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By Betsy Piper/Bach, JD, CIMA®, CFP®, CTFA

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Hidden Fees as a Source of Fiduciary Risk in Defined Contribution Plans

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The Employee Retirement Income Security Act (ERISA) requires various disclosures be made to pension plan participants.[1] These disclosures are required to ensure that plan participants are able to make informed decisions regarding their investment choices, for the plan to remain a tax-qualified plan under the Internal Revenue Code (IRC), and to provide fiduciary protection.[2] The intricacies of the fees require plan sponsors to be particularly diligent that they understand the fees and are able to clearly disclose them in a manner that allows participants to make appropriate choices. This paper will examine fiduciary and disclosure rules as they apply to IRC 401(k) plans to determine if such rules are able to provide full fee transparency.[3]

Section one defines the fiduciary and the fiduciary's need to understand the role of fees at both the plan level and the participant level. A fiduciary must act in the best interest of the beneficiary. A fiduciary's duty of loyalty requires the fiduciary to oversee plan expenses and therefore to understand fees and expenses related to ERISA plans.

The second and third sections describe required services and fee disclosures for these services. Generally, the services fall under two categories: investment and administrative. The fee disclosures are made in four ERISA-required documents. Further, if a plan's design allows participants to have independent control, additional disclosures will be required.

The next sections explain the maze of fees often imbedded in services and products provided to the plan, the accuracy of disclosures related to these fees, and whether these disclosures then would lift all restrictions as to the type and amount of fee to be implemented. Fees are transparent for certain services if the participant can traverse the various documents available, opaque for other services, and impossible to calculate for services that might be considered bartered services. It also will be seen that there is a limit to the types and amounts of fees that can be charged. Disclosing a fee does not mean that the fee is fair and may be charged.

The final two sections discuss the changes on the horizon and whether enough appropriate regulations are in place to protect the ultimate beneficiary of the plan—the individual participant. This paper will show that the industry is on the right track toward transparency but that many fees elude the uninformed plan sponsor and participant.

FEES AND THE ROLE OF THE FIDUCIARY

The Internal Revenue Code created an alternative employee benefit plan when it added §401(k) to the Code in 1978.[4] Its advantageous tax-deferred benefits were well-received by employers and employees alike. Due to greater portability, employee control, and matching contributions, 401(k) plans are quite popular. Growth of 401(k) assets continues at 20–22 percent per year, in contrast to the assets in defined benefit plans, which are shrinking each year.[5]

ERISA §404 defines how the fiduciary must act on behalf of the retirement plan participants' exclusive benefit.[6] The defining statement regarding this role is "exclusive benefit," and it requires that the interest of the beneficiary always comes first. ERISA §404(a)(1)(A) defines exclusive benefit as a duty of loyalty and, as such, a fiduciary must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and ... for the exclusive purpose of .. providing benefits to participants and their beneficiaries."[7]

In the discharge of this duty of loyalty ERISA §404(a)(1)(A)(ii) requires an ERISA fiduciary to "defray reasonable expenses in administering the plan." Expenses arise from costs incurred by the administrator, accountants, attorneys, custodian, trustees, and investment managers. The importance of this role can be explained through an example provided by the Employee Benefits Security Administration (EBSA) to illustrate the difference in paying 50 basis points (bps) in expenses versus paying 150 bps in expenses over thirty-five years on a $25,000 one-time contribution.[8] All other variables held equal, the retirement plan participant paying 150 bps would be $64,000 poorer at retirement by paying the extra 1 percent on the $25,000 over the term of the thirty-five-year investment.[9] Thus, the fiduciary must assure himself that he has engaged "in a prudent process of selecting options and investigating the fees associated with those investment options."[10]

ERISA §404(a)(1)(B) requires that the fiduciary act in the interest of the beneficiary but do so according to a defined standard. This standard is applied as the "prudent man" rule."[11] It requires the fiduciary to have the skills to carry out the fiduciary's responsibilities. If the fiduciary does not have the skills required, it is the responsibility of the fiduciary to delegate the responsibility and monitor the activity. In summary, the plan fiduciary must understand the fees pertaining to the retirement plan in order to act in the best interest of the plan beneficiaries; otherwise, the fiduciary should hire someone who has the skills and then monitor that person's activities.

ERISA has delegated to fiduciaries the oversight of fees and provides regulations and some assistance with IRC §101 and ERISA §404(c) by defining the type of disclosure required at the plan level as well as requirements for disclosure to the participant.[12] These requirements ultimately result in placing disclosure requirements on vendors to plans so that plans can disclose to beneficiaries.

ERISA also indirectly regulates plan compensation through ERISA §404 and §408. §404(a)(1)(A)(ii) states that the fiduciary "defray reasonable expenses in administering the plan," and ERISA §408(b)(2) provides an exemption for services if the contract or arrangement is "reasonable" and the amount is "reasonable."[13] This language provides the fiduciary some flexibility in interpreting the various fee plans available.

This flexibility allows fees to tend toward what the market will bear based on the plan's assets and service requirements. For example, international assets will have higher fees than aggressive stock investments.[14] A balanced fund composed of stocks and bonds will have a higher fee than a bond fund but a lower fee than an all-stock fund. Smaller plans often are composed of insurance products that have higher fees than mutual fund products. Smaller plans also purchase retail share classes of mutual funds that have higher fees while larger plans benefit from the ability to buy institutional shares of a mutual fund that carry a lower fee. Investments such as index funds and separate accounts charge less than active mutual fund investments. The research firm Cerulli Associates found that across all categories average investment expenses are "estimated for institutional mutual funds to fall in the range of 50–65 percent of retail expenses. Management fees in large-plan separate accounts are 30–45 percent of retail mutual fund expenses."[15] The plan sponsor needs to understand all the elements of the plan to be an informed market participant.

Recent complaints, many from class actions, about such firms as Northrup Grumman Corporation and International Paper Company soon will add weight to the discussion of what knowledge of fees is required from a fiduciary.[16] The complaints regard the failure of fiduciaries to understand the methods used and the revenues collected by the retirement industry, failure to clearly disclose these fees and expenses to plan participants, failure to disclose to the plan participants that excessive fees were being charged, and, failure to stop the hidden and excessive fees.[17] The action is being brought under ERISA§409 and §502.[18] The defendants allegedly did not inform themselves of industry practice regarding fees and did not account for all transactions involving participants' assets. Ultimately, these fiduciaries wasted dollars that were available to help pay for plan services.[19]

REQUIRED PLAN SERVICES

As Albert Einstein said, "Not everything that can be counted counts, and not everything that counts can be counted."[20] Fiduciaries need to be aware of the services available to plans and which services plan participants really want. One survey found that "85 percent of respondents voted for greater investment returns versus more services from their plans."[21] Some services are required and others are elective, but whether required or elected, services generally fall into one of two categories: administrative or investment.

Administrative services include record keeping, annual plan maintenance, tax reporting, custody, compliance, accounting, loans, financial planning, online access, and customer service.[22] Fees for these services are charged by myriad methods. Some fees may be charged directly to the plan sponsor as an itemized expense or per participant. Others are paid by the individual as a flat fee or a percentage of assets. Yet other fees are charged directly to the plan. Certain administrative services are required, such as compliance and accounting. Other services, such as financial planning, are elective. To make informed decisions about the plan, the plan fiduciary needs to understand the participants' needs, wants, and sensitivity to the various fees.

