2020 FIDUCIARY CLAIM TRENDS

from Euclid Specialty

June 10, 2020

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Introduction

EUCLID SPECIALTY

- As fiduciary underwriters for some of America's best employee benefit plans, we are often asked two questions:
  1) do you have claim examples to demonstrate the risks faced by employee benefit plans?; and
  2) how much insurance coverage should my plan purchase?
- The risk of sponsoring an employee benefit plan has never been greater.
- This presentation is designed to provide a helpful guide for plan professionals, to guide their ability to protect plan fiduciaries.

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Our Presenters

Daniel Aronowitz

Managing Principal of Euclid Specialty Managers

- Author of the Fiduciary Liability Handbook and the Fid Guru Blog.
- Before his underwriting career, Dan was a leading professional liability insurance coverage lawyer as a partner at the national law firm Shaw Pittman.

Jeffrey Koonankeil

Chief Claims Officer of Euclid Specialty Managers

- Jeff has extensive Professional Liability claims experience having worked on Fiduciary Liability, Directors and Officers, Employment Practices Liability and Fidelity claims for leading professional liability insurance companies for over 20 years.

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Key Claim Trends

Key trends driving claims against fiduciaries of employee benefit plans:

- Increased Regulatory Enforcement
- Sharp Rise in Cyber Claims
- Increase in Early Retirement Disability Claims
- Increased Use of Voluntary Compliance Programs
- Direct Provider Claims Under Participant Assignments
- Continued Increase in Excessive Fee and Other High-Stakes Class Action Litigation Against Benefit Plans

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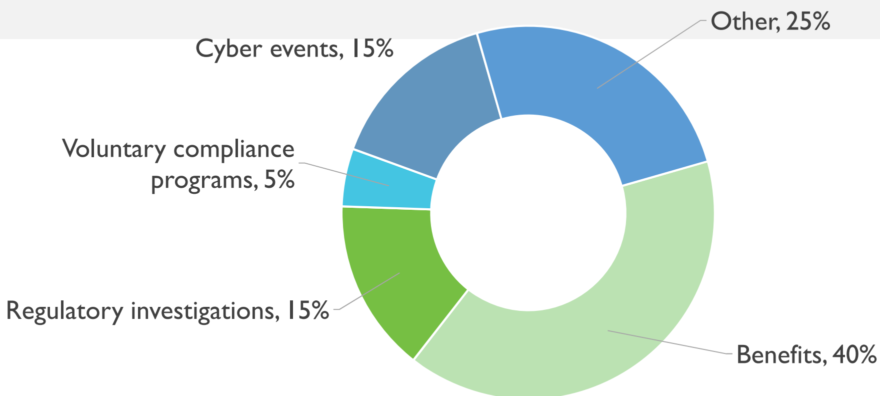
Fiduciary Claim Distribution



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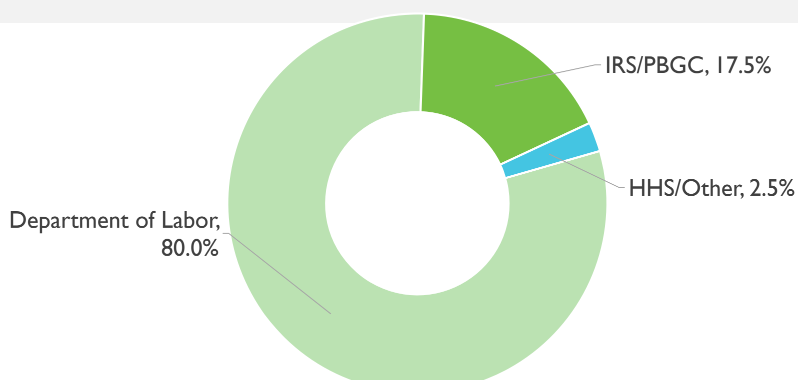
Fiduciary Claim Distribution Regulatory Investigations



