Expect More Difficulty Obtaining Fiduciary Insurance

Issuers of fiduciary liability insurance are paying close attention to the glut of lawsuits filed in recent years against plan sponsors and fiduciary service providers—and they don't like what they see.

Reported by JOHN MANGANARO

Erin Turley, a benefits partner with McDermott Will & Emery, recently sat down with PLANSPONSOR for a discussion about a key emerging issue that has the potential to impact all stakeholders in the retirement plan services industry.

Simply put, the insurance carriers that provide fiduciary liability insurance to retirement plan sponsors and their fiduciary service providers are growing cautious—even a bit cagey—when it comes to issuing their coverage policies. The basic reason for their reticence is the glut of retirement plan-focused litigation that has emerged in recent years, and especially the intensity of suits filed over the past year or two. So many plan sponsors are being sued and dragged into complex and lengthy litigation, the thinking goes, that the basic economics of the provision of fiduciary liability insurance are breaking.

In Turley's view, recounted in question-and-answer format below, it is all too likely that some plan sponsors or fiduciary service providers may find it impossible to source the kind of insurance policies they have relied on for years for peace of mind. And the downstream impacts are as numerous as they are concerning, Turley says, which means the retirement plan services industry is going to have to do some serious soul searching in the near future.

PLANSPONSOR: Please begin by describing for our readers your legal practice and experience working on these matters.

Turley: Certainly. I am a partner with McDermott Will & Emery in the firm's employee benefits group. I have been practicing in the employee benefits space for more than 25 years now, and I handle pretty much all aspects of employee benefits compliance and litigation for our clients, which include both publicly traded entities as well as privately held entities, across the size spectrum.

One unique feature about our benefits group is that we do a lot of work with private equity clients, both transactional work and helping them implement internal benefits programs across their holdings. So it is a full spectrum of services, and we stay very busy with all of this.

PLANSPONSOR: What have you been focused on in 2021? From our perspective, we are always writing about litigation. Plan sponsors and providers continue to be sued for a variety of things, so we have to image it has been a busy year for you?

Turley: That's correct. Litigation continues to be a major focus, of course, and we are seeing some new emerging consequences of this, namely changes that are happening in the fiduciary insurance marketplace.

I have a practice that spans both regular qualified plan work and employee stock ownership plan [ESOP] transaction and compliance work. We have, for the past several years, begun to have real challenges with respect to securing sufficient fiduciary insurance coverage for litigation in the ESOP space. In the past two to three years, this has now started to spill over into the traditional 401(k) plan space. More and more, it is an issue across our areas of practice.

I was just this week talking with a client, and we were discussing how, in just the past two years, we have seen something like a five-fold increase in the number of excessive fee lawsuits targeting 401(k) plans. That's a telling metric, and it has insurance providers and underwriters feeling pretty nervous, frankly.

PLANSPONSOR: So, in your experience, are we reaching the point where the fiduciary insurers are really starting to feel nervous and are having to scrutinize their clients even more closely? It's not a great situation for plan sponsors and fiduciary service providers, presumably?

Turley: That's right—it's not a great environment for plan sponsors or trustees who are serving as fiduciaries in this space, in any capacity. It is a challenging market right now, to the point that we are looking at trying to think about ways that insurance products might be differently structured, to address what we hope will only be a short-term tightening in the market.

The pressure on insurers and plan sponsors is having a direct impact on the progress of the industry. For example, consider a plan sponsor who is keeping up with the news and considering whether they want to join a pooled employer plan [PEP]. In any lawsuit, I'm guessing, the plaintiffs are going to sue both the plan sponsor and the PEP provider. Only if the PEP provider can prove there wasn't a fiduciary breach, can the plan sponsor then have comfort that they won't then have liability for failing to monitor and oversee the PEP provider properly.

While I see PEPs as a shift of some of the employer's fiduciary liability, it's not an entire shift, and that will cause some re-evaluation of the value proposition of PEPs. What am I, as an employer, paying for? What control am I giving up? What am I getting in exchange—that is, how much fiduciary protection am I really getting?

Ultimately, if an employer's insurance policy is still on the line for a fiduciary breach committed by a PEP provider, that can really challenge the value proposition. So the insurance topic is a broad one that is impacting all the different parts of the industry right now.

PLANSPONSOR: With such challenges in mind, how do employers make a good impression on the insurers? What does effective fiduciary monitoring look like?

Turley: Plan sponsors have to understand all the service providers they are working with—the investment adviser, the recordkeeper, the trustee, etc. If you go into a service provider arrangement, you need to make sure your providers are reputable, that they know what they are doing and that they have, for example, good cybersecurity policies. And, you need to know how your providers are planning to operate and who is doing what.

Once you have chosen to outsource services, or if you choose, for example, to join a PEP, you have to familiarize yourself enough with the providers' operations to know that they are doing their jobs. How does a plan sponsor do this? It involves different things, including receiving and reviewing reports coming back to the employer from the providers, showing things such as fund performance, fund analysis, menu changes, those types of things.

At a minimum, quarterly reporting and reviews are important, where you are making sure notices and statements are being sent appropriately, etc. On top of this, plan sponsors are especially on the hook for monitoring and understanding what fiduciary decisions they have delegated, and which have been made on their behalf, both in terms of investments and administration.

PLANSPONSOR: Let's say an issue has happened and an error was made. Does the employer's liability vary significantly depending on whether the mistake was made by someone to whom they gave discretion or if, on the other hand, the employer itself commits a fiduciary breach?

Turley: Good question. Let's make up an example and assume, say, that a plan sponsor picked a pooled plan provider [PPP] and joined a PEP in which the adviser serving that PEP chose investments with excessive fees—funds that had high revenue-sharing arrangements that didn't adjust for the plan's growing size—and the PPP didn't do anything to address that.

The first step in such litigation would be proving that the PPP violated its fiduciary duty. Once that is done, it becomes a potential liability for the plan sponsor, because if the PPP committed a fiduciary breach, and you failed to know that it was paying excessive fees and you did nothing to address this, then you are liable. The regulations have joint and several liability, meaning that damages are going to be sought according to who has the money to pay and who has the insurance to pay.

Stepping back, I think the insurance issue will actually have a chilling impact for the next few years on the growth of the PEP marketplace. That is, until we see a loosening in the fiduciary insurance market, I think PEPs are going to be challenged to get sufficient insurance to cover the assets they are hoping to manage. The whole benefit of the pooled employer rules is to create a mega plan with $500 million or $1 billion in assets. If you are managing that much in assets across 100 different employers, I think that's going to give the insurance underwriters working with the PEP some real concern and agitation.

PLANSPONSOR: What could ease that concern from the perspective of insurers? Perhaps precedents that reduce the number of cases that get past the motion to dismiss stage?

Turley: One thing on my radar that could help is the decision that is slated for issuance by the Supreme Court in 2022, regarding Northwestern University's excessive fee case. That is—a high-level case that demonstrates clearly what it takes to allege sufficient facts to demonstrate liability in a fiduciary excess fee case.

In my personal view, given my practice area, the simple claim that there was a cheaper possible investment or provider out there and a plan didn't pick it—that should not be sufficient to allege a fiduciary duty breach. This case will test that question. As we know, there are many factors that influence service prices. I think that case is going to be a bellwether for where we go on PEPs and the excessive fee issue broadly across 401(k)s, ESOPs and more.

Tags Fiduciary Liability Insurance, retirement plan litigation

Reported by John Manganaro