Introduction

A perfect storm is brewing for Canada's pension plans and employers are becoming concerned. Anemic returns due to low interest rates combined with longer life expectancy and a wave of retiring baby boomers threatens to overwhelm some pension plans. Employers are looking for strategies to limit their exposure. Such de-risking strategies, including plan conversions and other plan modifications, carry significant risk of litigation by beneficiaries against plan fiduciaries. Such litigation can be costly, protracted and may threaten not only the plan assets, but the personal assets of fiduciaries as well.

In this heightened exposure environment the transfer of some of a company's pension fiduciary risks to insurance is a cost-effective method to protect both corporate, personal and plan assets. The added protection, beyond the corporate indemnity, for the individuals involved in the plan administration will also help retain and attract qualified personnel.

Even a well-managed plan can be subject to litigation from a single plaintiff or group of plaintiffs. Allegations can range from a breach of fiduciary duty to misleading representations or conflicts of interest. The legality of using plan assets to defend litigation is questionable, and could potentially lead to additional exposures of both a trust and statutory nature. This whitepaper outlines the increasing risk environment and personal asset exposure, and provides a brief overview of Fiduciary Liability insurance.

Risk environment – increasing

The increasing risk in the current environment is evidenced by:

- Proposed amendments to provincial and federal legislation and regulations
- Recent court decisions
- Mergers and acquisition activity
- Corporate decisions to amend employee benefits, coupled with increasing funding obligations and changing demographics
- Conversion of plans from “defined-benefit” to “defined-contribution”

Although pension law reform in Canada is long overdue, uncertainty remains as to where the law is headed. The combination of unfavourable economic conditions and laws in transition make for a very dangerous cocktail with respect to fiduciary liability. This liability will attach to individuals who hold positions of trust in administering the property of others. While fiduciary relationships may be created by statute, individuals may also be deemed fiduciaries at common law. The responsibilities and duties undertaken by an employee with respect to a plan, rather than the job title of the employee, will determine whether or not that employee is in a fiduciary relationship with plan beneficiaries.
Personal asset exposure

Anyone who undertakes fiduciary responsibilities for a pension or benefit plan—whether they are plan administrators, pension committee members, or directors and/or officers of a sponsor company—faces increasing personal liability exposures due to a number of emerging trends.

Principles of trust law have been advanced by pension beneficiary lawyers and considered by the courts, widening the scope of liability faced by those charged with the management of plan assets. Class-action lawsuits are on the rise. In addition to being the perfect low-risk vehicles to advance claims on behalf of plan beneficiaries, they present a specialized and aggressive plaintiffs’ bar with substantial fee-earning opportunities.

A fiduciary relationship is defined as “one founded on trust or confidence reposed by one person in the integrity and fidelity of another.” A fiduciary must act with the utmost good faith and a heightened sense of loyalty toward beneficiaries. Fiduciary relationships may be created expressly or by operation of statutory or common law, and in Québec, by the Civil Code. Some commonly known fiduciaries are corporate directors and officers, pension and health plan administrators, pension committee members, trustees, lawyers, financial planners.

In Canada, the Pension Benefits Standards Act, the Canada Pension Plan Act as well as provincial pension legislation impose personal liability on fiduciaries for losses, shortfalls and mismanagement of pension plans. In the United States the Employee Retirement Income Securities Act (ERISA) functions in much the same way.

Evolving legislation

Several provinces have amended pension laws or are in the process of enacting reform. Alberta’s new Employment Pension Plans Act (EPPA) received Royal Assent on December 10, 2012 and is expected to come into force in January, 2014. The EPPA has been billed as a complete rewrite of Alberta’s current pension regime. The EPPA amends, and creates, new plan types and features. In addition, the EPPA places the plan administrator in an explicitly fiduciary capacity in relation to plan members and other beneficiaries and creates an obligation that such administrator “act honestly, in good faith, and exercise the care, diligence and skill that a person of ordinary prudence would use in dealing with the property of another person.” The EPPA also eliminates prescribed classes of employees with respect to pension membership, institutes immediate vesting and eliminates “partial wind-ups.” EPPA also implements an Administrative Monetary Penalty (AMP) regime for various statutory breaches and offences. AMPs are an increasingly used enforcement tool in legislation aimed at driving compliance with statutory provisions. These non-criminal fines may be insurable and fiduciaries should consult with their insurance brokers in order to determine if favourable language providing coverage can be procured.