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Retirement Plans

KEY TRENDS

1. Increased regulatory enforcement by the Department of Labor and higher regulatory penalties by DOL and IRS
2. Sharp rise in cyber claims
3. Increased use of Voluntary Correction Programs
4. Continued rise of class action benefit and excessive fee claims

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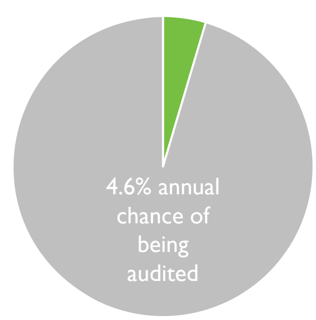
RETIREMENT PLANS

DOL Audits and Regulatory Enforcement

Euclid DOL Statistics:

- Historically, a defined benefit plan has a 4.6% annual chance of being audited [up to four times higher than that for a large multiemployer plan]
- That went down 50% in the first 18 months of the Trump Administration [2016-17], but returned to the historical annual rate in 2018 and 2019 with increased EBSA audit activity.



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RETIREMENT PLANS

DOL Key Investigation Focal Points

- **Key Focus on Missing Participants**
- Inadequate fidelity bonds
- Expense Management
- Plan fiduciary processes and claims procedures
- Timeliness of participant contributions
- Required plan documents and disclosures
- Fiduciary duties and prohibited transactions
- Hard to value assets
- Plan investment conflicts
- Proprietary funds and services
- Impact of pre-claim investigation coverage

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RETIREMENT PLANS

IRS Regulatory Audits

- Trend: the number of IRS audits are down by 50% in the last two years (likely because of staffing issues from the IRS), but the IRS has increased its enforcement with penalty notices for tax and filing-related violations.
- The IRS states that 95% of audits find non-compliance problems, which is confirmed by Euclid claims experience.

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RETIREMENT PLANS

Top Compliance Monitoring Issues identified during IRS audits

- Errors made in benefit calculations, crediting service, reduction factors, general administration
- **Minimum Funding deficiency** — IRC Section 412 violations
- Plan did not make required actuarial adjustments for benefit payments beginning after normal retirement date
- Deficient plan language and/or conflict between plan document and other agreements (collectively bargained, joinder participation)
- Internal Revenue Code Section 401(a)(9) violation (required minimum distributions)
- Plan fails to follow or does not have a participation agreement for each participating employer
- Accrual/service credit is dependent on employer contributions being made
- **Vesting or Benefit Accruals:** IRC Section 411 violations including cash out/forfeitures from lost participants, wrong vesting schedule used, and error in vesting percentages
- **Delinquent/late contributions**

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RETIREMENT PLANS

IRS Compliance Issues (cont.)

- **Prohibited Transactions**
- **Required Minimum Distributions**
- **Participation/Coverage** — Plans are failing to meet the testing requirements of section 410(b) since they are not following the participation entry requirements of the plan and law which is resulting in the late entry of employees who must be included for testing purposes.
- **Discrimination of Contributions/Benefits** — Plan did not make required actuarial adjustments for benefit payments beginning after Normal Retirement Date.
- **Non/Late Amender**
- **Joint and Survivor Annuity**: Internal Revenue Code Section 417 violations including spousal consent, QJ&S application, joint and survivor annuity adjustment when the non-spouse beneficiary is more than 10 years younger than the employee, and QDRO.

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RETIREMENT PLANS

IRS Penalties Continue to Increase

SECURE Act Section 403 penalties:

	Old Penalty	New Penalty
Failure to submit Form 5500	$25/day	$250/day *Not to exceed $150,000*
Failure to file a registration statement of deferred vested participants	$1/participant per day	$10/participant per day *Not to exceed $50,000*
Failure to file a required notification of a change in plan status (e.g. Plan name)	$1/day	$10/day *Not to exceed $10,000*
Failure to provide withholding notice (W-4P) for periodic pension payments	$10/each failure	$100/each failure, *Not to exceed $10,000 for all failures during calendar year*

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RETIREMENT PLANS

Regulatory Investigation Coverage

- **Impact of fiduciary coverage for pre-claim investigation:** plan can seek reimbursement of representation for regulatory audits even before an allegation of wrongdoing.
- Note that not all pre-claim coverage is the same: confirm that your policy is not limited to Department of Labor investigations. Some policies do not cover IRS or other regulatory investigations.

