

Memorandum

TO: DEFERRED COMPENSATION
ADVISORY COMMITTEE

FROM: Miguel Bernal

SUBJECT: FIDUCIARY LIABILITY
INSURANCE RENEWAL

DATE: June 1, 2020

Approved



Date June 1, 2020

RECOMMENDATION

Approve renewal of the City of San José Deferred Compensation (“457 Plan”) and Part-Time, Temporary, Contract (“PTC”) Deferred Compensation Plans fiduciary liability insurance coverage offered by Hudson Insurance Company (“Hudson”), the incumbent carrier, for the period from June 30, 2020, to June 30, 2021 with a \$5 million aggregate limit, a \$25,000 retention except a \$100,000 retention for class action claims, for a net premium of \$24,999.63¹ plus a broker fee allocation of \$1,321.00 for a total program cost of \$26,320.63.

BACKGROUND

The City of San José (“City”) purchases fiduciary liability insurance coverage for the City’s 457 and PTC Deferred Compensation Plans. The purpose of the insurance is to protect the City and the plans’ Board from legal liability. The coverage is designed to respond to claims from plan participants or regulating agencies alleging errors or omissions in plan administration, insufficient funding, or breach of fiduciary duties in the investment/advice, fund management, and/or disbursement of plan proceeds. The current policy provided by Hudson, the plans’ insurer since 2018, expires on June 30, 2020.

Arthur J. Gallagher (“Gallagher”) serves as the City’s insurance broker. Gallagher works with the Finance and Human Resources department to gather information to complete an application for fiduciary liability insurance coverage that is provided to the incumbent carrier and other interested markets.

ANALYSIS

The marketplace for fiduciary liability insurance is facing financial pressure. Overall, policyholders are seeing premium increases in the range of 5% to 15%. Insurers are expressing

¹ Net premium represents the gross premium quoted by Hudson less credit for the retail commission to Gallagher as the City has a fee arrangement with Gallagher.

concerns about fee litigation and asking underwriting questions about process and policies or procedures for evaluating professional fees or investment options².

Gallagher approached and requested quotes from a total of six markets, including established carriers such as Westchester Insurance Company (an operating company of Chubb Ltd.), Travelers Insurance Company, and Great American Insurance Company. Hudson, the incumbent carrier, offered the only firm quote. The remaining markets declined to quote, indicating that they either could not be competitive on pricing or with respect to the coverage terms and conditions.

Hudson quoted a \$5 million limit subject to a \$25,000 retention for an annual net premium of \$24,999.63. Hudson's renewal quote reflects an incremental net premium increase of \$2,701.13, or 12.11% increase relative to the expiring policy. Notwithstanding the increase, Gallagher believes the policy is priced well below the market average for program covering plans with nearly \$1 billion in sponsored plan assets³.

Policy terms and conditions are consistent with the expiring policy with one exception: Hudson will be endorsing the policy to increase the retention from \$25,000 to \$100,000 for all class action claims. This is a key coverage amendment, as common fiduciary liability claims such as allegations of payment of excessive fees or inappropriate investment options are typically filed as class action claims. Hudson has noted that they are not willing to waive this coverage amendment, as they generally assign a retention of \$500,000 to \$1,000,000 for plans with sponsored plan assets of the size of the City's Deferred Compensation Plans.

Following the review of Hudson's proposal, the City's Finance-Risk Management Division recommends continuation of coverage with the incumbent carrier. Hudson continues to hold a financial strength rating with A.M. Best & Company of A, Size Category XV, indicating that they hold over \$2 billion in policyholder surplus.

The total program cost includes a broker fee allocation in the amount of \$1,321.00. The City compensates Gallagher through a fixed fee agreement and the charge represents the cost allocation for Gallagher to place the policy.

² <https://www.willistowerswatson.com/-/media/WTW/Insights/2020/05/marketplace-realities-spring-2020-update.pdf?modified=20200506140748>

³ The City's insurance application reflected sponsored plan assets of \$928,542,828 as of March 20, 2020.

DEFERRED COMPENSATION ADVISORY COMMITTEE

June 1, 2020

Subject: Fiduciary Liability Insurance Renewal

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COORDINATION

This report was prepared by the Finance Department in coordination with the Human Resources Department and the City Attorney's Office.

MIGUEL BERNAL
Risk Manager

Appendix A: Year-Over-Year Cost Comparison

Appendix B: Hudson Insurance Quote and Coverage Outline

Appendix C: A.M. Best Financial Strength Ratings for Selected Insurance Carriers

Appendix A

Carrier	Plans	Aggregate Limits	Retention	19-20 Net Premium	20-21 Net Premium	\$ Change YOY	% Change YOY	Broker Fee Allocation	Total Cost
Hudson Insurance Company	PTC and 457 Plans	\$5,000,000	\$25,000	\$22,298.50	\$24,999.63	\$2,701.13	12.11%	\$1,321.00	\$26,320.63

Appendix B



City of San Jose

Coverage: PTC & 457 Plans - Fiduciary Liability
Carrier: Hudson Insurance Company (incumbent)
Policy Period: 6/30/2020 to 6/30/2021

