

Fiduciary Liability Insurance

The legal rules in Canada governing employee benefit plans are complex

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Pension Trustees: A position of trust brings with it a greater duty of care

The legal concept of the fiduciary relationship was developed to address the vulnerability of individuals in certain relationships. A pension plan trustee is a fiduciary, with a legal responsibility to protect the interests of beneficiaries. In many situations, a person's largest asset is their entitlement in their employer pension plan. As such, employees can be entrusting their biggest asset to the plan trustees/fiduciaries.

The duties of trustees or fiduciaries in Canada are derived from three distinct sources:

1. Trust documents such as the trust agreement, plan rules and statement of investment policies and procedures, as well as custodial, administration and investment management agreements
2. Common Law / Civil Law
3. Legislation such as the Pension Benefits Standards Act (PBSA) and any equivalent provincial and territorial act

The most common duties of trustees are the:

1. Duty to comply with the terms of the trust
2. Duty to act personally
3. Duty of loyalty, good faith and to avoid conflicts of interest
4. Duty of care
5. Duty to act with an even hand
6. Duty to inform and disclose to the beneficiaries

These duties create responsibilities for

pension committee members which can create exposures for liability. One of the greatest sources of liability for fiduciaries is the duty to avoid conflicts of interest, both actual and perceived. A fiduciary must not allow his or her personal interest to conflict with his or her duties as a fiduciary. As an example, if the fiduciary is an employee of the sponsoring organization, that fiduciary's loyalty to and financial interest in the sponsoring organization may colour his or her decisions on behalf of the plan. Any decision by the fiduciary is subject to criticism as being primarily for the advantage of persons or entities other than the participants and beneficiaries of the plan.

Another responsibility that can expose a fiduciary to risk is to fully and accurately disclose all material information regarding the plan in a timely manner. As outlined, under the duty to communicate, failure to do so can certainly create liability. But what constitutes too much or too little information? What is the correct balance between easy-to-read versus detailed language? How often should you update plan members? Is monthly too often, or is quarterly not often enough?

The fiduciary's duty to take reasonable care in choosing appropriate investments for the pension plan assets is yet a further area of responsibility. The number and variety of investment choices in defined contribution plans can vary greatly by pension plan. What is the right number and mix for your organization?

A well-designed, well-executed, and well-administered employee benefit plan is an important foundation for limiting litigation exposure.

Fiduciary Liability Insurance



Simply put, a fiduciary liability insurance policy is designed to protect insureds against claims alleging a breach of their fiduciary duties regarding the employee benefit plan or claims alleging they committed an error in the administration of the plan.

Fiduciaries can be held personally liable for losses to a benefit plan incurred as a result of alleged errors, omissions, or breach of their fiduciary duties. Protection from Chubb is available for a wide range of public, private, and not-for-profit organizations.

Key components that are a fundamental part of any fiduciary's arsenal against potential claims include:

1. Due diligence / good governance
2. Legal advice
3. Obtaining judicial opinion
4. Indemnification
5. Fiduciary Liability Insurance

Indemnification is not a guarantee

Benefit administrators and the individuals who act as fiduciaries of plans need protection against their legal risks. For individuals with personal exposure, indemnification is typically the first line of defence; however, given that indemnification may be an ineffective source of protection, fiduciary insurance should be considered.

The sponsor organization may not be able to indemnify the trustees due to:

- financial reasons
- prohibition, or
- the lack of requirement to do so in indemnification agreement and corporate by-laws

Fiduciary liability insurance is an integral piece of your tool kit of protection.

Plan sponsors and fiduciaries need to be proactive to protect themselves in an ever-changing legal environment. Fiduciary liability insurance is an important part of any comprehensive corporate risk management program.

Trustees can be held personally liable for breaches of their duties that result in loss or damage suffered by the beneficiaries. For example, the Ontario Pension Benefits Standards Act provides for a fine of up to \$100,000 on first conviction and a fine of up to \$200,000 on any subsequent conviction.