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Defined Benefit Plans

KEY TRENDS

1. New actuarial assumption litigation
2. Imprudent Investment cases remain the highest severity exposure
3. Increased Frequency of Cyber Events and improper disclosure of personally identifiable information of participants
4. Benefit overpayment mistakes are a persistent problem
5. Increased use of Voluntary Correction Programs to correct operational issues

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DEFINED BENEFIT PLANS

Defined Benefit Plan Claim Trends

- Benefit claims remain the most frequent type of claim, with more filed as class actions – increase in early retirement disability claims
- Benefit overpayment problems continue
- Imprudent Investment Claims – highest severity exposure
  - June 1, 2020 standing decision in *Thole v. U.S. Bank* – no standing for imprudent investments when plan sponsor made additional contributions to solve underfunding
  - Unclear whether there would be a concrete injury when plan is underfunded
- Improper plan expenses
- Reporting Violations: Failure to provide notice of benefit changes and other required notices

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Defined Benefit Claim Trends (cont.)

DEFINED BENEFIT PLANS

- **Cyber Events** – disclosure of participant personally identifiable information
  - Now the second most common type of claim behind benefit claims
- **Crime claims** – employee theft and social engineering claims
- **Equitable relief claims (Amara claims)** – expanding scope of relief to surcharges and reformation of the plan
- **Section 510 Retaliation claims**
- **Actuarial Assumption Litigation** – allegations that outdated mortality table assumptions harm annuity payouts
- **Increase in use of Voluntary Correction Programs to correct operational mistakes**

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Covered Transactions in the Voluntary Fiduciary Correction Program

DEFINED BENEFIT PLANS

- Delinquent Participant Contributions and Participant Loan Repayments to Pension Plans and Welfare Plans
- Fair market interest rate loans with parties in interest
- Below-market interest rate loans with parties in interest
- Below-market interest rate loans with non-parties in interest
- Participant loans failing to comply with plan provisions for amount, duration, or level amortization
- Defaulted participant loans
- Purchase of assets by plans from parties in interest
- Sales of assets by plans to parties in interest

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DEFINED BENEFIT PLANS

Covered Transactions in the Voluntary Fiduciary Correction Program (cont.)

- Sale and leaseback of property to sponsoring employers
- Purchase of assets from non-parties in interest at more than fair market value
- Sale of assets to non-parties in interest at less than fair market value
- Holding of an illiquid asset previously purchased by the plan
- Benefit payments based on improper valuation of plan assets
- Payment of duplicate, excessive, or unnecessary compensation
- Improper payment of expenses by plan
- Payment of dual compensation to plan fiduciaries

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Defined Contribution Plans

KEY TREND

1. Excessive Fee Claims have resumed with more plaintiff firms filing lawsuits
2. Increased regulatory enforcement focused on the failure to collect and timely remit contributions
3. More 401k plans have account losses due to cyber scams

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DC PLANS

Claim Trends for DC Plans

- Failure to collect and timely remit contributions — Late Deposit of Participant Contributions
- Investment losses for failing to follow participant investment changes
- Failure to perform ADP testing for highly compensated individuals (excluding bonuses and other compensation)
- Failure to automatically enroll and deduct percentage of wages
- Failure to calculate lost earnings on Plan forfeitures
- Failure to execute salary deferral elections
- Failure to operate as defined in the Plan documents and adoption agreements
- Failure to credit service as a temporary employee for temp-to-hire employees in determining eligibility
- Two recent cases filed for 401k losses based on cyber fraud

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DC PLANS

Excessive Fee Cases

Dozens of cases have been filed alleging the same core allegations that some of the plan's recordkeepers charged excessive fees or the investment options performed inadequately:

- Investment under-performance: That the plan fiduciaries failed to monitor the performance of actively managed plans that under-performed the results of index funds – or the investment choices are inappropriate;
- Excessive Investment Fees: That fees for individual plan investment choices were higher than Vanguard or other institutional share class index fund fees; and/or
- Excessive Recordkeeping Fees: That the record-keeping fees charged to plan participants were excessive

- Started with University plans, but has expanded to large plans over $1B in assets, and now smaller plans are being targeted
- First multiemployer plan defined contribution plan sued: Supplemental Income Trust Fund in California

- Key is whether plaintiffs can survive a motion to dismiss, which creates leverage for substantial settlements and high attorney fee rewards
- $231M in fee litigation settlements in 2019 with $77M in attorneys' fees

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DC PLANS

Excessive Fee Cases (cont.)

- First Circuit decision in *Brotherston v. Putnam Investments* proprietary fund case is most concerning – being read by some observers to require a fiduciary standing judged by the fees and performance of index funds, because plaintiffs can move the burden of proof to defendant plans just by showing that the fees charged in an active fund were higher than a purported index benchmark.
- Little clarity on the legal standard because the majority of the cases are settled when expensive discovery sued
- Trend: smaller plans being sued by copycat plaintiff firms:
  - University of Miami in May [under $200M Plan]
  - Aegis Media - $540M; Greystar Mgmt. Servs., L.P. - $194M
  - Several plans sued with less than $100M in plan assets [*Davis v. Stadion Money Mgmt.* ($29.4M); *Savage v. Sutherland Global Servs., Inc. ($52.2M); Diaz v. BTG Int'l Inc.* ($59M); *Draney v. Westco Chems., Inc.* ($4.5M)]

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DC PLANS

Excessive Fee Results 403 (b) Plans

	Organization	Date Filed	Details
DISMISSED	Essentia Health	12/2016	Both parties agreed to dismiss the case in November 2017
	George Washington Health	4/2018	Dismissed by a judge in July 2019; appeal denied March 2020
	Long Island University	5/2018	Voluntarily dismissed by plaintiffs in February 2019
	Northwestern University	8/2016	Dismissed by a judge in May 2018; appeal denied March 2020
	University of Rochester	5/2018	Voluntarily dismissed by plaintiffs in January 2019
	Washington University in St. Louis	6/2017	Dismissed by a judge in September 2018; (Euclid update: appealed and 8th Circuit remanded for further proceedings)
	Georgetown University	2/2018	Dismissed by a judge in January 2019
PARTIALLY DISMISSED	Cornell University	8/2016	Four counts dismissed by judge in September 2017; three remaining counts partially dismissed, with portions of each allowed to proceed. Motion of jury trial granted in September 2018, permitted to proceed as a class action suit in January 2019. Judge dismissed two of three remaining counts in September 2019, leaving one count to proceed. (Euclid update: May 2020 Judge requested parties confer about waiver of jury trial, trial before a magistrate judge, and settlement.
	Norton Healthcare	1/2018	Only a portion of one count dismissed by a judge in August 2019; otherwise, all seven counts allowed to proceed.
	University of Pennsylvania	8/2016	Dismissed by a judge in September 2017; partially overturned on appeal in May 2019. Appeal of that decision denied in July 2019 and Supreme Court decided not to review the appeal in March 2020.
	Yale University	8/2016	Three counts partially dismissed by a judge in March 2018; portions of each allowed to proceed, with four other accounts allowed to proceed in their entirety.

Source: Cammack Retirement Survey 403(b) Retirement Plan Fee Litigation | April 2020 Update

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DC PLANS

Excessive Fee Results – 403 (b) Plans (cont.)

