Pension Trustee Liability Insurance – A perfect storm?

Buyers of fiduciary liability insurance – or pension trustee liability (PTL) insurance – are facing a perfect storm. Emerging exposures such as excessive fee claims are growing on both sides of the Atlantic, while available risk transfer capacity is shrinking.

A combination of deteriorating claims experience, a more litigious environment (particularly in the US market, but also increasingly in the UK), and a hardening insurance market is making it more expensive and more difficult to secure specialist PTL insurance coverage. We explain why PTL insurance is no longer the 'poor cousin' of financial lines insurance, why the market has become particularly challenging and how commercial insurance buyers and their brokers can best navigate the current landscape.

PTL insurance: Mind the gap

Fiduciary liability insurance, or PTL insurance, as it is more commonly known in EMEA, is a product which fits into the broader financial lines management liability family, which also includes D&O, crime and employment practices liability insurance. While the latter products are well-known, mainstream products that are considered essential by most organisations, previously within EMEA PTL insurance was only considered necessary if the company had substantial employee benefit plans in the US, and was treated as an 'add-on'. But this is changing as the exposure evolves.

Similar to D&O, PTL insurance covers the defence costs and the liability for awards and damages of trustees and individuals administering any employee benefit or welfare plan. It also provides cover for the company that sponsors such plans. Limited aspects of PTL coverage can be found within D&O liability however, many D&O policies, if not specifically excluding PTL-related claims, do not provide broad coverage. Hence the full liabilities of trustees are likely to be underinsured if a company only has D&O coverage in place.

PTL claims usually allege breach of trust, duty or statutory provision, misstatements, mis-administration or errors and omissions. While many plan fiduciaries often outsource the administration of their plans, it is important to remember that the overarching responsibility still lies with the plan fiduciary, and they can therefore be held liable for any breaches.

What are 401(k) plans and why does it matter?

Some readers might be familiar with the terms 'defined benefit' and 'defined contribution' plans relating to PTL insurance. A defined benefit plan is a plan where an employer sets aside a certain amount of money and promises the employee that a certain sum of money will be paid on a regular interval upon retirement. A defined contribution plan allows an employee to make pre-tax contributions into a fund whose investment returns are tax-deferred. In many cases, 401(k) employee contributions are matched in whole or in part by the employer.

In a defined contribution plan, there is no guaranteed pay out of a certain sum once the employee retires. Instead, the sum is dependent upon the performance of the underlying assets in the plan. A 401(k) plan is the most common type of defined contribution plan and is mainly used for the employees of large corporations.

Wave of excessive fee claims

One of the most concerning trends in PTL claims is seen in the significant rise in litigation against plan sponsors and administrators, alleging a lack of oversight over fee arrangements (excessive fee) in plan investment funds, which have risen in both number and quantum of damages in the last couple of years. Similar to securities class action lawsuits under D&O insurance, excessive fee lawsuits have generated significant fee income and notoriety for a small group of aggressive plaintiffs' law firms. They have also become an area of growing concern for PTL insurers and their insureds.

While the recent growth in litigation around excessive fee claims is a phenomenon occurring largely within the US market, we have observed some trends that suggest the UK may be moving in a similar direction which may ultimately spread across EMEA. This includes the continued growth in third party litigation funding, the passing of more protective pension legislation (UK Pension Schemes Act 2021) and the global expansion of high-profile US-based plaintiff law firms and their networks.

Excessive fee claims are exactly as the name suggests, claims which allege that plan sponsors have paid excessively high fees to record-keeper(s) and/or investment manager(s) or permitted them to charge plan participants excessively high fees to manage their investments in a manner that was disproportionate to their contribution. Some plans may also employ a revenue sharing compensation agreement, which can inflate fees even further. In some instances, plaintiffs will also allege that the investment options offered by the plan underperform in comparison to their peers, resulting in larger investment losses or diminished returns.

