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EMPLOYEE BENEFITS AND COMPENSATION

New Developments in 401(k) Litigation: *Plan Fiduciaries Charged with Participating in Improper Fee and Revenue-Sharing Arrangements*

In September, 2006, several class action lawsuits were filed in federal courts across the country challenging the fee and revenue-sharing arrangements between 401(k) plans and their service providers. The lawsuits make novel and disturbing allegations of financial impropriety against some of the nation's largest employers relating to services associated with the investment of 401(k) plan assets. These 401(k) lawsuits bear some similarity to the broad scale allegations made against the insurance industry regarding broker compensation practices.

Background

Unlike traditional pension plans where plan assets are managed by a plan sponsor or an investment committee, these lawsuits target 401(k) plans where participants direct their own investments. Under these self-directed plans, each participant allocates his or her own contributions among several investment alternatives from a menu that is pre-selected by plan fiduciaries. In turn, the plan fiduciary monitors the administration and performance of each investment alternative. The recent lawsuits challenge the process by which plan fiduciaries select, monitor and compensate those entities providing retirement services to the plan and its participants, including investment advisors, recordkeepers and third party administrators.

These class action lawsuits follow a period of heightened regulatory scrutiny of 401(k) plan sponsors and service providers regarding reimbursement arrangements between them. In 2005, the U.S. Department of Labor and the U.S. Securities and Exchange Commission set forth guidance, on several occasions, concerning the selection and monitoring of 401(k) plan consultants and other service providers. In particular, the regulators have focused significant attention on conflicts of interest in fee arrangements between plans and providers of services to retirement plans. The potential for conflicts of interest is most likely in situations where pension consultants and service providers such as investment advisors, record keepers and third party administrators are either part of an affiliated company or participate in revenue sharing arrangements.

The Allegations

These lawsuits allege multiple violations of the Employee Retirement Income Security Act (ERISA) relating to existing fee and revenue-sharing arrangements between 401(k) plans and service providers. The named defendants include plan sponsors, plan administrators and administrative committees, company directors and officers. The plaintiffs allege that these plan fiduciaries:

- Entered into excessive fee and revenue-sharing arrangements with service providers causing the plan to incur unreasonable expenses;
- Entered into fee and revenue-sharing arrangements that were never disclosed to participants;
- Failed to protect the plan from incurring excessive and unreasonable expenses;
- Failed to monitor the activities of service providers that resulted in losses to the plan; and
- Failed to inform plan participants of expenses associated with the administration of investments under the plan.

Based on these allegations, the plaintiffs seek relief including removal of plan fiduciaries, monetary damages, and greater transparency of fees paid to service providers.
The law firm that brought these actions has indicated that more will follow. It should be noted that the information used to bring these lawsuits was obtained from plan documents, summary plan descriptions, Form 5500s and other generally available plan information. Plan sponsors, fiduciaries and service providers should consider undertaking a careful review of existing fee arrangements, expenses and compensation associated with plan administration, the disclosure of fees to participants, and the procedures in place to monitor and evaluate these costs. [back]

If you have questions about these new lawsuits or would like assistance in reviewing your plan administration arrangements, please contact Bruce Barth, chair of the Employee Benefits and Compensation Group at 860-275-8267 or Ted Tucci, chair of the Health and Benefits Litigation Group at 860-275-8210. Visit our website at www.rc.com.