Fiduciary liability insurance provides protection to plan sponsors and fiduciaries against both personal liability and the sometimes significant costs associated with the defence of employee benefit lawsuits.

Fiduciary Liability Insurance is “Third-Party Coverage”

In general a fiduciary liability policy provides coverage for breaches of fiduciary duties, and errors and omissions in the administration of the plan. A few examples of liability created by breaches of fiduciary duties include: Negligent misrepresentation, negligent supervision, and improper choice of agent (see page 6 for additional liabilities). Fiduciary liability insurance is “third-party” coverage, meaning that someone must make a claim against an insured for a wrongful act. In turn, the fiduciary liability insurance policy will provide a defence against the claim, and then pay for any settlement or judgment against the insured up to the policy’s limit (subject to the terms and conditions of the policy).

The policy will typically cover directors, officers and employees acting as fiduciaries or as members of any employee benefit committee, investment management committee, or administrative committee of the plan as well as all natural person employees of the plan (insureds).

Defence costs, settlements, judgments, compensatory damages, punitive damages (where insurable by law), and certain fines or penalties are common elements of coverage under these policies. A common misunderstanding is that fiduciary liability insurance can be used to restore losses to an employee benefit plan when a plan sponsor or employer discovers that it made an error. This is not the case. The insured cannot utilize the policy to restore losses to the plan. The insurance policy however may still provide coverage for defence costs against claims by members for “benefits due”.

Don’t take a chance... Litigation can last for years and defence costs alone can be significant. An effective Fiduciary policy may assist in reducing the impact of time-consuming and distracting claims litigation.

Fiduciary Liability may not be covered elsewhere

Typical Directors and Officers Insurance (D&O) does not provide coverage for the acts of pension plan trustees. In typical D&O policies there is a specific exclusion for the D&O’s acts as a trustee of pension or benefit plans that violate the laws governing pension benefit plans.

In addition, Employee Benefit Liability endorsements on a General Liability Insurance Policy may not provide coverage for breach of fiduciary duty, but only for errors in the administration of the plan. Even then, the coverage is often more restrictive than that which can be found on a stand-alone fiduciary liability insurance policy.

Other insurance to consider

Pension and Welfare Fund Fiduciary Dishonesty Insurance Policy. In general, this insurance product provides coverage for theft from pension assets, and is mandatory for some pension plans in the United States under ERISA law.

Fiduciary Liability Canadian Insurance Claims Scenarios



Potential Insurance Claims can include issues arising from:

- Administrative error
- Investments due diligence or Imprudent investment or lack of investment diversity
- Negligent misrepresentation
- Spousal waivers
- Improper amendments to trust documents
- Surplus ownership
- Failure to adequately fund a benefit program
- Imprudent choice of agent/delegation
- Surplus and contribution holiday
- Improper disclosures to plan participants
- Selection of inappropriate advisors or service providers

Administrative Error

Canadian Not-for-Profit Organization Labour Management Trust Fiduciary Liability Policy

A plaintiff sued alleging an error in the administration of his pension plan. Specifically, he maintained that the sponsor company (the Plan and its

Trustees) improperly administered his long term disability (“LTD”) benefits by failing to enroll him in the LTD plan. The plaintiff sought LTD benefits spanning well over a five year period. The plaintiff also claimed that the Trustees, as administrator of the Plan, breached their statutory, contractual, fiduciary and tortious duties owed to him by failing or refusing to provide him with LTD benefits. The plaintiff also sought punitive, exemplary or aggravated damages. Despite the sponsor company’s confidence in its defence that the plaintiff had not opted for LTD benefits under the Plan, a settlement was considered due to the significant defence costs that had been incurred and the length of years devoted to the litigation.

The matter had been in litigation for over six years and almost \$100,000 was spent on defence costs.