Investment services are composed of the investment management of assets through various vehicles such as mutual funds, group annuities, collective common funds, separate accounts, individual brokerage accounts, and sales activities. Fees for these services may include asset-based fees, upfront sales charges, contingent deferred sales charges, revenue sharing, and/or wrap fees. "It is clear from evidence in the literature that not all investment products disclose the fees and expenses that are charged to a 401(k) plan, nor are all of the fees and expenses charged by service providers disclosed."[23] It is the fiduciary's challenge to find out the charges for each product. David Wray, president of the Profit Sharing/401k Council of America, warned his constituency that lawsuits are coming. "Fees are in the dark," Wray said. "We've got to shed light on fees. Plan sponsors have to have fees in front of them."[24]

Most fees can be found out if the sponsor knows where to look and what questions to ask, matters that are discussed below.

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CURRENT REQUIRED DISCLOSURES

ERISA requires that specific disclosures be made to plan sponsors and plan participants. A defined contribution plan must provide the following disclosures:

1. Summary Plan Description (SPD)
2. Summary of Material Modifications
3. Form 5500 Annual Return/Report (Form 5500)
4. Summary Annual Report (SAR)
5. Total benefits accrued and nonforfeitable pension benefits

The SPD requirement applies to employee benefit plans in general. The SPD provides plan participants with the name of the plan, the names of those to whom various responsibilities have been delegated in carrying out the requirements of the plan, eligibility requirements, rights and obligations of the participant under the plan, and the possibility of losing benefits. The SPD summarizes plan provisions in understandable language. It is provided to participants within 120 days of formation of the plan or ninety days after a new participant enters the plan. If there are no material modifications, the SPD will be redistributed every ten years. If there have been material modifications, the document must be redelivered every five years. When a material modification is made, a Summary of Material Modifications must be delivered to participants within 210 days after the modification.[25]

Financial disclosures are required on Form 5500. This document is the main source of information regarding plan operations, funding, and investments and is available to plan participants and beneficiaries.[26] Various agencies and private sector organizations use Form 5500 to monitor employee benefits, tax, and economic trends and policies.[27] It documents plan assets and fees by categories. It also provides a statement of receipts and disbursements for the benefit of participants, aggregated by general sources and applications.[28]

The SAR summarizes plan accounting and information from Form 5500.[29] Distribution is required within nine months after the end of the plan year or two months after the due date of the annual report, unless fewer than 100 participants which then are allowed to issue simplified reports under IRC §104(a)(1) and §101.[30]

In addition to the four documents described above, a final disclosure is required under IRC §101(a)(2) and is found in IRC§105(a) and (c), but it is not a document. This section requires the administrator to provide, upon a participant's request, the total benefits accrued and the nonforfeitable pension benefits.[31] The IRC §101 disclosure is a general disclosure and applies to all employee benefit plans.

ERISA §404(c) plans require even more.[32] When a 404(c) pension plan allows participants to control the assets in individual accounts, none of those normally considered fiduciaries as to the performance of the individual participant's portfolios within the the pension plan will be considered fiduciaries if they follow the guidelines provided within this section of the law.[33] Regulations require an appropriate mix of asset class selections, information regarding the plan fiduciary, details regarding investment choices, and expenses related to the plan's investment elections. The information must inform plan participants so they can make appropriate investment choices, allowing for facts and circumstances of each situation.[34]

401(k) participants must be provided specific information regarding their investments and related expenses, such as a description of investments that includes identification of the investment manager, transaction fees, and expenses. This type of information can be found in the investment's prospectus. Participants can request further information about annual operating expenses that impact rate of return and aggregate expenses as a percentage of assets.[35] The plan fiduciary has the responsibility to be informed enough to look in all the right places and ask all the right questions. The checklist below will assist the plan fiduciary with this responsibility.

MAKING AN INFORMED DECISION

Plan sponsors are required to understand all fees that impact participants. Fees occur at many levels of a defined contribution plan and some are more easily detectible than others. Some can be found in the documents required by ERISA §101, which were described above.[36] Some are not that transparent.

Plan sponsors and fiduciaries need to be adequately informed about the following eight fee/service areas if they expect to uphold their responsibilities to plan participants.

ADMINISTRATIVE FEES

Plan administrative fees that are charged directly to the plan sponsor are easily disclosed through the invoice or plan document. These would include per-participant fees that are added to the annual base fee as well as for items such as communications expenses and other customized services to an individual.[37] Individual fees for administrative services also are easily discerned by the participant because they are related to individual loans and distributions are listed on the invoice to the participant.[38] Fees paid by the plan, versus fees paid by the sponsor or individual participant, also are reported on Form 5500 as a fee for bundled service.[39]

Although Form 5500 is a required disclosure, it does not detail the fees paid by individual participants. Form 5500 shows a cumulative expense against a cumulative asset value for the entire plan. It does not include any of the following: individual fees found on the participant's statement; asset-based investment fees, which are a percentage charged to the assets of the fund; 12b-1 fees, which are a percentage of the assets paid for the distribution and marketing of the mutual funds; finders' fees paid to brokers for the placement of assets in the mutual funds; or subtransfer agency fees paid for the record keeping of participant activity.[40] Thus, the plan document and participant's own statement are the best source of information for the participant regarding individual fees, but they still do not tell the entire story.

RECORD-KEEPING FEES

Subtransfer agency activity, also called "record keeping," often is contracted to third-party administrators by mutual funds.[41] The record keeper, not the mutual fund, then opens an account on its proprietary record-keeping system for every plan participant that has invested in the mutual fund. The mutual fund then deals with only one client, the record keeper. This saves the mutual fund the expense of dealing with thousands of plan participants. The mutual fund pays the record keeper for taking on this responsibility. ERISA allows funds to pay record keepers for this service.[42] These payments come out of the mutual fund's administrative expenses, which are disclosed in the prospectus. Often the record keeper also is the point of contact with the shareholder and is compensated for this activity through a shareholder servicing fee. This expense can be greater than the 12b-1 fee and is not disclosed separately in the prospectus, although it does come out of the assets of the fund.[43]

INVESTMENT FEES

Investment fees are even more subtle than administrative fees. The various investment vehicles have unique methods of charging for services, such as through revenue sharing, directed brokerage, service fees, and management fees used to pay for service providers. All are described further below. Not all are disclosed.[44]

Investment vehicles such as mutual funds disclose an expense ratio that is composed of the management fee, marketing and distribution fees, and other administrative fees (separate from the administration fees). These fees can be found in public databases as well as in the prospectus, but the underlying composition of each of these items is not disclosed.[45] Even these ratios do not include brokerage fees, which are composed of ticket charges for every trade and the commissions allocated to a trade. In addition to expense ratios, front-end sales charges are as high as 8.5 percent and back-end contingent deferred sales charges (for early redemption) come out of the participant's purchase or redemption price.[46] But some mutual fund classes do not charge these fees, so the plan sponsor must be fully informed about fees in order to choose the correct class of shares, because one will reduce the return to the participant more, or less, than another.

12B-1 FEES[47]

Sales charges are charged directly to the participant, but a 12b-1 fee is charged indirectly to the participant.[48] A 12b-1 fee is a form of revenue sharing from the assets of mutual funds to help pay fees for administration, trustee, and other services required by the plan. A daily percentage comes out of the value of the fund each and every day and impacts the participant's return. These fees, though charged indirectly, are an additional cost to the participant. Funds that charge a 12b-1 fee of 25 bps or less are allowed to call themselves "no load" funds, and funds that do not charge any 12b-1 fee are allowed to call themselves "100-percent no-load" or "true no-load."[49] Again, not every class of the mutual fund will charge these fees, so the fiduciary is responsible to know the difference in revenue-sharing activities and evaluate this in light of the entire charge to the participant.

