July 2021

Client Alert

What Drives Fiduciary Liability?

Survey of Leading Carriers for Fiduciary Liability Insurance

Executive Summary

Aon surveyed 12 top carriers for fiduciary liability insurance to understand their views on the biggest sources of fiduciary risk within the control of fiduciaries for defined benefit (DB) and defined contribution (DC) plans subject to ERISA. Key takeaways from the results of this survey are:

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1. Fees are very important
2. Committee minutes are important, but it matters less who takes them
3. Investment advisors are viewed as a moderate influencer of premiums
4. Employer stock in DC plans remains a top concern for insurers
5. Environmental, social, and governance (ESG) options in DC plans play a minor role in pricing fiduciary liability insurance

There is usually not a rigid formula for pricing, and factors that clearly influence pricing generally fall under the themes of good governance: having the right people and resources in place to act in the best interest of participants, while documenting the process and decisions well.

Introduction

Fiduciaries for employee benefit plans subject to the Employee Retirement Income Security Act (ERISA) are often concerned about fiduciary liability, as they are personally liable for fiduciary failures, meaning that their personal assets could be at risk. As a practical way of addressing this risk, it is common for fiduciaries to want to understand and focus on the biggest sources of fiduciary liability. While there are many ways to assess this risk, one way is to ask insurance companies providing fiduciary liability insurance coverage about what drives their pricing. Companies providing fiduciary liability insurance are well-informed of the factors that influence fiduciary risk and incorporate that into their pricing. Fiduciary liability insurance pricing varies greatly from a few thousand dollars per $1 million of limit purchased to over $25,000 per $1 million in limit. Understanding what drives pricing for fiduciary liability insurance is not just about managing those insurance costs, but also about understanding and managing fiduciary risks themselves—that is, avoiding a lawsuit altogether.

To this end, Aon surveyed top insurance companies providing fiduciary liability insurance coverage to understand how plan management typically impacts pricing for fiduciary liability insurance. Our survey focused on areas within the control of fiduciaries, as opposed to other factors such as plan size. For each area, we simply asked insurers to characterize the impact on premiums into three options:

- Significant
- Small
- Nonexistent

Their answers were revealing. We'll provide the detailed quantitative results, then share our interpretations as five key takeaways from the survey.

Continues

We're here to empower results

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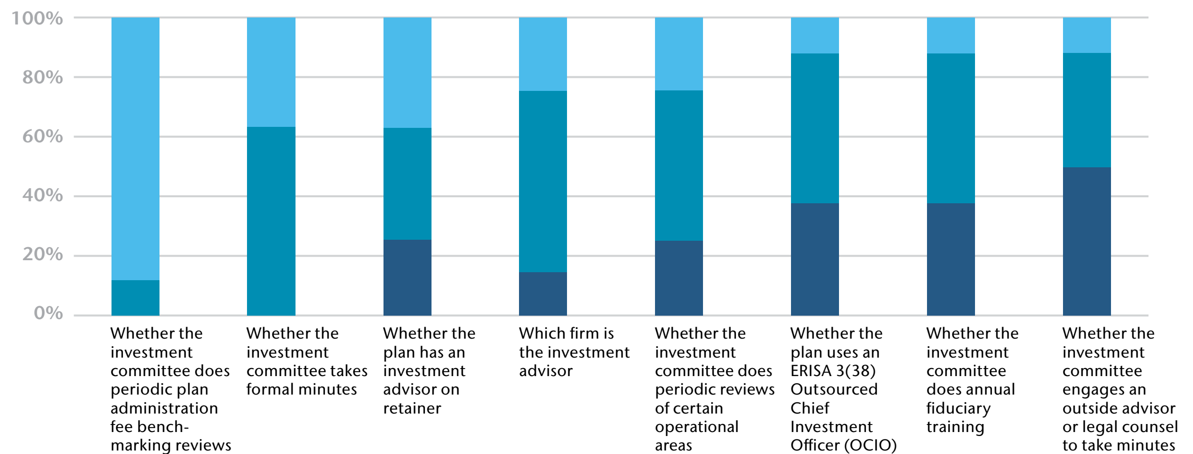
Quantitative Results

