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CHAPTER 17

401(k) Plan Fees: A Trifecta of Governmental Oversight

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Synopsis

§ 17.01 INTRODUCTION

Arguably, 401(k) plan fees[1] are the biggest policy issue in the retirement world today. They potentially raise questions about the fundamental business underpinnings of the principal form of retirement savings for the last twenty years. As an indication of their significance, three branches of the federal government: administrative, judicial, and legislative; are currently and simultaneously addressing 401(k) plan fees.

This Article will not attempt to provide a comprehensive discussion of 401(k) plan fees and all of the issues that they raise.[2] Instead, the Article will focus on recent governmental activity regarding 401(k) plan fees. It will begin by discussing three recent DOL initiatives governing the disclosure of plan fees: (1) the revision of Form 5500, and particularly Schedule C; (2) the proposed section 408(b)(2) regulations; and (3) the proposed section 404(a)/404(c) regulations. The Article will then turn to the 401(k) plan fee litigation. Specifically, it will discuss two leading decisions, *Haddock v. Nationwide Financial Services*[3] and *Hecker v. Deere*,[4] which represent opposite ends of the spectrum of judicial resolution of 401(k) plan fee disputes. Finally, the Article will discuss recent legislative proposals to mandate greater disclosure of 401(k) plan fees.

§ 17.02 DOL INITIATIVES

The Department of Labor (DOL) has focused on 401(k) plan fees for more than a decade. Following a number of media reports criticizing excessive 401(k) plan fees,[5]

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[1] For an overview of the structure of 401(k) plan fees, see, Richard W. Kopcke, et al., *The Structure of 401(k) Fees*, Center for Retirement Research at Boston College Issue Brief No. 9-3 (Feb. 2009).

[2] For more general, recent discussions of plan fees and the issues they raise, see, for example, Debra A. Davis, *How Much is Enough? Giving Fiduciaries and Participants Adequate Information about Plan Expenses*, 41 The John Marshall L. Rev. 1005 (2008); Matthew D. Hutcheson, *Uncovering and Understanding Hidden Fees in Qualified Retirement Plans*, 15 Elder L. J. 323 (2007); and Jonathan Barry Forman, *The Future of 401(k) Plan Fees*, NYU Review of Employee Benefits and Executive Compensation 9-1 (2007).

[3] 419 F. Supp. 2d 156 (D. Conn. 2006).

[4] 556 F.3d 575 (7th Cir. 2009).

[5] *See generally* Donald J. Myers, *Current Insurance Issues Under the Employee Retirement Income Security Act of 1974*, Understanding Variable Insurance Products 225-226 (PLI Jan. 1999) ("During 1997, there were a number of news reports giving publicity to problems with fees being charged to participants in 401(k) plans"). *See, e.g.*, Penelope Wang, *Protect Yourself Against the Great Retirement Rip-Off:*

the DOL held a public hearing on the subject on November 12, 1997.[6] In April 1998, the DOL released a lengthy report, entitled "Study of 401(k) Plan Fees and Expenses,"[7] that examined the incidence, structure, and magnitude of fees and expenses charged to 401(k) plan sponsors and/or participants. In July 1998, the DOL released a booklet, entitled "A Look at 401(k) Plan Fees,"[8] that was designed to provide plan participants with general guidance on how to evaluate plan fees. In addition, the DOL provided guidance for plan sponsors in the form of a booklet, entitled "A Look at 401(k) Plan Fees for Employers," which was later replaced by "Understanding Retirement Plan Fees and Expenses,"[9] and by publishing a detailed worksheet, "The 401(k) Plan Fee Disclosure Form,"[10] that plan sponsors may use to evaluate and compare 401(k) fees by competing vendors.

More recently, the DOL has embarked on three new initiatives to require greater disclosure of plan fees. First, it issued revisions to Form 5500, and particularly Schedule C, to require more detailed disclosure of fee information. Second, it proposed regulations under ERISA section 408(b)(2) to require that plan service providers disclose to plan fiduciaries the direct and indirect compensation the service providers will receive and any conflicts of interest that may arise in connection with the service providers' services to the plan. Finally, the DOL proposed regulations under ERISA sections 404(a) and 404(c) that would establish uniform, basic disclosure requirements for participants and beneficiaries in participant-directed defined contribution plans in a form designed to encourage and facilitate a comparative review among investment options. This section will discuss each of these initiatives in more detail.

