



Fiduciary Liability Insurance

Understanding the rapid rise
in excessive fee claims

Foreword

By Allison Barrett, Head of North America Financial Lines and Joel Townsend, Global Head of Financial Lines Claims

Today, benefit plans and their fiduciaries are experiencing a rapid rise in ERISA retirement plan excessive fee claims, as the plaintiff’s bar broadens its sights from a handful of the largest employer-sponsored 401(k)s and targets a growing number of smaller retirement plans and other plan types.

The surge in claims has jumped to unprecedented levels and has swept up retirement plans administered on behalf of financial, healthcare and educational institutions, as well as companies in the aerospace, manufacturing, retail and technology industries – and everywhere in between. Regardless of plan type, plan size or jurisdiction, no retirement plan or plan fiduciary is immune.

Indeed, almost 100 cases were brought forward in 2020 alone.¹ That’s a nearly five-fold increase as compared to the number of filings in 2019.² And there are few signs that the number of cases is slowing. What’s more, about one-third of those new cases were directed at fiduciaries overseeing plans with less than \$1 billion of assets, according to an analysis of claims tracked by AIG. That suggests a much broader array of retirement plans and their fiduciaries are at risk.

At the same time, excessive fee claims are becoming more challenging and more expensive to defend. Courts continue to review similar fact patterns inconsistently. And several recent decisions have been quite favorable to the plaintiff’s bar, curbing the ability of retirement plan fiduciaries to obtain dismissals and avoid the prospect of a protracted and costly discovery or even the rare trial.

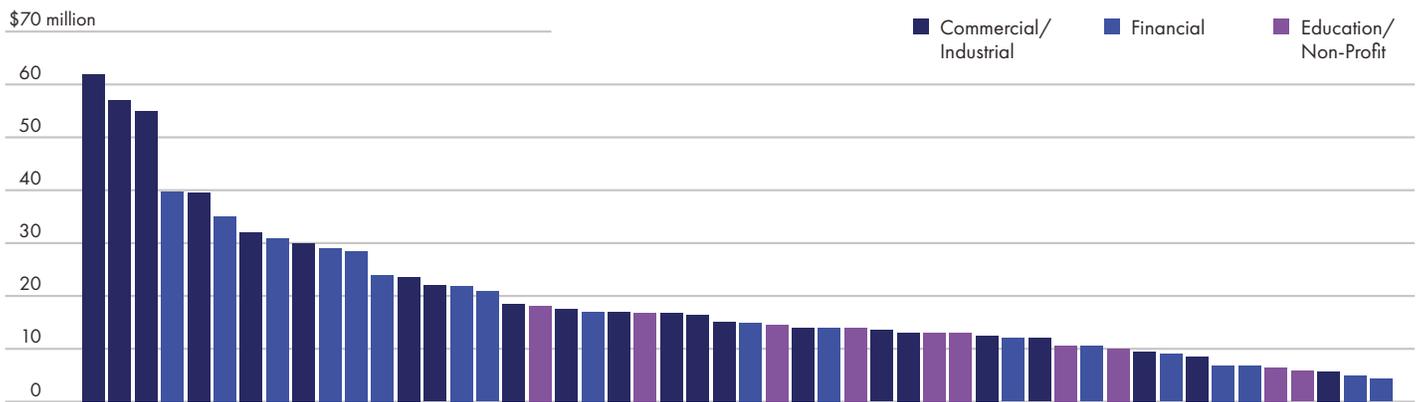
Further, a recent analysis found that roughly one-third of all cases are being dispatched at the motion to dismiss stage,³ compared with the dismissal of roughly half of all cases in federal, securities-related class action lawsuits.

Given the surge in frequency and severity of these claims, the financial fallout continues to pile up. (See Figure 1 above.) All told, settlements totaling more than \$1 billion, including \$330 million in legal fees, were paid between 2015 and 2020.⁴ And with dozens of cases still in litigation at the time of this publication,⁵ the total cost of projected settlements is likely to increase by hundreds of millions of dollars, if not more, over the next several years.

