Arthur J. Gallagher & Co.

Market Conditions

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Fiduciary Liability

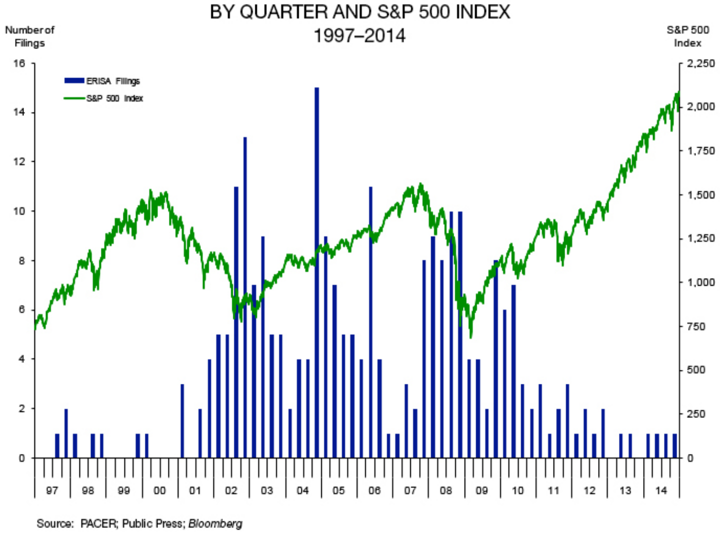
By Rebecca Dauparas and Brendan Goodwin

Fiduciary liability insurance renewals were stable in 2015. This coverage line continues to be the least affected by market changes of all management liability coverages. While there have been sizable settlements in this line over the past 12 months, we do not anticipate a change in overall market conditions in 2016.

ERISA COMPANY STOCK CASES

According to Cornerstone Research,[1] there have been 256 ERISA company stock drop cases filed against publicly traded organizations since 1997; 94% (240) were filed either post-Enron or after November 2001. The number of cases filed annually has trended downwards since 2011 due to a combination of positive stock market performance, lack of large-scale industry event (e.g., financial crisis), and decisions by employers to remove or reduce company stock held in their plans. Approximately 70% of ERISA stock drop cases follow securities class actions and, if settled, will average 60% of the amount of the securities settlement. Data shows the average ERISA settlement is $34.1 million and the median is $6.5 million. The average time between the case filing and the settlement is approximately three years. The average plan assets invested in company stock associated with ERISA stock drop cases is 36%, with an average value of $620 million. Carriers will typically add a separate retention for employer securities if it is a specific risk factor.

ERISA COMPANY STOCK DROP CASE FILINGS
BY QUARTER AND S&P 500 INDEX
1997–2014



FEE AND EXPENSE LITIGATION

Since 2007, nearly 40 lawsuits have been filed relating to 401(k) plan fees, primarily by law firm Schlicter, Bogard and Denton LLP. Additional plaintiff class action firms have recently filed cases motivated by successful prior outcomes. Initially, the suits were brought by plan participants against plan sponsors alleging excessive fees charged to participants due to revenue sharing arrangements which favored plan service providers or the company. Allegations of wrongdoing have expanded to include decisions to utilize retail share classes, actively managed funds, unitized company stock funds, bundled service providers and failure to capture revenue streams to the benefit of the plan participants. For financial institutions, these cases typically also include Proprietary Fund allegations. This subclass of fee and expense claims alleges the improper use of proprietary or affiliated funds or services resulting in a breach of fiduciary duty and/or prohibited transaction. There has been a steady increase in settlement amounts over the past two years since the beginning of 2014. Consequently, we anticipate plaintiff class action law firms to continue to seek these types of cases in 2016.

SIGNIFICANT FEE AND EXPENSE CLAIMS

COMPANY	ALLEGATIONS	OUTCOME
Lockheed Martin Corp.	Revenue sharing, use of retail class vs. institutional class mutual funds, fraudulent benchmarking, misrepresentation of a stable value fund, having a unitized company stock fund and engaging in prohibited transactions.	$62 million settlement approved on July 20, 2015. Claim initially filed Sept. 2006.
International Paper	Revenue sharing, placing revenue generated from plan assets into corporate accounts, self-dealing, service provider conflicts of interest, mandating company stock as an investment option, excessive fees and confusing disclosures.	$30 million settlement approved on Jan. 31, 2014. Claim initially filed Sept. 2006.
Boeing Co.	Revenue sharing, excessive fees, placing risky investment options in plan, did not consider/capture additional revenue streams, actively managed mutual funds, and utilization of mutual funds vs. separate accounts.	$57 million settlement reached on Aug. 26, 2015. Claim initially filed Sept. 2006.
ABB, Inc.	Revenue sharing, did not consider/capture additional revenue streams, actively managed mutual funds and utilization of mutual funds vs. separate accounts.	$36.9 million awarded on March 31, 2012. Currently under appeal. Claim initially filed Dec. 2006.

