CITY OF Los Angeles
DEFERRED COMPENSATION PLAN

Board Report 23-38

Date: December 19, 2023

To: Board of Deferred Compensation Administration

From: Staff

Subject: Fiduciary Liability Insurance Update

Recommendation:

That the Board receive and file this report regarding consideration of fiduciary liability insurance for the Deferred Compensation Plan.

Background:

At the Board of Deferred Compensation Administration's Special Meeting held on November 4, 2023, the Board requested staff provide a status on the consideration of fiduciary liability insurance.

Discussion:

A fiduciary is anyone who exercises discretionary authority over plan management or assets, has the responsibility or authority to provide investment advice, and/or has discretionary authority or responsibility over plan administration. The main duties for a fiduciary are duty of prudence and duty of loyalty. The duty of prudence expresses the responsibility to manage the plan with care, skill, prudence, and diligence that a person in like capacity and familiarity would use. Duty of loyalty requires that fiduciaries act for the benefit of its members and beneficiaries.

In order to further fulfill its fiduciary responsibilities, members of the Board are required to complete a Fiduciary Training provided during orientation upon joining the Board or roughly every three years (per the Board's Training, Education, and Travel Policies). Staff plans to request a Fiduciary Responsibility Training from Segal Consulting to the Board in early 2024.

Fiduciary liability insurance is designed to protect fiduciaries against lawsuits that allege breach of fiduciary duty and negligence. While it is not required, it can provide coverage and protection.

A. Timeline

The following is a summary of prior Board discussions regarding Fiduciary Liability Insurance:

- October 20, 2020: Board Report 20-38 - Fiduciary Education and Investment Advice Services
    - Since City Council established the City's DCP under the Los Angeles Administrative Code Division 4, Chapter 14, the City has a statutory duty to defend and indemnify individual Board members and staff acting in the scope of their duties, pursuant to California Government Code (CGC) Section 995.
    - However, the City may choose to defer its decision to indemnify until after the criminal or administrative action has concluded, thereby requiring the accused Board member to fund defense costs on an interim basis.
    - The Board may consider purchasing liability insurance for situations where the City would not provide indemnification.

- April 19, 2022: Board Report 22-24 - Fiduciary Liability Insurance
    - After the Board expressed interest in fiduciary liability insurance, staff researched the issue of identifying the funding source for this type of procurement and the types of coverage available.
    - Generally, the major types of policies available are indicated below, which can be obtained separately or within a single policy.
        - Side A coverage insures **directors and officers** for claims which are not otherwise indemnified.
        - Side B coverage insures **organizations** for claims which are not otherwise indemnified.
        - Side C Coverage insures **organizations for particula**r types of claims (e.g. claims related to violations of securities laws).
    - Ice Miller, which serves as an external counsel firm to the DCP via the City Attorney's Office, indicated that the Department of Labor, in its Information Letter 07-28-1998, identified that plan assets may be used to purchase fiduciary insurance. Any insurance policy would also need to provide recourse by the insurer if the fiduciary breached his/her fiduciary obligation.

- June 7, 2022: Segal Select Insurance Services Presentation on Fiduciary Liability Insurance
    - Segal Select Insurance Services provided an overview presentation regarding Fiduciary Liability Insurance and its scope, stating that it is designed to protect plans and/or trustees, committees, and employees against lawsuits alleging breach of fiduciary duty and negligence in the administration of the plan.
    - Segal noted that based on the DCP's peer group of similar asset size, typical limits purchased are between $15 million and $25 million for the Side-A policy and $25 million or higher for fiduciary liability insurance policies.
    - The Board expressed interest in developing an RFP to receive proposals for Side-A Fiduciary Liability Insurance.

- June 29, 2022: Minutes, City Attorney Oral Report on *Lexin vs. San Diego*
    - The court case *Lexin vs. San Diego* involved the charge of underfunding the City of San Diego's employment retirement system.
        - In May of 2005, the San Diego District Attorney charged the Board members with felony violation of Section 1090 of the California

Government Code on the grounds that the Board was financially interested in the pension funding modification.
    - The Board was required to hire their own counsel in their defense.
    - The Supreme Court determined that the Board's financial interest shared with the Board's constituency does not present dangers to the state's conflict of interest law.
    - The Board sued the Council for their fees and the CIty of San Diego was found to be responsible for reimbursing the Board members for the cost of their defense.
- The case clarifies that public entities, such as the City of Los Angeles, would be obligated to assume the cost of defense for its employees in a criminal or civil matter, but it is contingent on the facts and circumstances of the action of the employee and the action being faced in a criminal or civil setting.
- The case reaffirmed Sections 995 and 995.8 and explained the City's obligation to its Board members and to its employees, and what its obligation is not.

B. Other City Pension Boards

The DCP queried other City pension boards and found that the Los Angeles City Employees' Retirement System (LACERS), Los Angeles Fire and Police Pensions (LAFPP), and Water and Power Employee Retirement Program (WPERP) Boards have retained partial or full Fiduciary Liability Insurance. While LACERS and LAFPP have retained Side A coverage or D&O Insurance, WPERP is covered under the umbrella of insurance policies secured by the Department of Water and Power as a whole. The table below describes the coverages retained by LACERS and LAFPP for general comparative purposes.

	LACERS	LAFPP
Coverage Type	D&O Insurance (Side A)	D&O Insurance (Side A)
Coverage Provider	Hudson Insurance Company	Euclid/Hudson (primary) RLI (excess)
Coverage	$10,000,000	$15,000,000 *$10 million (primary)* *$ 5 million (excess)*
Annual Premium *Paid by plan assets*	$38,450	$66,670 *$46,200 (primary)* *$20,470 (excess)*
Waiver of Recourse Premium *Paid by individual*	$100 *Split between covered individuals*	$450 *$225 (primary)* *$225 (excess)* *Split between covered individuals*
Insurance Broker	Alliant Insurance Brokerage	Segal Select
RFP for Broker Services?	Yes	Yes

The WPERP board's coverage under the department policies include a $10 million policy for D&O Insurance and a $40 million policy for fiduciary liability insurance, and seem structured differently with associated retention amounts (or deductible).

C. Impact to DCP Reserve Fund

Should the Board wish to procure D&O insurance, the estimated annual premium for a DCP policy could be approximately $40,000 to $70,000, assuming the premiums would be aligned with the other pension boards. However, it is anticipated the premiums for the DCP could be higher as it would be a newer policy obtained in a different environment than when the pension boards first secured their policies. Additionally, as the DCP is a defined contribution plan and not a defined benefit plan like the other pension plans, it is unclear at this time how that would impact the premium as well, as the underwriters would consider the size of assets and other plan requirements.

With this additional expense, the DCP Reserve Fund projections should not alter substantially from those provided to the Board in September 2023 as contingencies were built in that could alternatively cover this cost, including the fact that the plan budget is rarely 100% expended. Staff however will be performing an analysis of actual versus budgeted expenditures as part of its larger review of the DCP resource and fees review.

D. Next Steps

The Board previously expressed its interest in releasing a Request for Proposals to secure an insurance broker as a first step in obtaining quotes for policies. Based on the discussion for this report, the Board may direct staff to come back with a recommendation on how to proceed in procuring a broker.

Submitted by: Eric Lan, Benefits Analyst

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