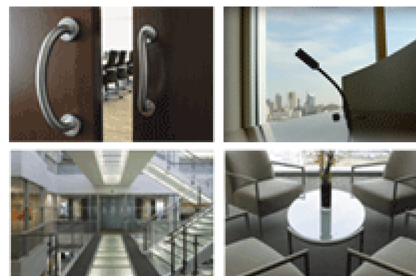

Recent 401(k) Fee Lawsuits: Is Your Plan Vulnerable?

By B. David Joffe & Charles M. Cain II

Earlier this year, a plaintiffs' law firm in St. Louis, Missouri, filed a number of class-action lawsuits targeting 401(k) plan fees and expenses. While the complaints have been brought against several large plans, the issues are similar for most, if not all, 401(k) plans.

The complaints generally allege that the plan fiduciaries allowed the plans to pay excessive fees and expenses out of plan assets, have not been prudent in monitoring the fees charged by the service providers, and have not fully disclosed the fees and expenses paid by the plans. The plaintiffs seek reimbursement of "excessive fees and expenses," restoration of plan losses, and attorneys' fees and costs.

The lawsuits highlight several specific fee-arrangement issues that fiduciaries should be reviewing on a regular basis and with respect to which they should be documenting their decision-making process:

Revenue-Sharing. The plaintiffs allege that revenue-sharing arrangements among the various plan service providers result in excessive payments to the service providers and are not properly disclosed to plan participants. To meet the current fiduciary standards, plan administrators should know exactly how much in fees, both directly and indirectly, are being paid to the various service providers, and they must determine if such fees are reasonable with respect to the cost of providing those services. The Department of Labor (DOL) has published a fee disclosure form, which can be located at http://www.dol.gov/ebsa/401kfeedisclosureform.doc. The form can be a starting place for obtaining information on revenue-sharing arrangements. The DOL will likely be issued further guidance on additional disclosure of such arrangements. In the meantime, plan administrators should evaluate the type of information that is being provided to participants.

Shadow-Index Funds. The plaintiffs allege that certain investments within the plans are "shadow-index funds," which they define as mutual funds that track their market index too closely (generally an R-squared value of greater than 95). They assert that many of these funds charge an expense ratio significantly higher than true index funds within the same investment category, and these funds have little, if any, active management that would justify a higher expense ratio. There is considerable debate among investment professionals regarding this issue. However, plan administrators should closely monitor the expense ratios of all of the investments offered by their plans relative to similar investment alternatives. In particular, for funds that produce returns that are very similar to their corresponding index funds, plan sponsors should determine if the continued use of those funds is prudent.

Master Trusts. Many of the defendants in these cases are large employers that maintain more than one retirement plan. In administering multiple plans, some of the defendants use a master trust to hold the assets of the plans. The plaintiffs allege that such master trusts pay expenses out of the assets of those plans that are not fully disclosed to the participants. For most companies, this is not an issue. However, for companies that utilize a master trust, they should determine if more detailed disclosure of the fees paid through the master trust is needed.

Expenses of Company Stock Funds. Several of the defendants offer employer stock as an investment option in their plans. However, those at issue in these lawsuits offer the stock through an investment that is similar to a mutual fund that invests almost exclusively in the employer's stock. The plaintiffs allege that, because these investments do not perfectly track the actual stock price, the expenses and the cash holdings of these investments are excessive. Plan sponsors that include employer securities as an investment option should regularly review the fees, expenses, and cash holdings within their stock fund. Although a certain amount of fees, expenses, and cash holdings are necessary for the operation of such investment funds, plan administrators should review and document their decisions regarding these issues on a regular basis. In addition, plan administrators should determine if the disclosure of the effect of fees, expenses, and cash holdings in such investments is adequately disclosed to plan participants.

It is important to note that these cases do not arise from any new standards imposed on fiduciaries and that the claims may very well be rejected by the courts. However, plan administrators would be well-advised to review the fees and expenses of their plans regularly and document their decision-making process to defend against these potential claims.

If you have any questions about this article, please contact one of the attorneys on the Boult Cummings Employee Benefits and Executive Compensation Team listed below:

Charles M. Cain II
615.252.2330
ccain@boultcummings.com

Andrew Elbon
615.252.2378
aelbon@boultcummings.com

B. David Joffe
615.252.2368
djoffe@boultcummings.com

Gordon Earle Nichols
615.252.2387
gnichols@boultcummings.com

John M. Scannapieco
615.252.2352
jscannapieco@boultcummings.com

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Roundabout Plaza, 1600 Division Street, Suite 700 Nashville, TN 37203
615.244.2582 www.boultcummings.com

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