[1] Revised Form 5500

Sections 101(b)(1) and 104(a) of ERISA require that plan administrators file an annual report with the Secretary of Labor that, among other things, discloses the financial condition, investments, and operations of the employee benefit plans they

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Excessive 401(k) Fees Skim an Estimated $1.5 Billion a Year from Retirement Savings. Here is How to Protect Your Nest Egg, Money 96 (April 1, 1997).

[6] *See* 62 Fed. Reg. 53802 (Oct. 16, 1997) (announcing public hearing).

[7] Pension & Welfare Benefits Admin., U.S. Dep't of Labor, Study of 401(k) Plan Fees and Expenses (1998).

[8] *See* Stephen H. Goldberg, et al., *401(k) Plan Fees-Disclosure, Reasonableness, and other Issues*, Conference on Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory Issues 190 (ALI-ABA Oct. 1998). The booklet is available at http://www.dol.gov/ebsa/pdf/401kFeesEmployee.pdf.

[9] Available at http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html.

[10] This model form, developed jointly by the American Bankers Association, the Investment Company Institute, and the American Council of Life Insurers is available at the DOL's website at http://www.dol.gov/ebsa/pdf/401kfefm.pdf.

administer.[11] Plan administrators may satisfy this requirement by filing a Form 5500 "Annual Return/Report of Employee Benefit Plan" and any required statements or schedules.[12]

Form 5500 was first developed shortly after ERISA was enacted in 1974. [13] At that time, defined benefit plans dominated the pension world, and plan fees and expenses were explicit.[14] According to generally accepted accounting principles, any fees and expenses paid by the plan were reported in the expense section of the pension plan's Income and Expense Statement, and the actual fees paid by the plan matched the fees reported in the plan's audit report and on the Form 5500.[15]

The pension world, and the way in which fees and expenses are charged, has changed dramatically since the enactment of ERISA. Defined contribution plans in general, and 401(k) plans in particular, are now the principal type of retirement savings plan, and these plans rely heavily on pooled investment vehicles such as mutual funds.[16] Rather than charging explicit fees, mutual funds and other pooled investment vehicles typically use an asset-based fee model.[17] Under this model, "the investment management fees and expenses of the mutual fund [or other pooled investment vehicle] are netted out of its performance on a daily basis in arriving at the mutual fund's [or other vehicle's] net asset value (NAV) and as such, those fees and expenses are intrinsic to the investment and not easily identifiable by the plan sponsor."[18] Moreover, many plan sponsors have moved to "bundled arrangements"[19] under which administrative costs such as recordkeeping or trustee fees are partially or wholly offset

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[11] *See* ERISA Section 103 (detailing information that must be included in annual report).

[12] DOL Reg. Sec. 22520.103-1(b)(1).

[13] *See* 40 Fed. Reg. 45143 (Sept. 30, 1975) (notice of proposed Annual Return/Report Forms to be filed by administrators of pension and welfare benefit plans).

[14] ERISA Advisory Council, Report of the Working Group on Plan Fees and Reporting on Form 5500, at 4.

[15] *Id.* at 4.

[16] *Id.* at 5.

[17] *Id.* at 5.

[18] *Id.* at 5.

[19] There are three basic types of "bundled arrangements." In a "fully bundled" arrangement, a record keeper provides all of the administrative services and only proprietary investment funds are offered as investment options. This arrangement is typically offered to small plans. In bundled arrangements available to most plans with more than $5 million in assets, a record keeper provides comprehensive administrative services and both proprietary and non-proprietary investment options are available. In the third type of bundled arrangement, a record keeper provides comprehensive administrative services and only non-proprietary investment options are available. The Spark Institute, *The Case for Employer-Sponsored Retirement Plans: Fees and Expenses* 20 n. 31 (May 2009).

by "revenue sharing"[20] with the mutual funds or other investment vehicles with asset-based fee structures.[21]