	Organization	Date Filed	Details
GONE TO TRIAL	New York University (NYU)	8/2016	Judge found in favor of NYU on all counts at trial in July 2018; decision affirmed on appeal in July 2019.
SETTLED	Allina Health Systems	8/2017	Settled in April 2019 for $2.4 million
	Brown University	7/2017	Settled in March 2019 for $3.5 million
	Duke University	8/2016	Settled in January 2019 for $10.65 million
	Emory University	8/2016	Settled in April 2020; terms not yet disclosed; (Euclid update: settled for $16.75 million in May 2020)
	Johns Hopkins University	8/2016	Settled in August 2019 for $14 million
	Massachusetts Institute of Technology (MIT)	8/2016	Settled in October 2019 for $18.1 million
	Princeton University	5/2017	Settled in April 2020; terms not yet disclosed (Euclid update: pending settlement details)
	University of Chicago	5/2017	Settled in May 2018 for $6.5 million
	Vanderbilt University	8/2016	Settled in February 2019 for $14.5 million
	Providence Health	11/2017	Settled in January 2019 for $2.25 million

Source: Cammack Retirement Survey 403(b) Retirement Plan Fee Litigation | April 2020 Update

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DC PLANS

Excessive Fee Results – 403 (b) Plans (cont.)

	Organization	Date Filed	Details
OTHERWISE PENDING	Allina Health Systems	12/2019	
	Columbia University	8/2016	In March 2020, the trial judge, acting on the recommendation of a magistrate judge, denied Columbia's motion for summary judgement.
	Kaleida Health	10/2018	Survived motion to dismiss in August 2019
	TriHealth	7/2019	Note: This case happens to be a 401(k) lawsuit, not a 403(b)
	University of Southern California (USC)	8/2016	USC filed motion to compel arbitration in December 2016, which was denied by a judge in March 2017; USC appealed and the 9th Circuit Court of Appeals upheld the denial in July 2018. USC then appealed to the Supreme Court, which declined to hear the case in February 2019.

Source: Cammack Retirement Survey 403(b) Retirement Plan Fee Litigation | April 2020 Update

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Health and Welfare Plans

KEY TRENDS

1. DOL investigations focused on Mental Health Parity and Affordable Care Act compliance
2. Significant increase by participants suing under the Mental Health Parity Act
3. Explosion of direct claims by providers under participant assignments
4. New COBRA notice cases

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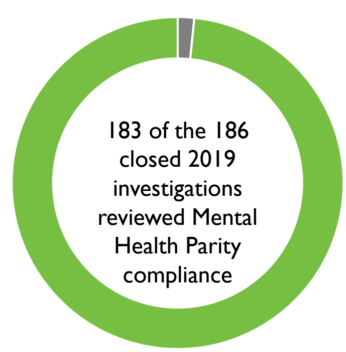
HEALTH & WELFARE PLANS

Health Plan Claim Trends

DOL Investigations – it's all about Mental Health Parity:

- EBSA reported that it investigated and closed 186 health plan investigation in fiscal year 2019 (and 3,758 since FY 2001)
- Mental Health Parity – six categories of violations:
  - Annual dollar limits
  - Aggregate lifetime dollar limits
  - Benefits in all classifications
  - Financial requirements
  - Treatment limitations
  - Cumulative financial requirements and quantitative treatment limitations



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DOL Health Plan Investigations - beyond Mental Health Parity

HEALTH & WELFARE PLANS

- Compliance with the Affordable Care Act
- Emergency room services
  - $14.5M settlement in *Perez v. Magnacare Administrative Services, LLC, et al.*
- Enforcement of health plan fees

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Private Participant Mental Health Parity Claims

HEALTH & WELFARE PLANS

- Wilderness Therapy litigation
- Autism Coverage litigation
- Other Mental Health Parity claims: eating disorder coverage; anger management coverage
- Out-of-network reimbursement claims

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HEALTH & WELFARE PLANS

Other Health Claims

- **KEY TREND: Direct claims by providers under participant assignments**
  - Plans need to evaluate whether to impose anti-assignment clauses
- HHS HIPAA Audits
- Other Health Benefit Claims
- ACA Compliance
- Voluntary Compliance Program claims
- Disclosure of Protected Health Information
- Improper Trust Expenses
  - Potential wave of excessive fee cases in welfare plans: *See Acosta v. Chimes District of Columbia, Inc., et al.* (DOL filed suit under ERISA against plan sponsor alleging that the plans paid millions of dollars of excessive fees and engaged in prohibited transactions); *Shore v. Charlotte-Mecklenburg Hospital Authority*; *Chavez v. Plan Benefit Services, Inc.*
- CMS Penalties for failing to comply with reporting obligations under Medicare Secondary Payer (MSP) laws
- COBRA deficient notice cases