Form Number: Policy Form - ESF-31210001 (9/2012)

Form Type:

COVERAGE	FORM TYPE	RETROACTIVE DATE	PENDING & PRIOR DATE
Fiduciary Liability	Claims Made and Reported	Not Applicable	4/11/2002

Defense Limitations:

COVERAGE TYPE	DEFENSE COST DOLLAR LIMIT	DEFENSE LIMIT	DEFENSE COST TYPE / COMMENTS
Fiduciary Liability	Applies	-	Within Policy Limits (expenses erode policy limit)

Coverage:

DESCRIPTION	AMOUNT
Fiduciary Liability - Aggregate	\$5,000,000
Trustee Claim Expenses (Non-Fiduciary Defense)	\$1,250,000
Voluntary Compliance Program Expenditures	\$100,000
HIPAA and HITECH Fines and Penalties	\$100,000
PPACA Fines and Penalties	\$100,000
Section 4975 Penalties	\$100,000

Deductibles / Self-Insured Retention

TYPE	COVERAGE	AMOUNT
Retention	All Coverages, except:	\$25,000
Retention	Class Action Claims	\$100,000

Claims Made Coverage:

Should you elect to change carriers (if a new retroactive date is provided) or non-renew this policy, a supplemental extended reporting endorsement may be available subject to policy terms and conditions. You must request the extended reporting period in writing to the carrier prior to expiration date. The cost of this extended reporting period is 100% of the annual premium and is fully earned. The extended reporting period extends only to those claims made during the extended reporting period for wrongful acts that occurred prior to the expiration date and would have been covered by the policy. Claims must be reported to the carrier within (365) days of the end of the policy period. The extended reporting period does not increase the limits of liability and is subject to all policy terms, conditions and exclusions.

Definition of Claim:

DESCRIPTION	
A.	Claim means:
1.	a written demand for monetary damages, non-monetary damages or injunctive relief;
2.	a civil proceeding commenced by the service of a complaint or similar pleading;
3.	a criminal proceeding commenced by the return of an indictment;
4.	a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document; or
5.	a written notice by the Department of Labor or the Pension Benefit Guaranty Corporation of the commencement of an investigation;
seeking to hold an Insured liable or responsible for a Wrongful Act committed or attempted, or allegedly committed or attempted, by such Insured or by any person for whose Wrongful Acts such Insured is or is alleged to be legally responsible.	

Incident or Claim Reporting Provision:

REPORTING CONDITION TYPE	DESCRIPTION
Direct	Refer to policy form

Endorsements include, but are not limited to:

DESCRIPTION
Policy Form No. ESF-31210001 (09/2012)
California Amendatory Endorsement - ESF-31230005
Vanguard Elite Endorsement for Governmental Plans - ESF-31220066G
Euclid Penalty Box Umbrella Endorsement (\$100,000) - ESF-31220061A
Class Action Claims Endorsement (\$100,000 retention) - ESF-31220082

Exclusions include, but are not limited to:

DESCRIPTION
Libel / Slander - Exclusion
Bodily Injury, Mental/Emotional Distress, Sickness, Disease and Death - Exclusion
Damage to or Destruction of any Tangible Property - Exclusion
Losses Attributable to a Profit or Advantage to which the Insured was not Legally Entitled - Exclusion

Binding Requirements:

DESCRIPTION
Subject To (prior to binding)
- Please describe your plan committee's process for evaluating the reasonableness of service provider fees, and in your record keeper(s), including the frequency of evaluations and whether you involve outside consultants
- How many record keepers does the Plan have and on what basis do you pay your record keeper(s) (per capital, flat fee, assets under management/revenue sharing)?
- Please describe your investment committee's process for evaluating the prudence and performance of plan investment options, including the frequency of evaluations and whether you involve outside consultants. a. Please explain whether you evaluate investment performance net of expense

Binding Requirements:

DESCRIPTION
- Please indicate whether you have received any inquiries from any law firm regarding your defined contribution plans and if so please provide date of inquiry. a. Please describe any follow up communications or actions to such law firms
- Are any mid-term plan valuations being contemplated such as revising the investment return/discount?
- Does the insured anticipate any issues with receiving contributions from the municipality such as delays or reductions?

Premium	\$24,999.63
ESTIMATED PROGRAM COST	\$24,999.63
TRIA/TRIPRA PREMIUM (+ Additional Surcharges, Taxes and Fees as applicable)	INCLUDED

Subject to Audit: Not Auditable

Carrier Ratings and Admitted Status

PROPOSED INSURANCE COMPANIES	A.M. BEST'S RATING & FINANCIAL SIZE CATEGORY *	ADMITTED/NON-ADMITTED **
Hudson Insurance Company	A XV	Admitted

*Gallagher companies use A.M. Best rated insurers and the rating listed above was verified on the date the proposal document was created.

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**If coverage placed with a non-admitted carrier, it is doing business in the state as a surplus lines or non-admitted carrier, and is neither subject to the same regulations as an admitted carrier nor do they participate in any state insurance guarantee fund.

Gallagher companies make no representations and warranties concerning the solvency of any carrier, nor does it make any representation or warranty concerning the rating of the carrier which may change.