

CHARLESTON REGIONAL BUSINESS JOURNAL

March 19 - April 1, 2007

www.charlestonbusiness.com

Volume 13, No. 7 • \$1.75

Lawsuits, congressional hearings put 401(k) fees at center stage

BY SHELIA WATSON
Contributing Writer

As the oldest of nearly 80 million baby boomers get ready to retire, the scrutiny over retirement-plan fees is reaching critical mass, with the U.S. Department of Labor considering whether to require companies to disclose more information about the fees amid a glut of lawsuits filed against major companies over 401(k) plans.

The lawsuits, filed last year against several companies, including airline industry giants Lockheed Martin and Boeing, alleged that employees were overcharged in their 401(k) plans, the employer-sponsored means under which workers make tax-deferred contributions from their salaries.

In a similar lawsuit in October, a St. Louis attorney took on seven big employers—Bechtel Group, Caterpillar Inc., Exelon, General Dynamics, International Paper, Northrop Grumman and United Technologies—for allegedly allowing their employees' retirement plans to be charged with fees that were too high, which violates the Employee Retirement Income Security Act of 1974.

Also in October 2006, the U.S. Department of Labor filed a lawsuit against the fiduciaries of the now-bankrupt agricultural cooperative Agway, accusing 47 directors of "imprudently investing \$50 million of its 401(k) plan in the company's securities." That investment allegedly overvalued the stock and gave employees misleading information.

In November, Seattle law firm Keller Rohrback launched an investigation against The Hartford Financial Services Group Inc. regarding its service to 401(k) plans as a service/investment provider.

Keller Rohrback said the investigation focuses in particular on "whether Hartford, in its capacity as a provider, breached its fiduciary duties under ERISA by, among other things, causing 401(k) plans to incur



excessive management and administration fees and/or entering into improper fee sharing arrangements with mutual fund companies that are selected by Hartford."

The crux of the issue is that the fees charged in 401(k) plans are all but "invisible" to investors, a situation that has created a dilemma over who holds fiduciary responsibility for conveying information, said Chip Hunt, a principal of PrimeTRUST Advisors, a pension consulting and investment advisory firm based in Columbia and Greenville.

"It's a legal disconnect," Hunt said. "Clearly fiduciaries have the responsibility to disclose the fees, but most service providers (such as record keepers) don't have that responsibility."

Making matters more confusing are complex fee arrangements, which are common in retirement plans, that often lump together administrative and fund-management fees. Regulators are studying whether such arrangements inflate retirement-plan fees by making it hard to figure out how

much individual services cost. Current law does not explicitly require disclosure to investors of comprehensive information on fees connected with 401(k) plans.

Chip Hardy, also a principal of PrimeTRUST, calls the dilemma “the great divide.”

“It’s a fiduciary’s duty to understand how much they’re paying, along with when, where, what, how and all that stuff,” said Hardy. “So on the one hand, you have employers, who are the ultimate fiduciaries for retirement plans for other people’s money, whether it’s a 401(k), 403(b), whatever. The employees are entrusting their retirement money to them, so the employer has fiduciary responsibility over this trust.

“On the other hand, there’s a gap because the non-fiduciary service providers, like a record-keeper or any service provider that does not accept the role of fiduciary, are not legally obligated to disclose compensation.

“The law says fiduciaries are required to know all the nuances of the fee arrangement. But if you’re an employer, how can you fulfill your responsibility if (the service providers) don’t disclose the fees?”

That question is “the heart of the matter” of a recent congressional hearing in which a member of the House of Representatives recommended that Congress consider making companies that manage 401(k) plans give clearer and more complete information on fees, which can drain thousands of dollars from a worker’s retirement savings.

“We have to ask whether all these fees are necessary and we have to examine whether they are undermining workers’ retirement security,” Rep. George Miller, D-Calif., chairman of the House Education and Labor Committee, said during the hearing.

Miller pointed out that a 1% difference in fees over time can cut the gains in a 401(k) account by as much as 20%.

However, not all were in favor of all points made in the hearing. Rep. Howard McKeon, R-Calif., the committee’s senior Republican, warned against congressional action that could result in unintended consequences, piling new requirements for 401(k) plan managers on top of current ones and overwhelming investors with data.

Changes to current rules shouldn’t “overload workers with information,” McKeon said.

Similarly, Robert Chambers, chairman of the American Benefits Council, which represents employers and 401(k) plan providers, said the group supports disclosure of fees, provided the information is useful to

investors, easy to understand and relevant to investment decisions.

The testimony, held March 6, referred to two reports by the Government Accountability Office, the research arm of Congress.

One report, titled “Increased Reliance on 401(k) Plans Calls for Better Information on Fees,” released the day before the hearing, underscored the purpose in the hearing.

“The pension plan universe has changed: 401(k) plans have emerged to cover most plan participants and the majority of plan assets,” the report stated. “With this shift, participants now bear more responsibility for ensuring they have adequate income in retirement, emphasizing the importance of having sufficient information to make informed 401(k) investment decisions.”

The report also spelled out the GAO’s recommendations.

“Amending ERISA and updating regulations to better reflect the impact of fees and undisclosed business arrangements among service providers will help put Labor in a better position to oversee 401(k) plan fees,” the report stated.

“Furthermore, requiring plan sponsors to report more complete information to labor on fees—those paid out of plan assets or by participants—would put the agency in a better position to effectively oversee 401(k) plans.”

The other GAO report, from November, titled “Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees,” recommended fee disclosure legislation. In that report, the GAO said the Labor Department, which has been the 401(k) regulator under 1974’s Employee Retirement Income Security Act, should take action.

The report recommended that the Labor Department require that investors get a summary of all fees paid either from plan assets or by participants. The most common 401(k) charges are investment fees charged by mutual fund managers to choose securities for plans to invest in. Record-keeping

fees are the second largest category, with a range of other fees assessed, including those for audits, legal matters, trustees and consulting.

Under ERISA, little disclosure of these fees is made, and what disclosure there is comes in piecemeal fashion, which makes plan-to-plan comparisons difficult, the GAO said. Investors in 401(k) plans typically pay fees without knowing what they are, with returns simply reduced to reflect the fees.

Hunt said he is quick to point out to his PrimeTRUST clients and others he consults with that the non-fiduciary service providers are not breaking the law.

“There’s nothing these providers are doing that is legally wrong,” he said. “It’s simply that the industry-accepted practices are set up so that by law they are not obligated to disclose the information.”

The GAO report noted that about 80% of investors in

401(k) plans do not know how much fees are eroding their account balances.

The report also concluded that workers often can’t understand, and in some cases can’t find out, what fees they pay to have their 401(k) money managed.

The GAO noted the

Labor Department has some power to make the financial industry disclose more and to do so in simpler, easy-to-understand language. The report recommended that Congress amend current law to require the industry to disclose all fees, charges and potential conflicts of interest.

Whatever action is taken will have a significant economic impact. As U.S. corporations have walked away from traditional pension plans offering workers’ guaranteed retirement benefits, 401(k) plans have become the primary nest egg vehicle for workers’ retirement plans, along with Social Security, profit-sharing and stock ownership plans, and individual retirement accounts.

The GAO report revealed that in the mid-1980s, fewer than 8 million workers participated in such plans, which totaled \$100 billion. Today nearly 50 million workers have invested about \$2.5 trillion in these plans.

