The Expanding Minefield Of Nonprofit Fiduciary Liability

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Nonprofit oganizations and their leaders who take comfort in having directors' and officers' liability insurance should be mindful of a gaping hole. It's a universal one and has been there for years, but regulatory changes governing group health and welfare plans raise the stakes for plan fiduciaries – and unders ore the importance of plugging the hole.

What's Fiduciary Liability–And Why Should I Care?

Fiduciary liability, as we define it in insurance, arises from "wrongful acts" – that is, acts, errors, omissions, misstatements, misleading statements, neglect, or breach of duty – as a fiduciary of group health and welfare benefit plans. Activities that can create liability include benefit plan design and funding, plan asset management, provider selection, plan disclosures and communications, and plan termination, to name but a few.

IRS regulatory changes in the treatment of tax-sheltered annuity, or 403(b) plans – the retirement vehicle of choice for many nonprofits – required new levels of fiduciary diligence and disclosure beginning in 2007. Although the changes are too technical and detailed to outline here, their effect was to force 403(b) plans to operate within the same framework as 401(k)s, with comparably stringent requirements of transparency, documentation, communication, disclosure, and privacy. Internal Revenue Service Publication 4546 provides a handy self-audit compliance checklist.

The minefield of other compliance pitfalls has continued to expand, encompassing a virtual 'alphabet soup' of federal statutes – COBRA, HIPAA, EEOC, ERISA, and now PPACA. This latest legislation, the Patient Protection and Affordable Care Act, imposes a variety of intricate insurance coverage, reporting, communication and other requirements upon employers, together with a set of detailed compliance milestones. Even if an organization isn't subject to ERISA – as in the case of a religious entity, for example – state and local look-alike regulations may create risk.

Failure to comply strictly with federal health and welfare statutes, as well as their state and local counterparts, can trigger liability, as can other wrongful acts by benefit plan sponsors and their fiduciaries.

The 'Gotcha' Factor

A Directors' and Officers' Liability policy invariably excludes coverage for the entity and its individual decision-makers for actual or alleged violations of fiduciary responsibilities imposed by the Employee Retirement Income Security Act of 1974 (ERISA) and its amendments, as well as similar federal, state, local and common laws. Examples of such fiduciary responsibilities include management of benefit plan assets, selection of providers, disclosure of plan rules and fees, and plan communications, to name but a few.

A common misconception is that Employee Benefit Liability (EBL) or Employment Practices Liability (EPL) plug the hole in D&O protection. But the former, typically added to a Commercial General Liability policy, addresses only mistakes in the administration of benefit plans – for example, the inadvertent failure to enroll a participant – while the latter responds to employment-related management offenses such as wrongful termination, discrimination and harassment. Neither EBL nor EPL insurance protects against fiduciary acts, errors, omissions, misleading statements, neglect, or breach of duty associated with benefit plans.

"We Don't Actually Manage The Funds" And Other Popular Myths

Nonprofit buyers tell us, sometimes dismissively, that "we don't actually manage the fund assets – we hire an investment manager to do that." The strategy of engaging independent expertise is often a prudent one, but it doesn't absolve the sponsoring organization and its leaders of potential liability. If the plan manager underperforms in its professional assignment, participants are likely to target the sponsoring employer first with allegations of negligent selection/retention, inadequate oversight, and other theories of fiduciary liability.

Even with the most astute asset manager in a buoyant economy, there's room for error. Fees associated with investment options and inter-account fund transfers are seldom crystal-clear, opening the door to grievances from participants who don't understand the frictional costs of investing and managing their contributions. Here again, they often target the employer for failure to fully and clearly communicate the fee structures associated with investment elections and account maintenance.

Many employers overlook their group medical, dental, disability and ancillary benefit plans as sources of potential fiduciary liability. While retirement plans arguably present the greatest, or most conspicuous, risk, employee benefit offerings that fail to meet workforce needs, cost too much, aren't clearly communicated, or are poorly managed can create fiduciary liability.

A Simple Fix

The good news for exposed nonprofits is that fiduciary liability risk can be managed with relative ease, and insurance is both plentiful and affordable, especially when purchased as an adjunct to existing D&O/protection. Some major insurers provide no-cost risk management support.

Virtually every nonprofit D&O/EPL market offers a fiduciary liability product, including AIG, ACE, Alliance for Nonprofits Risk Retention Group (ANI-RRG), AXIS, Chubb, Markel, Philadelphia, Travelers, USLI, and Zurich, to name some stalwarts. Rating is based primarily on asset size (funds under management), the scope of the applicant's employee benefit offerings, and the integrity of internal plan management controls. Pricing varies in direct relationship to limits and self-insured retentions/deductibles.

Conclusion

As group health and welfare sponsors and fiduciaries, nonprofit organizations and their leaders operate on a dynamic regulatory landscape. They must comply with the same federal, state and local laws as their for-profit counterparts – but sometimes do so with less rigorous governance by good-natured volunteer boards, leaner human resource infrastructures, and a focus on mission that can trump attention to nuts-and-bolts business detail. At the same time, their employees are becoming more informed, discerning benefits consumers with heightened performance expectations. These factors exacerbate exposure to fiduciary liability – a risk that transcends simple employee benefit liability insurance (added, by endorsement, to a commercial general liability policy) yet is flatly and universally excluded by directors' and officers' liability and employment practices contracts.

The best defense is a multi-pronged strategy set including compliance self-audit; adoption of clear written benefit plan documents; obedient, loyal and diligent fiduciary governance; clear, frequent, and fully-transparent employee communication; and fiduciary liability insurance that achieves the most efficient, cost-effective commercial risk transfer.

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