

Retirement Plan Fee Disclosures

Getting Ready For Change

I. NEW WAVE OF ERISA LITIGATION

- Recent spate of ERISA fiduciary breach actions (16 by latest count) brought against sponsors, fiduciaries and service providers challenging fees charged to 401(k) plans and participants.

II. WHAT HAS PROMPTED THESE LAWSUITS?

- Industry trends have played significant role.
 - Shift away from defined benefit plans to defined contribution plans.
 - Growing popularity of participant-directed 401(k) plans.
 - Recordkeeping and other administrative fees for participant-directed 401(k) plans increasingly borne by participants through asset-based fees deducted from investment returns.

WHAT HAS PROMPTED THESE LAWSUITS (cont.)?

- “Excessive fee” cases may be seen as a predictable outgrowth of increased public interest in 401(k) plan fees.
 - 1998 Report funded by Department of Labor, entitled “Study of 401(k) Plan Fees and Expenses.”
 - 2004 ERISA Advisory Council Working Group on Plan Fees and Reporting on Form 5500.
 - 2005 SEC staff report.

WHAT HAS PROMPTED THESE LAWSUITS (cont.)?

- 2006 GAO Report, "Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees."
- Current Department of Labor initiatives to improve fee disclosures to sponsors and participants.

III. OVERVIEW OF "EXCESSIVE FEE" CASES

- Common theme is that defendants breached fiduciary duties by:
 - failing to investigate or disclose "revenue sharing" payments received by 401(k) plan providers.
 - causing or allowing 401(k) plans and their participants to be charged excessive fees for services.

OVERVIEW OF “EXCESSIVE FEE” CASES (cont).

- ERISA actions filed to date may be divided into three categories.
 - Participant claims against sponsors and related plan fiduciaries:
 - *Abbott v. Lockheed Martin Corp.*, 3:06-cv-00701-MJR-DGW (S.D. Ill.)
 - *Beesley v. International Paper Co.*, 3:06-cv-00703-DRH-CJP (S.D. Ill.)
 - *George v. Kraft Foods Global, Inc.*, 3:06-cv-00798-DRH-PMF (S.D. Ill.)
 - *Kanawi v. Bechtel Corp.*, 3:06-cv-05566-CRB (N.D. Cal.)

OVERVIEW OF “EXCESSIVE FEE” CASES (cont.)

- *Loomis v. Exelon Corp.*, 1:06-cv-04900 (N.D. Ill.)
- *Martin v. Caterpillar, Inc.*, 2:06-cv-04208-SOW (W.D. Mo.)
- *Spano v. Boeing Co.*, 3:06-cv-00743-DRH-DGW (S.D. Ill.)
- *Taylor v. United Technologies Corp.*, 3:06-cv-01494-WWE (D. Conn.)
- *Waldbuesser v. Northrop Grumman Corp.*, 1:06-cv-04897 (N.D. Ill.)
- *Will v. General Dynamics Corp.*, 3:06-cv-00698-WDS-CJP (S.D. Ill.)

OVERVIEW OF “EXCESSIVE FEE” CASES (cont.)

- Participant claims joining plan providers:
 - *Hecker v. Deere & Co.*, 06-C-0719-S (W.D. Wis.).
 - *Renfro v. Unisys Corp.*, CV06-8268-FMC-FFMx (C.D. Cal.)
 - *Kennedy v. ABB, Inc.*, 2:06-cv-04305-NKL (W.D. Mo.)
- Plan fiduciary claims against plan providers:
 - *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp. 2d 156 (D. Conn. 2006)
 - *Phones Plus, Inc. v. Hartford Financial Services, Inc.*, 3:06-cv-01835-AVC (D. Conn.)
 - *Ruppert v. Principal Life Ins. Co.*, 3:06-cv-00903-DRH-PMF (S.D. Ill)

OVERVIEW OF “EXCESSIVE FEE” CASES (cont.)

- All cases except *Haddock* have been filed since September 2006.
- Only written opinion to date is denial of summary judgment in *Haddock*.
- Motions to dismiss are pending in several other cases.

IV. PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES

- Ten ERISA cases filed September and October 2006
 - Same St. Louis, MO law firm, Schlichter, Bogert & Denton.
 - Claims brought by 401(k) participants for breach of fiduciary duty under Sections 502(a)(2) and 502(a)(3) of ERISA.
 - Complaints seek certification of a class of all similarly situated participants in their respective plans
 - Defendants include sponsoring employer, plan committees and company officers, directors and employees.
 - Plan providers *not* joined as defendants.

PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES (cont.)

