

LABOR AND EMPLOYMENT LAW UPDATE



INFORMATION GAP REGARDING 401(K) FEES SPAWNS WAVE OF LAWSUITS

Increasingly, 401(k) plans are supplanting defined pension plans as the retirement plan of choice for U.S. workers. In 2005, 401(k) plans boasted 45 million participants and \$2.4 trillion in assets. The average savings per worker is more than \$100,000.

Various fees are associated with 401(k) plans. The type, amount, allocation and method of calculation of these fees can vary significantly depending upon such factors as (1) whether the investment alternatives are provided by one service provider in a bundled arrangement or multiple service providers in an unbundled arrangement, (2) the identity of the service provider(s), (3) the investment options under the plan, (4) the amount of assets in the plan, and (5) the distribution of assets within the plan.

As noted in a November 16, 2006 Report by the Government Accounting Office ("GAO"), fees are increasingly being borne by plan participants and can "significantly decrease retirement savings over the course of a career." The Report warned that plan participants are not being provided with adequate information regarding fees: "To get a complete picture of fees, participants must collect various documents over time and may be required to seek out some documents." The GAO recommended new legislation mandating additional disclosures.

The GAO Report follows a similar report by the U.S. Department of Labor ("DOL") in 1997. The DOL is apparently working on rules which require greater disclosure by employers to plan participants.

THE WAVE: While the government ponders further action, lawsuits are being filed under the Employee Retirement Income Security Act ("ERISA") alleging that inadequate fee disclosures breach fiduciary duties owed to plan participants by employers, directors, officers and other employees. This fall, a St. Louis law firm brought ten suits against employers such as Lockheed Martin Corp., General Dynamics Corp. and International Paper Co. The suits allege that inadequate disclosures undermined the performance of 401(k) plans by masking excessive fees and less costly alternatives.

Although these lawsuits are still progressing, the cost of defense alone is a loud wake-up call to employers who sponsor 401(k) plans. The time to bridge the information gap by educating employees regarding the type, amount, allocation and method of calculation of fees is now.

TYPES OF FEES: The GAO noted that the vast majority of 401(k) fees comprise two categories:

"INVESTMENT FEES – such as those charged by mutual fund advisors to select securities for the fund - account for the largest portion of total fees in most plans."

"PLAN RECORD-KEEPING FEES – those associated with maintaining participants' accounts, such as processing their fund selections and preparing and mailing account statements – are the second largest portion of plan fees."

METHOD OF CALCULATION: The GAO reported that the method for calculating fees often differs. Investment fees "are usually charged as a fixed percentage of assets and then deducted from investment returns." Plan record-keeping fees are typically "charged as a percentage of a participant's assets, a flat fee or a combination of both."

AMOUNT OF FEES: The percentage of fees charged a participant can vary from as low as .5% to as high as 3%. In emphasizing the importance of even a single percentage point, the GAO Report cited the example of a 20-year investment of \$20,000 with an annual return of 7%. An annual .5% charge for fees will allow the retirement savings to grow to \$70,500. A 1.5% annual charge will allow growth only to \$58,400.

ALLOCATION OF FEES: Certain financial arrangements may be more beneficial to a service provider than a plan participant. The GAO Report observed that “a service provider that assists a plan sponsor in selecting investment options for the plan may also be receiving compensation from mutual fund companies for recommending their funds. The service provider may not disclose this information to the plan sponsor and as a result, participants may have more limited investment options and pay higher fees for these options than they otherwise would.”

RECOMMENDATIONS FOR EMPLOYERS: To avoid the prospect of a costly lawsuit, employers who sponsor 401(k) plans should heed the following recommendations:

- * Employer should be diligent about seeking and obtaining information concerning the fees paid or to be paid a service provider and the revenue sharing arrangements of the service provider.
- * Employers should consult the following materials on the DOL website:
 - “Understanding Retirement Plan Fees and Expenses”,
 - “Tips for Selecting and Monitoring Service Consultants”; and
 - “Selecting and Monitoring Pension Consultants – Tips for Plan Fiduciaries.”
- * Employers should provide information in the form of a summary to plan participants setting forth all fees that are paid out of plan assets or directly by the participants.
- * Employers should direct plan participants to consult the following on the DOL website:
 - “A Look at 401(k) Plan Fees.”

FIRM NEWS

RELOCATION: Campbell & Chadwick, P.C. has relocated its office to the following address: 4201 Spring Valley Road, Suite 1250, Dallas, Texas 75244. The firm telephone number has not changed.

DEMONSTRATIVE EVIDENCE: Please visit the firm website for a newsletter regarding demonstrative evidence authored by Dale Howe, the firm’s Demonstrative Evidence Specialist.

DISCLAIMER

This paper is not intended to provide legal advice in general or with respect to any particular factual scenario. Any such advice should be obtained directly from retained legal counsel.

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