Complaints were filed in September and October 2006 involving such firms as Northrup Grumman concerning the fiduciary's lack of awareness of this 12b-1 element of revenue sharing.[50] In *Abbott v. Lockheed Martin Corporation*, the complaint specifically cites the defendants for failing to "capture the available revenue sharing and use it solely in the interest of the plans and the participants and beneficiaries."[51] Interestingly, the complaint charges the fiduciaries with failing to "inform themselves of, and understand, the various methods by which vendors in the 401(k) retirement industry collect payments and other revenues from 401(k) plans."[52] Here, the plan was investing in classes of mutual fund shares that paid revenue-sharing fees. The plan did not collect the fees, so it was paying more for the shares in that fund but not benefiting from the revenue it was allowed to take back in the form of revenue sharing. As a result, the plan paid more for services than other plans that took the fee and applied it to plan expenses. The defendants could have solved this problem by buying institutional shares that did not include the revenue sharing and that priced shares less expensively.

Further, the complaint states that this revenue-sharing information was not disclosed as required under 29 CFR §2550.404c-1(b)(2)(i)(B)(2)(i) and 29 CFR §2550.404c-1(b)(2)(ii)(A)."[53] One of the court's challenges will be to determine the first level of nondisclosure. Was the fund's disclosure not clear within the prospectus or was the initial failure at the plan sponsor's level?

That a plan sponsor does not avail itself of a source of revenue sharing that it is paying for causes the fund to pay higher-than-necessary fees and reduces the return of the plan. Revenue sharing is not illegal nor unethical. In this case, the plan sponsor either was insufficiently aware of the fees or did not use them in the best interest of plan participants. It is the fiduciary's responsibility to be informed of these available revenues and then disclose them.

MANAGEMENT FEES

Management fees are paid to the investment manager for managing the assets in the fund. These fees appear to be one of the most transparent fees until one realizes that many advisers use the management fee for things other than investment management of the portfolio. A fiduciary needs to confirm that the investment manager is charging a fair fee. When an investment manager earns a higher than normal fee, the fiduciary must determine what the manager actually is using this fee for. The manager may be paying for administrative functions with the management fee rather than the administrative fee.[54] The management fee may be another source of sales compensation, in the form of a finder's fee paid to a sales entity for placing investments into the fund.[55] The fiduciary may need to determine whether an investment manager may be inflating the management fee to pay for other services and continue to earn a profit. The fiduciary must consider whether this is a share of fees due to profits rather than due to an inflated management fee. This is not an easy task, because many advisory firms are private companies and not required to disclose their financial statements.

SEC §28(E) FEES

Securities and Exchange Commission (SEC) safe harbor rule §28(e) creates the ability for an investment manager to pay a commission at a higher rate than the cost of the execution of the trade.[56] These fees are created through such practices as "directed brokerage" and "soft dollars."[57] In these instances a portion of the commissions paid to the brokerage firm for transactions is allocated to an account that the investment manager names. The revenue will grow in that account based on the number of trades conducted by the manager for that account. It then will be used to pay for such things as hard-copy research, online analytic services, and electronic systems, as well as other items allowed by a July 13, 2006, SEC interpretive release.[58] This process pays for services the investment manager needs in order to provide investment services to the plan. If the investment manager does not pay for the services through this directed brokerage process, they would be required to pay for the services in hard dollars and ultimately would raise their management fees to pay for the services the soft-dollar activity can cover. For this reason, SEC §28(e) was created to allow soft-dollar activity. The difficulty for the fiduciary is that a hard-dollar fee is transparent while a soft-dollar fee is opaque. Either way, this charge can impact the participant by increasing the cost of the trade and lowering the return of the investment. In the case of ERISA accounts, any fees directed into this soft-dollar account from ERISA trades fall under ERISA §404(c) and must be used for the exclusive benefit of plan participants. SEC §28(e) may provide a safe harbor for this activity, but ERISA governs exactly how the fees may be used under its exclusive benefit rule.

For fiduciaries to be informed about the use of plan fees, they must be aware of the fees. An independent review of revenue payments between brokerage firms and mutual fund companies found undisclosed revenue payments between brokerage firms and mutual fund companies.[59] How specific the disclosure should be is not clear. What is clear is that, today, disclosures entail only a statement that soft-dollar activity is conducted within the plan and that the activity the investment manager is using the money for falls within safe harbor SEC §28(e).

An example of a soft-dollar activity often used by plan sponsors involves compensating pension consultants hired to assist plan sponsors, administrators, and trustees in hiring appropriate investment managers, finding appropriate investment vehicles, and further refining the composition of plan assets. The various methods of payment can impact the return of the participants' investments. For instance, a pension consultant recommends the hiring of manager "X," who is asked to place all trades through a specific broker-dealer. That broker-dealer, in return, pays the compensation of the pension consultant for its role in assisting the plan with its investments. The trades are made for 6 cents a share and out of that 6 cents, 4 cents are allocated toward paying the consultant's $100,000 annual fee. Since the consultant's fee needs to be paid regardless, should we be concerned that the plan is paying more than a market rate for a trade?[60] Is the commission rate the real concern or should it be the best price?

Best price, commission cost, and the other services provided by the broker-dealer to the investment manager and the plan must be evaluated in total to determine "best execution" documentation. For example, consider a plan fiduciary that obtains a "best execution" report from the investment manager's trading desk. The report indicates that the price obtained was a best execution but that the plan paid a higher commission because the excess over the regular commission was put into an account to pay the consultant's fee. In this case, the plan fiduciary should be unconcerned about the higher commission. Had the commission not been used to pay the consultant, other assets of the same plan would have been used to pay the fee to the consultant and in the end would have the same impact on the assets of the plan.

The risk in using soft dollars is that a very active manager may be hired; someone who trades often and creates lots of commissions in the soft-dollar account to be used to pay for services. This source of hidden fees impacts plan participants by forcing them to pay a higher commission on their trades as well as by forcing them to pay for many more trades than in an environment with fewer trades. The return on the investment needs to be high enough to compensate the participant for this added expense. A plan sponsor needs to be informed if these types of arrangements are in place especially if the soft dollars are used to pay the pension consultants. Ultimately the plan sponsor, as the fiduciary, chooses the investment managers. If there is any conflict of interest in regard to the relationship, it should be disclosed. When fiduciaries are unable to conduct these types of oversight, they should require their consultants to provide this information to them. An independent fiduciary is yet a better source for an unbiased analysis.[61]

EMPLOYER STOCK

Employer stock is unitized so that participants can invest through an employer's 401(k) retirement plan. In creating this unitized vehicle, the fund is required to have shares and cash. Each contribution will buy a unit of cash and stock minus the expenses of the trustee, custodian, administrator, and investment manager. The September 2006 complaint filed against Lockheed Martin states that it is more expensive to buy employer stock in a retirement plan than directly in the market and that CFR §2550.404c-1(b)(2)(B)(2)(ii)(A) requires this to be disclosed to participants.[62] Yet investment markets are not free, and other than a transfer of stock to an employee through a stock option or stock purchase program, the participant would pay commissions outside of the retirement plan for this stock. The cash in the unitized fund is earning interest. Must this also be disclosed? To what degree is the disclosure a requirement?

An analysis of the disclosure requirements of IRC §101 and ERISA §404(c)(1) will shed some light on the disclosure requirements regarding the unitized fund and related interest earned. Under ERISA §404(c)(1)(a)(2)(B), the beneficiary must receive enough information to make an informed decision regarding the investments within the plan. The specific information required to make this informed decision can be found within the regulation including the requirement that the participant receive a description of the investment, which includes: disclosing the commissions charged; upon request, a description of the annual operating expenses that reduce the rate of return; upon request, a list of the assets comprising the alternative investment; and informing the participant that a plan may charge participants for reasonable expenses of carrying out investment instructions provided that procedures are established to inform participants of actual expenses incurred.[63] The employer stock fund is an investment alternative being charged commissions. The rate of return is impacted by the amount of the contribution being reduced by administrative fees, custody fees, and trustee fees, and part of the contribution is sitting in cash earning interest instead of in a share of stock earning market participation rates. Thus, the make-up of the unitized fund and the interest earned must be disclosed. However, there is not a requirement to inform participants that they could purchase employer stock at a lower rate outside of the plan investment election.

