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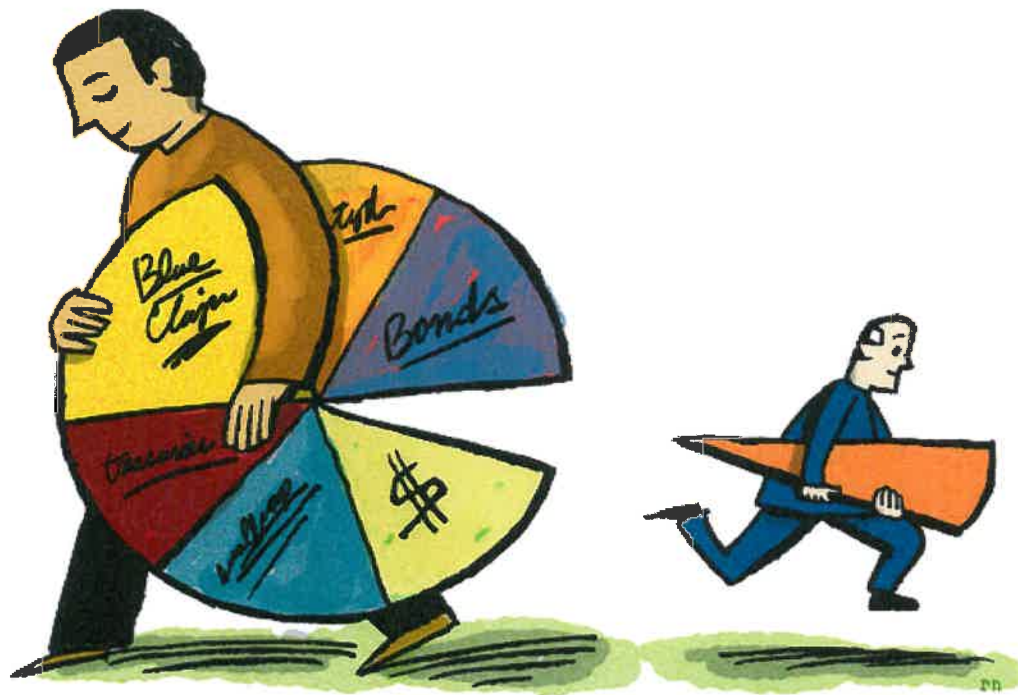
Limiting the 401(k) Finder's Fee



Robert Neubecker

By TARA SIEGEL BERNARD
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Given the speed with which 401(k) accounts have been replacing pensions, workers can only hope that their employers have assembled a low-cost diversified portfolio that will keep earning money over time — perhaps a long time, given the number of people living to their 90s and beyond.

Dilip Vishwanat for The New York Times

Jerry Schlichter, of Schlichter Bogard & Denton, spent almost two years researching industry practices before filing a suit.

It is an employer's legal duty, after all, to look after their employees' interest in overseeing the accounts.

A series of lawsuits making their way through the courts have raised questions about whether employees are being overcharged for the accounts.

Experts say the suits and new federal rules have helped bring the fees down to a more reasonable level, and have prompted at least some employers to adopt less murky fee arrangements that more clearly separate what they are paying for investments and what it costs to administer the plan. But the fees workers pay can still vary widely and be hard to discern.

One recent lawsuit was brought on behalf of employees at Cigna by Jerome J. Schlichter, a lawyer whose success in similar cases has caused some anxiety among human resources executives. His firm, Schlichter Bogard & Denton, has brought 14 similar lawsuits over the last seven years on behalf of 401(k) plan participants. Typically, the suits claim that the employees were paying too much in fees. Several employee benefit experts have said that Mr. Schlichter's cases and others have

resulted in lower charges as other employers began to fear attracting lawsuits of their own.

"It's unfortunate that it took litigation to focus attention on costs," said Fred Reish, a lawyer with Drinker, Biddle & Reath in Los Angeles and an expert on the federal law that governs 401(k) plans. "But it clearly has."

More recently, another force has been putting pressure on 401(k) fees, which typically include investment and administrative expenses. Last summer, the Labor Department started to require the companies that provide 401(k) plans to disclose more details on fees. Given the complex way these companies price their wares, the new rules are making it easier for employers to comparison-shop. (A separate rule required employers to provide more fee disclosures to employees.)

Benefit experts agree that because of the combination of forces, the cost of running and investing in the plans, on average, have been on the decline for several years.

According to BrightScope, a financial research company that tracks 401(k) plans, the total costs, including fees and administrative expenses, were 0.8 percent of assets in 2011. That's down from 0.85 percent in 2009.

Still, workers can pay a fairly wide range of fees. Many plans cost between 0.2 and 1.8 percent, but some plans, particularly smaller ones, are more costly.

