North America Financial Lines: Fiduciary Liability

Over the past decade, excess fee litigation has become a recurring worry for employee benefit plan fiduciaries. Despite a reduction of filings from the record years of 2020 and 2022, the overall state of litigation alleging excess fees and failure to monitor investment performance remains alarming. Settlement values have dropped, but the number of settlements has steadily increased during the past three years. Fiduciary liability exposures and claim severity remain significant, and the costs to defend fiduciary lawsuits are not decreasing. This edition of AIG's Claims Intelligence Series offers insights on fiduciary exposure, litigation, and judicial trends. Our analysis draws on AIG's extensive experience as a leading provider of fiduciary liability insurance as well as third-party data supplied by leading defense law firms.

At a glance

- Fiduciary liability allegations involving excess fees may use different terms — "excessive fee," "investment underperformance," or "prohibited transaction" — but all relate to fiduciaries not achieving the maximum benefit at a minimum cost to plan members.
- The incentive to file excess fee lawsuits remains high as plaintiffs' suits in many jurisdictions continue to survive a majority of motions to dismiss. In 2023, of 76 motion to dismiss decisions, 59.2% were allowed to proceed to the discovery phase. In the first half of 2024, that percentage was 62.5%.[1]
- Defense costs increase significantly in cases that proceed to discovery, even if they do not result in a verdict for defendants.
- Defense costs through trial vary widely, but commonly exceed $10 million, which does not include additional costs if plaintiffs appeal.
- The plaintiffs' bar continues to find novel ways to interpret the Employee Retirement Income Security Act of 1974 (ERISA) and file new variations of excess fee cases, with no indications that this trend will slow in the foreseeable future.

[1] *Proskauer Rose LLP data as of June 30, 2024*

What are the main sources of fiduciary exposure to excess fee litigation?

Fiduciaries are exposed to litigation in multiple areas, as plaintiffs' attorneys push novel theories of liability, but excess fee lawsuits continue to drive ERISA litigation and wreak havoc on defendants. These lawsuits use different names, but they share a common cause of action — that is, allegations of a breach of fiduciary duty to minimize the cost or financial impact on plan participants. The main types of excess fee allegations are:

Excess fee. In this type of case, plaintiffs allege fiduciaries imprudently monitored or selected service providers for plan recordkeeping, administration, and/or investment management services. Excess fee suits typically allege failure to monitor the fees or expense rates of such service providers, resulting in excess costs to the plan and its participants.

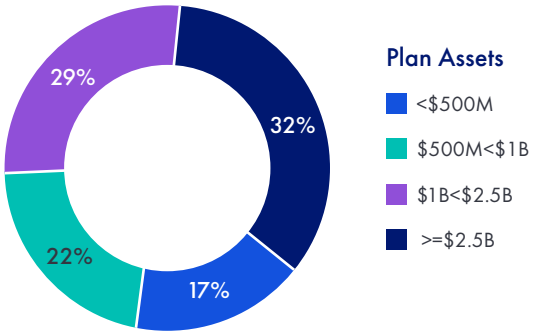
Investment performance. This category of litigation seeks to establish investment imprudence by alleging failure by the fiduciaries to continuously monitor the performance of plan investment options, including amending the investment mix.

Prohibited transaction. This type of suit alleges fiduciaries gained benefits in excess of the market cost of the services provided and the investment returns generated. These allegations typically arise where plans offer proprietary investment products or services in which the fiduciaries may gain financially. Plaintiffs will claim fiduciaries failed to objectively evaluate the cost and performance of proprietary investments compared to other options.

How does plan size correlate to excess fee suits?

Excess fee suits are distributed across all plan sizes, whether measured by assets or number of participants. And, although jumbo plans, or those with $1 billion or more in assets, tend to experience the majority of lawsuits, smaller plans are still recurring targets for litigation. For example, between Q1 2020 and Q2 2024, plans with less than $500 million in assets accounted for 17% of fiduciary liability suits, compared with 83% for plans with more than $500 million in assets — of which jumbo plans saw 61% of suits.