FLOAT

Where is the participant's retirement plan contribution between the time it leaves the paycheck and the time it enters the elected investment? Employers withhold an employee's 401(k) contribution with the agreement of the employee. The law says that this contribution must be deposited as soon as possible but no later than fifteen business days after the month in which the payroll deduction was made.[64] For example, if the pay period ends on the first of a month, the employer would have fifteen days to make the contribution. During that fifteen days, the employer is earning a return on the withdrawal and the employee has lost the opportunity to earn return on investment.[65]

The Department of Labor (DOL) has issued Advisory Opinion 93-24A, which states that the interest earned on the assets in the service provider's bank account must be used for the exclusive benefit of the plan participants.[66]

At retirement, when plan participants begin taking income distributions, the custodian bank may receive income on the float from assets transferred to an operating account before beneficiaries present checks for payment. This float is the amount the bank uses to meet its daily loan needs. Banks are required to disclose this operating procedure to plan participants.

One other plan activity related to float does not appear to have been addressed by the DOL or any other legal entity. Service providers collect 12b-1 payments from the plan's mutual fund investment accounts as they are earned by the plan. The service provider holds these payments until a monthly or quarterly payment is due to the record keeper. Whose asset is this pool of fees? Should it earn interest for the service provider or for the plan? No invoice will be issued, nor will any check be presented for payment. The agreements between the service provider, the funds, and the record keeper state that the 12b-1 fees will be paid. The agreements do not address float. This float is among the general assets in the service provider's bank account until payment. Must this interest be disclosed to plan participants?

The DOL is investigating these types of activities and has not resolved these questions. In this situation, the service provider has an operating account that receives 12b-1 fees from mutual funds in which the plans invest. As the 12b-1 fees are collected throughout the month or quarter, it would be efficient and cost effective for the record keeper to allow the assets to earn interest while awaiting disbursement as the assets are co-mingled with all of the other intermediaries' clients' retirement plan assets. The exclusive benefit rule, read literally, suggests that a plan with any number of periodic 12b-1 payments coming in via the intermediary must make the same number of immediate disbursements to the plan.

Transaction costs are incurred in transferring payments. A daily check, wire, or automated clearing house incurs cost that immediately reduces revenue to the plan. By applying a cost-benefit analysis, both the intermediary and the plan can determine the impact of reducing expenses by issuing and receiving one disbursement per pay period. The 12b-1 fees are paid in entirety to the plan, as required under the service agreement, just at a later date. Since the intermediary provides a service to the plan by disbursing the 12b-1 fees, it may be appropriate for the plan and the intermediary to document the charge for this service, or alternatively disclose that there will be no charge because the financial intermediary will retain all interest earned on its operating accounts that accommodate 12b-1 payments. Disclosure concerning operating accounts of intermediaries would be a positive outcome from the current investigation.

INSURANCE PRODUCTS

Insurance products are not regulated under the 1933 Securities Exchange Act, so they are not held to the strict disclosure requirements of mutual funds under the Investment Company Act of 1940 and the Investment Advisers Act of 1940. Stable value accounts are used widely in defined contribution plans.[67] They are composed of insurance products such as guaranteed insurance contracts (GICs) or synthetic GICs. A GIC is a contract issued by an insurance company guaranteed to pay a specific percentage of interest for the life of the contract. A synthetic GIC is "an asset owned directly by the plan trust and a wrap contract providing book value protection for participant withdrawals prior to maturity."[68] The wrap contract is issued by a bank or life insurance company. This wrap provider tracks the performance of the funds and credits the account a flat percentage rate of interest that is reset, based on the performance of the underlying assets, each quarter.[69] The synthetic GIC provides a good example of the opacity of fees. The fees for this product are composed of the fees of the institutional funds that make up the underlying asset, the fees of the insurance "wrapper," the fees of the investment adviser managing the crediting rate process, and the fees of the custodian, trustee, and administrator.[70] These fees are converted into a percentage and charged against the net asset value of the funds. Thus, each participant is paying its share of the expense by accepting the lower return on the investment. The fiduciary will be well-challenged to find all these fees.

Two other widely used employee benefit investments are group and individual variable annuities.[71] These investment vehicles are wrapped with guarantees of minimum death benefits, post-retirement rates of return, and a guaranteed level of expenses.[72] In return for these guarantees investment management fees are charged directly to the investment vehicles and a wrap fee is charged against all assets. The wrap fee includes an additional distribution fee as well as direct and tail commissions, and mortality and expense guarantees. Although the wrap fee is disclosed, as in the expense ratio of mutual funds, the composition of the wrap fee is not disclosed.[73] Lastly, there also are 12b-1 fees that pay for the distribution of the product and are paid out of the mutual fund assets of the annuity. These fees are disclosed in the fund prospectus, not in the insurance documents. The challenge for the fiduciary is to find the fees within the various documents.

The landscape may be changing for insurance companies. On June 14, 2006, the New York Attorney General reached a settlement agreement with ING Groep NV, a large insurance conglomerate, "over allegations that it took undisclosed fees, i.e., revenue sharing payments, to promote certain funds in a retirement plan for New York State teachers."[74] The settlement requires that ING disclose fees it receives to include other companies' mutual funds in its variable annuity choices, currently not a requirement, as well as provide in plain English all of the fees charged customers.[75] One of the insurance companies investigated stated that all fees were waived, when in reality the fees were coming out of the participants' balances, reducing their returns.[76] Insurance companies are not required to make these types of disclosures. As part of the settlement, ING will pay $30 million as restitution directly to the retirement plan participants.[77]

PENSION CONSULTANT DISCLOSURES

In its examination of pension consultants, the SEC found that many lacked disclosures consistent with the guidelines provided within the 1940 Investment Advisers Act. In *the Matter of Feeley and Wilcox Asset Management Corp.*, the court held that "an investor seeking the advice of a registered investment adviser must, if the legislative purpose [of the Advisers Act] is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving two masters or only one, especially if one of the masters happens to be economic self-interest."[78] The SEC issued a staff report concerning pension consultants in 2005 suggesting that the policies and procedures of the pension consultant registered as an investment adviser include a policy and procedure to prevent "conflicts of interest or disclose material conflicts of interest in regard to compensation from brokerage commissions" and other areas that create risk exposure for the firm and its clients in relation to the firm's operations.[79]

One of these "other areas that create risk exposure" regarding the consultant's compensation is any arrangement by the consultant that includes compensation from investment managers and mutual funds recommended by the consultant to plans for which the pension consultant is consulting. It would be of interest to plan sponsors that the consultant is receiving revenue from money managers who are attending programs sponsored by the consultant; alternatively, it would be of interest to plan sponsors if these money managers are receiving products and services from the consultant. The question to be answered remains: Are the plan's assets being used for the benefit of anyone other than the plan participants? If the answer is "yes," there is a violation of ERISA. Thus, the fiduciary must have a method to evaluate these consultant conflicts.

Pension consultants registered as investment advisers now are subject to the "Chief Compliance Officer Rule," Rule 206(4)-7 under the Advisers Act. Under these rules the pension consultant must have policies and procedures designed to prevent violations of rules adopted under the Advisers Act of 1940. This would include policies and procedures for disclosing conflicts. An "adviser owes its client a duty of 'utmost good faith, and full and fair disclosure of all material facts' as well as an affirmative obligation 'to employ reasonable care to avoid misleading clients.'"[80] These requirements originated from a study in which "The Public Utility Holding Company Act of 1935 'authorized and directed the SEC' to make a study of the functions and activities of investment trusts and investment companies."[81] A fiduciary should ask to see the consultant's policies regarding conflicts.

ARE DISCLOSURES ACCURATE?

