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Fiduciary Liability Insurance Basics

Fiduciary liability insurance protects companies and the individuals responsible for managing employee benefit plans from claims of negligence, mismanagement, or errors in administration that lead to financial harm to the plan or its beneficiaries. Coverage is specifically for unintentional acts and does not apply to deliberate fraud or theft, which are covered by separate ERISA fidelity bonds. The policy covers the costs of defending against claims and any financial losses resulting from these unintentional fiduciary breaches.

What it Covers

- **Errors and Omissions:** Protects against mistakes made in the administration of a benefit plan, such as incorrect plan information or errors in managing plan records.
- **Breach of Fiduciary Duty:** Guards against claims that fiduciaries did not act solely in the interest of the plan's participants and beneficiaries, as required by law.
- **Negligent Selection of Service Providers:** Covers the cost of imprudent choices of third-party administrators, investment advisors, or other service providers for the benefit plan.
- **Imprudent Investment Decisions:** Provides protection for poor investment choices or a failure to diversify investments, which can lead to losses for the plan.
- **Defense Costs:** Pays for the legal expenses associated with defending against claims of mismanagement or breach of duty.
- **Fines and Penalties:** May cover certain penalties and fines levied by government agencies, like the Department of Labor or IRS, related to non-compliance with voluntary settlement programs.

What it Does Not Cover

- **Fraud and Dishonesty:** Deliberate acts of misconduct, such as embezzlement, fraud, or theft from the plan, are excluded.
- **Third-Party Claims:** Fiduciary liability insurance typically does not cover advisors or consultants involved in the benefit plans; they should carry their own insurance.

Why It's Important

- **Personal Liability:** Under laws like ERISA, fiduciaries can be held personally responsible for financial losses to a benefit plan. This insurance protects their personal assets.
- **Complexity of Plans:** Managing retirement and other employee welfare plans is complex, and honest mistakes can have serious consequences, making this coverage essential.

Fiduciary Liability Civil Penalties and Losses

Voluntary Correction Program (VCP) loss

The VCP is an IRS program that allows a plan sponsor to voluntarily correct certain failures and restore the plan to compliance. Submitting to the VCP, rather than having a failure discovered through an audit, can result in significantly lower financial consequences.

Plan value loss (restoration of lost earnings)

Rather than a penalty, the VCP requires the plan sponsor to restore any "lost earnings" to the plan. This is an amount representing the lost investment return caused by the plan failure.

- **Correction Method:** The plan and its participants must generally be put in the same financial position they would have been in if the failure had not occurred.
- **Example:** For a missed contribution, the plan sponsor must pay the contribution amount plus any lost earnings from the date the contribution was missed.
- **Self-Correction Program (SCP) Limit:** A subset of the VCP, the SCP, can be used for certain failures with lost earnings of $1,000 or less.

VCP user fees

The fees for VCP submissions are generally based on the amount of plan assets.

- **Plan Assets $0 to $500,000:** $1,500 fee.
- **Plan Assets over $500,000 to $10,000,000:** $3,000 fee.
- **Plan Assets over $10,000,000:** $3,500 fee.

ERISA civil penalties

The Employee Retirement Income Security Act (ERISA) includes several provisions that authorize the Department of Labor (DOL) to assess civil penalties for violations.

ERISA Section 502(i)

This provision concerns prohibited transactions in welfare and non-qualified pension plans.

- **Initial Penalty:** 5% of the "amount involved" in the transaction for each year the transaction is outstanding.
- **Second-Tier Penalty:** 100% of the amount involved if the transaction is not corrected within 90 days of a final agency order.

ERISA Section 502(l)

This provision applies to fiduciaries who breach their responsibilities or to others who knowingly participate in a breach.

- **Penalty:** 20% of the "applicable recovery amount" obtained in a settlement with the DOL or a court order.
- **Offset:** This penalty is reduced by any excise tax imposed under IRC Section 4975 for the same transaction.

PPACA/PPA civil penalties limit

The Patient Protection and Affordable Care Act (PPACA) and Pension Protection Act (PPA) include penalties that are indexed for inflation.

PPACA "Pay or Play" penalties (for 2026)

- **"A" penalty (no offer of coverage):** $3,340 per full-time employee (minus the first 30), triggered if an Applicable Large Employer fails to offer minimum essential coverage to 95% of full-time employees and at least one employee receives a premium tax credit.
- **"B" penalty (unaffordable coverage):** $5,010 per full-time employee who receives a premium tax credit.

PPA "Blackout notice" penalties

- **Penalty:** Up to $100 per day per affected participant or beneficiary for failing to provide timely notice of a blackout period.

Affordable Care Act Penalties (ACA)

ACA employer penalties, for the 2026 tax year, include the "A" penalty of $3,340 per full-time employee for failing to offer minimum essential coverage to 95% of full-time employees and dependents, and the "B" penalty of $5,010 for offering unaffordable or substandard coverage, with the specific penalty applied based on which one an employee receives. These penalties are assessed on a monthly basis, and both are applied if an employee receives a premium tax credit through the Marketplace.

HIPAA Privacy Civil Penalties Limit

The Health Insurance Portability and Accountability Act (HIPAA) penalties are tiered based on culpability. The following amounts were updated as of August 8, 2024, and are subject to future inflation adjustments.

- **Tier 1: Unknowing Violations**
  - Minimum penalty per violation: $141.
  - Annual cap: $2,134,831.
- **Tier 2: Reasonable Cause**
  - Minimum penalty per violation: $1,424.
  - Annual cap: $2,134,831.
- **Tier 3: Willful Neglect (timely corrected)**
  - Minimum penalty per violation: $14,232.
  - Annual cap: $2,134,831.
- **Tier 4: Willful Neglect (not timely corrected)**
  - Minimum penalty per violation: $71,162.
  - Annual cap: $2,134,831.

IRS Section 4975 Penalties Limit

IRC Section 4975 imposes excise taxes on "disqualified persons" who engage in a prohibited transaction with a tax-qualified retirement plan.

- **First-Tier tax:** 15% of the "amount involved" for each year (or part of a year) the transaction is uncorrected.
- **Second-Tier tax:** 100% of the "amount involved" if the transaction is not corrected within the taxable period.

Settlor Claims

"Settlor functions" are decisions by an employer that relate to the formation, design, or termination of a plan, rather than its day-to-day management.

- **ERISA Protection:** Settlor functions are generally not subject to the fiduciary duties and liability standards under ERISA.
- **Limitations:** Claims cannot typically be brought against an employer under ERISA for decisions made in its settlor capacity, though this can be a complex area of law.
- **Use of Plan Assets:** Plan assets cannot be used to pay for settlor expenses.

Plan Value Loss

Plan value loss is the direct financial loss incurred by the plan itself due to fiduciary misconduct or other violations.

- **Restitution Requirement:** Under ERISA, fiduciaries who breach their duties are personally liable to make the plan whole for any losses that result from the breach.
- **Measurement:** This is typically measured as the difference between what the plan actually earned and what it would have earned if the breach had not occurred.
- **Examples:** This includes losses due to improper investments, unpaid contributions, or excessive fees.

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