Fees can make a significant difference. According to the Labor Department, paying just 1 percentage point more in expenses over the course of 35 years could reduce a worker's retirement savings by nearly 28 percent. Consider a worker with a 401(k) balance of $25,000 who earns 7 percent over the next 35 years. If this person paid 0.5 percent in fees, even if she stopped making new contributions, her account would grow to $227,000 at retirement. But if she paid fees totaling 1.5 percent, her savings would rise to only $163,000, or 28 percent less.

That kind of swing has been at the heart of most of the lawsuits brought by participants.

In Mr. Schlichter's most recent case, a group of 401(k) participants say that Cigna, the employer, charged them excessive fees (Cigna was using proprietary investments for

its own employees; that's legal, but the fees need to be reasonable). On top of that, the workers say that the employer breached its fiduciary duty — in other words, failed to act in the employees' best interests — when it sold its retirement division to Prudential in 2004.

Instead of shopping around to be sure the workers would get the best rates, their lawsuit says, Cigna lumped the plan with the rest of the assets it sold, and promised Prudential it could continue to manage their money for at least three years, according to court documents.

Cigna and Prudential dispute the lawsuit's claims, according to a news release issued by Mr. Schlichter's firm, which is based in St. Louis, and they said the plan had always been appropriately managed. The proposed $35 million settlement, filed in United States District Court for the Central District of Illinois, requires the approval of an independent financial expert and a judge, he said. The settlement would cover all people in the plan — which had more than $2.8 billion in assets as of 2011, with more than 42,000 participants — from April 1999 through May 31, 2013.

"In addition to the money, Cigna employees and retirees will now have a very attractive 401(k) plan to protect and build their retirement assets," Mr. Schlichter said. The plan will have an independent monitor for three years, for example, and it will take competitive bids to ensure it is paying a fair price for administration.

Mr. Schlichter came to the world of 401(k)'s as an outsider. Though he said he had always represented workers and individuals, once he began to hear from more people who had concerns about their retirement plans, he started to investigate. "We then spent almost two years researching industry practices and talking to independent experts and fiduciaries about what was going on in 401(k) plans before filing a suit," he said. "We came away convinced that some employees and retirees were paying excessive fees and were subject to conflicts of interest in the handling of their 401(k) plans."

His most prominent case involved ABB Inc., a Swiss manufacturer of power equipment, whose workers sued their employer and Fidelity, the manager of the retirement plan, claiming excessive fees. A Federal District Court judge ordered that

ABB pay $35.2 million in damages and that Fidelity pay $1.7 million; he said Fidelity and ABB were appealing the judgment.

He has also received settlements for employees and retirees at Kraft, Caterpillar, General Dynamics and the Bechtel Corporation, an engineering and construction company, among others, largely on grounds that the workers were paying too much, he said. He has had his share of dismissed cases as well, including a suit on behalf of employees at John Deere against Fidelity.

But even as the lawsuits and regulations help bring down fees in one part of the retirement plan universe, it is likely that financial services companies will find a way to make up for it. "If you start pushing the air out of the balloon in one place it will move to some other place," said Mercer E. Bullard, an associate professor at the University of Mississippi School of Law and founder of Fund Democracy, an advocacy group for mutual fund shareholders. "There will be even more pressure to roll 401(k)'s over into individual retirement accounts when there is less and less of a reason to do so."

Rolling over a 401(k) into an I.R.A. can be the right choice for many investors, particularly for people who leave an employer whose plan is filled with poor quality, high-cost investments. But for other people, it may make sense to remain invested in an old 401(k), if the employer has kept fees low. "All things being equal, an investor in a 401(k) should be able to get lower expenses because of the buying power of the plan," said Bud Green, chief investment officer at MJM 401K, a consultancy in Phoenix.

As a March report by the Government Accountability Office found, 401(k) investors are sometimes pressured to roll their 401(k) into I.R.A.'s offered by the financial services company behind their 401(k).

"Plan participants are often subject to biased information and aggressive marketing of I.R.A.'s when seeking assistance and information regarding what to do with their 401(k) plan savings when they separate or have separated from employment with a plan sponsor," the report said.

That's one reason the Labor Department has turned its attention to better oversight of retirement plans. It is reworking rules that would reduce conflicts of interest when advisers provide advice in investments like I.R.A.'s. Members of the financial services industry, as well as some lawmakers from both parties, are trying to block those efforts, fearing it would put limits on the way they can do business.

"Many workers will rely solely on what they have saved in 401(k) plans and I.R.A.'s during retirement," said Phyllis C. Borzi, the assistant secretary of labor, who oversees the department's Employee Benefits Security Administration.

"It makes sense that people seek out investment advice. But when they do, they are often reaching out to people who are not accountable for the advice they give — particularly in the I.R.A. marketplace, where today there are few protections for investors. This needs to change."