Understanding these dynamics is key to forging a close partnership around your insurance needs. At AIG, we are committed to an evidence-based dialogue with our distribution partners and clients. By sharing data and insights that arise from our position as a leading provider of fiduciary liability coverage, we hope this white paper can help foster a clearer, mutual understanding of current market dynamics and risk mitigation solutions available.

Figure 1. 50 of the Largest Excessive Fee Settlements, 2010-2021

The surge in claims has swept up retirement plans of all sizes and across almost every industry class, according to an analysis of settlement data tracked by AIG. No plan, nor its fiduciaries, is immune.



Source: AIG Research

1 Chrinos, Tulio D. and Robert Rachal, Myron D. Rumeld, and Kyle C. Hansen. Benefits Law Journal. Vol. 34, No. 1: Spring 2021
 2 Wille, Jacklyn. “401(k) Fee Suits Flood Courts, Set for Fivefold Jump in 2020.” Bloomberg Law: <https://news.bloomberglaw.com/employee-benefits/401k-fee-suits-flood-courts-on-pace-for-fivefold-jump-in-2020>: 21 June 2021
 3 Chrinos, Tulio Russell L, Hirschhorn, “An Update on 401(k) and 403(b) Investment Litigation.” Proskauer Rose, LLP. Webinar: 9 June 2020
 4 Chrinos, Tulio D. and Robert Rachal, Myron D. Rumeld, and Kyle C. Hansen. Benefits Law Journal. Vol. 34, No. 1: Spring 2021
 5 Based on internal research of AIG data

The responsibilities of retirement plan fiduciaries

Under the Employment Retirement Income Security Act of 1974, known as ERISA, retirement plan fiduciaries have numerous responsibilities. These responsibilities include acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them; carrying out their responsibilities prudently; following the plan documents (unless inconsistent with ERISA); diversifying plan investments; and paying only reasonable plan expenses. It's a high bar, and compliance requires a rigorous process for making these decisions.

But in recent years, plaintiff's lawyers appear to be exploiting ERISA to take aim at plan fiduciaries and sponsors. Excessive fee class action claims, as the name suggests, generally allege that fiduciaries of defined contribution plans (and occasionally defined benefit plans) subject to ERISA breached their fiduciary duties by (1) failing to adequately negotiate and/or monitor the fees charged by plan service providers (fund managers, administrators and record-keepers, etc.) and/or (2) selecting imprudent investment options for plan participants and/or failing to monitor performance and reassess those options consistent with their fiduciary obligations under ERISA. Below, in Figure 2, we categorize several other common allegations facing plan fiduciaries:

