



CAMBRIDGE
PROPERTY & CASUALTY

MANAGEMENT PRACTICES IN A NUTSHELL

The purpose of this article is to clarify the various forms of management-practices insurance and identify the common exposures employers face within each area. The major exposures to be discussed are as follows:

- Directors and Officers Liability Coverage
- Fiduciary Liability Coverage
- ERISA Bond
- Employment Practices Liability Coverage
- Employee Benefit Liability Coverage
- Employers' Liability Coverage

Directors and Officers Liability

Directors and Officers Liability Insurance provides financial protection for the directors and officers of the company in the event they are sued in conjunction with the performance of their duties as they relate to the company.

D&O policies do not cover the business entity unless that policy is specifically endorsed to include entity coverage. Since lawsuits brought by stockholders, employees, and clients may be made against the company, AND against the directors of that company, the entity should also be covered. Most policyholders are unaware that such entity coverage even exists let alone that it is excluded under the policy, absent an endorsement adding entity coverage.

Directors and Officers Liability Insurance ("D&O") is insurance purchased by the company and is payable to the directors and officers of that company to cover damages they personally incur defending and/or paying damages for covered lawsuits. These types of lawsuits are typically brought by shareholders, shareholder-derivative actions, customers, regulators, and competitors (for anti-trust or unfair trade practice allegations).

A study done by Wyatt & Co. examined the total number of claims against officers and directors and found that 52% of the claims were brought by shareholders, 22% by employees, 16% by customers, 2% by competitors, 3% by the government, and 5% by others.

One of the main purposes of maintaining D&O coverage is that it assists the company in attracting and retaining officer and directors. Since a director can be held personally responsible for acts of the company, most directors and officers will demand to be protected rather than put their personal

assets at stake. Investors and members of the company board of directors may not be willing to risk their personal assets to serve as a corporate director or officer, no matter how closely they may be related to your company.

Investors, especially venture capitalists, usually require that a company show evidence of Directors & Officers Liability insurance as part of the conditions of funding that company.

D&O lawsuits come in many different forms. Employment practices constitute the single largest area of claim activity under D&O policies with over 50% of D&O claims originating under employment practices disputes.

The following illustrate other common areas of D&O claims

- Acquiescence in conduct of fellow directors engaged in improper self-dealing.
- Approval of corporate acquisition with resulting loss of corporate assets.
- Causing the corporation to incur unnecessary tax liabilities.
- Civil liabilities in connection with prospectuses and communications.
- Compensation arrangements.
- Competition with corporation.
- Conflicts of interest.
- Continual absence from meetings.
- Corporate debts and delinquencies.
- Corporate gifts or contributions.
- Declaration of dividends.
- Failure to purchase insurance.
- Ignorance of corporate books and records.
- Improper repurchase of stock.
- Inadequate dividend payments.
- Inadequate investigation of facts included in public filings.
- Inefficient administration resulting in losses.
- Loans by corporations.
- Loans from to and/or from officers, directors, or stockholders.
- Misuse of insider information.
- Neglect of proper management with respect to corporate debts and delinquencies.
- Transactions between corporations having common directors.
- Transactions with other companies in which officers or directors are personally interested.
- Unfair competition.
- Violations of specific provisions of articles or by-laws.
- Wasting of corporate assets.

Fiduciary Liability

Fiduciary Liability Insurance provides financial protection for an organization's liability arising out of mismanagement of pension and welfare plans such as 401K plans. The most significant of the sponsor employers' liability was created under ERISA (the Employee Retirement Income Security Act of 1974). Although not mandated by ERISA, fiduciary liability coverage is designed to cover losses caused by administrators, trustees, and other fiduciaries as a result of their wrongful acts committed while handling covered employee benefit programs.

ERISA is a comprehensive law covering many different aspects of employee benefit plans. The law is designed to protect the rights of pension and welfare plan participants as well as their ability to collect future benefits.

