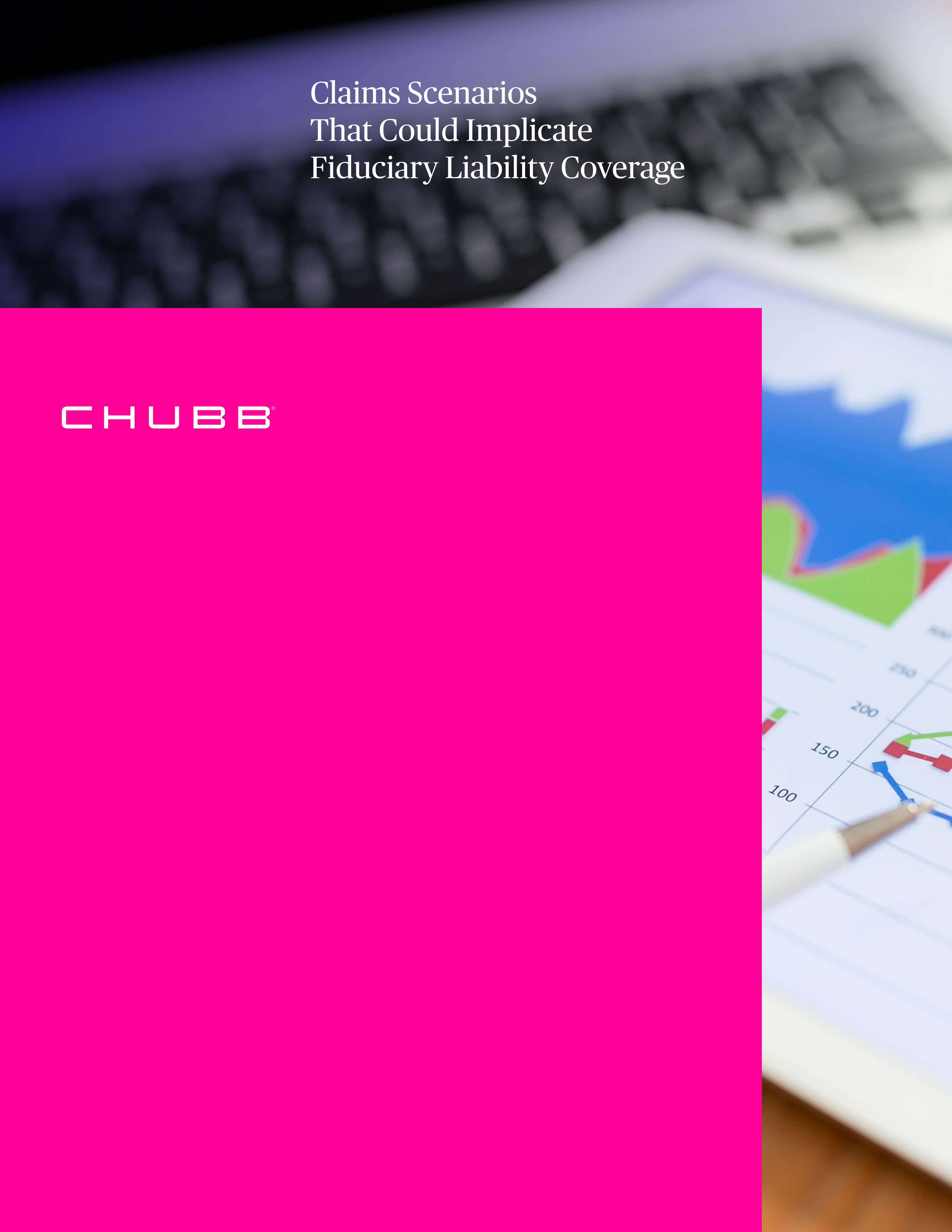
Claims Scenarios That Could Implicate Fiduciary Liability Coverage



Claims Scenarios That Could Implicate Fiduciary Liability Coverage

Fiduciaries of all types of employee benefit plans are increasingly exposed to claims regarding errors or mismanagement with respect to their plans or plan investments. Following are claim scenarios that depict some of these exposures.

Although these scenarios are based on actual events, facts and details have been altered for purposes of illustration and/or to protect the parties' privacy. Coverage for an actual claim depends on the specific facts of such claim. Nothing contained in these scenarios should be relied upon or used as a basis for granting or ensuring coverage.