[1]Source: Cornerstone Research–Employee Retirement Income Security Act (ERISA) Company Stock Cases, 2015 https://www.cornerstone.com/Publications/Research/ERISA-Company-Stock-Cases

Ameriprise Financial	Proprietary funds offered as investment options were poorly rated and underperforming; record keeper kickbacks, self-dealing by plan fiduciaries.	$27.5 million settlement approved on July 13, 2015. Claim initially filed Sept. 2011.
FMR (Fidelity)	Proprietary funds charged significantly higher fees than comparable nonproprietary funds, plan assets were used to "seed" newly formed proprietary funds, plan's ownership percentage too large in certain proprietary funds, too many investment options resulting in an excessive fee schedule.	$12 million settlement approved on Oct. 14, 2014. Claim initially filed March 2013.

SUPREME COURT RULES ON ERISA STATUTE OF LIMITATIONS

On the heels of *Fifth Third Bancorp v. Dudenhoeffer*,[2] the Supreme Court in 2015 heard *Tibble v. Edison International.*[3] Though ultimately an excessive 401(k) fees case, the Court was focused on the six year statute of limitations for ERISA fiduciary breach claims. The court confirmed that an ERISA fiduciary has an ongoing duty to monitor plan investments. ERISA's six year statute of limitations does not bar a claim challenging investments in a plan selected more than six years before the alleged fiduciary breach. This case highlights the need for thorough review of all aspects of investments in a 401(k) plan. Prudent fiduciaries should analyze and document their investment decisions regularly, consult with professionals, and routinely review both fees and performance of service providers and investments.

DEPARTMENT OF LABOR DEVELOPMENTS

The Department of Labor continues to move forward on the proposed expansion of the definition of a fiduciary. For plan sponsors and fiduciaries, the proposal would expand the duty to monitor advisors and investment managers, and potentially exposes existing plan fiduciaries with claims based on co-fiduciary liability, participation in prohibited transactions and/or breach of fiduciary duty for failure to monitor external advisors. Discussions and revisions based on industry feedback are expected to occur over the next several months.

PRIVATE/NOT-FOR-PROFIT MARKET

The claimant of significance for ERISA cases in the Private/Not-For-Profit segment continues to be the Department of Labor/ Employee Benefit Security Administration (EBSA). During fiscal year 2015, EBSA recovered $696.3 million for direct payment to plans, participants and beneficiaries.[4] More than 2,400 civil investigations were closed by EBSA during 2015, with 1,640 or 67.2% of these cases resulting in losses restored to employee benefit plans or other corrective actions. EBSA typically pursues voluntary compliance as the preferred means to correct violations and restore losses to employee benefit plans. In cases where voluntary compliance and corrections efforts have failed or are not appropriate, EBSA will refer the case to the Solicitor of Labor to initiate litigation. In 2015, 136 cases were referred for litigation and 89 civil cases were subsequently filed. During fiscal year 2015, EBSA closed 275 criminal investigations; 67 (or 24%) were closed with guilty pleas or convictions. Additionally, 61 individuals were indicted, including plan officers, corporate officers and service providers, for offenses related to employee benefit plans. Most fiduciary liability policies, whether purchased monoline or in a package, offer a sublimit for fees, including fines and penalties, defense, and compliance costs associated with the Voluntary Fiduciary Correction Program (VFCP).

Employee Stock Ownership Plans (ESOPs) have been consistently identified over the past few years as an EBSA National Enforcement Project. The ESOP Project is designed to identify and correct violations of ERISA in connection with ESOPs. The most common violations are found in the incorrect valuation of employer securities. Other issues involve failure to provide participants with specific benefits required or allowed under ESOPs and the refinancing of ESOP loans.

2016 MARKET OUTLOOK

Given the long-term profitability of the fiduciary liability product line, we expect to see flat to modest increases in renewal premiums (0-5%) in 2016 and stable terms and conditions. Companies with heightened exposures such as a large concentration of company stock in defined contribution plans, proprietary fund investment options and ESOPs, may see adjustments to retentions and/or increased premiums. As always, stressed risks (poor claims history, underfunded plans and plan sponsors in financial distress) should prepare for larger increases than those previously indicated and potentially restrictive exclusions.

Rebecca Dauparas is a Client Advisor and Brendan Goodwin is a Client Service Manager in Arthur J. Gallagher & Co.'s Management Liability Practice. This group focuses on providing insurance and risk management solutions related to executive and management liability issues. For additional information, please contact Rebecca at Rebecca_Dauparas@ajg.com, Brendan at Brendan_Goodwin@ajg.com or visit www.ajg.com/mlp.

[2]Source: Dudenhoeffer v. Fifth Third Bancorp, 12-751, 6th Cir., Argument 4/2/14, Opinion 6/25/14

[3]Source: Tibble v. Edison International, 13-550, 9th Cir., Argument 2/24/15, Opinion 5/18/15

[4]Source: U.S. Department of Labor / Employee Benefits Security Administration - EBSA Restores Over $696.3 Million to Employee Benefit Plans, Participants and Beneficiaries http://www.dol.gov/ebsa/newsroom/fsFYagencyresults.html

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