Retirement [401(k)] plan fiduciaries are responsible for overseeing, among other things, the investment management fees, administration fees and the overall performance of the investments in the plan. When they fail to carry out their duties satisfactorily, the risk of facing an excessive fee claim is increased. Common allegations against plan sponsors under excessive fee claims include:

- Failure to monitor service providers and fees in plans;
- Recordkeeping fees are too high or paid through expensive revenue sharing compensation agreements;
- Class of shares used are more expensive than others (retail versus institutional), and
- Failure to conduct request for proposals (RFP) to ensure service provider fees are reasonable.

Excessive fee claims have existed in the US market since the early 2000s. Originally those lawsuits targeted companies with the largest 401(k) plans (with billions of dollars in plan assets and tens of thousands of participants) where the potential for large recoveries was more likely.

More recently, litigation has become broader and excessive fee lawsuits are being filed against companies with smaller retirement 401(k) plans, some with only a few hundred participants and plan assets in the region of $200m or less. This represents a significant and growing exposure for EMEA companies with US subsidiaries. Moreover, in the UK market we are seeing a noticeable increase in excessive fee litigation for most multinationals, not just those with US exposures.

Drivers of claims severity

One reason for the uptick in claims against smaller companies and plans is simply that local plaintiff law firms have become aware of them and considered it a potential growth area. Similar to securities class action claims we have witnessed a new group of plaintiff firms entering this space, driven in no small part by the high success rate and the seven to eight figure fees these firms can sometimes earn.

Another reason for the increase in claims frequency can be linked to the Tibble v. Edison International US Supreme Court decision in 2015 affirming that plan fiduciaries, under ERISA [Employee Retirement Income Security Act], have an ongoing duty to monitor the prudence of plan investments, which immediately increased the potential exposure of plan trustees.

A third driver is that in some instances, a general increase in litigation has motivated some plan fiduciaries to review the level of fees being charged and seek reductions from investment managers and record keepers. When plan participants are notified of this, lawyers have sought to legally exploit the notifications as admissions by plan fiduciaries that prior fees may have been excessive.

As discussed, plans of all sizes are now exposed to excessive fee claims. Previously, the biggest focus was on plans with billions of dollars in plan assets but now it is not uncommon for plans with less than $200m to be targeted. In the current economic climate, the trend towards increased claim frequency and severity is expected to continue and potentially worsen.

For many large corporates this means their exposure is increasing at a time when the PTL insurance market is becoming significantly more challenging. We have seen a number of insurers reduce or withdraw capacity in recent months, driving up the cost of cover and making it more difficult to secure coverage. The advice to brokers and clients is to begin renewals as early as possible to avoid any gaps in cover.

Risk management best practice

Fiduciaries and trustees are personally liable for their duties regardless of whether or not they outsource some of the responsibility to a third party. If the plan has a history of paying excessive fees or only offering expensive or underperforming investment options, then the chances of a facing an excessive fee claim is deemed to be higher.

There are a number of ways of managing and mitigating the risk of litigation, according to the advice of brokers and risk associations. These include:

- Ensuring the average cost per participant is not excessive and that the cost trend is decreasing;
- Renegotiating financial agreements with record-keepers on a periodic basis and benchmarking the quotes;
- Introducing caps and rebates to participants when revenue sharing compensation agreements are in place;
- Limiting the use of record keepers;
- Retaining a reputable plan consultant to assist with fiduciary decisions;
- Ensuring there are a diverse and suitable number of investment options for the plan participants, and
- Replacing underperforming and/or expensive investment options and verifying the benchmarks.

Just as many companies today take out D&O insurance to protect the personal liabilities and assets of their directors and officers, so should companies protect their plan fiduciaries and trustees with dedicated PTL insurance. Far from being an add-on any more, the cover is essential in protecting fiduciaries' personal assets from an increasing number of excessive fee claims on both sides of the Atlantic.

However, the perfect storm of a worsening claims environment, economic downturn and hardening commercial insurance market means this cover is becoming more challenging to place. The earlier brokers and insurance buyers can start renewal discussions, the more likely they will be to secure the coverage they need, offering peace of mind to plan fiduciaries and trustees.

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