

FINPRO Focus

Blended D&O and Fiduciary Liability Policies—Pros and Cons

The emergence of a new kind of fiduciary liability class-action lawsuit has led to increased liability exposure of ERISA fiduciaries. These “tag along” or “follow on” claims typically follow the filing of a securities class action. These claims are also filed as class actions, but instead of being brought for the benefit of injured shareholders, they are brought on behalf of participants and beneficiaries of a company’s retirement plans to the extent those plans own securities of the company. The allegations generally involve failure by the fiduciary to manage the assets of the plan prudently and loyally by investing a significant amount of the assets in company stock when it was no longer a prudent investment for participants’ retirement savings. Instead of claiming a violation of securities laws, the “tag along” cases claim that the defendants breached their fiduciary duties under ERISA. Corporate directors (and senior management) are often named in these cases when they appoint ERISA fiduciaries. The theory behind suing directors is that the appointment of a fiduciary is, in itself, a fiduciary act, and that the power to appoint may include an ongoing duty to monitor.

Procedurally, these “tag along” cases present some unique issues. These cases may be filed simultaneously with a securities class action, and generally allege the same basic facts. But because the Private Securities Litigation Reform Act does not apply to the “tag along” case, the pleading standards are more relaxed. In addition, unlike in a securities class action, discovery is not stayed (pending resolution of the motion to dismiss) in the “tag along” case. For these reasons, oftentimes the “tag along” case moves forward on a faster track, and may be resolved (most often by settlement) earlier than the companion securities class action.

The emergence of these “tag along” cases along with these procedural issues has caused a reaction in the fiduciary insurance marketplace. Most insurers have attempted to manage their overall exposure to the possibility of claims that “double dip”, i.e., a securities class action and an ERISA “tag along” action, which would trigger coverage under both the directors and officers (D&O) liability policy and the fiduciary liability policy. At least two of the leading primary insurers have implemented ratings models that allow for significant premium increases for risks with large company holdings in their defined contribution plans. Some insurers have attempted to add policy language that adds a common-claim tie-in of limits.

Due to escalating pricing, potential coverage restrictions and reductions in capacity, many insurance buyers have considered blending their D&O and fiduciary programs. While there are advantages to blending coverage, there are also advantages to maintaining separate, standalone programs.

Advantages to Blending Coverages

1. **Cost Savings:** The key advantage to a blended program structure is mitigation of the increase in fiduciary pricing. Insureds with a high percentage of company stock in their defined contribution plans have seen significant premium increases, and the trend to higher pricing continues. By blending the fiduciary and D&O policies, companies may be able to achieve significant savings.
2. **Capacity:** Insurers are examining their overall aggregate exposure and, in many instances, they are reducing either their D&O or fiduciary limits. Consequently, standalone fiduciary capacity has become an issue and it may be more limited than in previous years. With D&O capacity well in excess of the available fiduciary capacity, by blending the policies, insureds will have an ability to significantly increase their fiduciary limits.
3. **Claims Handling:** A blended D&O and fiduciary program may afford certain efficiencies in the claims handling process if a securities class action and an ERISA “tag along” case are filed. However, certain aspects of claims handling, including selection of counsel, may still be somewhat problematic. With regard to the ERISA “tag along” case, many insurers may exercise their right and duty to defend under the fiduciary portion of the policy and can appoint specific ERISA litigation counsel to represent the insured.
4. **Application of Retention:** In a truly blended D&O and fiduciary program (in which the policy is not written with separate coverage sections), the Insured may be responsible for only one retention (rather than two) if the insured sustains both a securities class action and an ERISA “tag along” case. In a truly blended program, the “tag along” case and the securities class action would likely be viewed as “interrelated wrongful acts.” However, in some blended programs, the D&O and fiduciary insurance are written as separate coverage sections, and separate retentions may apply to each section. In structuring a blended program, a goal should be to structure the program in such a way that only a single retention would apply to any “Loss.”

Disadvantages of Blending Coverage

1. **Erosion of Limits/Costs of Additional Limits:** There is a risk that, in a blended program, the payment of a Fiduciary claim may erode a substantial portion of the limits available to the insureds for other losses, most notably D&O losses. This concern may be minimized by purchasing additional limits and/or sublimiting the fiduciary coverage. However, much of the cost savings of a blended program may be lost if additional limits need to be purchased.

2. **Claims Handling:** Even in the case of a blended program, if there is an ERISA “tag along” claim, except where the insured is specifically given the right to select counsel, the insurer is likely to invoke its right and duty to defend and may select its preferred counsel to represent the insureds.
3. **Potential Issues With Continuity of Coverage:** In blending coverage, there is a potential issue with continuity of coverage. Specifically, the insurers that would come on to the program in excess of the current fiduciary limits may seek to impose a current continuity date. Likewise, insurers who participate on the current D&O program but not on the current fiduciary program may not want to grant continuity for the “new” fiduciary coverage and may attempt to add a pending and prior litigation exclusion at inception.
4. **Sharing of Limits:** Independent directors may oppose sharing their limits with ERISA fiduciaries and the employee benefit plan.

Advantages of Standalone Coverage

1. **Erosion of Limits:** With separate standalone coverages, there is no risk that an ERISA claim may erode a company’s D&O limits. Where there is a securities class action and an ERISA “tag along” claim,” both policies may ultimately respond to the loss.
2. **Capacity Is Available:** Sufficient fiduciary capacity remains available, even though there have been changes in the insurance marketplace. So, while costs of a standalone program may be greater, there is still the ability to purchase adequate limits for both D&O and fiduciary liability.

Conclusion

Many of Marsh’s clients have considered blended D&O and fiduciary coverage, but the majority continue to purchase standalone programs. Still, a blended program may be appropriate, depending on the insured’s risk profile and overall placement goals. Additionally, many of the deficiencies of a blended program may be able to be mitigated with careful policy drafting.

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