



Management Liability Risks: Are You Covered?

Overview

As the economy continues climbing back from the abyss, recent studies show management-related liability claims are on the rise, in some cases, by double-digits. The entities on the sharp end of these litigation sticks were public and private, for profit and not-for-profit, large and small...in other words, organizations of virtually of every type, size and industry.

Protecting your organization against financial loss due to management liability issues can be viewed from three perspectives: fiduciary liability, employment practices liability, and directors and officers (*D&O*) liability. Professional organizations, such as accounting firms, law firms, and healthcare providers should add “*professional liability*” risks to the mix, but that’s a discussion for a future column.

Fiduciary Liability Insurance

Any organization that exercises discretionary authority over an employee benefit plan such as a retirement, profit-sharing, or health plan is a fiduciary. As a fiduciary, you are liable to your employees, and possibly their dependents, for failing to act in their best interests.

The risk exposures confronting fiduciaries grow more diverse, complex, and costly every year. The risks associated with 401(k) and managed healthcare plans are just the tip of the exposure iceberg. In 2010, healthcare reform legislation brought with it a whole new array of liabilities. Employers now face penalties, as well as litigation from employees, for failing to comply with the minimum standards for healthcare plans as defined in this massive legislation.

Fiduciaries can also be held liable for the errors and omissions of third-party service providers such as actuaries, attorneys, accountants, and investment advisers.

SNAPSHOT:

Every year brings an increasing number of management liability risk exposures. The core exposures are Fiduciary Liability, Employment Practices Liability, and Directors & Officers Liability.

Fiduciary liability insurance provides protection against legal liability arising out of the management of employee benefit plans, including the cost of defending against such claims. Some insurers offer a single policy addressing the risk exposures created by both retirement plans and health plans. Other insurers offer separate policies for each risk exposure.

For employers that do not provide retirement plan benefits, “*employee benefits liability*” coverage may be sufficient. This narrower form of insurance protects against claims arising out of the administration of a benefit plan, including the failure to enroll an employee in the plan; however, it specifically does not provide coverage for the imprudent investment of funds.

AT RISK:

Fiduciary Liability insurance protects the corporation against errors in administering employee benefit programs; Fidelity Bonds protects the corporation and the plan from fraud committed by plan trustees and key employees.

Employment Practices Insurance

Every employer, regardless of size or ownership structure, is a potential target of legal action from past, present and prospective employees. Recent studies estimate that three out of five firms will be sued by an employee. These suits can originate at any point, from the pre-hiring process to the exit interview, even from individuals who were never hired, or only with the company for a few days.

Employment Practices Liability Insurance (*EPLI*) was designed in response to the above trend and is a relatively new form of liability insurance. It covers discrimination (*age, sex, race, disability, etc.*), wrongful termination, sexual harassment, and other employment-related allegations.

While an employment lawsuit may be groundless, simply defending your organization against such a claim can be financially crippling. When reviewing *EPLI* proposals, determine whether defense costs are in addition to or included in the policy limit. In most cases, policies where defense costs are “*in addition to*” policy limits are more advantageous for the insured.

Directors & Officers Liability Insurance

A third component of the management liability discussion is Directors and Officers (*D&O*) liability insurance. *D&O* insurance protects corporate directors and officers in the event they are personally sued for management related actions. This insurance typically covers legal fees, settlements, and other costs.

Virtually all public companies purchase *D&O* insurance as it is almost impossible to attract investors and directors without this coverage. However, such is not the case with private companies.

Many owners of closely held companies, particularly family owned companies, do not purchase D&O insurance under the belief it is unlikely they will be involved in a D&O lawsuit because “*we have too few shareholders*”, “*we’re all family here*” or “*we’re covered*”.

Unfortunately, this perspective overlooks the fact that D&O claims frequently originate from a much broader base: customers, vendors, competitors, suppliers, employees, government regulators, creditors, etc. It also incorrectly assumes directors and officers are covered by general liability, fiduciary liability and employment practices liability policies, which in most cases, they are not.

“WE’RE FAMILY”:

Many family-owned firms do not purchase D&O liability coverage based on the premise their shareholders will not sue. This logic overlooks the major source of D&O claims -- *non-shareholders*.

One recent survey indicated the cost to settle and/or litigate a D&O case averaged more than \$225,000 and losses on the high end approached \$5 million.

For small and middle-market organizations, the incremental cost to obtain D&O coverage can be almost nominal if you are already purchasing other forms of management liability insurance.

Conclusion

While this is a simplified review of management liability risk exposures and the insurance coverages that can protect against financial loss (*or ruin*), it should help you assess your own risk management strategies. When assessing insurance options, some management liability policies may include coverage for additional risks such as privacy/cyber liability (*identity theft*), crime and kidnap/ransom. Talk to a qualified insurance broker to develop a comprehensive protection plan for your organization.

This notice is provided as information only and should not be considered a legal opinion. If you have questions, contact Seacrest Partners at 912-544-1900.