As a result of this shift in the structure of plan fees, Form 5500 did not do a very good job of capturing the actual cost of operating a 401(k) plan.[22] Accordingly, the DOL revised Schedule C[23] to Form 5500 to require more detailed disclosure of fee information.[24] The changes are intended to increase the transparency of fees and expenses and ensure "that plan officials obtain the information they need to assess the compensation paid for services rendered to the plan, taking into account revenue-sharing arrangements among plan service providers and potential conflicts of interest."[25] Specifically, revised Schedule C, applicable to plans with over 100 participants, requires disclosure of (1) identifying information for all direct and indirect compensation over $5,000;[26] (2) the types of services being provided;[27] (3) the relationship of the service provider to the plan and any party in interest;[28] (4) whether the indirect fees

[20] "[R]evenue sharing is a broad term that means many different things to different constituents. .... In the employee benefit community, the term 'revenue sharing' is used loosely to describe virtually any payment that a plan service provider receives from a party other than the plan." Report of the Working Group on Fiduciary Responsibilities and Revenue Sharing Practices. *See also* "Revenue sharing" refers to an arrangement pursuant to which fees assessed against a participant's account are shared with the vendors providing recordkeeping and related administrative services. Richard W. Kopcke, et al., *supra* note 1.

[21] ERISA Advisory Council, Report of the Working Group on Plan Fees and Reporting on Form 5500, at 5.

[22] Indeed, according to a 2003 Hewitt Associates' survey, only about a third of plan sponsors even attempted to calculate the cost of maintaining their plan. *Id.* at 5 n.3 (citing 2003 Trends and Experience in 401(k) Plans, Hewitt Associates, LLC, at 79).

[23] The DOL did not make any major substantive changes to Schedule A, which provides for the reporting of insurance information, but did decide that two of the Schedule C changes should be applicable to Schedule A. First, "compensation paid by the insurer to third parties for recordkeeping and claims processing services provided to the insurer as part of the insurer's administration of the insurance policy is not required to be reported as fees and commission on Line 2 of the Schedule A." *See* 72 Fed. Reg., at 64,746. Second, "occasional and insubstantial non-monetary compensation paid by an insurance company to agents, brokers, and other persons from the fees and commissions that would otherwise be required to be reported on the Schedule A" may be excluded. *Id.* For DOL guidance on the scope of the Schedule A reporting obligation, see DOL Advisory Opinion 2005-02A.

[24] *See Revision of Annual Information Return/Reports*, 72 Fed. Reg. 64731 (Nov. 16, 2007).

[25] 72 Fed. Reg., at 64738.

[26] Schedule C to Form 5500, Question 2(a). *See* 72 Fed. Reg., at 64790.

[27] Schedule C to Form 5500, Question 2(b). *See* 72 Fed. Reg., at 64790. A code specifies different categories for different services. *See* 72 Fed. Reg., at 64826-27.

[28] Schedule C to Form 5500, Question 2(c). *See* 72 Fed. Reg., at 64790.

are "eligible" or "ineligible" indirect compensation[29] and (5) whether any service provider failed or refused to provide the fee disclosure information necessary to complete Schedule C.[30] The revised schedule C is effective for all annual report filings made for plan years beginning on or after January 1, 2009.[31]

[2] Proposed Section 408(b)(2) Regulations

Section 406(a)(1)(C) of ERISA generally prohibits the furnishing of goods, services, or facilities between a plan and any party in interest to the plan, including a service provider.[32] Section 408(b)(2) of ERISA exempts from this general prohibited transaction rule "[c]ontracting or making reasonable arrangement 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." Currently, the DOL regulations provide little guidance on the meaning of the term "reasonable" contract or arrangement. The regulations simply state that a contract or arrangement is not reasonable unless it permits the plan to terminate without penalty on reasonably short notice.[33]

On December 13, 2007, the DOL proposed to amend the Section 408(b)(2) regulations to redefine the meaning of a "reasonable" contract or arrangement to require that plan service providers disclose to plan fiduciaries the compensation the service provider will receive, directly or indirectly, and any conflicts of interest that may arise in connection with the service provider's services to the plan. The proposed regulations are intended help plan fiduciaries ensure that the plan only pays "reasonable" fees and help fiduciaries determine what is "reasonable."[34]

The proposed regulations apply to service providers (1) who are fiduciaries under ERISA or under the Investment Advisers Act of 1940; (2) whose services include one or more of the following services: banking, consulting, custodial, insurance, investment advisory (plan or participants), investment management, recordkeeping, securities or other investment brokerage, or third party administration; or (3) who receive or

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[29] Schedule C to Form 5500, Question 2(f). *See* 72 Fed. Reg., at 64790. "Eligible indirect compensation" includes fees or expense reimbursement payments charged to "investment funds" and reflected in the value of the plan's investment or return on the investment. *See* 72 Fed. Reg., at 64742.