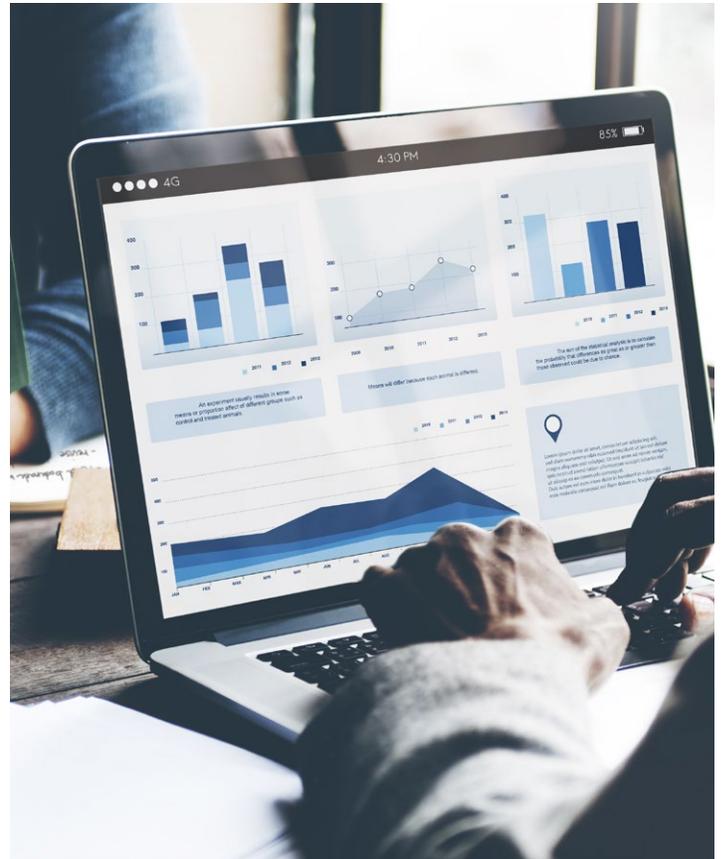


Figure 2. Common Allegations Cited in Excessive Fee Cases

Service Providers	Investment Management	Plan Governance
<ul style="list-style-type: none"> • Paying excessive fees to service providers (e.g. recordkeeper, investment manager) • Failing to use plan "purchasing power" to control costs by employing multiple recordkeepers • High fund expense ratios • Failure to monitor the fees paid to service providers • Not implementing revenue sharing caps • Creating imprudent expense by negotiating fees based upon a percentage of assets as opposed to a fixed/flat rate • Failure to monitor or supervise the discretionary fiduciary, trustee 	<ul style="list-style-type: none"> • Offering too many investment options or an investment menu which is too complex • Failure to monitor investment performance • Failure to replace or alter underperforming investment options • Failure to consider Collective Investment Trusts or separate accounts • Offering Collective Investment Trusts which are too conservative • Selecting actively managed funds over allegedly equivalent passively managed funds which are equivalent in performance and less expensive • Offering investment options with limited performance history • Offering proprietary products (including self-dealing) • Failure to leverage less expensive mutual fund share classes 	<ul style="list-style-type: none"> • Failure to follow investment policy statement • Lacking a regular RFP (Request-For-Proposal) process • Lack of detailed documentation for all plan decisions • Providing inconsistent or incomplete notifications and/or disclosures to plan participants • Failure to disclose indirect investment expenses

A new wave of excessive fee claims

Initially, a single plaintiff's law firm filed the bulk of excessive fee complaints. Starting in the mid-2000s, it brought lawsuits against fiduciaries at 18 of the largest employer-sponsored 401(k) plans, each with billions of dollars in plan assets and tens of thousands of plan participants.⁶ These plans' large size made them attractive targets for extracting enormous settlements. The average settlement cost was over \$10 million, with at least three settlements exceeding \$30 million during this timeframe, according to AIG research. (And that did not include the significant costs associated with mounting a legal defense.)

As this litigation strategy proved successful, the law firm broadened its focus beyond the biggest 401(k)s – including certain 403(b) retirement plans sponsored by large non-profit organizations, such as universities and healthcare systems. Its success also spawned a cottage industry of copycat plaintiff's firms that filed even more lawsuits. Between 2015 and 2020, hundreds of excessive fee cases were filed, with more than 30 claims settling for more than \$10 million, according to AIG research.

Today, we are experiencing a third wave of excessive fee complaints as a growing number of plaintiff's law firms enter the fray and bring a flood of similar cases against retirement plan sponsors, fiduciaries and service providers. Amid this surge, more than one-third of those cases were filed against much smaller retirement plans – those with less than \$1 billion in plan assets and many with just a few thousand plan participants.⁷ Meanwhile, the average settlement cost over the last few years continues to remain outsized: our research suggests it exceeds \$10 million, and there is still no sign that the frequency of filings is abating.⁸

Put another way, both the frequency and severity of excessive fee claims continue to rise. And this may be just the start. At AIG, we believe the current wave of claims activity is accelerating quickly, with future growth to result in even more excessive fee lawsuits filed against retirement plans with fewer than \$1 billion in assets. Given the inconsistency of judicial rulings and the difficulty of mounting a successful defense, we expect the severity of claims also to sharply increase. Our analysis of historical claims data suggests that just looking at outstanding claims, fiduciaries and their plans could face settlements totaling hundreds of millions of dollars over the next several years.⁹ Tens of millions in additional legal defense bills will only increase these overall expense projections.

