

## Answers to 5 Liability Questions

Save you Money, Time & Headaches

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## Take aways

- Do not guess at your coverage
  - Avoid "gray areas" of intent
  - Whenever possible, get affirmative coverage
- Mandated Broker/Dealer Coverage may not be enough
  - If you are a "fiduciary", you need affirmative fiduciary coverage
- ERISA Bonds for Investment Advisors are required if you have **any** discretionary authority
- Be prepared
  - Client may want to see your insurance policy
- Minimize Underwriter questions
  - The better the submission, the better potential premium

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**Just because you have Insurance  
It does not  
mean you are  
covered !**



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## Does my policy cover Fiduciary Exposure ?

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### What the experts say

What the "Final" DOL Regulation Means  
- Fred Reish, Bruce Ashton, and Jason Roberts

*"Affected firms should begin by undertaking a review of their errors & omissions policies to ensure that the proffered method of advice delivery is covered and to determine whether there are any exclusions to providing advice as fiduciaries."*

Quoted from the Reish, Lufman, Reicher & Cohen Bulletin Newsletter with permission.

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### Policies can be written in 1 of 4 ways

- Absolute ERISA Exclusion
- Silent on ERISA Coverage/Exclusion
- Limited Coverage
- Affirmative Coverage

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## Fiduciary Coverage

- **Absolute ERISA Exclusion**
  - This policy does not respond to any claims arising from professional services rendered as a fiduciary under ERISA
- **Silent on ERISA Coverage/Exclusion**
  - Professional Services defined as registered Investment Advisor, Reg/Rep, or Life Insurance Agent for others for a fee.
- **Limited Coverage**
  - Does not respond to any claims arising from professional services rendered as a fiduciary under ERISA, unless you are considered a fiduciary solely for professional services rendered.

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## Affirmative Fiduciary Coverage

1. Section 8 DEFINITIONS 8.7 **Covered Act** is amended to add the following:  
  
**Covered Act** also means a **Fiduciary Act** by you, during the Policy Period and after the retroactive date stated in the Declarations.
2. Section 8 DEFINITIONS is amended to add the following definitions:  
  
**Administration** means:
  - (a) counseling Employees, beneficiaries or **Plan** participants with respect to any **Plans**; or
  - (b) providing interpretations with respect to any **Plan**; or
  - (c) handling records in connection with any **Plan**; or
  - (d) enrolling, terminating or canceling employees under any **Plan**.**Benefits** mean retirement, health or welfare **plans** established by **your** client for Employees of **your** client.  
  
**Fiduciary Act** means any actual or alleged:
  - (a) breach of the responsibilities, obligations or duties imposed upon any of **you** in **your** capacity as a fiduciary of any **Plan**, other than a **Plan** organized for the benefit of **you** or **your** employees, by, (i) ERISA; (ii) HIPAA; or (iii) the common or statutory law of the United States of America or any other jurisdiction anywhere in the world; or
  - (b) other matter claimed against **you** solely because of **your** service as a fiduciary of any **Plan**; or
  - (c) act, error or omission solely in the **Administration** of a **Plan**.

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## Am I required to carry an ERISA Bond ?

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### ERISA States:

ERISA section 412 and related regulations (29 C.F.R. § 2550.412-1 and 29 C.F.R. Part 2580) generally require:

- Every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan **shall be bonded**.
- ERISA's bonding requirements are intended to protect employee benefit plans from risk of loss due to fraud or dishonesty on the part of persons who "**handle**" plan funds or other property.

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### Exemptions:

• Every person who "*handles funds or other property*" of an employee benefit plan within the meaning of 29 C.F.R. § 2580.412-6 (i.e., a plan official) is required to be bonded unless covered under one of the exemptions in section 412 for certain

- **Banks**
- **Insurance companies**
- **Registered Brokers and Dealers**
- or by one of the regulatory exemptions granted by the Department in its regulations

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### Exceptions:

A person who provides investment advice, but who **does not exercise or have the right to exercise discretionary authority with respect to purchasing or selling securities or other property for the plan**, is not required to be bonded solely by reason of providing such investment advice

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## Handling

The term "handling" carries a broader meaning than actual physical contact with "funds or other property" of the plan. A person is deemed to be "handling" funds or other property of a plan so as to require bonding whenever his duties or activities with respect to given funds or other property are such that there is **a risk that such funds or other property could be lost in the event of fraud or dishonesty on the part of such person**, whether acting alone or in collusion with others.