In *Mehling v. New York Life Insurance Co.,* the plaintiffs complained that "NYL engaged in a scheme to fraudulently induce the Trustees to invest the Plans' assets into 'certain NYL-proprietary investment products.'"[82] An employee, serving as the investment adviser and fiduciary, convinced the trustees that the NYL funds were appropriate. She accomplished this through material omissions and false representations such that the plan was not aware that it could have purchased funds for "lower fees for identical, if not superior, investment management services" and as a result lost millions of dollars in earnings they could have had.[83] Due to misrepresentation and inadequate information, the trustees were unable to make informed decisions regarding the appropriate investments for the plan participants.

In *State of New York v. Hartford,* another insurance company was found to have inadequate disclosures. Hartford created a scheme under an "Expense Reimbursement Agreement" where brokers would be reimbursed for expenses they incurred in providing Hartford a "last look" at annuity policies for retirement plans.[84] Commissions were disclosed, but the reimbursement payments, which were in addition to the commissions, were not. These payments caused the premiums of the annuities to increase and forced retirement plans to pay more in fees than they would have been required to pay with other insurance annuity products. In fact, it was found that these expense reimbursements were a ruse to buy the brokers' commitment to bring in business to Hartford.[85] By having the last look at the annuity need, Hartford was able to better the bid but was in totality not necessarily the best result for the retirement plan. It was found that these agreements were secret within Hartford and without. The commission quotes included the regular commission but not the Expense Reimbursement Agreement commission. By not fully disclosing the extra commission, the plan administrators consistently filed inaccurate Form 5500 Schedule A's. These schedules require insurers to disclose "commissions and fees 'directly and indirectly attributable to a contract between a plan and insurance company.'"[86] The commission earned from the Expense Reimbursement Agreement would be considered a commission directly or indirectly earned.[87] This example of Hartford is a good indication that disclosures may not be what they appear to be.

DOES DISCLOSURE GRANT FREE REIN?

When fiduciaries would like guidance about the suitability of their activities conducted for ERISA plans, they can request an opinion from the DOL concerning the specific situation. The DOL will issue an Advisory Opinion on the topic. The DOL has issued three opinion letters directly addressing disclosure and 12b-1 payments made to administrators of retirement plans:

1. "Frost Opinion," No. 97-15A
2. "Aetna Letter," No. 97-16A
3. "ABN AMRO Trust Services," No. 2003-09A[88]

In Opinion Letter No. 97-15A, Frost Bank, as trustee to ERISA-type plans, had discretion to add or subtract funds from the platform of funds offered to the plans. The question posed to the DOL concerned the fees the bank received from mutual funds in which the plans were investing. These fees were 12b-1 fees paid directly to the bank for providing shareholder services for the plans on behalf of the funds. As a result of full disclosure to the plans and the rebate to the plan if the fees received from the funds exceeded the costs of services, the DOL opined that the trustee "would not be dealing with the assets of the plan for its own interest or for its own account in violation of §406(b)(1)."[89] Disclosure was required, but so was the application of excess fees to the services of the plan.

In Advisory Opinion 97-16A, Aetna Life Insurance and Annuity Company (ALIAC) was receiving fees from unrelated funds. These fees were disclosed in the mutual funds' prospectuses and in marketing and other disclosures provided to plan participants. The DOL analyzed the role of ALIAC and determined that it was not a fiduciary to the plan. Then the DOL commented that the "responsible plan fiduciaries" must consider the reasonableness of the amount of the compensation received for services and to do so must obtain sufficient information regarding any fees.[90] Not only was the fee disclosure required, but the fees needed to be determined to be reasonable and ALIAC was not a fiduciary.

Lastly, in Advisory Opinion 2003-09A, the DOL also allowed a trust company, ABN AMRO Trust Services Company, to receive the investment advisory fee, 12b-1 fees, and any other fees from their proprietary funds invested in by plans as long as ABN AMRO did not direct the selection of the funds, provide disclosures in regard to the fees, or disclose what other funds in the same category had as fees.[91] The fees were applied to the costs of administering the plans, thus they were benefiting the plan and not accruing to the benefit of the employer, as required under ERISA §406(b)(1), 406(b)(3), and 404(a)(1). As can be seen in Frost, Aetna, and ABN AMRO, even where disclosures are appropriate and the structure is in place regarding the appropriateness of the fees the fiduciary was accepting, other factors apply. Disclosure is not the only requirement for a fee to be reasonable.

A recent case involving Nationwide Financial Services reflects just this situation regarding fee-sharing disclosure. Nationwide contracted to "share revenue" in return for services provided and disclosed to the plans and participants that it received these payments.[92] 29 CFR §1106(b) states that "a plan fiduciary cannot deal with the assets of the plan in his own interest or for his own account … or receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan." The triable issue in this case is not whether the fees were disclosed but whether Nationwide was a fiduciary at the time it received these payments, whether the payments were received as a result of Nationwide's relationship to the plan, and whether the fees were received at the expense of the participants.

Disclosure is important because it assists the plan fiduciary in carrying out its responsibility to act for the exclusive benefit of the plan participant, but disclosure does not occur in a vacuum. Knowing all the fees is only part of disclosure. In the end the exclusive benefit rule drives the ability to accept any fee, disclosed or undisclosed.

THE COMING WAVE OF CHANGE … IS IT ENOUGH?

ERISA created the Advisory Council on Employee Welfare and Pension Benefit Plans to provide advice to the Secretary of Labor concerning the state of fees and disclosures in defined contribution plans as well as recommendations for changes. The report of the Council's Working Group on Fee and Related Disclosures to Participants, which was published in November 2004, concluded that three levels of disclosure need to be addressed: (1) the service provider to the plan sponsor, (2) the investment provider to the plan sponsor, and (3) disclosures to plan participants.[93]

Council member Dennis Simmons, senior counsel in Vanguard's ERISA Legal Department, addressed the service provider to plan sponsor level disclosure. He concluded that the service provider fee should be an all-inclusive expense ratio fee that would include the investment-related expenses as well as direct administrative and record-keeping charges because it allows sponsors to monitor trends by total fees and would encourage price competition.[94] This would create a benchmark against which to measure the appropriateness of investment fees.[95]

As for disclosures to the plan sponsor, Stephen P. Utkus, director of Vanguard's Center for Retirement Research and a council member, stated that "a public policy goal should be to encourage greater price transparency and greater price competition at plan sponsor level."[96]

As for plan participants, Mr. Utkus stated that "a public policy goal should be to ensure that plan participants have full access to information on the costs of investment options available to them. This disclosure should be simple to understand and provided in a uniform manner for all investment options."[97]

Mr. Utkus further recommended making this disclosure an easy-to-read sheet available on the internet and via e-mail. He urged that fee disclosures be sent to participants annually and include the investment expense ratio, wrap fees, and the comparative benchmark for all other investments with a similar investment style. [98]

The Working Group was sensitive to the fact that fee disclosure is beneficial but needs to be useful. In other words, it posed the question of whether the participant benefits from in-depth disclosures of such items as the costs of trade efficiency. The Working Group members also were sensitive to costs to a small plan versus costs to a large plan to implement some disclosure measures. The group recommended that fee disclosures be user-friendly, which would suggest the use of a mutual fund profile prospectus rather than a full prospectus. It suggested that expense disclosure as a percentage of each fund would be acceptable but that a participant-by-participant expense analysis would be desirable. Lastly, the group recommended that the annual statement provided by the record keeper should include an expense ratio as a percentage of the investments and set administrative expenses apart from the investment expenses.

In 2006 the DOL, the states, and the private sector began focusing on fees. The DOL submitted Form 5500 for revision in July 2006,[99] ten complaints were filed in various states concerning fee disclosures during September 2006, and the New York State attorney general reached a settlement with an insurance company regarding fees and disclosures related to a defined contribution plan.

