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Recent 401(k) legal cases are only the beginning



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In the last few months, numerous class-action lawsuits have been filed against 401(k) plan sponsors, challenging the fees paid to their providers.

Many expect more such cases that focus on provider fees and expenses.

Revenue sharing refers to an arrangement where a mutual fund shares a portion of its asset-based fee with a service provider. As recently as five years ago, many 401(k) providers refused to disclose the amount of revenue sharing that underlying mutual funds were paying them.

Plaintiffs object to this. According to the complaints, if revenue sharing payments exceed the cost of record-keeping and other services, the excess revenue should be reverted back to and for the benefit of the plan.

If the plaintiffs are successful, a floodgate of litigation should be expected. Some experts say that although the cases thus far have been against large employers, middle-market employers may be even more vulnerable as these provider practices were seemingly more common there.

Under ERISA, fiduciaries have a duty to ensure that fees paid to plan providers are "reasonable" and to adequately disclose those fees to participants. These lawsuits should serve as an important reminder as to the importance of a sound fiduciary process. The following actions can be taken to guard against becoming a defendant in one of these suits.

- Audit expenses and fee arrangements with service provider.

Your provider should freely disclose all charges to the plan and all revenue sharing from underlying funds. Mutual fund investment expenses should be disclosed as well.

ERISA requires "reasonable" expenses and therefore, adequate benchmarking should be performed. Disclosure is only part of the equation.

- Maintain records of fee audits and negotiations.

A full accounting should be recorded and maintained. In addition, the process for review and evaluation of the provider and investments should be documented, as well.

- Monitor on an ongoing basis.

This is an ERISA fiduciary requirement as well. The problem is that many plan sponsors rely on the provider for monitoring activity. If the provider is collecting revenue sharing from mutual funds and/or they have proprietary products in place, this is clearly the fox guarding the hen house. In these cases, independent evaluation is prudent.

- Be open with participants.

Many Summary Plan Descriptions (SPD) can be difficult for participants to decipher. Consider putting together a summary for participants that provides important information to them in easy-to-understand language.

- Maintain an Investment Policy Statement (IPS).

The document should outline the goals and objectives of the plan, the process for designing the investment menu and selecting specific investment options, and the ongoing evaluation process. The courts frequently will ask for the IPS even before the plan document.

ERISA expects that plan sponsors manage decisions solely in the best interest of participants. Peeling back the layers may be necessary to confirm that interests are aligned properly for participants.