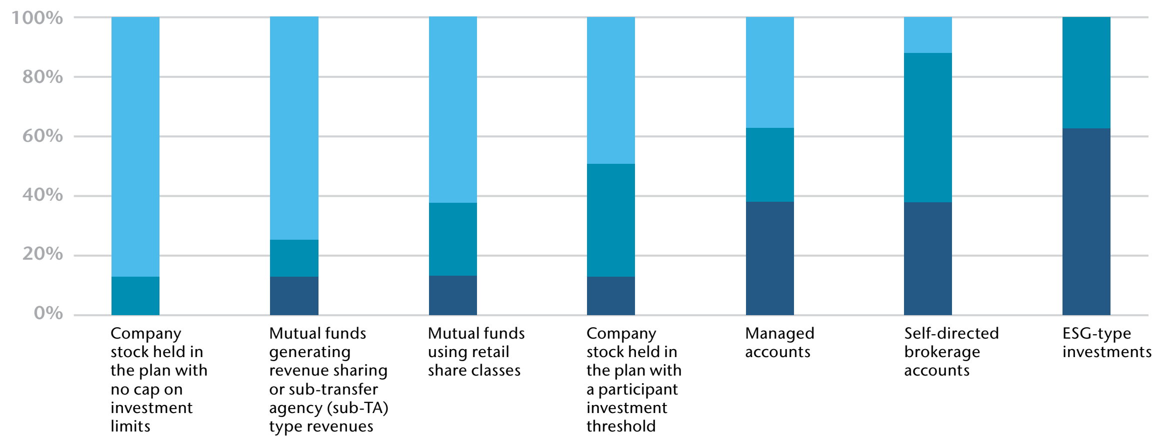
How do various aspects of retirement plan management typically impact pricing for fiduciary liability insurance? (DB and DC plans)

- Significant
- Small
- Nonexistent



How do various aspects of retirement plan management typically impact pricing for fiduciary liability insurance? (specific features of DC plans)

- Significant
- Small
- Nonexistent



Key Takeaway #1: Fees are very important

For those following ERISA litigation over the past several years, it should come as no surprise that the questions about fee levels and structures as well as processes for reviewing fees ranked as top drivers of fiduciary liability insurance premiums. Specifically, 88% of respondents said that it was a "significant" driver of insurance premiums whether the investment committee does periodic plan administration fee benchmarking reviews. For defined contribution plans, 75% of respondents said that it was a significant driver of insurance premiums if plans use mutual funds generating revenue sharing or sub-transfer agency (sub-TA) type revenues (i.e. revenue sharing), and 63% said mutual funds using retail share classes would be a significant driver of premiums. Fees are clearly a key item to keep a close eye on and document that they are being managed well.

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Key Takeaway #2:
Committee minutes are important, but it matters less who takes them

When asked about the impact of the Investment Committee taking formal minutes, all respondents said that it would have an impact on premiums: about a third of respondents said that the impact would be significant and the remainder said that it would be small. However, when we asked about the impact of engaging an outside advisor or legal counsel to take minutes, half the respondents said that would have no impact, and most of the remainder described the impact as small. We interpret these answers to mean that it is important to have good minutes, but external advisors may not have a particularly strong comparative advantage in writing them, at least in terms of reducing fiduciary liability insurance pricing. Many plan sponsors engage Aon to write their meeting minutes, which the clients may find effective for good governance and process management, but this may not be viewed as explicitly reducing fiduciary liability relative to writing high-quality minutes in-house.

Key Takeaway #3:
Investment advisors are viewed as a moderate influencer of premiums

When asked about the plan sponsors' investment advisors, the responses pointed toward the impact being moderate related to the other areas included in the survey. When asked about the impact of having an investment advisor on retainer, respondents were almost evenly split among the impact being significant, small, or nonexistent. When asked about the impact of what firm is the investment advisor, more than half of the respondents said that this would have a small impact, with a fourth saying that it would be significant, with the remainder saying it would not have an impact. Whether the plan sponsor uses a 3(38) outsourced chief investment officer (OCIO) was viewed as having a small impact by 50% of respondents, no impact by 38%, and a significant impact by 12%.