Contents

Claims Scenarios Involving Defined Contribution Retirement Plans

Type of Scenario	Details
Service Provider Dishonesty	A privately owned company retained a third-party administrator ("TPA") to manage the day-to-day operations of its 401(k)-retirement plan. The TPA, in turn, hired a professional investment manager to invest the plan's assets. The employer eventually discovered that the outside investment manager (who turned out to be affiliated with the TPA) was "skimming" money off the top of the employees' retirement fund contributions. The DOL accused the employer of a breach of fiduciary duty for failing to have adequate safeguards in place and demanded that the employer make the plan whole. The employer had to pay $2,000,000 to replace the funds embezzled by the investment manager, and for the lost investment income that the stolen funds should have earned but for the theft. Legal expenses topped $75,000.
Failure to Timely Follow Employee's Investment Instructions	A participant in a 401(k) plan gave instructions to change his 401(k) investments so as to decrease his investment in a fund that was heavily concentrated in sub-prime investments. The transfer was executed within the week. However, in the interim, the sub-prime market imploded, and the employee suffered investment losses of $150,000 due to the subprime investments. The employee sued for the lost principal plus lost investment income, claiming that the fiduciaries took too long to process and execute his transfer instructions, thus leaving him exposed to the losses in the sub-prime market.
Investment in a Ponzi Scheme	The fiduciaries of a 401(k) plan, seeking to shield themselves from liability for investment decisions, retained the services of a third-party investment manager. The investment manager invested the plan assets with funds that ultimately turned out to be part of a Ponzi scheme, and all of the plan assets were lost. The plan participants sued the fiduciaries for negligently selecting and failing to monitor the investment manager. The employer tendered the suit under its Fiduciary Liability Insurance, and the matter was eventually settled, costing the insurer millions of dollars in defense costs and indemnity.
Decline in Employer's Company Stock Value	A publicly traded company offered its own company stock as one of its 401(k) investment options. The company stock price declined due to a downturn in the market, resulting in a decline in the participants' plan balances. The participants sued the company's fiduciaries – including its directors and officers acting as unnamed, functional plan fiduciaries – for offering the company stock as an investment option and investing the company's matching contributions in the company stock. The plaintiffs alleged that the defendants knew or should have known (based upon nonpublic information) that the company stock was an imprudent, risky investment. After spending more than $10,000,000 in defense costs, the case settled for $7,000,000, all of which was paid for by insurance.
Use of Proprietary Funds as Plan Investment Options	An investment firm used its affiliated fund manager's mutual funds (i.e. "proprietary funds") in its own sponsored 401(k)'s plan investment lineup. The plan participants sued over the use of proprietary funds, claiming a breach of the duty of loyalty and care because the proprietary funds were expensive, underperformed their peers, and were selected in order to generate revenue for the affiliated fun manager. The Plaintiffs demanded disgorgement of the excessive fees and payment for the lost investment opportunity.

Type of Scenario	Details
Financially Unsound GIC Investment	A company that sponsored a 401(k) plan utilized Guaranteed Investment Contracts (GICs) as part of its plan investment lineup, and plan participants invested $12,000,000 in these GICs. However, the GICs were offered by an insurance company that was not AAA rated and had extensive junk-bond holdings. The GIC issuer eventually went into receivership, causing significant losses to the plan participants. The participants sued the plan investment committee, the plan administrator, the plan and the plan sponsor for a breach of fiduciary duty and for violating the Master Trust Agreement, which authorized GIC investments underwritten only by AAA rated companies. The case eventually settled for more than $4,000,000 and cost over $750,000 to defend.
Failure to Guard Against Social Engineering Fraud	A plan's recordkeeper improperly distributed a participant's entire 401(k) balance to a perpetrator who impersonated the participant via email. The recordkeeper refused to make the participant whole, causing the participant to sue its employer for breach of fiduciary duty under ERISA, for failing to properly vet and monitor the recordkeeper and the recordkeeper's online safety protocols. The result was that case settled for $140,000.
Excessive Recordkeeping Fees and Investment Expenses	A class action was filed against 401(k) plan fiduciaries for agreeing to pay the plan recordkeeper its fees based on an percentage of assets under management without any cap based on a per capita dollar amount. Plaintiff also claimed that the plan investment lineup imprudently included retail share classes, actively managed funds, and underperforming funds, and that some imprudent funds were included in the plan because they were managed by the recordkeeper's affiliated fund manager. A $10,000,000 Fiduciary Liability Insurance policy was exhausted to defend and settle the matter.
Missed Plan Contributions Discovered	A company realized that it missed certain deposits of employee salary reduction contributions for its sponsored plan, so it entered a Voluntary Fiduciary Correction Program with government regulators in order to address the issue and avoid any future claims. Fiduciary Liability Insurance paid $50,000 in filing fees and legal expenses.
Erroneous Eligibility Advice	An employee was erroneously advised that he was not yet eligible to participate in his employer's 401(k) plan, so he did not enroll or contribute to the plan. Upon learning that he should have been eligible earlier, the employee sued for lost tax advantages and investment opportunities during the time he was denied enrollment. Fiduciary Liability Insurance paid over $10,000 to defend and resolve the matter.
Maintenance of Former Parent's Company Stock in 401(k) Plan	A private company that was spun off from a public company retained the former public company parent's stock as an investment option in its 401(k) plan post-spin. (The former parent's stock was present in the plan due to profit sharing contributions that had been made by the former parent pre-spin.) Following a decline in the former parent's stock price, plan participants sued for imprudently maintaining an undiversified concentration in the former parent's stock. Result was $275,000 spent in defense costs through the motion to dismiss.

