

Consultants seek 401(k) fee equality

By Rick Miller

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CHICAGO - The practice of allowing some 401(k) plan participants to bear a greater burden of the record-keeping and trustee costs than others is a potential fiduciary violation that could lead to lawsuits, plan consultants warn.

The problem arises in open-architecture plans when plan sponsors do not always use the lowest-cost share class of funds available. In those cases, investors in the higher-expense share class funds may be unfairly shouldering a disproportionate part of the plan expenses.

"Is it fair to require certain plan participants to pay a higher-than-necessary fund expense ... so that plan participants in aggregate do not pay record-keeping or trustee fees?" asked a consultant, Mike Francis, who is among those raising a red flag.

"I suspect the [U.S. Department of Labor] would answer no," said Mr. Francis, president of Francis Investment Counsel LLC in Hartland, Wis.

"This is an area that has not been litigated," noted Donald Stone, president of Plan Sponsor Advisors LLC in Chicago. "It may very well end up being litigated."

How plan expenses should be accounted for and whether it is reasonable to have some participants pay a greater share because they invest in funds that pay revenue sharing are questions the experts said the Labor Department has yet to address.

"It doesn't sound very fair," said Fred Reish, managing director of the law firm Reish Luftman Reicher and Cohen in Los Angeles, adding: "I think that it cries out for DOL guidance."

Fairness problem

"This whole thing about money sloshing around inside plans and mutual funds and all that, if you think about it, we've just been dealing with that for a couple of years now," he said. "What I am finding is that every time we peel another layer off of the onion, we find more issues underneath, and, yes, I do think this is one of the issues that are emerging now."

Financial advisers who work with qualified plans ought to be looking for ways to solve

the fairness problem, Mr. Reish continued, "because I think most plan sponsors do want to be fair."

Fees and revenue-sharing arrangements have been a hot industry topic, as well as an area of scrutiny for regulators.

Last month, the Securities and Exchange Commission released a report taking aim at plan consultants who skew their investment recommendations to plan sponsors based on the compensation they receive from money managers.

The DOL and SEC published tips last week to assist plan fiduciaries in reviewing conflicts of interest facing pension consultants. They offered questions fiduciaries should ask to bring to light potential conflicts.

The allocation of plan expenses is becoming more of an issue with the growing popularity in recent years of open-architecture plans, experts said. Now that there's been a proliferation of new, lower-cost share classes the fund companies offer, plan fiduciaries and their advisers have an obligation to consider them, some believe.

Mr. Francis said there are times when a fund that provides money for record keeping and other expenses may be the most attractive for participants. Conversely, that also can be said for funds that don't offer revenue sharing.

"But once you decide 'this is the fund for us,' you've got to ask another question that people just aren't asking, and that is: 'Are we utilizing the best, the fairest share class of that fund to equally and equitably distribute plan expenses across all participants?'" he said.

Mr. Francis believes it is "quite common" that an inequity exists when it comes to allocating plan expenses.

Plan sponsors, he believes, do not want to switch to lower-cost shares because "they fear their record keeper might begin charging the plan a fee to offset lost revenue-sharing payments from high-cost funds," he said. "Plan sponsors are making decisions that are best for the participants collectively," said David Wray, president of the Profit Sharing/401(k) Council of America in Chicago, which represents about 1,200

companies on retirement-plan issues.

"Any decision regarding the fees is not made with individual participants in mind but rather the plan as a whole," he said.

But those who question the fairness of the expense arrangement aren't necessarily sure the arrangement is illegal.

Paul Jacobson, a partner at Quarles and Brady LLP in Milwaukee, said under the Employee Retirement Income Security Act there are no provisions that specifically address how plan expenses are to be allocated among participants and beneficiaries.

"I think it would depend on the particular facts and circumstances in each case," he noted.

Consultants and lawyers interviewed said a preferred scenario for plans is that they use the lowest share class available and have the plan pay the record-keeping and other costs directly, spreading them among all account balances.

But there is reluctance among plan sponsors to have a charge for plan expenses show up directly on plan participants' statements, said Mr. Reish.

"I would prefer to see plan sponsors do it that way," he said. "I don't understand the reluctance they have for really truly showing what their costs are. I wish they would."



Mike Francis: *He questions the fairness of fund expense payments.*