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DEFINED CONTRIBUTION

8 big companies sued over 401(k) plan fees

Revenue sharing is put under spotlight in class-action cases

By Doug Halonen

Participants fired a broadside against corporate sponsors of eight major 401(k) plans, alleging the companies failed to monitor and disclose fees under so-called revenue-sharing arrangements.

The litigation puts an intense spotlight on revenue sharing. In the long run, it could place pressure on fees paid to managers and record keepers of 401(k) plans.

The eight corporations sued are: Lockheed Martin Corp., Bethesda, Md., with more than $14 billion in defined contribution assets; United Technologies Corp., Hartford, Conn., nearly $14 billion; Northrop Grumman Corp., Los Angeles, more than $11 billion; Caterpillar Inc., Peoria, Ill., $4.5 billion; General Dynamics Corp., Falls Church, Va., $5.96 billion; International Paper Co., Memphis, Tenn., $4.4 billion; Bechtel Corp., San Francisco, $3.9 billion; and Exelon Corp., Chicago, with more than $3 billion.

The class-action suits all allege the companies failed to meet their fiduciary duties by ignoring payments that managers used by their 401(k) plans made to record keepers and other service providers. What's more, the suits, all filed by the law firm of Schlichter, Bogard & Denton, St. Louis, charge that the companies failed to disclose these fees to participants, as required by the 1974 Employee Retirement Income Security Act.

The lawsuits also allege that companies that offered employer stock funds as part of their plans — Lockheed Martin, United Technologies, Northrop Grumman, Caterpillar, General Dynamics and International Paper — charged high management fees for the funds and held too much of the assets in cash, which reduced participants' returns.

Vulnerable to litigation

Some experts think plan sponsors are vulnerable to litigation because they haven't exercised adequate oversight of plan fees.

"Fiduciaries aren't doing the due diligence, the kind of digging, needed to reduce costs or enhance services to participants," said Brent Glading, managing director of financial consultant Glading Group, Montclair, N.J.

"The No. 1 message (from the suits) is it's probably a good time to take a close look at your investment fee allocations. Do it before the plaintiff attorneys make you do it," said Michael S. Melbinger, partner and chair of employee benefits and executive compensation, Winston & Strawn LLP, Chicago.

"These cases will have a significant impact on the 401(k) industry, given that they will create a great deal of awareness among fiduciaries, and it's going to cause fiduciaries to examine the fees being charged," added Ronald S. Kravitz, an ERISA attorney with the law firm Liner Yankelevitz Sunshine & Regenstreif LLP, San Francisco.

Some observers also expect the Department of Labor will weigh in. "There's speculation that the DOL may require disclosure of revenue-sharing payments," said A. Richard "Brick" Susko, an ERISA attorney

See **Fee** *on page 38*

'It's probably a good time to take a close look at your investment fee allocations,' said Winston & Strawn's Michael S. Melbinger.

with Cleary Gottlieb Steen & Hamilton, New York.

Revenue sharing refers to the common industry practice of a mutual fund or other investment manager sharing part of the direct fee it gets from a plan with other service providers to the plan.

According to industry analysts, there are essentially two kinds of revenue sharing.

The edgier form is referred to as "pay to play." It occurs when mutual funds pay consultants or plan administrators as a reward for getting them business.

The other form occurs when mutual funds use part of their investment and management fees to compensate plan administrators, record keepers and other service providers.

'Definitely wrong'

"The misperception (that there is) some kind of kickback or bribe is definitely wrong," said Ed Ferrigno, vice president in the Washington office of the Profit Sharing/401(k) Council of America.

were higher-cost actively managed funds, according to the suit against that company.

Also, Bechtel allegedly switched reporting of plan expenses from the plan itself to a master trust. Because the master trust doesn't disclose payments to plan participants, that enabled Bechtel to report that administrative costs in 2004 were only $33,257; the company claimed its had made $5.9 million in costs, according to the complaint.

In reality, the plan's expenses had gone up by more than $2 million, with the payments apparently coming from the master trust — with the plan ultimately getting stuck with the tab, the complaint alleged.

Elsewhere, the International Paper lawsuit said IP used "misleading" benchmarks to measure plan fees and performance.

And Caterpillar, which administers its own plan, came under fire for allegedly turning a profit from the "unreasonable and excessive fees" charged participants to invest

"How the manager then uses that fee in terms of acquiring the goods and services it needs to discharge its duties should not be something fiduciaries should be required to investigate," Mr. Susko said.

Nevertheless, some consultants and attorneys advised retirement-plan administrators to closely review their fee arrangements.

"For employers, this is probably a good time to go back and review your vendor relationships to make sure you have high-quality service at reasonable fees," said Kyle Brown, retirement counsel, Watson Wyatt Worldwide, Arlington, Va.

Some attorneys also suggest having a separate committee review fees.

To insulate themselves from potential liability, it would behoove company executives to delegate their fiduciary responsibilities to a fiduciary committee that reviews plan fee allocations and communicates them to plan participants, Winston & Strawn's Mr. Melbinger said. ■