- Core allegation is that defendants breached fiduciary duties by:
 - causing or allowing plan providers to be paid excessive fees for their services.
 - Includes “hard dollar” payments made directly by plans and “revenue sharing” payments made indirectly by third parties.
 - “foregoing” or failing to “capture” revenue sharing monies embedded in the expense ratios of the investment vehicles offered under the plan.

PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES (cont.)

- Other allegations include:
 - Inappropriate mutual fund share classes
 - “Shadow” or “closet” index funds
 - Employer stock funds
 - Inappropriate benchmarks

PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES (cont.)

- Requests for relief:
 - Restoration of all losses, including “investment losses” (Section 502(a)(2)).
 - Section 404(c) protection allegedly unavailable.
 - Accounting of all transactions and dispositions in connection with plans and their assets (Section 502(a)(3)).

PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES (cont.)

- Complaints raise a number of issues, including:
 - Did the fiduciaries prudently investigate the fee arrangements between the plan's service providers and third parties?
 - Were the total payments received by plan providers for services rendered to the plan "reasonable" by market standards?
 - Are "foregone" revenue sharing payments plan assets?
 - Can participants recover allegedly excessive fees as an "investment loss" under Section 502(a)(2)?

PARTICIPANT CLAIMS AGAINST SPONSORS AND RELATED FIDUCIARIES (cont.)

- Did defendants act prudently in selecting investment options available to participants under the plan?
 - Does it matter? *See Langbecker v. Electronic Data Systems Corp.*, Slip Op. 04-41760 at 14-22 (5th Cir. Jan. 18, 2007).
- Are the defendants entitled to Section 404(c) relief?
- Do plan fiduciaries have a duty to seek to eliminate or reduce the expense ratios of mutual funds offered as investment options?
 - Consistent with federal securities laws?

V. PARTICIPANT CLAIMS JOINING PLAN PROVIDERS

- *Deere, Unisys* and *ABB* cases filed December 2006.
 - Plaintiffs are 401(k) plan participants.
 - Schlichter firm represents plaintiffs.
 - Complaints seek certification of a class of all similarly situated participants in their respective plans.
 - Claims against sponsors and related fiduciaries are similar to those asserted in the earlier ten cases.
 - Complaints seek same relief against plan sponsors and related fiduciaries that was sought in earlier ten cases.

PARTICIPANT CLAIMS JOINING PLAN PROVIDERS (cont.)

- What's different?
 - Complaints join plan providers (Fidelity Management Trust Co. (FMTC) and Fidelity Management & Research Co. (FMRCo)) as defendants.
- Complaints generally allege that FMTC and FMRCo acted as ERISA fiduciaries by agreeing with plan sponsor that sponsor would limit its selection of investment options to funds offered by FMTC.

PARTICIPANT CLAIMS JOINING PLAN PROVIDERS (cont.)

- Complaints generally allege that FMTC and FMRCo breached fiduciary duties by:
 - causing or allowing plans to pay “Plan service providers” excessive fees, either directly (“hard dollars”) or indirectly (“revenue sharing”).
 - “secretly” charging and retaining revenue sharing payments that should have been used to benefit plans and participants.
- Relief sought against FMTC and FMRCo generally includes restoration of losses, including “investment losses” (Section 502(a)(2)), an accounting of all transactions and “equitable restitution” (Section 502(a)(3)).
 - Section 404(c) protection allegedly unavailable on Section 502(a)(2) claim.

VI. PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS

- Alleged fiduciary status of plan providers raises issues under ERISA §§ 406(b)(1) (self-dealing) & 406(b)(3) (kickbacks).
 - Department of Labor has grappled with similar issues in a number of advisory opinions.
 - Related issues addressed in PPA “investment advice” exemption, Section 408(b)(14) & (g).

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Three ERISA actions brought by 401(k) plan fiduciaries against providers specifically allege 406(b)(1) & (b)(3) violations.
 - Plaintiffs in each case represented by different law firms (not Schlichter firm).
 - Complaints allege that providers breached fiduciary duties and engaged in prohibited transactions by arranging for, receiving and retaining revenue sharing payments from mutual funds.
 - Complaints seek certification of a nationwide class of similarly situated plans.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp. 2d 156 (D. Conn. 2006).
 - March 7, 2006 decision denying summary judgment found that several issues were genuinely disputed.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Whether Nationwide exercised fiduciary control over selection of plan's mutual fund options.
 - Acknowledged Nationwide's control might be limited to deleting or substituting funds from plan's approved list.
- Whether revenue sharing payments made to Nationwide were "assets of the plan" within the meaning of Section 406(b)(1).
 - Acknowledged that assets of mutual funds were not plan assets under Section 401(b)(1).