Percentage of excess fee suits filed by plan size
Q1 2020 through Q2 2024



Source: U.S. Department of Labor data and other public information

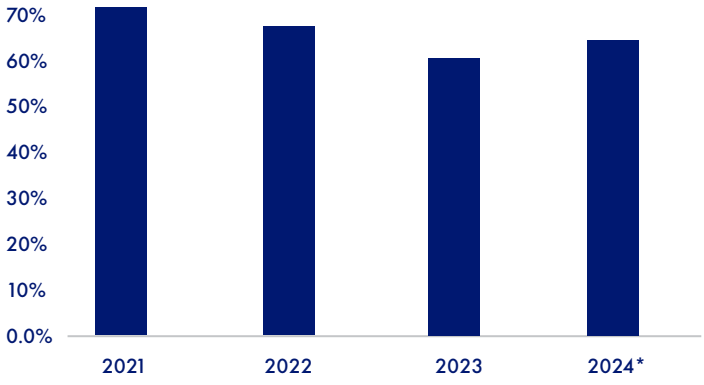
What are the trends AIG is seeing in the motion to dismiss (MTD) stage of litigation?

Plaintiffs' success during the MTD stage is encouraging the filing of more excess fee suits. In 2022 and 2023, the dismissal rate for defendants improved marginally, but continues to fluctuate and is worsening in 2024. Another factor contributing to plaintiffs' success rate at the MTD stage is inconsistency by the courts in requiring a pleading standard for imprudence lawsuits under ERISA. Overall, during the past three years, plaintiffs in excess fee cases have won at least two-thirds of courts' motion to dismiss decisions. This number is unlikely to go down due to plaintiffs continuing to be creative in pressing ERISA suits, filing newer versions of excess fee litigation. These newer actions include suits:

- Brought against health plans, alleging plan fiduciaries misapply drug rebates, overpay for benefits and services, and fail to apply prudent, conflict-free selection and oversight processes for pharmacy benefit management (PBM) services.
- Alleging misuse of plan forfeitures.
- Alleging failure to have a proxy voting policy in place while reviewing the cost/benefit analysis of the voting.

The creativity of the plaintiffs' bar in interpreting ERISA is effective in persuading judges to allow cases to proceed beyond the MTD stage. One driver of excess fee lawsuit filings is exaggerated allegations of excess fees for recordkeeping and investment management relative to those of "similar" plans. Plaintiffs' attorneys frequently cite participant fees from vastly different sized plans, rather than focusing on accurate and meaningful benchmarking metrics. For example, a jumbo plan with $1 billion in assets is unlikely to have the same negotiating leverage to reduce fees as plans with $10 billion or more in assets. Nevertheless, these suits allege fiduciary imprudence for failing to leverage the size of the plan to negotiate lower recordkeeping or investment management fees. Other drivers increasing excess fee litigation in 2023 and 2024 are underperformance of fund investment returns, share class suits, and indirect revenue-sharing agreements that do not equitably reduce fees for participants.

Percentage of MTD decisions allowed to proceed to discovery



*Source: Proskauer Rose LLP (*2024 data through Q2)*

Behind the Numbers: Defense Costs

The cost to defend fiduciary liability suits varies during different phases of litigation. Generally, average defense costs through the motion to dismiss stage range from $350,000 to $600,000. Once a case is denied MTD, defense costs typically rise significantly.

Defense costs through trial vary widely, but commonly exceed $10 million, which does not include additional costs if plaintiffs appeal.Expert witness expenses can double the cost to defend.

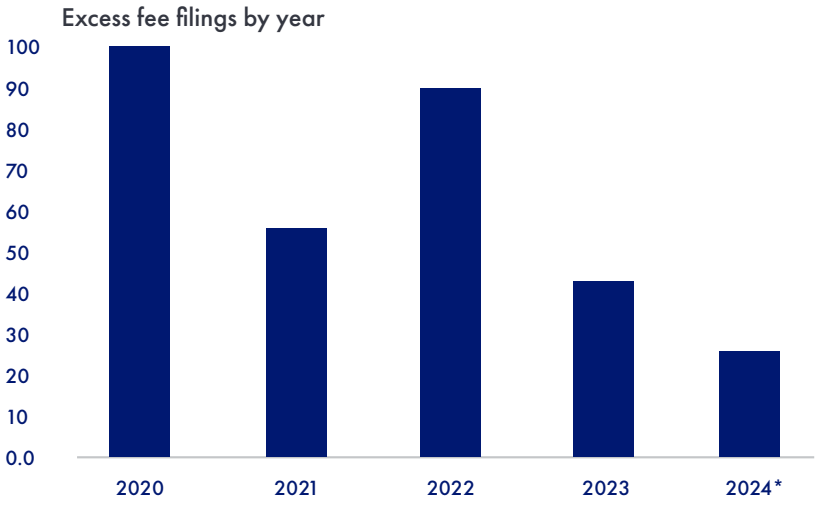
Even though the cost to defend fiduciary suits varies widely, defense costs are not necessarily less for smaller plan sponsors.

