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How Excessive Fee Litigation is Changing the Fiduciary Insurance Market

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If you've handled a fiduciary liability insurance placement for a client in the last several months, you've likely noticed that insurance companies are implementing major changes for many plan sponsors. The reason is the dramatic risk from excessive fee litigation.

This article explores the drivers of the fiduciary market turn and steps you can take to prepare your clients for the changes.

What is Excessive Fee Litigation?

Plaintiff law firms have begun to flood federal courts with Employee Retirement Income Security Act (ERISA) class action litigation against defined contribution plans and the employees who agree to serve as fiduciaries for their company's retirement plans. With nearly 225 total lawsuits filed, and more than 85 in 2020, this litigation is particularly concerning as it's aimed at common, longstanding retirement plan investment options.

Plan fiduciaries have a duty under ERISA fiduciary law to ensure that plan investment management and recordkeeping fees are reasonable and that plan investments perform at a reasonable level. These lawsuits allege that defined contribution plan administrative and investment fees are too high, and that any investment performance that lags a benchmark is actionable negligence that should generate indemnity payments as well as high attorney fees to the firms bringing these lawsuits.

The damage models in this type of litigation can be staggering as even a small reduction of plan expenses or purported investment loss is enormous for large plans with large assets. Plaintiffs continue to develop and pursue new theories and trends, including claims based on investment options having modestly higher fees and/or slight underperformance as compared to plaintiffs' handpicked options as well as claims based on service providers' use of participant data to market-related services.

Plaintiffs are now targeting plans of all sizes – not just large plans. In the last two years, for example, plans with assets as low as $4.5 million have been sued.

State of the Fiduciary Liability Insurance Market

Fiduciary liability insurance represents malpractice insurance for fiduciaries of employee benefit plans. It covers plan fiduciaries and the plan itself against claims of breach of fiduciary duty or mismanagement of the plan.

Since 2015, carriers have paid an estimated $1 billion+ in settlements and well over $250 million in attorney fees. As a result, plan sponsors are facing sticker shock in their annual fiduciary liability insurance renewals.

Fiduciary insurers have started to re-underwrite their books of business by raising insurance premiums, increasing policyholder deductibles, limiting excessive fee retentions and adding limits or sub-limits to the amount of excessive fee or class action exposure. While most plans focus on premium increase, the key change in the fiduciary market is

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the increased level of policyholder retentions. Formerly routine renewals are now difficult to place, with many large plans having trouble finding adequate and affordable fiduciary coverage or facing $1 to $5 million in retention.

Another significant change is the requirements needed for renewal. Insurers are now requiring supplemental applications that ask excessive fee risk questions to evaluate each plan's approach to recordkeeping and investment expenses. Carriers will also often require production of the plan's participant rule 405 fee disclosure and the plan rule 408b2 fee disclosure. These fee disclosures outline the recordkeeping and investment fees paid by participants.

Mitigating Excessive Fee Litigation Risks

Plan sponsors can no longer rely exclusively on fiduciary insurance as a risk management plan to fund and absorb these losses. Plan committees need to learn from this loss trend and take proactive steps to mitigate their risk.

Every plan fiduciary should take the following list into every quarterly plan meeting to make certain your plan has a documented approach to ensuring plan fees are as low as possible.

- **Document your fee and performance reviews:** Review plan fees and investment performance quarterly and document the due diligence. Ensure that plan fees are reasonable based on industry benchmark.
- **Do not tie low fees to a percentage of assets:** Ensure that all plan recordkeeping fees are offered on a low, flat-per-participant rate, instead of a percentage of assets. If using a percentage, document why (i.e., if your plan has many accounts with small asset levels).
- **Engage in formal RFPs to reduce fees:** Conduct a formal Request for Proposal with plan vendors at least every three years. Fees have gone down dramatically in the last five years. If you have not acted to reduce fees, then your plan fees are likely higher than peer plans.
- **Include low-cost index funds:** Ensure that your plan has low-cost index funds, even if you have actively managed funds in your plan's investment lineup.
- **Ensure lowest-cost share fees available:** Have your investment manager certify that you have the lowest cost funds available.
- **Eliminate revenue sharing:** Reduce all recordkeeping expenses, or have these fees applied to participant accounts.

Given the heightened risk environment, plan sponsors should also hire an experienced consultant to review plan fees and investment performance annually. Even if your plan committee has diligently addressed and documented a thoughtful process to reduce plan fees, you may still need an expert to adequately mitigate plan risks and reduce fees. Large plan sponsors like Fidelity, Vanguard and T. Rowe Price have multiple mutual fund offerings with complex fee structures and only an experienced expert can determine if you have the lowest possible class of mutual fund shares and explain any hidden fees and pitfalls.

Conclusion

Plan sponsors now face increased fiduciary risk exposure and need to take affirmative risk management steps to address the risk. Amwins can help you prepare your clients to understand and address this novel risk exposure. We can also help you position your clients to secure the best possible fiduciary liability insurance terms in a difficult and changing market.

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