Why Governmental Entities Need Fiduciary Liability Insurance

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Governmental entities often believe they do not need fiduciary liability insurance because they erroneously believe that they have limited exposure. The following are responses to the most common objections to demonstrate why governmental entities need to protect against fiduciary exposure with a quality scope of fiduciary coverage.

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1 **Governmental Entities are Subject to the High Fiduciary Liability Standard of Care.** Even though fiduciaries of governmental plans are not subject to most of the Employee Retirement Income Security Act "ERISA", they are still subject to fiduciary responsibility exposure under state and local law, common law rules, ERISA Title II tax provisions, and plan documents. These sources of fiduciary liability typically mirror ERISA's high fiduciary standard of care, or impose similar fiduciary requirements on governmental plans. The bottom line is that governmental fiduciaries are at risk of personal liability and need risk protection.

2 **Governmental Entities Cannot Rely on Governmental Indemnification and Statutory Indemnification.** Most stateshave some version of either an indemnification and/or sovereign immunity statute to reduce legal claims againstgovernmental officials. But these statutes do not provide sufficient protection against claims of breach of fiduciary dutyor failure to properly administer employee benefits. The reason is that most indemnification statutes contain significantexceptions and are sometimes even discretionary. For example, most state indemnification protections are limited toactions within the scope of employment and offer no protection for willful conduct, gross negligence, or breach ofgood faith – allegations that are included in many breach of fiduciary duty claims. Consequently, governmental officialscannot rely on governmental immunity or indemnification for fiduciary exposures.

3 Participation in a state Public Employee Retirement System does not relieve the member entity of fiduciary responsibilities. Some states provide that the pension benefits of city or county employees are handled in a state-wide Public Entity Retirement System "PERS" that provides pension benefits. This does not, however, relieve city or county executives from fiduciary responsibility. Indeed, while the state handles certain administrative and investment functions for the pension fund, fiduciary responsibility still resides with local officials for many responsibilities:

- Local entities must still ensure contributions to the state PERS are sent on a timely basis, as participants can allege loss of contribution credit or investment income for delays, and the state can sue for failure to provide required contributions;
- Local officials still have a duty to monitor and ensure that investments are consistent with the investment guidelines outlined under the plan documents;
- Local officials must also review the fees charged by investment managers or incurred through investment vehicles and defray excessive plan expenditures;
- Local officials are also responsible for non-defined benefit pension benefits (such as supplemental defined contribution plans), and non-pension benefits, including health and welfare plans, and Other Post Employment Benefit "OPEB" Plans; and
- Trustees must also ensure the financial solvency of the plans under their administration to secure the benefits of participants and retirees.

4 **When suing PERS, a participant alleging breach of fiduciary duty or improper calculation or distribution of benefits can include the contributing governmental entity as a defendant along with PERS.** The member entity has its own independent liability against which to defend.

5 **Even if a member entity contributes to state PERS, any fiduciary liability insurance protecting PERS will not protect contributing member entities.** The state PERS may purchase fiduciary liability insurance. But any such insurance is intended to protect the specific PERS plan – not contributing members. Those entities need to protect themselves independently of PERS.

6 **Even with PERS, member entities still have responsibility for non-defined benefit pension benefits, including supplemental defined contribution plans (like 401(a) and 457 plans) and health and welfare plans, including OPEB plans.** Most municipalities and other governmental entities have supplemental pension plans and health-related plans that are not subject to PERS. Governmental entities have substantial fiduciary responsibility – and individual liability for responsible governmental officials – for these additional employee benefit plans.

Benefits of a Fiduciary Policy

- Fiduciary policy protects against the **personal liability** imposed on plan trustees and responsible governmental officials for any plan losses resulting from the breach and for any profits that were attained through the misuse of plan assets. The policy protects the plan and individual fiduciaries.
- Fiduciary policy protects fiduciaries that are found liable for statutorily imposed penalties such as monetary sanctions or corrective fees imposed by the IRS and other governmental entities.
- Fiduciary policy protects against lawsuits commenced by parties with standing such as a participant or beneficiary, co-fiduciary, or governmental entity.

Claims Examples

1. **Imprudent Investments:** Trustees of a $9.5B employee retirement plan were alleged to have conducted illegal and imprudent investments involving hundreds of millions of dollars. The lawsuit raised questions concerning low return on investments and excessive management fees.

2. **Failure to Monitor:** Participants of a health plan sued the plan's board of trustees alleging that the trustees paid excessive fees in administering the plan. Participants alleged that trustees breached their duty to monitor the fees of the plan administrator.

3. **Conflict of Interest:** Trustees of a $1.3B plan were alleged to have breached their fiduciary duty and accused of conflict of interest when plan assets were invested in products owned by an investment manager. The fees paid to the investment manager were also called into question.

4. **Benefit Claim:** Participant alleges that the plan officials failed to properly credit the service time of the participant, resulting in reduced pension benefit.

5. **Benefits Dispute — Supplemental Distributions:** City Attorney filed lawsuit against the board of trustees regarding the supplemental distributions provided to participants of the plan. City attorney alleged that plan trustees breached their fiduciary duty by providing a 13th check without having satisfied the requirement under state law, including sufficient annual return on plan investments.

6. **Defined Contribution Claim:** Fiduciaries of defined contribution plan failed to notify retirees of a blackout period that occurred to accommodate a switch to a new administrator. The retirees were unable to change their investment options during that period and brought suit claiming that had they been notified, they would have moved their funds prior to the blackout.

7. **Challenge to Supplemental Retirement Plan:** Participants in deferred retirement option plan sued when plan trustees adjusted to a lower guaranteed interest rate to prevent further losses. Participants alleged that they have contractual right to original guaranteed interest rate.

8. **Improper Expenses/Ethics Violations:** State Board of Ethics conducted a confidential investigation concerning information it received suggesting that certain Trustees may have violated provisions of law within the Board of Ethics' jurisdiction. Specifically, Board of Ethics investigated whether plan trustees violated certain state laws by taking extended stays at investment conferences for the Trustee and his/her family members, food and drink for the Trustee and his/her family members, and transportation for the Trustee and his/her family members, to which the Trustee was not duly entitled to receive for the performance of his/her job duties as a member of the Board of Trustees. Fiduciary policy provided a defense to the trustee for the Board of Ethics investigation, including interviews of plan trustees.

9. **HIPAA:** The U.S. Department of Health and Human Services Office for Civil Rights (OCR) investigated a public university after multiple breach reports affecting thousands of individuals, including two reports involving unencrypted laptops and another large breach involving a stolen unencrypted thumb drive. University settled potential violations of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) Privacy and Security Rules by agreeing to a comprehensive three-year corrective action plan and a monetary payment by OHSU to the Department for $2,700,000.

**According to the Tillinghast Fiduciary Liability Survey Report Paid claims are averaging about $1M, with average defense costs that are just under $400,000.*

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