Claims Scenarios Involving Defined Benefit Pension Plans

Type of Scenario	Details
Improper Offset of Social Security Benefits	A manufacturing company maintained a defined benefit plan for its unionized labor force. This plan provided for survivor benefits for decedent employees' spouses. The surviving spouses filed a class action alleging an error in calculating their benefits under the plan because the benefit payments were reduced by the amount of social security benefits, which was allegedly contrary to the plan and the collective bargaining agreement. Result was payment of $2,000,000 in defense costs, as well as about $2,000,000 for an award of plaintiff's attorneys' fees.
Investment in High Risk Funds	An employer hired a professional investment manager to handle its defined benefit pension plan investments. The manager invested the plan assets in high-risk investments, counting on a significant return in a bull market. However, the market turned and the plan rapidly lost tens of millions of dollars, threatening the plan's viability. The employees sued the employer for negligently hiring and inadequately monitoring the investment manager. The fiduciaries faced millions of dollars in exposure, but were ultimately successful by defeating the claim for lack of standing.
Cash Balance Plan Conversion	An employer attempted to "de-risk" its pension plan by converting it into a cash balance plan. Participants sued, claiming that their benefits were reduced as part of the conversion process in violation of anti-cutback provisions. Approximately $15,000,000 was paid in defense costs.
Out-Dated Mortality Data	An employer was sued for sponsoring a pension plan that used decades old mortality data to convert the value of single life annuities to joint and survivor annuities. Result was that over $2,000,000 in Fiduciary Liability Insurance was exhausted for defense.
Improper Crediting of Years of Service	A retiree claimed that he was denied pension credit for his years of service after his employer was acquired by another company, despite verbal promises to the contrary during the acquisition process. The new employer did not recognize or credit the prior years of service. Fiduciary Liability Insurance paid $300,000 in defense costs before the case resolved.
Estranged Spouse Claim Against Pension Distribution	Pursuant to ERISA, an employer required a retiree to obtain his estranged wife's consent before honoring his request for a lump sum distribution of his pension benefits. The employee threatened to sue the employer if the benefits were not released, claiming his wife abandoned him, making it impossible to get spousal consent. Upon execution of sworn affidavits to this effect, the employer paid the lump sum to the retiree. Years later, after the retiree died, hisestranged wife's children (i.e. his stepchildren) sued the employer for releasing the pension funds to their stepfather without their mother's consent. Fiduciary Liability Insurance paid over $115,000 to resolve the matter.