### And

If the committee makes investment decisions for the plan, are the committee members "handling" plan funds or other property?  
Yes, **if the committee's investment decisions are final and not subject to approval by someone else**, the committee members are "handling" within the meaning of 29 C.F.R. § 2580.412-6, and each committee member must be bonded.

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## Who is responsible for bonding?

The responsibility for ensuring that plan officials are bonded may fall upon a number of individuals simultaneously. In addition to a plan official being directly responsible for complying with the bonding requirements in section 412(a) of ERISA, section 412(b) specifically states that it is unlawful for any plan official to permit any other plan official to receive, handle, disburse, or otherwise exercise custody or control over plan funds or other property without first being properly bonded in accordance with section 412. In addition, section 412(b) makes it unlawful for "any other person having authority to direct the performance of such functions" to permit a plan official to perform such functions without being bonded. Thus, by way of example, **if a named fiduciary hires a trustee for a plan, the named fiduciary must ensure that the trustee is either subject to an exemption or properly bonded in accordance with section 412, even if the named fiduciary is not himself or herself required to be bonded because he or she does not handle plan funds or other property.**

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## ERISA Attorneys Interpretation

- "A person who advises a plan as to the investment of plan assets, but does not have discretionary authority, will be a fiduciary if the advice is provided on a regular basis and is customized to the particular need of the plan"
- "Bonding is required regardless of whether the fiduciary has custody of or otherwise actually handles assets of the plan, because the bonding rules apply to all plan fiduciaries who have these rights or powers (with noted exceptions)"

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Have all the custodians who hold the assets for the ERISA plans for which you provide advice been advised in writing never to release client assets back to anyone from your firm?

Yes \_\_\_\_\_ No \_\_\_\_\_

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Is an Investment Adviser ERISA Bond, same as a Fidelity Bond ?

- ERISA Bond has \$0 deductible
- ERISA Bond calculates limits on plan assets up to \$500k
- ERISA Bond specific to each plan and liquid
- Fidelity Bond is blanket over all plans
- Fidelity Bond, regardless of limit, may not meet ERISA requirements per plan

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Is sufficient coverage provide by Broker / Dealer ?

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## Maybe !

- Many Broker/Dealer policies do not offer fiduciary coverage or offer very limited fiduciary coverage.
- Be a smart consumer and know before hand if your current policy provides affirmative fiduciary coverage.
- Do not take the insurance broker or Broker/Dealer's representations for they often they believe there is coverage. Get written confirmation or a copy of the actual policy with all endorsements

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## Do I have Fiduciary Coverage?

- The only correct way is to read and understand the full policy including all endorsements.
- Policies are all worded different and often contain coverage restrictions and contradictory clauses on policy coverage intent.

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Eight disadvantages of maintaining your professional liability insurance ONLY through your Broker/Dealer

**1. Not portable**

Insurance through your Broker/Dealer (B/D) is tied directly to the services you provide for that B/D. If you move to another B/D, or move on to provide other services, you can not take your insurance coverage with you.

**2. Prior acts coverage may end when you leave the Broker/Dealer**

In addition to not being portable, you will typically lose your prior acts coverage (coverage for previous work that you performed) when you move to another B/D.

**3. Limits may be eroded by other Registered Representatives claims**

The aggregate limit on a B/D policy is typically shared by all of their Registered Reps. Therefore, claims against other Representatives may reduce your available coverage.

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Eight disadvantages of maintaining your professional liability insurance ONLY through your Broker/Dealer

**4. May not cover other services or products outside of those provided by the Broker/Dealer**

A typical B/D policy will only provide coverage for services and products provided with that named B/D

**5. May exclude RIA activities**

The B/D policy may not cover all of the services that you provide and typically will not provide coverage for RIA services.

**6. May exclude entity coverage**

A B/D policy is intended to provide coverage for the individual representative of the B/D. Coverage may not be provide for you entity.