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Multiemployer Plans

KEY TRENDS

1. Higher frequency of DOL Audits, particularly for higher asset plans
2. Increased benefit claims – early retirement disability claims
3. Sharp increase in withdrawal liability counterclaims and challenges from contributing employers
4. Benefit Overpayments are a challenge for many plans

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MULTIEMPLOYER PLANS

Claim Trends for Multiemployer Plans

- **Regulatory Investigations**
  - Multiemployer Plans are three times more likely to be audited by the Department of Labor -- plans with over 25,000 participants face a potential audit every five to six years
- **Benefit Claims** – sharp increase in early retirement disability claims
  - see 2018 California Field Ironworkers Pension Trust $15.4M settlement in lawsuit by workers seeking increased pension benefits for the time they worked late in their careers
- Plan Expenses
  - Training funds (long-time DOL focus)
  - Sharing office and staff members with union
  - Health plan expenses [example: reimbursement of employment-related drug tests]
- Imprudent Investment Cases
  - KEY ISSUE: will trustees of critical and declining plans be sued for imprudent investment? *See* 2020 $26.7M settlement of the American Federation of Musicians class action lawsuit
- Rehabilitation Plan Challenges – see Pace Industry Management Pension Plan litigation

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MULTIEMPLOYER PLANS

Multiemployer Plans (cont.)

- Reciprocal Agreements – contributions for traveling employees
  - See IBEW Pacific Coast Pension Fund and UA 38 Plumbers & Pipefitters Benefit Funds
- Withdrawal liability disputes with contributing employers
  - See challenge to the Segal Blend method in the New York Times case and lawsuits related to smoothing methods and interest rates for withdrawal liability
- Benefit Overpayments
- Problems after plan mergers
- Disputes between labor and management trustees
- Section 301 of the Labor Management Relations Act claims relating to collective bargaining agreement

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Governmental Plans

KEY TREND

1. Significant Number of Denial of Disability benefit lawsuits
2. Class Action challenges to pension reform and benefit changes
3. Challenges to contribution assessments
4. New penalty assessments by the IRS for plan operational mistakes

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GOVERNMENTAL PLANS

Governmental Plan Claim Trends

- Benefit/Participant Claims
  - Miscalculation of retirement benefits
  - Pension spiking
  - Pro se whistleblowers
- Challenges to Plan Amendments/Benefit Changes
  - **Changes to benefits or how compensation is calculated is the number one indicator of claims against governmental plans.** Most are styled as class actions (or writ of mandates in states like California).
- Objections to contribution assessments
  - See City of Chicago case filed August 29, 2019
  - ICERS
  - DeKalb County – class action alleges $250M in lost contributions when retirement plan ended for school teachers.
- Inadequate Funding Claims
  - Kentucky Retirement System
  - Singing River Plan in Mississippi

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Governmental Plan Claim Trends (cont.)

- DROP/Supplemental Benefit Plan challenges
  - Dallas Police & Fire (guaranteed interest rate)
  - Cal Fire – five years of airtime
  - City of Hollywood Firefighters
  - City of Miami Beach
- Long-Term Disability Claims – see CalPERS Long-term Care Plan challenge
- Imprudent Investment claims
- Benefit Overpayment claims
- Voluntary Compliance claims
- IRS penalty claims
- Excessive fee exposure for defined contribution plans

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Employee Stock Ownership (ESOP) Plans

KEY TRENDS

Proper Valuation of the plan remains subject to regulatory scrutiny and class action challenges

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ESOP PLANS

Employee Stock Ownership Plans

- DOL Enforcement Priority
  - Focus on valuation – whether at fair market value
  - Conflicts of interest
- Plaintiff firms also target ESOPs
  - Leading example is *Brundle v. Wilmington Trust*, 919 F.3d 763 (4th Cir. 2019) – holding that trustee breached duty of prudence because it failed to properly scrutinize an investment bank's valuation. Four failures: (1) trustee's failure to investigate the omission of its consultant's report of another, much lower, valuation of company stock issued months prior; (2) failure to adequately probe the reliability of financial projections prepared by company management and used by consultant; (3) ESOP did not have control over company due to unique arrangement, so "control premium" was too high, almost illusory; and (4) trustee's failure to probe why consultant consistently rounded the valuation of company stock upwards.