Proposed Revision of Annual Information Return/Reports (Form 5500) was submitted as 29 CFR Part 2520 for the DOL Employee Benefits Security Administration on July 21, 2006.[100] Proposed changes address some of the concerns the industry has regarding fees and disclosure of fees to plan sponsors and participants. One change is directed at 403(b) plans that previously were allowed to file a short Form 5500, which contained only basic plan identification. 403(b) plans are becoming as common as 401(k) plans, and with that has come more abuse.[101] Investment vehicles for 403(b) plans often are annuity contracts and mutual funds. Since the Internal Revenue Service has found more abuses, it made a determination to place 403(b) plans on the same level as 401(k) plans for reporting.[102] Through this enhanced reporting, the DOL will have more opportunity to provide oversight of 403(b) plans.[103]

One of the revisions will be that a plan sponsor will be able to notify the DOL, by checking a box, that a service provider has not supplied the necessary information for the plan sponsor to complete its Form 5500. Since a separate schedule is required for each provider, the DOL will be able to garner information regarding specific providers responsible for the failure of disclosure information.[104]

Revisions to Form 5500 Schedule C might be the most helpful. Currently, expenses reported on Form 5500 are expenses charged against plan assets. Thus, any expenses the corporate entity picks up are not listed. Neither are 85–90 percent of the actual fees because they are paid out of the investment management fee debited directly to the participant account.[105] The form is being updated in a way focused on finding some of these hidden fees paid to service providers. Specifically, Part I would "require the identification of each person who received, directly or indirectly, $5,000 or more in total compensation (i.e., money or anything else of value) in connection with services rendered to the plan or their position with the plan during the past year."[106] Additionally, service providers such as the broker, trustee, and custodian that have received this $5,000 also will be required to provide the name of the payer of compensation amounting to more than $1,000 per year to the service provider if this compensation was due to the service provider's relationship with, or as a result of services provided to the plan from a party other than the plan or plan sponsor.[107] Here the service provider will be required to disclose fees shared among the service providers, yet do not impact plan costs. It appears that the DOL is attempting to catch rebates, float, and revenue-sharing instances within this element of Schedule C. For the plan sponsor to obtain this information for the Form 5500, it will be necessary for it to obtain education regarding fees.[108] Yet, another challenge will be to summarize these elements from the new report to provide the annual SAR to participants. This actually could be confusing and even upsetting to the participant.[109] Plan sponsors have until 2009 to be ready for submission of the 2008 new Form 5500.

By requiring more in-depth information the DOL is providing itself the tools to oversee an area that it perceives to be abusive to employee benefit plans. If the plan pays for a bundle of services, Schedule C will not require a break-out of those services. Fees that are charged to the plan that are additive to the bundled fee will require separate disclosure. Additionally, should the recipient of the fee be a fiduciary and be one of the listed service providers earning more than $1,000 a year from someone other than the plan or plan sponsor, but as a result of the relationship with the plan, then they, too, will be required to disclose those fees.[110] This should now allow the DOL to reach revenue sharing, float, and rebates as separately and fully disclosed through the use of the revisions to Schedule C. A later part of the document will require the naming of those service providers who refuse to provide the required information.[111] The question remains whether bundled fees and single cumulative financial information is an improvement for the participant.

CONCLUSION

The time for greater transparency is here. At the plan level this might mean written explanations between mutual fund providers and plan sponsors.[112] At the participant level this would mean greater simplicity in fee disclosure and a personalized explanation of how much the individual's plan costs or providing a simple comparison of the "average dollar cost of a $10,000 investment, compared with similar service providers' plans."[113] In the end, education surrounding how and what expenses are possible as well as how those expenses might be impacting the participants' ultimate retirement quality of life must be provided.

Much of the problem is driven by a very competitive marketplace. Plan sponsors are not willing to pay more for a plan than need be paid. The plan provider that has built its product in a way to hide all fees will more often than not win a plan sponsor's business. Whether fees are transparent or hidden, the total of all of these fees reduces the participant's investment return. The plan provider that itemizes its fees so that the participant can see each charge made to their account often loses the business before they enter the room to present their product. For the uninformed plan sponsor, it is nearly impossible to comprehend why they should pay for something that they can otherwise obtain free, that is, through hidden fees. The new disclosure regulations have been designed to level this playing field.

In the end, the services provided have a cost that is not much different from plan provider to plan provider. Economies of scale and the amount of services offered drive the fee. All levels of service providers need to be held responsible for disclosure to the next level of purchaser. When each link in the chain accepts its full fiduciary responsibility in regard to the ultimate plan beneficiary, the requirement of full disclosure will be met. Until all service providers become fully transparent in a manner that can be understood by those outside of the provider industry, full disclosure will remain elusive.

The industry has begun to address the necessary elements of full disclosure through the insurance company investigations, plan sponsor lawsuits, and Form 5500 updating. As each of these issues sorts itself out, the solution will lie in a compromise of written disclosures regarding indirect costs, such as trading efficiency, specific documentation of direct fees such as the wrap fee, and documenting direct, previously hidden fees such as revenue sharing, proprietary fund fees, and soft-dollar fees. Until the fees are available in plain English in one easily accessible location the industry will not have met its fiduciary duty of full disclosure. It is possible to meet this goal and it starts with the service provider providing clear, concise documentation to the plan sponsor. It ends with the plan sponsor documenting and providing clear and concise information to the participant.

Betsy Piper/Bach, JD, CIMA®, CFP®, CTFA, is president of ASAE Business Services, Inc. in Washington, DC. She earned a BS in special education from St. Cloud University, an MEd from The George Washington University, and a JD from CUA Columbus School of Law. Contact her at bpiperbach@asaecenter.org.