Recently in Ontario several changes to the Pension Benefit Act came into force, including grow-in benefits being available to members with at least 55 points who are involuntarily terminated, immediate vesting of benefits and the use of letters of credit for solvency funding in certain conditions. Several more changes are proposed for 2014.

On February 1, 2013 the Supreme Court of Canada (SCC) rendered its long-awaited decision in Sun Indalex Finance (“Indalex’), LLC v United Steelworkers. The decision clarified how the law balances the interests of pension plan beneficiaries of an insolvent organization with the organization’s other creditors. Despite ruling in favour of the “debtor-in-possession” lender, the case also highlighted the conflict that can exist between a corporation’s fiduciary duties to plan beneficiaries and its corporate interests with respect to business decisions about benefit plans (termed “settlor duties” in the United States). While the conflict between these dual roles is not resolved by the SCC decision, the judgment directly addressed this “dual role” conflict and advised debtors to bring the conflict to the CCAA judge overseeing any restructuring to ensure that the interests of plan beneficiaries are fully represented in restructuring proceedings.

Merger and acquisition activity can often trigger lawsuits. Pension beneficiaries of companies that have merged into, or been acquired by, other companies often commence legal action for any number of reasons: to obtain severance benefits; to access the excess cash in defined-benefit plans; to rectify plan distributions that were incorrectly calculated; to revert back to previous benefits when current benefits are less generous; or to ensure that enough money was transferred to the new company’s plan.

In addition to increased governance in these situations, plan sponsors would be wise to review possible risk transfer solutions.
Fiduciary Liability Insurance

Although the actual pension plan contributions, and any deficiencies, are generally not covered by insurance due to public policy considerations, defense costs for allegations for breaches of fiduciary duties may be. Given the propensity for multiple plaintiffs, the potential length of the class period and potential lack of clarity in historical pension documents, as well as the cost of qualified legal representation along with e-discovery costs, these claims are expensive to defend.

It is vital to understand how Fiduciary Liability Insurance can help protect companies, their fiduciaries and the benefit plans they manage against fiduciary liability claims. As each fiduciary liability policy is unique, it is important to understand the major coverage provisions including the insuring clause, its definitions, exclusions, claims-made format, waiver of recourse, notice of claim and other terms and conditions.

The Commercial General Liability Insurance policy offers only limited protection, via an endorsement, for errors and omissions in the administration of employee pension and benefit plans. It does not provide protection for fiduciary liability for sponsoring employee pension and benefit plans. The typical Directors’ and Officers’ Liability policy excludes coverage for fiduciary liabilities stemming from employee pension and benefit plans. Finally, fidelity bonds do not protect fiduciaries for breach of duty claims, as they are designed to provide coverage for the theft of assets by company employees, or in the case of an ERISA Fidelity Bond, by those engaged in the management of an ERISA plan.

The market for fiduciary liability continues to be stable, with ample capacity available, despite ongoing concerns that a prolonged period of low interest rates and the fallout from the 2008 housing market crash would create unfunded pension liabilities in the long term. Some insurance companies have begun to expand coverage to include wrongful acts stemming from a corporation’s role as settlor – that is, their business capacity – alongside their role as fiduciary, solving some of the allocation issues that have plagued fiduciary liability insurance. This type of coverage is offered as an optional policy enhancement via endorsement by some markets, and within the basic policy form by others.

Conclusion

As noted earlier, statutory and common law holds fiduciaries to an extremely high standard of conduct. A wide range of individuals involved in the administration of pension and benefit plans, including corporate directors, qualify as fiduciaries. Their responsibilities are broad, and their liability personal. It is therefore highly recommended that fiduciaries educate themselves about the risks they face, and purchase fiduciary liability insurance to guard against them. As such insurance is both unique and complex, it is also recommended that fiduciaries seek out insurance advice from the best qualified insurance professional. Obviously, the most effective method of pension de-risking is through robust and high level governance. However, risk transfer through insurance may provide an added measure of protection and aid in retaining highly qualified individuals to provide oversight and plan management.
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