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Church Plans

KEY TRENDS

The church plan exemption continues to be challenged for church-affiliated health care entities notwithstanding the 2017 Supreme Court decision

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CHURCH PLANS

Church Plans

- The Supreme Court ruled in 2017 that pension plans do not have to be established by a church in order to be exempt from ERISA minimum funding rules – but that has not stopped church plan litigation, especially against church-affiliated health care entities.
- **Claim Example:** May 2019 lawsuit against the Archdiocese of Newark in New Jersey by former employees of St. James Hospital over at least $2.7 million in unpaid pension benefits, claiming violations of state law, including breach of contract and breach of fiduciary duty.
- **Claim Example:** The receiver for the insolvent St. Joseph Health Services of Rhode Island Retirement Plan filed several state and federal lawsuits against the plan sponsor and the Diocese of Providence, and to have the Pension Benefit Guaranty Corp. assume responsibility for it. A proposed settlement in the court cases calls for an immediate lump-sum payment of at least $11.15 million and an admission that the plaintiffs' damages are at least $125 million, including unfunded liability.

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MEPs and MEWA Plans

KEY TRENDS

The DOL has an national enforcement focus on fraudulent MEWAs

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Multiple Employer Retirement Plans (MEPs) and Multiemployer Employer Welfare Plans (MEWAs)

MEP & MEWA PLANS

DOL Enforcement Priority: EBSA is continuing its long-standing efforts:

- To seek out and shut down abusive Multiple Employer Welfare Arrangements (MEWAs) – higher risk for self-insured plans
- To proactively identify known fraudulent MEWA operators to ensure they do not terminate one MEWA just to open another in a different state
- Key issue is expenses paid to the plan sponsor – such as trade associations – for marketing the plan

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COVID-19 & Current Market Conditions

KEY TRENDS

Limits Compression in Fiduciary Market and Plans with Excessive Fee Exposure facing underwriting changes and capacity issues

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COVID-19

Predictions for Future Claims based on COVID-19 and the Market Downturn

- Employers/plan sponsors operating in good faith should not be penalized for market losses, but the risk of imprudent investment cases has increased, particularly for plans with funding issues.
- Plan issues will more likely come to the surface during market volatility.
- Potential increase in early retirement disability claims.
- Short of legal protection for a potential litigation epidemic, this is when quality fiduciary liability insurance becomes paramount.
- Your carrier should have experience in handling complex claims – tested by prior recession.
- The market downturn is a reminder that the quality of your fiduciary carrier is vital. Long-term commitment, financial stability, claims paying ability and expertise matter.

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Fiduciary Market

The Current State of the Fiduciary Market

- Fiduciary Liability – many carriers are reducing capacity, with industry-wide limits management, increasing pricing, re-underwriting accounts at renewal, with possibly higher retentions, depending on niche.
- But quality coverage is still generally available without the same pricing increases as the D&O market.
- Significant capacity issues for plans with excessive fee risks – like universities and other sponsors with large DC plans; ESOPs are also having trouble finding capacity.
- Fidelity/Crime - Computer fraud and social engineering schemes continue to be a significant exposure, while increased reliance on remote work access may result in additional exposure. Adequate social engineering limits are challenging at the current low cyber premiums for employee benefit plans. Nevertheless, cyber coverage is currently available at very low premiums.
- Consider purchasing your fiduciary, crime and cyber insurance from one insurance market.
  - Avoid coverage disputes to determine which policy is primary for a cyber event [competing "other insurance" clauses among policies]
  - Ensure claim is covered, regardless of which policy is triggered

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