ENDNOTES

1. Pub. L. No. 93-406, 88 Stat. 829 (1974). ERISA was designed to protect the pension plan participants in private industry. The Internal Revenue Service (IRS), the Department of Labor (DOL), and the Pension Benefit Guarantee Corporation (PBGC) all have authority over activities occurring under ERISA.
2. ERISA § 2(a) and (b), 29 U.S.C. § 1001(a) and (b) (2006) (declaring that "owing to the lack of employee information and adequate safeguards concerning their operation, it is desirable in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of such plans; that they substantially affect the revenues of the United States because they are afforded preferential federal tax treatment"); see also IRC § 401(k) (2006) and ERISA § 404, 29 U.S.C. § 1104 (2006).
3. IRC § 401(k) (1994 & Supp. II 1996). ("a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.")
4. Idem.
5. Economic Systems, Inc. *Study of 401(k) Plan Fees and Expenses*, DOL (April 13, 1998), available at http://www.dol.gov/ebsa/pdf/401kRept.pdf (last visited September 15, 2008).
6. ERISA § 404, 29 U.S.C. § 1104 (2006) (defining fiduciary as "discharging his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan; with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so").
7. Idem.
8. One bp (basis point) is 1/100th (.0001) of one percent; 50 bps (.005) is equal to one-half of 1 percent; $5 is 50 bps of $1,000.
9. *A Look at 401(k) Plan Fees for Employees*, (DOL, Employee Benefits Security Administration), available at http://www.dol.gov/ebsa/publications/401k_employee.html (last visited September 15, 2008).
10. Joe Faucher, *Excessive 401(k) Plan Fees and Costs: The Coming Storm of ERISA Litigation* (February 2005), available at http://www.reish.com/publications/article_detail.cfm?ARTICLEID=506 (last visited October 13, 2008).
11. See ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (2006).
12. See ERISA § 101, 29 U.S.C. § 1021(2006). Cause to be furnished to each participant and beneficiary a summary plan description written in a manner understood by an average plan participant, within 210 days after the close of the fiscal year a summary report of assets and liabilities, receipts and disbursements, and actuarial assumptions and methods used to determine costs, and to the participant upon request a statement of the total benefits accrued and nonforfeitable benefits that have accrued, and file with the Secretary within 210 days after the close of the fiscal year an annual report of assets, liabilities, and costs as well as any terminal and supplementary reports required by the Secretary and a copy of the report is to be filed with the PBGC. Further, under §101(c) notices of blackout periods must be provided to participants. See ERISA §404(c) which requires an explanation that the plan is intended to constitute a plan described in section ERISA §404(c), a description of the investment alternatives and investment objectives available under the plan, identification of any designated investment managers, an explanation of the circumstances under which participants and beneficiaries may give investment instructions, any restrictions, description of any transaction fees and expenses that affect the participant's or beneficiary's account balance, name, address, and phone number of the plan fiduciary, a list of information that may be obtained upon request, description of confidentiality related to purchasing employer stock, and the name, address, and phone number of the plan fiduciary responsible for monitoring compliance with the procedures, copy of most recent prospectus upon the purchase of an initially registered 1933 Act security and descriptions relating to the voting or tender rights attached, a description of the annual operating expenses of each designated investment alternative which reduce the rate of return to participants and beneficiaries, and the aggregate amount of such expenses expressed as a percentage of average net assets of the designated investment alternative, copies of any prospectuses, financial statements, and reports and of any other materials relating to the investment alternatives available under the plan, to the extent such information is provided to the plan, a list of the assets comprising the portfolio of each designated investment alternative which constitute plan assets, the value of each such asset, and, with respect to each such asset which is a fixed rate investment contract the name of the issuer, term, and rate of the contract and information concerning the value of shares or units in designated investment alternatives held in the account of the participant or beneficiary.
13. See ERISA § 404(a)(1)(A)(ii), 29 U.S.C. § 1104(a)(1)(A)(ii) (2006) ("defraying reasonable expenses of administering the plan" and ERISA §408(b)(2), 29 U.S.C. § 1104(b)(2) (2006) "Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.")
14. See Economic Systems, supra note 5.
15. See Economic Systems, supra note 5.
16. *Complaints Beesley v. International Paper Co.*, No. 3:06cv703 (S.D. Ill. filed September 11, 2006); *Loomis v. Exelon Corp.*, No. 1:06cv5566, (N.D. Ill. filed September 11, 2006); *Martin v. Caterpillar, Inc.*, No. 2:06cv4208 W.D. Mo. filed September 11, 2006); *Taylor v. United Technologies Corp.*, No. 1:06cv4895 (N.D. Ill. filed September 22, 2006); *Waldbuesser v. Northrop Grumman Corp.*, No. 1:06cv4897 (N.D. Ill. filed September 11, 2006); *Will v. General Dynamics Corp.*, No. 3:06cv698 (S.D. Ill. filed September 11, 2006); *Kanawi v. Bechtel Corp.*, No. 3:06cv5566 (N.D. Cal. filed September 11, 2006); *Spano v. Boeing Co.*, No. 3:06cv00743 (S.D. Ill. filed September 28, 2006); *Abbott v. Lockheed Martin Corp.*, No. 3:06cv00701 (S.D. Ill. filed September 11, 2006); *George v. Kraft Foods Global, Inc.*, No. 3:06cv00798 (S.D. Ill. filed October 16, 2006).
17. 401(k) Plan Fees and Expenses Lawsuits Continue to Proliferate, available at http://www.morganlewis.com/pubs/LEPG_401(k)_LF_14dec06.pdf (last visited September 15, 2008).
18. ERISA §409, 29 U.S.C. § 1109 and §502, U.S.C. 29 § 1132 (2006).
19. See Complaints, supra note 16.
20. Albert Einstein, available at http://www.quotedb.com/quotes/1348 (last visited September 15, 2008).
21. See Economic Systems, supra note 5.
22. Employee Benefits Security Administration, *A Look At 401(k) Plan Fees for Employees,* DOL, available at http://www.dol.gov/ebsa/publications/401k_employee.html (last visited September 15, 2008).
23. See Economic Systems, supra note 5.
24. Lisa Shidler, "New pension legislation to bring more focus on 401(k)'s, especially fees,"*Investment News* (October 9, 2006): 38.
25. Pillsbury Winthrop Shaw Pittman, LLP, *Disclosure Requirements for Plans Subject to ERISA and SEC Rules,* available at http://library.findlaw.com/1999/Oct/1/128307.html (last visited September 15, 2008).
26. *Proposed Revision of Annual Information Return/Reports (07/21/2006),* DOL, available at http://www.dol.gov/ebsa/regs/fedreg/notices/2006006329.htm (last visited September 15, 2008).
27. Idem.
28. *ERISA Disclosure Requirements*, Compensation and Benefits Library, available with subscription only at http://cb.bna.com/cblw/display/doctype_display_hit_highlight.adp?fedfid=1255734&vname (last visited September 9, 2006).
29. Idem.
30. Idem.
31. IRC § 105(a) and (c) (1994 & Supp. II 1996).
32. See ERISA, supra note 12.
33. Reish Luftman Reicher & Co., *ERISA Section 401(c) Plans §2550.404c-1*, available at http://www.reish.com/pa/benefits/404cregs.cfm (last visited September 15, 2008).
34. Idem.
35. See ERISA, supra note 28.
36. ERISA § 101(a)(1) and (2), 29 U.S.C. § 1021(a)(1) and (2) (2006).
37. See ERISA, supra note 28.
38. See ERISA, supra note 28.
39. See ERISA, supra note 28.