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Whether Nationwide's receipt of revenue sharing payments from mutual funds violated Section 406(b)(3).
 - Reasonable inference could be drawn that "service contracts" with mutual funds were simply shelf-space arrangements or that any additional services were "nominal."
 - DOL Adv. Ops. 97-15A, 97-16A & 2003-09A "assumed" revenue sharing payments were for actual services.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- *Ruppert v. Principal Life Ins. Co.* (S.D. Ill., filed Nov. 8, 2006).
 - Complaint alleges Principal acted as a fiduciary by:
 - Narrowing the list of mutual funds from which the plan sponsor could choose.
 - Retaining authority to substitute other mutual funds for those chosen by the plan sponsor.
 - Retaining authority to close mutual funds chosen by the plan sponsor to new investment.
 - Providing investment advice to plan sponsor and participants.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- *Phones Plus, Inc. v. Hartford Financial Services, Inc.* (D. Conn., filed Nov. 14, 2006).
 - ERISA action brought by 401(k) plan fiduciary against Hartford Financial Services, Inc. (HFS), Hartford Life Insurance Co. (Hartford Life), and Neuberger Berman Management, Inc. (Neuberger).

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Fiduciary status allegations against HFS and Hartford Life (Hartford):
 - Select menu of mutual funds available to plans with Hartford group annuity contracts.
 - Periodically review performance of mutual funds on the menu available to plans and may recommend removal of a particular fund from a plan's investment platform.
 - Have discretion to substitute or eliminate mutual funds from a plan's investment platform.
 - Exercise control over plan assets: (1) accumulation units held in separate accounts established by Hartford, and (2) revenue sharing payments made by mutual funds.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Fiduciary status allegations against Neuberger:
 - Serves as investment advisor to plans.
 - Selects investment vehicles to be offered to plan's participants.
 - Reviews and evaluates investment vehicles offered to plan's participants.
 - Exercises control over revenue sharing payments made by mutual funds.

PLAN FIDUCIARY CLAIMS AGAINST PROVIDERS (cont.)

- Complaint asserts that Hartford and Neuberger engaged in a “revenue sharing scheme.”
 - Group annuity contracts do not disclose that mutual funds will make revenue sharing payments to Hartford.
 - Services Hartford claims to provide mutual funds are no different from those previously provided to the plan.
 - Mutual funds’ inclusion on menu of investments available to plans conditioned on making revenue sharing payments to Hartford and Neuberger.
 - Undisclosed revenue sharing arrangements between Hartford and Neuberger.
 - Neuberger made revenue sharing payments to Hartford for recommending Neuberger as investment advisor.

VII. IMPLICATIONS AND RELATED DEVELOPMENTS

- Implications of “excessive fee” cases:
 - Cases generating lots of discussion in the employee benefit plan community.
 - Still at preliminary stages of litigation – whether they will produce “big dollar” recoveries has yet to be seen.
 - Cases highlight fee issues that the Department of Labor has been talking about for years.
 - Expect more of these cases to be filed in the months ahead.
 - Sponsors are likely to demand more extensive and detailed fee disclosures from plan providers to protect against claims.

CONGRESSIONAL ACTIVITY

- 2006 GAO Report, "Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees."
 - GAO findings:
 - ERISA requires 401(k) plan sponsors to disclose only limited fee information that does not facilitate easy comparison of investment options.
 - Participants may not have a clear picture of the total fees paid because the limited fee information they receive is often provided piecemeal.
 - Department of Labor lacks sufficient information about service provider arrangements and fees to provide effective oversight.

CONGRESSIONAL ACTIVITY

- GAO recommendations:
 - Consider amending ERISA to require sponsors of participant-directed 401(k) plans to disclose fee information for each investment option that facilitates comparison among the options.
 - Consider amending ERISA to require 401(k) service providers to disclose to plan sponsors compensation received from other providers.
 - Department of Labor should require plan sponsors to report a summary of all fees paid out of plan assets or by participants.

DEPARTMENT OF LABOR

- Current Department of Labor initiatives to improve fee disclosures to sponsors and participants.
 - Proposed changes to Form 5500 for reporting years beginning January 1, 2008 would require more extensive reporting of payments to service providers, including revenue sharing.
 - Working on proposed amendment to Lab. Reg. § 2550.408b-2 that would require party in interest service provider to disclose fee arrangements with third parties in connection with services provided to a plan.
 - Considering development of proposed rule regarding provision of fee information to participants under Lab. Reg. § 2550.404c-1.