We also gave respondents the opportunity to provide additional comments in the free response sections of the survey, and this area evoked a disproportionate number of comments which were particularly enlightening, suggesting a more nuanced approach. Comments about this area include:

- "experienced advisor is expected"
- "interested in scope and price [of the investment advisor] and what advice they are giving/conflict of interest issues"
- [what firm the investment advisor is has a small impact] "unless related party in which case significant impact"
- [OCIO arrangements do not currently impact premiums, but] "we are interested in evaluating the overall favorable impact that a 3(38) may have in this space."
- "While we are not adding a premium change for a plan's usage of an OCIO, we will increase pricing/review additional policy restrictions for insured's which don't have a strong investment committee in place. This includes seeking various outside council and advisory services to lead the investment committee through the constant duty of prudence which is necessary to run these plans."
- [using a 3(38) OCIO typically reduces premiums 0-5% for defined benefit plans] "but would want to know the arrangement regarding fees with the OCIO"
- [Regarding the impact of OCIO arrangements for DC plans] "I can't tie this to a specific premium impact, but it is viewed favorably and would play into consideration of specific retention and pricing"
- [Regarding the impact of OCIO arrangements for DB plans] "Unlikely to have an impact, though possibly helpful if there were concerns over funding level and sponsor's ability to financially support the plan"
- "the level of investment expertise deployed in investment decisions is a factor in our underwriting, and greater expertise would be a positive factor among the multiple factors we consider. Of course, as you know, outside vendors are not foolproof and the insured retains fiduciary liability with respect [to] them."

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Key Takeaway #4:
Employer stock in DC plans remains a top concern for insurers

88% of respondents viewed it as a significant driver of premiums when company stock is held in the plan with no cap on investment limits. That figure drops to 50% when there is a limit on the size of such investments. This should come as no surprise given the history of lawsuits related to company stock.

Key Takeaway #5:
Environmental, social, and governance (ESG) options in DC plans plays a minor role in pricing fiduciary liability insurance

Of all the topics we asked about, ESG options in DC plans seemed the most innocuous. 62% of respondents said that they have no impact on pricing and the remainder described the impact as small. It is noteworthy that this survey was done after the Biden Administration announced its nonenforcement policy for the "final rule" created by the Trump Administration about including funds based on non-financial factors. One survey respondent included comments expanding on his thoughts about this area "[The impact of ESG options] depends on the % of plan assets or # of investment options offered. As well as if the plan were to attempt to force a requirement to its participants." Anecdotally, we've seen a lot of plan sponsors spending time thinking about the liability associated with these funds. It appears that it is not viewed as a big fiduciary liability by insurance carriers—possibly because of a combination of the nonenforcement policy as well as the typically low asset levels these options have.

Conclusions

Through Aon's experiences brokering fiduciary liability insurance policies as well as the comments in the free responses to this survey, insurers have consistently made it clear that they price each deal individually based on the unique circumstances. There is usually not a rigid formula for pricing, but there are some factors that clearly influence pricing. Those factors generally fall under the themes of good governance: having the right people and resources to act in the best interest of participants, while documenting the processes and decisions well.

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Aon is a leader in brokerage for fiduciary liability insurance as well as retirement and investment consulting

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Aon Investments USA Inc. is a leading institutional advisor with more than 300 U.S. colleagues[1] and $2.715 trillion in assets under advisement[2] and $142.1 billion in U.S. discretionary assets across 182 clients.[3]

[1] *As of 6/30/2020*

[2] *As of 12/31/2020, represents US retainer non-discretionary assets*

[3] *As of 3/31/2021, total assets under management represents $142.1 B in U.S. discretionary assets under management advised by Aon Investments USA Inc.*

Appendix 1: About Fiduciary Liability Insurance

If you have discretionary authority for the management or administration of an employee benefit plan that is subject to the Employee Retirement Income Security Act (ERISA), or if you exercise any authority of control with respect to the management or disposition of the assets of an ERISA plan, then you are considered a fiduciary of that plan. Under ERISA, plan fiduciaries shall be personally liable for fiduciary failures, meaning that your personal assets could be at risk. In a worst-case scenario, even bankruptcy would not offer protection.

