December 2020

Client Alert

Excessive Fee Litigation Upends the Fiduciary Liability Insurance Market

The recent rise in both frequency and severity of “excessive fee” cases has turned the Fiduciary Liability Insurance marketplace on its head, resulting in decreases in capacity as well as significant increases in pricing, retentions and underwriting scrutiny.

The first true wave of excessive fee litigation commenced in 2005. These complaints, filed on behalf of 401(k) plan participants, primarily alleged that plan fiduciaries breached their fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA) by overpaying for third-party plan administration and/or investment services. Since this time, plaintiffs’ firms have filed more than 240 excessive fee lawsuits. More alarming, over 85 excessive fee cases have been filed in 2020 alone – i.e., greater than four times the average number (21) filed in each of the previous three calendar years. Allegations included within excessive fee cases have also expanded.

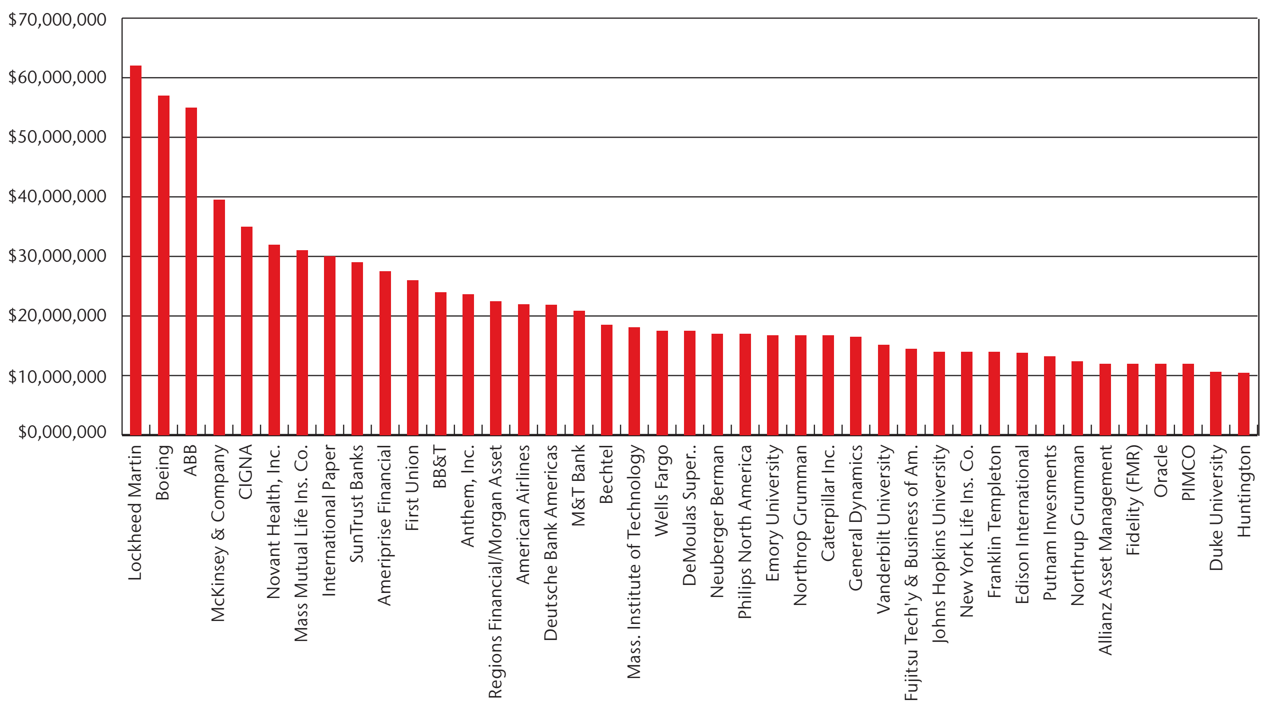
Plaintiffs often contend the fees charged have caused investment performance to suffer, and even second-guess the selection and type of the investments themselves. To that end, typical allegations in excessive fee litigation now include:

Record Keeping	Investments	Record Keeping & Investments
• Paying record keeping fees as a percentage of assets rather than on a fixed or flat-fee basis • Paying recordkeeping fees on a fixed or flat-fee basis at a higher cost per participant than other similar plans • Paying higher fees to the plan’s recordkeeper so the employer can receive other services from the recordkeeper (e.g., payroll processing) at or below market cost • Using revenue sharing that results in the payment of excessive fees to the plan’s record keeper	• Failing to remove underperforming investment funds • Failing to offer less expensive investment funds • Selecting actively managed funds when equivalent (and less costly) passive investment funds are available • Selecting a low-return money market fund as the plan’s “low risk” investment option versus a higher-return stable value fund • Allowing an excessive number of investment fund options or duplicate options within the same asset class	• Failing to leverage plan size to negotiate lower fees • Failing to competitively bid third-party services • Failure to monitor third-party fees/ performance

Sources: “401(k) Excessive Fee Litigation”, Steve J. MacGillivray, Eric F. Gladbach; “Workplace Class Action Litigation Report”, Seyfarth Shaw; “Minimizing The Risk of Costly 401(k) and 403(b) Investment Fund and Fee Lawsuits”, Jordan Schreier, Dickinson Wright PLLC (appearing in www.advisen.com); “Excessive Fee Litigation is Getting Excessive”, Mark E. Bokert and Alan Hahn (appearing in Employee Relations Law Journal)

Excessive fee litigation is both expensive to defend and costly to settle. Indeed, over 40 cases have settled for over $10 million as reflected in the following chart:

Excessive Fee Litigation Settlements > $10M



Excessive fee litigation has impacted multiple industry sectors including private universities and their analogous 403(b) plans. However, Fiduciary Liability Insurance underwriters consider Financial Institutions (FIs) – particularly those offering their own proprietary funds as an investment option within the plan – as having an even greater exposure. Claims have been made against FIs, for example, on the basis that they allegedly breached their fiduciary duty to their employees by profiting from their proprietary funds and related recordkeeping charges. Notably, over half of the settlements exceeding $10M involve FIs.