Economics favor plaintiff filings

The economics of ERISA litigation favor plaintiffs, as fiduciary lawsuits are generally less expensive to file than to defend. For example, the filing process and plaintiff search are easily repeated and may cost less than $250,000. Expert witness costs into discovery may cost less than $1 million and up to $5 million through the trial phase. Plaintiffs' law firms approach ERISA litigation differently, with some seeking a high volume of lower-value cases and others more selectively pursuing higher-value cases against jumbo plans. The relative ease and low expense of filing excess fee lawsuits mean fiduciaries should expect to see more litigation ahead.

Dip in settlement values offset by frequency uptick

The average value of excess fee settlements from 2023 through 2024 has dropped since the record high set in 2020 through 2022, however, the increasing number of settlements since 2021 will keep the aggregate value of all settlements at record levels. In 2020 and 2021, the average settlement was greater than $10 million, while in 2022 it fell below $5 million. In 2024 the average settlement value has again increased, hovering around $5 million. While this individual settlement severity is lower than that in the record period, the number of settlements has increased steadily each year from 2020 through the first half of 2024, creating annual overall severity exceeding earlier records.



*Source: AIG data (*2024 data through Q2)*

Fiduciaries and their risk advisors should not conclude that the reduction in filing activity in 2023 and early 2024 signals that litigation is ending or becoming easier to defend. In addition to judicial backlogs of pending cases, ERISA has a six-year statute of limitations. Future excess fee filings may well increase sharply.

There is an unfortunate irony in excess fee litigation, where plaintiffs' attorneys allege fiduciaries caused harm to plan participants. The volume of litigation is discouraging fiduciaries from offering anything but the lowest cost and least complex investment options. Who then is harmed? Ultimately, it's plan participants, who may be missing out on opportunities for maximizing investment growth.

Case Studies

Excess fee

The sponsor of a plan with less than $2 billion in assets faced a lawsuit alleging the plan investment committee failed to monitor the fee rates of the recordkeeper and the investment options offered. Among other allegations, plaintiffs contended the fiduciaries failed to leverage the plan asset size to negotiate lower recordkeeping and investment management fees and retained higher-cost investment options instead of offering lower share classes. The parties settled after a motion to dismiss was lost, with the defendant's fiduciary liability policy paying approximately $5 million in settlement and defense costs.

Investment performance

A plan with assets of more than $5 billion was sued for investment underperformance after the plan offered investment options that performed worse than 70% to 90% of similar funds. Plaintiffs alleged the plan sponsor began offering the investment options after the funds already demonstrated poor performance. The litigation settled after two years in the low eight figures, along with an agreement to remove the underperforming investment options from the plan. The plan sponsor's fiduciary liability policy paid for the settlement in addition to the costs to defend the lawsuit.

Investment performance

Employees of an insured manufacturer filed a complaint against its plan and its administrator, alleging failure to monitor recordkeeping, administrative, and investment management fees, including revenue sharing, while not leveraging the plan's aggregate plan asset size ($250 million) to negotiate lower expense rates through an institutional share class. The complaint also alleged failure to monitor the performance of investment options against alternative options. The insured notified AIG of the complaint and worked together to determine the best course of action, ultimately deciding to settle the matter to protect the insured's balance sheet and avoid the potential risk of surpassing their coverage limits. The insured's fiduciary liability policy paid more than $4 million.

Prohibited transaction

A financial organization that sponsored a plan with less than $5 billion in assets faced a lawsuit over proprietary investment options and investment management services. Plaintiffs alleged the plan sponsor failed to employ a prudent process for selecting, monitoring, and reviewing the plan's investment options, failed to monitor recordkeeping expenses, and lacked a formal request for proposal process to compare fees. After two years, the case settled for eight figures, along with more than $5 million in defense costs, the majority of which was covered by the insured's fiduciary liability policy.

AIG has more than six decades of experience providing management liability solutions for public companies, private and non-profit organizations, financial institutions, and their directors, officers, and employees. Our extensive experience, expertise, and insights enable us to tailor solutions that meet our clients' individual needs. Coverage is backed by AIG's financial strength, integrated claims model, and proven claim expertise, ensuring that we are there for our clients when they need us most.

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