

# FIDUCIARY LIABILITY INSURANCE

## WHAT DOES IT COVER?

Fiduciary Insurance protects plan sponsors (employers) and plan fiduciaries (executives and employees designated to manage benefit plans) from claims that they have violated requirements laid out under ERISA. These claims allege mismanagement of plan assets or failure to follow ERISA rules when controlling or managing plan assets and paying plan benefits. Fiduciary liability policies cover the cost of defending sponsors and fiduciaries and indemnify them for monetary liabilities that result from a legal settlement or adverse judgment.

## ERISA – WHAT IS IT?

The Employee Retirement Income Security Act (ERISA) of 1974 was enacted to address public concern that funds of private pension plans were being mismanaged and abused, leading employees/beneficiaries without income when they retired.

ERISA requires sponsors of private employee benefit plans to provide participants and beneficiaries with adequate information regarding their plans. It also requires financial reporting to government agencies (DOL), and those reports are generally publicly available.

## WHO IS A FIDUCIARY?

Generally speaking, a fiduciary is a person or entity that is put in a position of trust. They are held to the highest standard of conduct under the law because those trusting them are dependent on the results of their actions. Under ERISA, anyone with discretionary authority over the management of plans and the disposition of assets is a Fiduciary. It is a “functional” test, meaning that a person can be determined to be a fiduciary even though they are not “named” as such in any plan documents.

## WHY FIDUCIARY INSURANCE IS NEEDED?

As a fiduciary under ERISA, they must meet the high legal standard of the “Prudent Person”. This means they must act ‘with the same care, skill, prudence and diligence’ that a prudent person in their shoes would use. There are civil enforcement provisions aimed at assuring plan funds are protected and participants receive their benefits. Importantly, ERISA fiduciaries can be held personally liable to restore losses to a plan caused by the breach of their duties - even if the breach was inadvertent.

## COMMON CLAIMS SEEN

Most frequent allegations in these cases are that fiduciary duties were breached by:

- Relying upon faulty processes for the selection or retention of investment options in the plan's fund lineup;
- Failing to negotiate and monitor direct and indirect compensation (fees) that the plan paid to service providers: administrators, record-keepers, and investment advisers. For example: paying for record-keeping as a percentage of assets under management rather than per participant and/or not submitting requests for proposals to multiple record-keepers;
- The employer or fiduciaries had a conflict of interest and obtained a benefit from investment advisors and funds selected for the plan – most commonly alleged against financial institutions and employers that include their own stock as an option; and
- Failing to monitor investment fund performance and reassess the cost efficiency of available options and share classes, subjecting the participants to fees that substantially exceeded fees for alternative available investment products or services. Example: not offering Index funds
- Additional Allegations seen:
  1. Improper COBRA notices (Fines of \$110 per participant per day);
  2. Cyber exposures (DOL has new guidance to protect against cyber incursions and has started related audits);
  3. Actuarial equivalence (allegations that life expectancy tables have not been updated); and
  4. ESG (environmental, social, governance related issues)

## TRENDS

Recent Supreme Court decisions about suits filed in the area have made it easier for Plaintiff Firms to bring class actions against fiduciaries (Fifth Third Bancorp, *Tibble v. Edison Int'l* and *Hughes v. Northwestern University*). These decisions asserted that evaluating whether fiduciaries' decisions rise to the level to permit a suit to move forward must be evaluated in each case's context. This makes it very difficult for lower courts to dismiss such suits in their early stages.

Fiduciary cases are only dismissed at a rate of 30% vs. 50% for Securities-related cases. In pure economic terms, a more relaxed pleading standard means substantial increases in the time and expense of defending workplace fiduciaries and fiduciary service providers named in these lawsuits.

The resulting trends:

- Plaintiff's firms are more eager to file suits. Several new plaintiff's firms have entered this space, often filing a series of nearly identical lawsuits based solely on reviews of plans' publicly available Form 5500 filings.
- The biggest driver in ERISA class actions in 2020 was a dramatic increase in the number of smaller plans facing lawsuits, including plans with under 1,000 participants and less than \$100M in assets.
- These cases typically involve extensive electronic discovery that can significantly increase the cost of litigation, and costs to defend now average \$5M.
- Average cases resolve around \$7.5M (\$10M combined defense and indemnity)
- Settlements of top 10: According to Seyfarth's 17th Annual Workplace Class Action Report, released in 2021, the top ten ERISA class action settlements totaled \$380.01M, slightly up from years past.

This has led to more underwriting appetite scrutiny. Carriers are presently offering lower primary limits and higher retention amounts, particularly for Mass/Class Actions, and demanding increased rates for this product.

**To learn more about Fiduciary Liability Coverage, contact our team:**

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