An ERISA bond will not offer protection against breaches of fiduciary duty. Under ERISA, plan fiduciaries and those who handle plan funds or assets must be bonded to protect the plan from losses caused by dishonest or fraudulent actions. But the ERISA fidelity bonds that you are legally required to purchase will not protect from losses arising from breaches of fiduciary duty (such as the failure to prudently invest plan assets) or plan administrative errors. These exposures require fiduciary liability insurance.

Fiduciary liability insurance is designed to provide coverage for:

- The Company/Sponsor Organization and its subsidiaries
- Covered Plans including:
  - Qualified Retirement and Health and Welfare Plans – e.g., Welfare (such as medical, dental, life insurance, disability and accident plans); Pension (defined benefit and defined contribution plans)
  - Non-Qualified Plans – e.g., deferred compensation programs, excess benefit plans, and supplemental executive retirement programs
- Insured Persons – i.e., any natural person serving as a past, present or future director, officer, partner, or employee of the Sponsor Organization or a Plan, in his/her capacity as a Fiduciary, Administrator or trustee of a Plan

Covered claims may include:

- Breaches of Fiduciary Duty – violations of fiduciary obligations, responsibilities or duties under Employee Benefits Law (including ERISA)
- Administration – acts, errors or omissions in the administration of a Plan, such as:
  - Advising, counseling, or giving notice to employees, participants and beneficiaries
  - Providing interpretations
  - Handling records
  - Activities affecting enrollment, termination or cancellation of employees, participants, and beneficiaries under the Plan

Aon's Financial Services Group ("FSG") is the premier team of executive liability brokerage professionals, with extensive experience in representing buyers of complex insurance products including directors' and officers' liability, employment practices liability, fiduciary liability, fidelity, and professional liability insurance. FSG's global platform assists clients in addressing their executive liability exposures across their worldwide operations. Aon's Financial Services Group manages more than $3.7 billion in annual premiums, assisted with annual claim settlements of approximately $4.0 billion over the last 5 years, and uses its unmatched data to support the diverse business goals of its clients.[4]

If you are a plan fiduciary of your employer's retirement or welfare plans, ask your risk management department if your employer has a fiduciary liability insurance policy covering the plans and plan fiduciaries. While some employers may advise employees that the employer will indemnify them if they are involved in any plan-related litigation, such promise will be of little solace to plan fiduciaries should the employer become insolvent in the future. Remember, your personal assets are on the line.

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[4]*All descriptions, summaries or highlights of coverage are for general informational purposes only and do not amend, alter or modify the actual terms or conditions of any insurance policy. Coverage is governed only by the terms and conditions of the relevant policy. Aon is not a law firm, nor does it provide legal advice. We recommend that you consult with your own legal counsel on your specific situation.*

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Appendix 2:
Additional selected comments provided in free response areas

- "While we look at a number of the items that are in the survey, the problem is that there is pressure to settle, in some cases because the cost to defend would be greater than the settlement value. Defense costs and settlement amounts in the so-called fee cases are incredibly high, even where the client has robust fiduciary processes."
- "Brokerage accounts, for now, have a neutral effect on underwriting. They are a potential source for litigation, and at least one plaintiffs' firm was exploring them. However, nothing has come of the exploration so far, and the accounts are generally undersubscribed, with usually no more than 5 or 6 percent of any plan's assets invested in them."
- [Insurance company] "does not 'paint with a broad brush' – we look at the individual merits of each account and price accordingly, taking into account the overall relationship, claim history and risk profile characteristics."
- "Underwriters are informed of guidance provided by the DOL [Department of Labor] to plan sponsors and fiduciaries in satisfying the duties under ERISA and they are free to use that when underwriting risks (for example – the DOL's "Tips for Selecting and Monitoring Service Providers", "FAQs about Retirement Plans and ERISA," "Meeting your Fiduciary Responsibilities," etc.)... The assessment of a risk must consider all of the policies, procedures and due diligence plan fiduciaries engage in while carrying out their duties. Underwriters consider all of these factors, and many more, in the review of a risk before applying any appropriate credits or debits to an account."

Appendix 3:
Survey methodology

Between March and April of 2021, Aon emailed a survey to our contacts at 12 leading providers of fiduciary liability insurance. These 12 markets account for approximately 85% of the total gross written premium placed by Aon in 2020. Eight of them answered the survey questions, with two additional insurers responding solely to the free response questions.

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What Drives Fiduciary Liability?

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