⁶ Stewart, Todd. "Fiduciary Considerations For Investment Vehicle Selection." Sageview Advisory Group: <http://static.fmgsuite.com/media/documents/bec52f74-fac5-4609-a158-9c3011a905e0.pdf>; 20 June 2021

⁷ Based on internal research of AIG data

⁸ Based on internal research of AIG data

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Four factors exacerbating excessive fee risk

So, what is causing the rise in this fiduciary liability risk? We have identified four major trends.

1. ERISA excessive fee cases are easy to bring.

With most lawsuits, the burden of proving the various components of a claim lies with the plaintiff. However, under ERISA, the Circuit Courts have reached different conclusions as to which party bears the burden of proving causation, as required in section 409(a), in a suit for breach of fiduciary duty. Some courts have held that the plaintiff is responsible, but others, applying the common law of trusts, have stated that the burden of proof is shifted to the defendant: once a plaintiff has made a prima facie case alleging a breach and a resulting loss to the plan, it becomes the responsibility of the defendant fiduciary to show the loss was not caused by a breach of fiduciary duty. That makes it much easier for the plaintiff to survive the pleading stages of litigation and put the burden on defendants to show why the choices they made were appropriate, prudent and within the bounds of reasonableness.

Of course, the cost of demonstrating this is high: it is both a technical and highly factual defense. Meanwhile, the Supreme Court has determined that courts can award ERISA attorney fees when there is “some degree of success on the merits”. Taken together, these procedural aspects provide the plaintiff’s bar with powerful incentives to file cases.

Meanwhile, efforts to improve plan structures are giving rise to additional claims of a fiduciary breach. When plan fiduciaries initiate a large-scale review of investment fee arrangements or seek fee reductions from investment managers and recordkeepers, that’s generally good news for plan participants. But in an ironic twist, it may be even better news for the plaintiff’s bar. That’s because, in many cases, they seek to characterize the results of these reviews and renegotiations as admissions by fiduciaries that they were not previously monitoring the plan properly since the prior fees may have been excessive.

2. ERISA excessive fee defenses require costly legal expertise.

Plaintiff’s lawyers bringing ERISA class action lawsuits tend to work for highly specialized, boutique firms that mount aggressive and carefully crafted cases. That makes it particularly expensive to build a defense since it will typically require engaging defense counsel with specialized ERISA litigation expertise. And many of these ERISA class action defense firms are top tier national firms with the highest billable rates commensurate to federal securities law attorneys.

3. The ERISA statute of limitations runs from actual knowledge of the violation.

Over the past few years, several court decisions have been favorable to the plaintiff's bar. None has been more impactful than the Supreme Court's 2015 ruling in *Tibble v. Edison International*, which effectively nullified ERISA's six-year statute of repose defense for duty to monitor claims and thereby strengthened the hand of the plaintiff's bar by ensuring their case would move forward toward pre-trial discovery or a financial settlement.

In *Tibble*, the Supreme Court held that ERISA plan fiduciaries have a duty to continuously "monitor" retirement plan investments, fee expenses and services providers. This immediately increased the potential exposure of a plan's fiduciaries since it effectively eliminated what had been a six-year statute of repose, which foreclosed challenges to investment options added to the plan more than six years before a lawsuit was filed. Instead, the *Tibble* decision made the six-year lookback period a rolling target, with the "clock" continuously being reset, and took away one of plan fiduciaries' most powerful defenses.

A 2020 Supreme Court ruling took another step toward making dismissals on the basis of a statute of limitations argument more difficult. In *Intel Corp. Inv. Policy Comm. v. Sulyma*, the court held that "actual knowledge" of fiduciary breaches necessary to trigger ERISA's three-year statute of limitations cannot be established merely by making disclosures available to plan participants.

