definition to encompass any relevant fiduciary law. For example, the definition names ERISA, the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the Newborns’ and Mothers’ Health Protection Act of 1996, the Mental Health Parity Act of 1996, the Women’s Health and Cancer Rights Act of 1998, the Pension Protection Act of 2006, and Patient Protection and Affordable Care Act (PPACA), the privacy and security provisions of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and the Health Information Technology for Economic and Clinical Health Act of 2009 (HITECH).

Governmental plans often ask why ERISA is named when the federal law does not apply to governmental plans, but the definition includes any applicable state or local fiduciary law that would apply to the plan. The purpose of including ERISA even when it may not apply is to ensure that the definition is comprehensive enough to include any applicable law.

## What Is the Waiver of Recourse and When Is it Needed?

Under ERISA, fiduciary insurance is not required like a fidelity bond. But ERISA does allow fiduciary liability insurance to be paid for out of plans assets, but only if the policy contains a recourse provision giving the insurance company the right to seek recourse against any individual causing the liability. This means that a breaching fiduciary's personal assets would still be at risk for all losses caused by the fiduciary notwithstanding the fiduciary insurance policy. To prevent the right of the insurer to recoup any payments from the individual fiduciary, therefore, the fiduciary liability insurance policy must include a **"waiver of recourse" provision**. A waiver of recourse provision generally means that the insurance company agrees that it will not seek to recover from a fiduciary any payments made by the company under the policy to discharge the fiduciary's liability. The insurance company must charge an additional premium for the waiver of recourse provision, which cannot be paid with the benefit fund's assets. Instead, the waiver of recourse premium must be personally paid by the fiduciary, or by an employer, the employer association, or a union. Typically, insurance companies charge a nominal twenty-five dollars waiver of recourse premium per individual fiduciary since it will normally be paid out of pocket by individuals. While small, this is the most important portion of the policy premium for a fiduciary to pay.

Whether waiver of recourse applies to governmental plans is often unclear. It is an ERISA concept, and ERISA does not apply to governmental plans. By many states, like California, have adopted ERISA's mandated recourse requirement if the policy premium is paid out of plan assets. For states in which the law is not clear, you will likely want your plan attorney to give advice as to whether waiver of recourse should be added to your policy to ensure that any right of recourse against you personally is eliminated.

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## Make the Prudent Choice

Encore Fiduciary specializes in fiduciary and other management liability insurance for multiemployer, governmental and other non-profit employee benefit plans, with over 15,000 policies issued in this niche. Known for our expertise and thought leadership in protecting Insureds from complex liability, we also offer Directors & Officers Liability, Employment Practices Liability, Cyber Liability and Crime Insurance Coverages to employee benefit plans and plan officials.

Our carrier partner is Hudson Insurance Group, a leading underwriter of specialty lines programs. Hudson is the US Insurance Division of Odyssey Re Holdings Corp. Hudson is an A.M. Best "A+" (Superior) financial size category XV (\$2.0 billion or greater) rated insurance carrier that has an impressive track-record in the employee benefit plan niche.

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