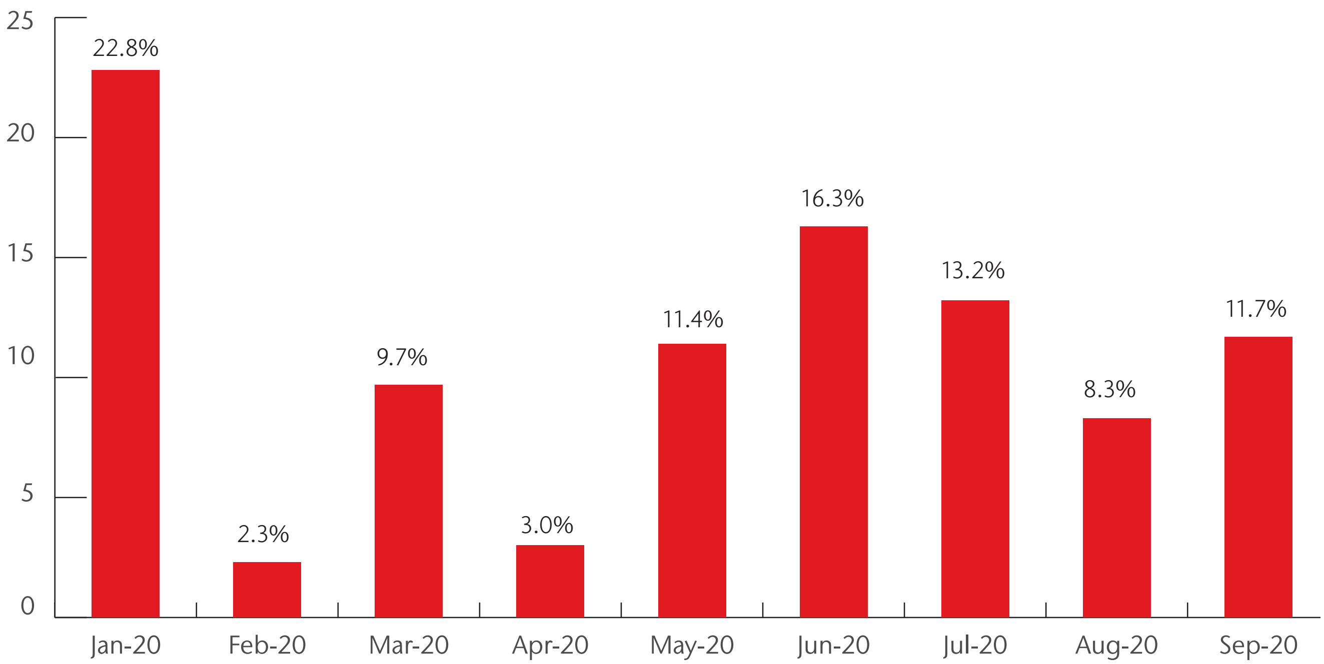
Fiduciary Liability Insurance Implications of Excessive Fee Litigation

In response to the rise in frequency and severity of excessive fee litigation, Fiduciary Liability underwriters have undertaken the following actions:

Reduced Capacity: Regardless of industry sector, insurers have been reducing capacity offered on any one program, and rarely offer primary limits of liability greater than $10 million. For FIs that offer proprietary funds (or even non-traditional FIs that have subsidiaries offering proprietary funds), capacity has been adversely impacted with several insurers leaving the space. Further, some insurers have effectively reduced capacity by imposing absolute excessive fee exclusions for FI and Higher Education insureds.

Increased Pricing: Not surprisingly, Fiduciary Liability premiums have increased significantly. Aon's proprietary pricing data reflects that primary pricing has increased in each month (year-over-year) in 2020, with even higher increases on excess layers that have historically had low increased limits factors.

Further, overall program pricing has increased by double digits in four of the last five months:



Per FSG Quarterly Pricing Index (as of October 8, 2020)

Higher Retentions: Many insurers are mandating much higher retentions for excessive fee claims, particularly for Insureds with plan assets greater than $500 million. Depending upon the Insured's risk profile, one insurer requires co-insurance for excessive fee claims, while yet another offers Insureds the choice between: (a) sublimits for excessive fee claims, or (b) significantly higher retentions for all forms of mass/class actions and derivative claims.

Underwriting Scrutiny: Insurers are now requiring that Insureds answer numerous supplemental application questions concerning their selection of third-party service providers, their procedure for assessing the reasonableness of associated fees, the plan's investment lineup including any proprietary funds, and the like.

Looking Forward

Excessive fee litigation has dramatically altered the Fiduciary Liability Insurance marketplace to the detriment of Insureds. To optimize renewal results, Insureds should start the process early and be prepared to market their program among several insurers to generate competitive pricing, retention and terms. Aon also recommends scheduling a call between the Insured (including the Head of HR/Benefits) and the underwriters to communicate all steps taken by the Insured to mitigate their risk against excessive fee litigation.