Administrative Error

Canadian Private Company

The plaintiffs, retiree members of a pension plan, sought a class action lawsuit against the sponsor company, the administrator of that plan, to force it to make changes to the pension plan documents. Proposed changes addressed various issues ranging from plan committee member eligibility to the handling of plan proceed surplus. The certification motion was unsuccessful, and the plaintiffs appealed the decision to the Court of Appeal which upheld the lower court’s decision.

The matter was in litigation for over a decade. Just over \$750,000 was spent on defence fees.

Wrongful Refusal to Pay Benefits

Canadian Publicly Traded Company

The plaintiff, a widower of a former employee of the sponsor company and (from whom the plaintiff was previously separated from) sought survivor pension benefits pursuant to the terms of a separation agreement that had been forwarded to the insured. Allegations were made that the separation agreement, which outlined that the plaintiff was solely entitled to full survivor benefits, was forwarded to the sponsor's defined benefit pension plan administrator and acknowledged by the sponsor's but that no benefits had been paid. The plaintiff also sought punitive damages in the amount of \$100,000.

The plaintiff alleged that the sponsor committed various breaches of the Pension Benefits Standards Act ("PBSA") in connection with the sponsor's refusal to pay the plaintiff's defined benefit pension plan. The insured argued that the separation agreement did not constitute a proper assignment. The plaintiff was unsuccessful at first instance and appealed to the Court of Appeal. The Court of Appeal dismissed the plaintiff's appeal and ordered the plaintiff to pay \$10,000 in costs to the insured.

The matter had been in litigation for over four years and just under \$150,000 was incurred in defence costs.

Investments Due Diligence

Canadian Not-for-Profit Organization

The plaintiff, a former employee of the sponsor company, disputed the

payment amount owed under her pension plan after her employment relationship was terminated. At the time of her termination, the value of the pension plan was substantial, but when time came for the sponsor to issue payment, valuation had deteriorated significantly due to overall market conditions. Investigation by the Office of the Superintendent of Financial Institutions (OSFI) ultimately concluded that the sponsor did not properly manage the pension funds and did not meet its fiduciary obligation.

The matter was in litigation for over two years. The matter was settled for approximately \$350,000 including indemnity and defence costs.

Pension Valuation - Negligent Misrepresentation/Administrative Error

Canadian Not-for-Profit Multiple Employer Pension Plan

A member of a multiple employer benefit pension plan was provided with a statement of her pension plan monthly entitlements and relied on this information to make critical financial decisions, including the decision to retire. Unfortunately, the statements that the plan member received contained errors in calculations and her pension was to be considerably less than what had been represented to her. The difference represented a greater than 30% reduction in benefits.

After an approximately two year period, a settlement in the amount of approximately \$100,000 was reached between the parties.

The Chubb Advantage

Market leadership

Operating in Canada for over 30 years, we are one of the largest providers of Fiduciary Liability Insurance as organizations continue to entrust their complex Fiduciary Liability risks to Chubb. Our depth of understanding of trustees roles and exposures allows us to provide bold, clean, broad coverage that stands out in the market.

Full suite of Fiduciary Liability coverage options

Chubb is one of the few insurers that can offer organizations a complete spectrum of Fiduciary Liability insurance solutions for organizations and individuals.

Global Fiduciary Liability capabilities

Our worldwide expertise and local presence enable us to solve complex global protection problems.

Financial stability

Our financial stability and ability to pay claims rate among the best in the insurance industry, as attested by the rating we receive from the leading independent insurance rating services. For more than 75 years, Chubb has remained part of an elite group of insurers that have maintained A. M. Best company's highest ratings.

Superior claims management

The true measure of an insurance carrier is how it responds to and manages your claim. Chubb is renowned in the industry for fair, prompt claims handling and unparalleled claims service.

We understand that when you buy insurance, you're really buying peace of mind. You want your claims handled in a professional manner that is as painless to you and your business as possible. This is the Chubb difference.

There are benefits to choosing a local carrier

We have a significant claims and underwriting team in Canada that are well versed in Canadian legal and risk issues, issues that affect companies and their trustees every day.



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