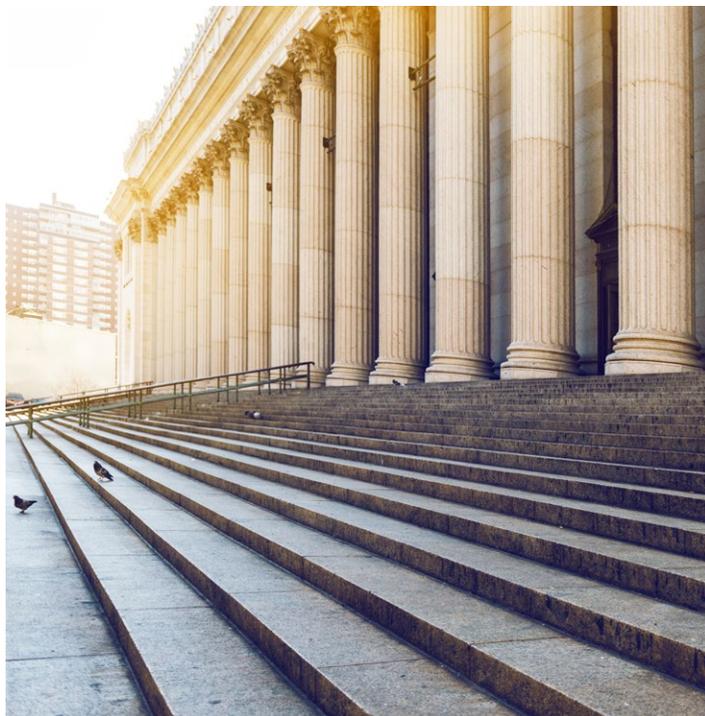
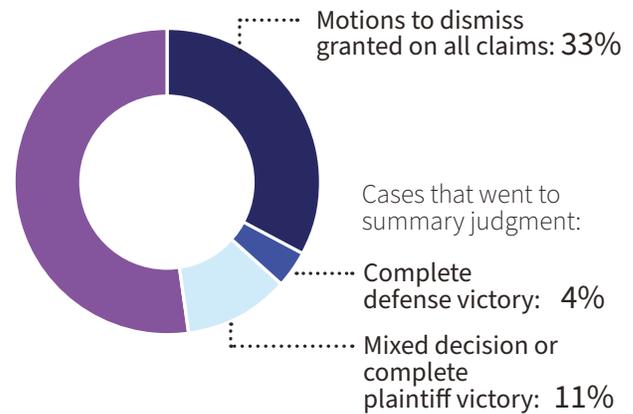


Figure 3. Excessive Fee Cases Have Low Dismissal Rates

Only about 33% of the motions to dismiss have been granted on excessive fee class action cases filed since 2015.



Source: Proskauer Rose

4. ERISA excessive fee lawsuits are difficult to have dismissed.

Beyond whittling away the statute of limitations dismissal arguments, the nature of most ERISA excessive fee cases makes it very difficult for defendants to achieve a dismissal. One reason, as noted above, is procedural: under ERISA, the burden of proof to demonstrate compliance with fiduciary obligations can fall on the defendant fiduciary once a plaintiff has cleared the relatively low hurdle of alleging a fiduciary breach. Another reason reflects the nature of the complaints. In most fiduciary breach cases, the typical grounds for a dismissal are: (1) a lack of specificity in alleging imprudence in selection or oversight; (2) inadequate allegation of flawed process, as prudence standard is process-based; and (3) improper benchmarks and/or comparisons. All of these are inherently factual issues, making dismissal at the pleading stage less likely.

This is evident in the data. According to a review published in June 2020 by a leading ERISA law firm, approximately 33% of the motions to dismiss have been granted on all excessive fee cases filed since 2015, compared to more than half of all motions to dismiss in federal securities-related class actions.¹⁰ Only about 15% of the total cases made it to a decision of summary judgment, while only about one-fourth of that 15% resulted in complete victory.¹¹ An AIG analysis of its own fiduciary liability claims showed even less favorable results.¹²

It also helps explain why the cost of settling is so high. Because there is no mandatory stay of discovery pending a determination of a motion to dismiss, costs may accrue even while a dismissal motion is pending. And they will continue to accumulate if the motion to dismiss is denied – and the case heads into the pre-trial, discovery phase.