Claim Scenarios Involving Employee Stock Ownership Plans

Type of Scenario	Details
ESOP Valuation Expert With Conflict of Interest	Following an ESOP's purchase of all of the shares of a company, the Department of Labor filed an enforcement action against the ESOP fiduciaries for selecting a valuation expert who had a pre-existing relationship with the selling shareholder to appraise the shares, claiming that the appraiser overvalued the shares in favor of the seller. The $1.000,000 Fiduciary Liability Insurance Policy limit was exhausted on defense.
Two-Part Sale of a Company to an ESOP	A shareholder sold 50% of his shares to a new ESOP for $10,000,000 in a fully leveraged transaction. Later that same year, the shareholder sold the remaining 50% of his shares to the ESOP for the same amount. The participants sued for overpaying for the remaining 50% of the shares due to the alleged failure to account for the impact of the new leverage on the second stage transaction's purchase price. They also claimed that the ESOP purchase left the company excessively leveraged and unable to fund future capital expenditures. Result was the exhaustion of $5,000,000 in Fiduciary Liability Insurance., plus additional debt forgiveness.
ESOP Valuation Issues in Divorce Proceedings	Two sisters established and managed a privately-owned company, which was 100% owned by an ESOP. Both sisters and their husbands worked for the company and participated in the ESOP. One of the husbands eventually filed for divorce, at which time his employment was terminated. Shortly thereafter, the company paid almost $2,000,000 for 10 years of backlogged management fees to a consulting company that was separately owned by one of the sisters. The estranged spouse alleged that these payments were designed to diminish the value of his distributive share from the ESOP. Result was over $500,000 was spent to resolve the matter.
Diluted Share Value Through the Use of Warrants	When an ESOP purchased all of a company's shares for $35,000,000, the selling shareholder helped to fund the purchase by carrying some of the debt and accepting some warrants. The Department of Labor claimed that the fiduciaries breached their duties by failing to consider the dilutive effect of warrants on the share price, thus overpaying for the stock by over 20%. The carrier paid the full $1,000,000 fiduciary insurance limit to defend the matter.
Deficient Sale Price for ESOP Shares	Ten years after an ESOP purchased a company, the company's senior executives purchased the ESOP's shares, thus taking over the company. The price paid by the executives was lower than the price paid by the ESOP initially due to adverse financial developments in the interim. The fiduciaries were sued for agreeing to sell the ESOP shares at too low of a price.

Claims Scenarios Involving Health and Welfare Employee Benefit Plans

Type of Scenario	Details
Reduction in Collectively Bargained Retiree Medical Benefits	A manufacturer and a labor union renegotiated their union contract to require all participants in the union's medical plan, including retirees, to contribute towards their health insurance premiums. The retirees sued, alleging that their benefits were vested and could not be renegotiated, and they sought damages and reinstatement of the benefits. Almost $3,000,000 was paid in defense costs.
Enrollment Error	An employer offered healthcare benefits to its employees through a third-party health insurer. Under the plan, participants had 60 days to add newborn children to their medical plan. Following the birth of a child, an employee worked with his employer's HR department to add the child, but the employer failed to submit the paperwork to the carrier within the 60-day window. The child became ill and incurred significant hospital bills, which the medical insurer eventually denied due to the fact that the child wasn't enrolled in the plan. The employee sued the employer for failing to submit the enrollment forms and Fiduciary Liability Insurance paid over $200,000 to settle the matter.
Systemic Underpayment of Medical Benefits	An employer retained a third-party administrator ("TPA") for its self-funded health plan. Out-of-network medical service providers (via an assignment of benefits) claimed they were systemically underpaid for emergency medical services provided to participants. Plaintiffs alleged that the plan fiduciaries were complicit in hiring the TPA and making the underpayments. Defense costs exceeded $1,000,000.
Improper Instructions on How to Claim Benefits	An employee became ill and, in compliance with her employer's HMO processes, notified the HR department of an illness and impending hospitalization. The HR department advised the employee that it was unnecessary to provide any advance notice of her hospitalization to the HMO. This advice was erroneous as the HMO's notification rules had recently changed, so the HMO denied coverage for the hospital bills. Fiduciary Liability Insurance eventually paid more than $500,000 to settle the matter, including the Plaintiffs' attorney's fees.
COBRA Notices	An employer was sued for failing to comply with the updated legal requirements for COBRA notices, as well as for the use of forceful fraud warnings in their COBRA notices which allegedly chilled the participants' exercise of their COBRA rights. Result was the payment of $200,000 to resolve the lawsuit.
Failure to Inform of Ineligibility	An employee signed up for $100,000 in life insurance benefits offered through his employer. When the life insurance company declined the application for coverage due to ineligibility, the employer failed to notify the employee and instead proceeded to deduct premiums from the employee's paychecks. Upon the employee's death, the life insurance company denied the claim and employee's widow sued the employer. Fiduciary Liability Insurance eventually paid $100,000 to resolve the matter.

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The claim scenarios described here are intended to show the types of situations that may result in claims. These scenarios should not be compared to any other claim. Whether or to what extent a particular loss is covered depends on the facts and circumstances of the loss, the terms and conditions of the policy as issued and applicable law. Facts may have been changed to protect privacy of the parties involved.