[30] Schedule C to Form 5500, Question 4. *See* 72 Fed. Reg., at 64793.

[31] *See* 72 Fed. Reg., at 64733.

[32] Section 3(14)(B) of ERISA defines the term "party in interest" to include "a person providing services to [the] plan."

[33] *See* DOL Reg. Sec. 2550.408(b)-2(c).

[34] *DOL Proposes Fee Disclosure Amendment*, 401(k) Handbook Newsletter 9 (Feb. 2008) ("In a press briefing Bradford P. Campbell, assistant secretary for EBSA, said the proposed rules will help fiduciaries ensure they pay only 'reasonable' fees and should help determine what 'reasonable' is.").

may receive indirect compensation in connection with providing one or more of the following services: accounting, actuarial, appraisal, auditing, legal, or valuation services.[35] The preamble to the regulations makes it clear that the regulation would not apply to contracts or arrangements that are providing benefits to participants and beneficiaries, rather than providing services to the plan itself.[36] In testimony before the DOL, the Investment Company Institute asked the DOL to clarify that businesses that service mutual funds, such as brokers and fund accountants, are not service providers subject to the disclosure rules.[37]

The proposed regulations require that there be a written contract between the plan and the service provider[38] and that the terms of the contract provide for a variety of disclosures to be made to the "responsible plan fiduciary" before the contract is entered into and before a contract is renewed.[39] The disclosures must be made to the "best of the service provider's knowledge."[40]

Specifically, the proposed regulations require that the service provider disclose all services to be provided to the plan, the compensation or fees received, or to be received, by the service provider with respect to each service, and the manner (e.g., direct or indirect) in which compensation will be received.[41] The service provider must also disclose the method for calculating and repaying any prepaid compensation if the contract terminates.[42] "Compensation or fees" is defined to include money or any other thing of monetary value, such as gifts, awards, and trips, received, or to be received, by the service provider.[43]

With respect to "bundled arrangements," the proposed regulations provide that the bundled service provider must disclose the allocation of compensation or fees that are

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[35] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(i)(A)–(C); 72 Fed. Reg. 71004.

[36] 72 Fed. Reg. 70989.

[37] *ICI Supports Proposal to Improve 401(k) Disclosure*, Money Manager's Compliance Guide Newsletter 8 (June 2008). *See also* Melanie Franco Nussdorf, *The New Disclosure Rules Under ERISA*, Life Insurance Company Products: Featuring Current SEC, FINRA, Insurance, Tax, and ERISA Regulatory and Compliance Issues 713, 715 (ALI-ABA Nov. 13–14, 2008) ("Proposed regulation appeared to suggest that advisers to mutual funds or other non-plan asset vehicles were covered by the regulation. That suggestion will apparently be corrected in the final rule.")

[38] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(ii); 72 Fed. Reg. 71004. The writing requirement is designed to ensure a meeting of the minds between the service provider and responsible plan fiduciary. 72 Fed. Reg. 70989.

[39] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii); 72 Fed. Reg. 71004.

[40] *Id.*

[41] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(A); 72 Fed. Reg. 71004.

[42] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(A)(4); 72 Fed. Reg. 71005.

[43] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(A)(1); 72 Fed. Reg. 71004.

either a separate charge directly against the plan's investment reflected in the net value of the investment or that are fees set on a transaction basis, such as finder's fees, brokerage commission, and soft dollars.[44] The service provider is not required to disclose the allocation of compensation under a bundled arrangement that does not fit into either of these two categories.[45]

The proposed regulations also require that all relationships that may lead to a conflict of interest be disclosed. Specifically, service providers must disclose: (1) whether they are acting as a fiduciary;[46] (2) any financial or other interest in any transaction in which the plan will partake in connection with the contract or arrangement;[47] (3) any material, financial, referral or other relationship it has with various entities[48] that may create a conflict of interest for the service provider;[49] (4) if the service provider can affect its own compensation without prior approval from an independent plan fiduciary;[50] and (5) any policies or procedures developed to mitigate any conflicts of interest that exist.[51]

