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# What is your Fiduciary IQ?

*Are you a fiduciary? Do you have fiduciary duties? What is a fiduciary anyway?*

A quick check for the meaning of the word on the Internet revealed three pages of definitions. The common thread running through all is that *fiduciaries* have discretionary authority over another's money, property, or other assets, and a legal duty to act in a manner that benefits the other person, or organization.

Using this meaning, many persons are considered fiduciaries. Insurance agents and brokers, for example, have fiduciary duties and corresponding liabilities, as do executors of estates, trustees of organizations, and guardians. In addition to these, administrators of employee benefit plans (especially retirement plans) qualify as fiduciaries.

Therefore if your organization has a retirement plan (401(k), 403(b), or another qualified, retirement plan subject to ERISA, the administrators of that plan are fiduciaries. In addition, if your organization administers other employee benefit plans (health insurance to which the employees contribute) those individuals with administrative duties may be fiduciaries as well.

## Retirement Plans

The Employee Retirement Income Security Act of 1974 (ERISA) is the milestone legislation which governs employee retirement plans and specifically defines the duties and responsibilities of fiduciaries.

Considering the uncertain future of Social Security, the Secretary of Labor Elaine Chao, wants to improve workers health and retirement security by educating employers and service providers about their fiduciary duties under ERISA. The government has published a small business guide to compliance titled *Meeting Your Fiduciary Responsibilities* available on the Internet at [www.dol.gov/ebsa](http://www.dol.gov/ebsa). Published

in May 2004, the booklet provides an explanation of the ERISA law and regulations applicable to private sector (including for profit and non profit) companies. Public sector (government) retirement plans and plans sponsored by churches are not covered by ERISA.

## The Bottom Line

Most businesses hire a third party service provider to establish their retirement plan, offer investment options, keep records, produce reports, and communicate with the government and their employees. Some business owners are under the mistaken impression this eliminates their fiduciary responsibility. Nothing could be further from the truth. Any person exercising discretion, or control over the plan, is a fiduciary and may be held responsible.

## Fiduciary Duties

One of the central duties of a fiduciary is to act prudently. Prudence typically requires a process and a set of advisors. Documentation of meetings and decisions becomes critically important under these circumstances. The plan document serves as the foundation for operations. It should be followed carefully and kept up to date.

## The Risk

Fiduciaries through their actions, or inactions, motivated by malice, or through ignorance or neglect, may be held personally liable if they breach their duties. Furthermore, fiduciaries should be aware of the actions of co-fiduciaries, since fiduciaries have potential liability for the actions of fellow fiduciaries. This legal concept is known as *joint and several liability*.

## Risk Management

Administrators of employee benefit plans, as well as qualified retirement plans should determine if they meet the definition of fiduciary. The next step involves understanding the role and the duties of a fiduciary (Risk Identification Step).

Once these are established, a risk reduction plan can be implemented to minimize the exposure as much as possible through administrative procedures; then consideration can be given to transferring the rest of the risk to an insurance company through the purchase of *employee benefits liability* and *fiduciary liability*.

## Risk Reduction

One way to reduce the risk of being held personally liable is to establish a compliance procedure. This puts some parameters around the term "prudence". Obviously, once compliance procedures are established follow them precisely, documenting the process and the decisions made along the way.

Another way to reduce fiduciary related risks is to get knowledgeable advisors who can handle some of the fiduciary functions for you. This includes third party service providers such as mutual fund or investment managers, banks, insurance companies, lawyers, and accountants. Under these circumstances, the fiduciary is not held liable for the individual investment decisions of the third party manager but is still required to monitor the manager periodically to make certain the assets are being handled "prudently."

Read your agreements with these third party service providers carefully. Pass any contract language regarding insurance, or hold harmless/indemnification language

by your insurance broker and attorney. Consider asking the third party service provider for additional insured status on their fiduciary liability.

Another risk reduction measure for a 401(k) plan or profit sharing plan is to give participants control over the way their assets are invested. The Labor Department has some requirements which must be met if you choose this option to reduce risk. Consult your advisors to ensure compliance.

## Insurance

ERISA also requires that those who handle retirement plan funds or other property must be covered by a Dishonesty Bond (Fidelity Bond) to protect the retirement plan's assets from fraudulent or dishonest acts of the fiduciaries. The limit of the bond is typically a minimum of 10 percent of the assets of the retirement plan. Beyond this there is no other requirement for insurance.

## General Liability Insurance Is Not Enough

There is some confusion about the type of liability insurance needed to address fiduciary risks even among insurance professionals. Is the general liability policy sufficient, or is more specific insurance needed?

A commercial general liability policy is not sufficient to respond to the broad range of risks confronting fiduciaries. A general liability policy with an employee benefits liability endorsement is also insufficient, and only does part of the job of risk transfer.

The scope of a typical employee benefits liability endorsement is limited to liability arising out of errors and omissions in the administration of employee benefits programs. Furthermore, these endorsements usually exclude liability arising out of ERISA. Employee benefits liability insurance is usually provided by endorsement to the general liability policy. They are designed to respond to liability which arises out of mistakes in the administration of health insurance, flexible spending accounts, and other employee benefit programs.

## Recommended Action

It is imperative that owners and directors with fiduciary responsibilities examine their general liability insurance to confirm the scope of their coverage for employee benefits liability, if any. If your policy doesn't include this coverage, contact your insurance broker to discuss your risk and if

appropriate get a proposal to add employee benefits liability insurance to your insurance program.

## Fiduciary Liability Insurance

If your organization sponsors a retirement plan, the administrators of that plan are fiduciaries under ERISA and personally exposed to civil liability for breach of their fiduciary duties. The general liability policy, even with an employee benefits liability endorsement, doesn't cover the fiduciary risk under ERISA.

Fiduciary liability insurance is available as a stand alone policy, or as part of a management liability package, which typically includes directors and officers liability, employment practices liability, and fiduciary liability.

Nonprofit camp organizations are more likely than for-profit camps to carry fiduciary liability insurance protection in a management liability package. Many for-profit and nonprofit camp organizations are uninsured for fiduciary liability risks.

## Recommended Action

Confirm the risk. If fiduciaries in your camp business are uninsured, take immediate steps to secure an insurance proposal for fiduciary liability.

## Buyer Beware

Sometimes employee benefit liability insurance is provided on a *claims made* policy form. Fiduciary liability is almost always

provided this way. It is a good idea to proceed with caution when the insurance coverage is a *claims made* format, because there are usually no standardized policy provisions. Insurance protection may vary greatly from one insurer to the other, making comparisons and decision making more complicated.

Seek the professional analysis and advice of your insurance broker concerning the unique aspects of *claims made* insurance. Be sure to ask about prior acts coverage, deductibles, defense costs (inside, or outside limits), as well as the cost and length of the extended reporting period. Always determine if the insurance will be placed on an admitted or nonadmitted basis. This is important if the insurance company becomes insolvent at some point in the future. Under these circumstances, it is more advantageous to place coverage through an underwriter admitted to do business in your state.

## Prudence

Perform due diligence. Identify your risk as a fiduciary. Expand your fiduciary IQ. Document, document, document!■

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