One important dimension of ERISA is the definition of a fiduciary. A fiduciary is broadly defined as anyone with discretionary authority over the plan and its assets. This includes the sponsor employer, officers, directors and even some employees. Outside service providers, such as investment managers and plan administrators, are also fiduciaries. Each fiduciary can be held liable for claims, including those claims for acts of other fiduciaries.

Fiduciaries must discharge all duties solely in the best interests of participants and beneficiaries. Fiduciaries that fail to meet the standard of care can be held personally liable for their errors and omissions involved in administering an employer's ERISA plan.

The reference to "retirement" in the official title of the Act may be misleading because more than retirement or pension plans are involved. Covered benefit plans include any plan, fund, or program that provides, through insurance or otherwise, medical, hospitalization, sickness, accident, disability, death, vacation, and/or unemployment benefits and includes health plans as dental vision, life, and short and long term disability.

ERISA BOND

ERISA requires a fidelity bond covering fiduciaries (those responsible for managing the plan) and any person who handles funds or other property of such a plan. This bond covers the plan assets (not the trustee's assets) in the event of embezzlement or theft. The bond does not however provide coverage in the event poor investment choices result in losses or claims other than embezzlement or theft. The amount of the bond must be at least 10% of the pension plan's assets up to \$500,000.

Do not confuse an ERISA bond, which pertains to dishonesty, with fiduciary liability insurance, which covers management of the plan.

Employee Benefits Legal Liability

Employee Benefits Liability Insurance (EBLI) covers an entity, its officers, directors, stockholders, partners and partnerships, and any employees authorized to act in the administration of a covered plan, for claims against them by former, present, or future employees, their beneficiaries, or legal representatives for mistakes, negligent acts, and errors or omissions in the administration of the plan.

EBLI EXCLUDES COVERAGE FOR LIABILITY ARISING UNDER ERISA as this should be covered under a fiduciary liability policy.

Covered plans usually include group life and health; profit-sharing and pension plans; employee stock subscription plans; workers compensation and unemployment insurance; social security; and disability benefits coverages.

The following are two examples of common EBLI claims. First, a plan administrator might erroneously calculate the amount of a pension program and subsequently the employee elects early retirement only to find out that the amount is considerably less. Second, a plan administrator might forget to enroll an employee for the company's hospitalization program and the employee finds out about this omission following a serious illness. Third, if an employee fails to send an appropriate COBRA letter to new and terminated employees, this could result in a claim under this coverage.

Employment Practices Liability (EPLI)

Employment Practices Liability Insurance (EPLI) covers businesses against claims by employees that their legal rights as employees of the company have been violated. Given tort reform and damages caps in other areas of the law, the number of employment related lawsuits, which remains largely unregulated, continues to rise. While most suits are filed against large corporations, no company is immune from such lawsuits.

EPLI provides protection against many kinds of employee lawsuits, including claims of:

- Sexual harassment
- Discrimination
- Wrongful termination
- Breach of employment contract
- Negligent evaluation
- Failure to employ or promote
- Wrongful discipline
- Deprivation of career opportunity
- Wrongful infliction of emotional distress
- Mismanagement of employee benefit plans

Employers' Liability

Employers liability insurance pays for the employers' defense and indemnification costs associated with claims by injured employees which fall outside the scope of the workers' compensation insurance. With few exceptions, workers' compensation laws prohibit employees from bringing lawsuits against their employers for work-related injuries. This is sometimes referred to as the exclusive remedy provision. In an attempt to bypass the exclusive remedy provision, some plaintiff attorneys will allege that the employee's injury falls within one of the few exceptions to the rule, such as an employer's intentional act. These "back door" allegations are generally not covered by workers' compensation insurance policies and therefore employers' liability coverage is necessary.

Employers' liability is automatically part of workers' compensation policies in states where workers' compensation coverage is required to be provided by standard insurance carriers. In some states, such as Ohio, workers' compensation coverage is provided by the state and employers' liability is not provided and must be secured from private insurance carriers. This is known as Ohio Stop Gap coverage.