

# healthcare report

VICTOR O. SCHINNERER & COMPANY, INC.

Information and Risk Management Ideas for Healthcare Professionals

## MANAGING FIDUCIARY RESPONSIBILITIES IN HEALTHCARE ORGANIZATIONS

### The Contraction of the Economy Creates Systolic Risk

#### PART III

Welcome to the third part in a special multi-part series on the effects of the down economy and how healthcare organizations can manage the risks that come with increased pressure to stay profitable while managing staff and patient needs. This third issue discusses fiduciary liability. Go to [www.DandORx.com/riskmanagement.html](http://www.DandORx.com/riskmanagement.html) to read the first two issues on directors and officers (D&O) liability and employment practices liability.

Organizations in the healthcare industry have complex managerial requirements. With that complexity comes a higher likelihood that mistakes may be made. Often, such organizations focus intensely on their delivery of services and less so on their internal operations. Now, however, the increased public scrutiny that such organizations face, coupled with the economic downturn that has restricted staffing and amplified concern over pension and benefit programs, creates increased exposure for in-house and contracted administrative personnel.

Government requirements of clarity and transparency increase the likelihood of a situation where an employee can bring a claim of mismanagement or negligence against an organization. As such, interest in the healthcare industry includes a demand for quality not only in the application of services, but also in the operation of internal programs.

#### **Fiduciary Liability Is Often an Unrecognized Risk**

Any employee who has discretionary authority over a benefit plan or who assists in its administration can be

exposed to liability. The role the employee is filling is that of a fiduciary. As a fiduciary, the employee and the organization the employee represents have a high level of risk.

A fiduciary duty represents the highest standard of care in either equity or law. A fiduciary is expected to be extremely loyal to the organization to whom a duty is owed, and the duty must be carried out with diligence and competence. Too often, however, this important obligation is muddled in the routine administrative duties of the organization.

For instance, fiduciaries of employee benefit plans are expected to act in the best interests of the plan participants. Under the Employee Retirement Income Security Act of 1974 (ERISA), if this duty is compromised either intentionally or unintentionally, fiduciaries can be held personally liable for losses. Obviously, a plan administrator must meet that level of fiduciary responsibility, but so too must a human resources employee or any other employee who helps to administer a plan.

Increasingly, employees who perceive that they have been wronged by a plan administrator react by filing lawsuits. Fiduciaries are the targets for such lawsuits. The valuable protection that such plans afford to their participants and the recent downturn in benefits makes such suits more likely than ever. Such actions can be extremely costly to defend and settle.

#### **Pension Plans May Be at a Critical Status**

Employees are concerned over pension funding. Coupled with recent court decisions that define a broader range of possible plaintiffs harmed by improper decisions, the result may be increased litigation from beneficiaries.

ERISA requires that anyone who exercises discretionary control over a pension or retirement plan to protect the plan's assets by acting solely in the interest of its participants. In other words, if an employee believes that the plan's administrator has not been acting at this high level of responsibility, the employee may sue the administrator. If plan mismanagement is determined, the

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plan sponsor or anyone who makes administrative decisions regarding the plan can be held liable. These ERISA-based complaints can be made against third parties such as consultants, asset managers, and actuaries, even while holding the plan sponsor liable.

## Other Benefit Plans Often Engender Litigation

In addition to pension investment plans, other employee benefit plans also require administration that rises to the level of fiduciary responsibility. Increasingly, employees are cognizant of performance that does not meet their expectations. That recognition can lead to lawsuits alleging intentional or negligent administration.

Litigation can be a significant financial burden because defense usually occurs over several years, which is a continuous drain on an organization's financial resources. The financial burden can become the personal responsibility of an organization's leadership or employee. If there are no assets to defend and indemnify the individual, or if such protections are not lawful because of the specific allegations, such responsibility can lead to financial disaster. The personal assets of the organization's directors, officers, and employees may be at risk.

The most frequently alleged claims against fiduciaries include significant

mismangement issues, such as the breach of responsibilities or fiduciary duties imposed by ERISA, the wrongful termination of a plan, the failure of the organization to adequately fund a required or offered benefit program, and errors during cash balance plan conversions. Simple administrative actions or inactions can lead to tremendous losses and costs, as demonstrated in the examples on the following page.

## Organizations Need Sound Management Now More Than Ever

Hospitals and healthcare organizations can reduce their fiduciary liability exposure by good loss prevention procedures, such as seeking and following the advice of independent experts, selecting diverse and financially sound investments, and taking the time to attend to plan and operational details. Unanticipated risks are best mitigated through insurance protection.

Organizations need broad management liability insurance protection, including fiduciary liability coverage. Broad coverage is necessary to protect organizations from both vicarious liability for the negligence of others within their control and for specific risks, such as personal information protection, errors in administration, and negligence in the conduct of benefit plans.

Organizations cannot entirely eliminate fiduciaries' personal liability. A policy that provides liability protection for employees with discretionary authority over a benefit plan or who assist in the administration of a plan should include these protection features:

- Broad definitions of insureds, covered plans, plan administration, wrongful acts, claims, and covered employees.
- Automatic coverage for claims made against an insured's spouse or domestic partner for wrongful acts of the insured.
- Voluntary settlement program insurance coverage.
- Coverage for punitive and exemplary damages where insurable by law.
- Duty to defend.
- Loss prevention expertise.
- Worldwide coverage.

During this economic downturn and the resulting unprecedented challenges to the financial viability of organizations and the economic security of individuals, all in the healthcare industry should be concerned about protecting operations and financial stability through appropriate practices and suitable and responsive insurance coverages, including coverage for the organization's fiduciary exposure.

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## FIDUCIARY LIABILITY CASE STUDIES

### **Denial or Change of Benefits**

A management-level employee at a hospital died in an automobile accident. The employee's group life insurance paid a benefit to the employee's spouse equal to two times the employee's salary. The spouse, as the primary beneficiary of the insurance policy, claimed that the amount was in error because, prior to the accident, the employee had requested that the insurance be changed to five times the employee's salary. After denying that the change had been requested—and thus denying the claim for the additional insurance payment—the hospital was sued by the spouse. During litigation, it was determined that the employee had requested an increase in the amount of the group life insurance coverage, but the request had not been properly processed. As a result of the investigation, the hospital settled the beneficiary's case for more than \$250,000. The hospital also spent over \$25,000 on its defense.

### **Administrative Error**

A new employee of a management services organization (MSO) submitted her medical insurance plan enrollment forms to the MSO's health plan administrator, who erroneously failed to forward the enrollment forms to the insurance company. Receipt of the forms was a prerequisite to coverage. A few months later the employee required surgery; coverage for the surgery was denied by the medical insurance plan because there was no valid enrollment. The denial of benefits was challenged and the MSO ended up paying directly for the medical fees and surgery, post-operative care, and the employee's attorney fees to pursue the claim. The case settled for more than \$350,000.

### **Negligence in the Administration of a Plan**

An employee of a healthcare association requested that the human resources department invest the employee's retirement plan savings in specific mutual funds. After a year, the employee questioned the poor performance of the retirement fund and discovered that the human resources department had mistakenly rolled the retirement fund not into the selected mutual funds, but into a money market fund that did not perform as well as the requested investment. Based on an allegation of negligence in the administration of the retirement plan, the employee demanded that the healthcare association rectify the error by adding the difference in earnings over the period to the employee's retirement plan. After an investigation, it was determined that the investments were erroneously made. After spending over \$5,000 in its defense, the healthcare association settled the claim by adding \$80,000 into the employee's retirement plan.

*Source: Chubb Group of Insurance Companies*