40. DOL, Employee Benefits Security Administration, *Report of The Working Group on Plan Fees and Reporting on Form 5500* (November 10, 2004), available at http://www.dol.gov/ebsa/publications/AC_111804_report.html (last visited September 15, 2008); see also Joseph L. Paller, Jr., Fiduciary Investment Issues in Defined Contribution Plans, *Benefits & Compensation Digest* (August 2006): 6–7.
41. Paller, supra note 40, 6.
42. Advisory Opinion 97-15, DOL (1997), available at http://www.dol.gov/ebsa/programs/ori/advisory97/97-15a.htm (last visited September 15, 2008).
43. See Economic Systems, supra note 5.
44. Idem.
45. Idem.
46. See Paller, supra note 40, 7.
47. "12b-1 fees" are fees paid by mutual funds "out of fund assets to cover distribution expenses and sometimes shareholder service expenses. 12b-1 fees get their name from the SEC rule that authorizes a fund to pay them. The rule permits a fund to pay distribution fees out of fund assets only if the fund has adopted a plan (12b-1 plan) authorizing their payment. 'Distribution fees' include fees paid for marketing and selling fund shares, such as compensating brokers and others who sell fund shares, and paying for advertising, the printing and mailing of prospectuses to new investors, and the printing and mailing of sales literature. The SEC does not limit the size of 12b-1 fees that funds may pay. But under Financial Industry Regulatory Authority (FINRA) rules, 12b-1 fees that are used to pay marketing and distribution expenses (as opposed to shareholder service expenses) cannot exceed 0.75 percent of a fund's average net assets per year." For more information, see http://www.sec.gov/answers/mffees.htm#distribution.
48. 17 CFR §270.12b-1(2006) (It is unlawful for an open-end management company [mutual fund] to act as a distributor of securities of which it is the issuer unless it is done through an underwriter. The mutual fund will be considered as distributing if it is seen as financing "advertising, compensation of underwriters, dealers, and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature." It may act as a distributor if the plan is in writing, agreements with those involved with the implementation are in writing, the plan is approved by the majority of outstanding voting securities of the company, the plan and related agreements are approved by a vote of the board of directors, the plan must be in existence for at least one year, a report of the expenses is reported to the board, the plan and agreements must be able to be terminated at any time by a vote of the majority of directors, may not be assignable, any material increase in the amount of payment must be approved by the majority of the board, and the board must be structured under the fund governance standards per 17 CFR §270.0-1(a)(7) (2006).)
49. See Paller, supra note 40, 6.
50. See Complaints, supra note 16.
51. *Abbott v. Lockheed Martin Corp.*, No. 3:06cv00701 (S.D. Ill. filed September 11, 2006).
52. Idem.
53. Idem and 29 CFR § 2550.404c-1(b)(2)(i)(B)(2)(i) and 29 CFR § 2550.404c-1(b)(2)(ii)(A) (1992).
54. *A Look at 401(k) Plan Fees for Employees*, DOL, available at http://www.dol.gov/ebsa/publications/401k_employee.html (last visited September 15, 2008).
55. See Paller, supra note 40, 6.
56. SEC 1934 Act §28(e) (no person will be found to have acted unlawfully or to have breached a fiduciary duty by having caused the account to pay a commission in excess of the amount of commission another member would have charged if it is reasonable in relation to the value of the brokerage and research services provided by that member).
57. John Lohr & Ian Lohr, *The Fiduciary Sale: The Director's Cut* (Buffalo, WY: Isle Press, 2003): 113–114.
58. *Commission Guidance Regarding Client Commission Practices under §28(e) of the Securities Exchange Act of 1934,* Securities and Exchange Act Release No. 34-54165 (July 13, 2006).
59. Benefits & Compensation Management Update, Special Report: *Mutual Funds, Hidden Plan fees May Be Next Issue in Mutual Fund Scandal,* June 23, 2004, available with subscription at http://cb.bna.com/cblw/display/doctype_display_hit_highlight.adp?fedfid=1401732&vname (last visited September 9, 2006).
60. *Staff Report Concerning Examinations of Select Pension Consultants*, The Office of Compliance Inspections and Examinations, Securities and Exchange Commission (May 16, 2005): 4, available at http://www.sec.gov/news/studies/pensionexamstudy.pdf (last visited September 15, 2008).
61. See Economic Systems, supra note 5.
62. See *Abbott v. Lockheed Martin Corp.*, supra note 51.
63. ERISA§404(c)(1)(a)(2)(B).
64. Jonathan Burton, Skimming the 401(k), *Marketwatch*, (January 21, 2005), available at http://www.marketwatch.com/news/story/employer-401k-skimming-costs-us/story.aspx?guid=%7B55D4E190-F43D-4919-851A-D3160C113D9D%7D (last visited September 15, 2008).
65. Idem.
66. Advisory Opinion 93-24A, DOL (1993), available at http://www.dol.gov/ebsa/programs/ori/advisory93/93-24a.htm (last visited September 15, 2008).
67. See Economic Systems, Inc., supra note 5.
68. Stable Value and GICS, a chapter for the *Pension Investment Handbook*, available at http://www.lmstrategies.com/issuer.html (last visited September 15, 2008).
69. Idem.
70. Idem.
71. See Economic Systems, supra note 5.
72. Idem.
73. Idem.
74. Tom Lauricella, Teachers' Union To Settle Issue of ING Payments, *Wall Street Journal* (June 14, 2006): C3.
75. Idem.
76. Idem.
77. Idem.
78. In the Matter of Feeley and Wilcox Asset Management Corp, Advisers Act Release No. 33-8249 (July 10, 2003), available at http://www.sec.gov/litigation/opinions/33-8249.htm. (where advisor appealed certain findings and sanctions imposed by an administrative judge for failing to disclose conflicts of interest in violation of §206(1) and 206(2) of the Investment Advisers Act of 1940 when he neither updated his investment advisory filing to reflect the structural changes of his investment advisory firm nor informed his advisory clients that he would be receiving commissions from trading his security recommendations in their accounts and would use those commissions to reduce notes owed to the broker/dealer for whom he worked. Citing *Capital Gains Research Bureau*, 375 U.S. at 186-89 (1963), the court said, "A loyal investment adviser must give disinterested advice. But…an adviser who has a pecuniary interest in a client's transaction other than the agreed fee cannot give disinterested advice. The adviser must disclose that interest to clients or be liable under the antifraud provisions…of the Advisers Act").
79. See Staff Report, supra note 60.
80. Idem, 1.
81. *SEC v. Capital Gains Research Bureau, Inc. et al.*, 84 S.Ct. 275 (1963). (Found that an investment advisor could not provide competent and unbiased advice unless all conflicts in the relationship were removed. It was felt that any fees earned above the fee for advice would cause the advisor to be driven by a pecuniary interest, even if it was subconscious. It refers to The Public Utility Holding Company Act of 1935, which authorized the SEC "to make a study of the functions and activities of investment trusts and investment companies" and resulted in the Investment Advisers Act of 1940. This study is entitled *Investment Trusts and Investment Companies*, report of the SEC, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong., 2d Sess.1(1940).)
82. *Mehling v. New York Life Insurance Co.* 413 F. Supp.2d 478 (E.D. Pa 2005).
83. Idem, 479.
84. *N.Y. v. Hartford Financial Services Group, Inc.*, Complaint (May 10, 2006): C 5.
85. Idem, C 6.
86. Idem, 24.
87. Idem, 25.
88. Advisory Opinion 97-15, DOL (1997), available at http://www.dol.gov/ebsa/programs/ori/advisory97/97-15a.htm (last visited September 15, 2008); see also Advisory Opinion 97-16, DOL (1997), available at http://www.dol.gov/ebsa/programs/ori/advisory97/97-16a.htm (last visited September 15, 2008); see also Advisory Opinion 2003-09, DOL (2003), available at http://www.dol.gov/ebsa/regs/aos/ao2003-09a.html (last visited September 15, 2008).
89. Idem Advisory Opinion 97-15, DOL, supra note 88.
90. See Advisory Opinion 97-16, DOL, supra note 88.
91. See Advisory Opinion 2003-09, DOL, supra note 88.
92. *Haddock v. Nationwide Financial Services Inc.*, 419 F. Supp.2d 156, 162 (D. Conn. 2006).
93. *Report of the Working Group on Fee and Related Disclosures to Participants*, DOL

(2004), available at http://www.dol.gov/ebsa/publications/AC_111704_report.html (last visited September 15, 2008).
94. Idem.
95. Idem.
96. Idem.
97. Idem.
98. Idem.
99. Proposed Revision of Annual Information Return/Reports, *EBSA Federal Register Notice* 71, no. 140 (2006): 41615–41651. See 401(k) Plan Fees and Expenses Lawsuits Continue to Proliferate, supra note 5.
100. Idem.
101. Idem.
102. Idem.
103. Idem.
104. Idem.
105. Idem.
106. Idem.
107. Idem.
108. Report of the Working Group on Plan Fees and Reporting on Form 5500, DOL (2004), available at http://www.dol.gov/ebsa/publications/AC_111804_report.html (last visited September 15, 2008).
109. Rules/Regs: More Than Meets the Eye, *Plan Sponsor* (October 1, 2006), available at http://www.plansponsor.com/magazine_type3/?RECORD_ID=35192 (last visited September 15, 2008).
110. See Report of the Working Group on Plan Fees and Reporting on Form 5500, supra note 108.
111. See EBSA, supra note 99.
112. See Strench and Bissett, and Nobel, supra note 59.
113. Stephen Schurr, Hidden 401(k) Fees are Stealing Your Nest Egg, TheStreet.com (September 5, 2003), available at http://www.thestreet.com/funds/stephenschurr/10111226.html (last visited September 15, 2008).

INVESTMENTS & WEALTH INSTITUTE®
formerly IMCA

5619 DTC Parkway, Suite 500
Greenwood Village, CO 80111
Phone: +1 303-770-3377
Fax: +1 303-770-1812
www.investmentsandwealth.org