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Eight disadvantages of maintaining your professional liability insurance ONLY through your Broker/Dealer

**7. May limit best options as a fiduciary**

Not all policies are the same and with increasing scrutiny on fiduciary responsibilities, you want to make sure your policy provides coverage for your role as a "fiduciary".

**8. No ability to amend coverage as a certificate holder**

As a certificate holder of your B/D's coverage, you do not have the ability to amend coverage as necessary to your specific needs.

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 Just because you have Insurance  
It does not mean you are covered!



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How do I use Insurance as Marketing Tool ?

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*“Sixty-nine percent of the advisers pointed to clients’ lack of trust in their old firms as their primary reason for defecting. Sixty-four percent said they switched firms because they wanted more-personal advice.”*

Investment News By Darla Mercado, March 4, 2009.

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### Trend from Broker/Dealers to smaller Investment Advisors

- Now is the time to tell you potential new clients that you have the skills, knowledge and experience to protect your client's assets and can provide them with specific investment advice that meets their long and short terms objectives.
- In addition, your firm carries E & O insurance with **affirmative** fiduciary coverage.
- For those clients where your firm had discretionary authority over their ERISA assets, you have ERISA bonding as required under ERISA 412.

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### Trend from Broker/Dealers to smaller Investment Advisors

- Complementary to this your firm also maintains employee dishonesty coverage that protects client funds.
- Providing evidence of insurance in advance in either a RFP or any other type meetings will make your firm stand out and will set out expectations for other Investment Advisors that the potential client might interview.

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### Insurance Checklist

- E&O Insurance with affirmative fiduciary coverage
- Investment Adviser ERISA Bond
- Employee Dishonesty Insurance
- Have talked with client about First-party Fiduciary Insurance

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### Average Cost of Fiduciary Insurance

| Plan Assets                 | Avg. Premium*     |
|-----------------------------|-------------------|
| \$1,000,000 - \$5,000,000   | \$300 - \$1,325   |
| \$5,000,000 - \$10,000,000  | \$1,000 - \$2,200 |
| \$10,000,000 - \$25,000,000 | \$1,850 - \$3,500 |
| \$25,000,000 - \$50,000,000 | \$3,500 - \$5,000 |

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\*Premium are averages only and for demonstrative purpose only. Actual premium determination will be subject to review of completed application. Based on Defined Contribution Plans.

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Just because you have Insurance  
It does not mean you are covered!



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How do I get  
Discounts on Insurance ?

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## Underwriting requirements

Underwriters will review the following information before providing pricing, limits and deductibles when quoting this investment adviser consultant exposure:

- Investment Advisers/Consultants application
- Asset types
- Asset under management
- ADV or other marketing information
- Manager experience
- Prior claims experience
- Designations
- Client contracts

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## Secrets of discounts

1. QC Quality Controls: what distinguishes your firm from a risk management perspective?
2. What designations do you and your employees hold?
3. Why do you feel your firm is a superior risk for the carrier
4. CEFEX Certified

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## Secrets of discounts

5. Claim narratives, what to say and what not to say (example) this was a frivolous claim that had no merit and we were disappointed that the carrier paid out anything....
6. Why my ADV11 is completely different from my application and what should I add so the Underwriter can assess my risk accurately
7. SEC audits why your response letter may need additional information and clarification.
8. Does your firm utilize other professionals , ERISA attorney, Compliance Consultants that should make a difference to the Underwriter.

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## Take a ways

- Do not guess at your coverage
  - Avoid "gray areas" of intent
  - Whenever possible get affirmative coverage
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  - If you are a "fiduciary", you need affirmative fiduciary coverage
- ERISA Bonds for RIA's are required if you have any discretionary authority
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  - The better the submission, the better potential premium

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## Resources

- [www.InvestmentAdvisorInsurance.com](http://www.InvestmentAdvisorInsurance.com)
  - Information on E & O
  - Information on Advisor ERISA Bonds
- [www.fiduciaryinsurance.com](http://www.fiduciaryinsurance.com)
  - Tutorial and presentation
  - Estimated Premiums
- Questions
  - Tom Schrandt
  - TomS@naplia.com
  - 1-866-262-7542

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