⁹ Chrinos, Tulio Russell L, Hirschhorn, "An Update on 401(k) and 403(b) Investment Litigation." Proskauer Rose, LLP. Webinar: 9 June 2020; AIG Research

¹⁰ Chrinos, Tulio Russell L, Hirschhorn, "An Update on 401(k) and 403(b) Investment Litigation." Proskauer Rose, LLP. Webinar: 9 June 2020.

¹¹ Based on internal research of AIG data

Mitigating the rise in fiduciary litigation risk

Retirement sponsors and members of the fiduciary committee are liable for any breach of their duties, even if they arrange to outsource certain tasks to professional service providers. Given the frequency and severity of excessive fee claims, that could mean taking on significant litigation exposure.

So, how can plan fiduciaries manage and mitigate this risk? Experts suggest that it starts with strong governance practices, including establishing a committee to oversee the plan's financial responsibilities and develop, adopt and periodically review an investment policy statement. Fiduciaries should also keep close tabs on the third parties they engage. Among the best practices that they should consider:

- Ensuring the average cost per participant is not excessive;
- Benchmarking fees and renegotiating financial agreements with recordkeepers at least once every three years;
- Introducing caps and rebates to participants when revenue sharing compensation agreements are in place;
- If the plan uses more than one recordkeeper, document justification, which may include different types or levels of services and associated fees;
- Where possible, retaining a reputable plan consultant to assist with and provide input on fiduciary decisions;
- Ensuring a suitable number and diversity of investment options for plan participants;
- Replacing underperforming and/or expensive investment options and verifying the benchmarks used are appropriate;
- Creating and updating an investment policy statement with outside counsel;
- Ensuring investment committee members have relevant business, financial or legal expertise, and understand their responsibilities; and
- Documenting investment committee meeting minutes and decisions in writing, especially if a decision is made to go against the plan's investment policies.



Of course, the sobering reality is that even the most well-run plans can still fall victim to excessive fee claims. Given the ease of bringing these cases, none of these risk mitigation actions will necessarily prevent a plaintiff's lawyer from filing a complaint. And even being victorious against an excessive fee case can mean millions in defense costs, with some plans spending eight figures or more to successfully defend their prudent fiduciary plan oversight. That's why it is imperative that fiduciaries of plans of all sizes always deepen their understanding of potential excessive fee allegations and act prudently, including when engaging third-party service providers.

Bracing for the next wave of excessive fee litigation

The potential risks that retirement plan fiduciaries face in fulfilling their duties are not new. But the frequency and severity of excessive fee complaints has sharply increased – irrespective of industry, jurisdiction or plan type. What's more, it's no longer fiduciaries of jumbo retirement plans with over \$1 billion in assets and thousands of plan participants that face the greatest exposure. Fiduciaries of small plans are increasingly affected, and the cost both to defend these cases and to negotiate a financial settlement, if desired, continues to rise.

Given the propensity of plaintiff's lawyers to bring excessive fee cases against such a broad swath of retirement plans and their fiduciaries, liability insurance is increasingly difficult to underwrite. Meanwhile, almost every company is a potential target. That's why the most forward-thinking companies are constantly assessing their risk tolerance and taking steps to ensure that both they and their insured retirement plan fiduciaries are doing everything they can to anticipate or prepare for the next wave of litigation.

At AIG, we are committed to an evidence-based dialogue with our distribution partners and clients. By sharing data and insights that arise from our position as a leading provider of fiduciary liability coverage, we hope to help foster a clearer, mutual understanding of current market dynamics and risk mitigation solutions available.

For more information, visit www.aig.com/excessivefeeclaims or contact your AIG Underwriter or Distribution Leader.



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