The proposed regulations would likely have a relatively modest impact on independent registered investment advisers (RIAs) because independent RIAs typically already have written contracts that spell out their services in detail.[52] In contrast, the rules are likely have a significant impact on broker-dealers and financial advisers because (1) they typically do not have ERISA-specific agreements already in place that can be modified to meet the disclosure requirements; (2) they must state in the contract or arrangement whether they are acting as fiduciaries, and it is not always clear whether they qualify as a functional fiduciary; (3) their compensation is indirect and varies based on the types of investments selected; (4) they have significant interests and relationships that may be viewed as conflicts of interest that must be disclosed; and (5) many do not currently have procedures in place to describe and explain, prior to

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[44] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(A)(3); 72 Fed. Reg. 71005.

[45] *Id.*

[46] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(B); 72 Fed. Reg. 71005.

[47] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(C); 72 Fed. Reg. 71005.

[48] Those entities include "a money manager, broker, other client of the service provider, or any other entity." Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(D); 72 Fed. Reg. 71005.

[49] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(D); 72 Fed. Reg. 71005.

[50] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(E); 72 Fed. Reg. 71005.

[51] Prop. DOL Reg. Sec. 2550.408b-2(c)(1)(iii)(F); 72 Fed. Reg. 71005.

[52] *See* Fred Reish et al., *The DOL's Proposed 408(b)(2) Regulation: Impact of the Mandated Disclosures on Registered Investment Advisers*, Reish, Luftman, Reicher & Cohen Bulletin (Feb. 4, 2008).

sale, all of the direct and indirect compensation they may receive.[53]

The DOL proposed that the regulation be effective 90 days after the publication of the final regulation,[54] and anticipated that the regulation would be become final on January 1, 2009.[55] In fact, however, the future of the proposed regulations is uncertain. On January 20, 2009, the date of President Obama's inauguration, the regulations were waiting for approval in the Office of Management and Budget.[56] A January 20, 2009, memorandum from the President's Chief of Staff called for all proposed regulations, which had not yet be finalized, to be withdrawn and made subject to further review by the appropriate agency or department head.[57] It is not clear when the Obama administration will turn its attention to the proposed Section 408(b)(2) regulations or how it might amend the rules. It is unlikely, however, that the regulations will be completely discarded.

Although the proposed section 408(b)(2) regulations are not yet effective, it would be prudent for service providers to still make the types of disclosures required by the proposed regulations.[58] As far back as 1997, the DOL has opined that fiduciaries have an obligation to

> assure that the compensation paid directly or indirectly by [a plan to a service provider] is reasonable, taking into account the services provided to the plan as well as any other fees or compensation received by the [service provider] in connection with the investment of Plan assets. The responsible Plan fiduciaries

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[53] *See* Fred Reish et al., *The DOL's Proposed 408(b)(2) Regulation: Impact on Broker-Dealers and Registered Representatives*, Reish, Luftman, Reicher & Cohen Bulletin (March 13, 2008). For a discussion of the likely impact of the regulations on independent recordkeepers, see Fred Reish and Bruce Ashton, *The DOL's Proposed 408(b)(2) Regulation: Impact on Independent Recordkeepers*, Reish, Luftman, Reicher & Cohen Bulletin (August 2008)

[54] 72 Fed. Reg. 70994.

[55] Richard Loebl, *Reporting & Disclosure of Fees for 401(k) and Other Plans - Coping with the New Regime*, 2008 Joint Fall CLE Meeting (Sept 13, 2008) ("The DOL anticipates that this rule will become final and effective January 1, 2009.").

[56] Michael A. Lawson and Andrew L. Oringer, *A Report on Certain Reporting Issues Under ERISA — Disclosure of Fees for Services and Special Issues for Gifts and Entertainment*, Pension Plan Investments 2009 162 (PLI April 13, 2009).

[57] 74 Fed. Reg. 4435 (Jan. 26, 2009).

[58] *See* Fred Reish and Bruce Ashton, *Update on Service Provider Disclosure Under 408(b)(2)*, Reish, Luftman Reicher & Cohen Bulletin 1,1 (Jan. 12, 2009) ("Even without the final regulation, from a risk management perspective, the prudent course for service providers is to make the types of disclosures provided for in the proposed regulations); Ellie Behling, *Advisers Still Headed for More Fee Transparency*, plan adviser (Jan. 29, 2009) ("[E]ven though the regulations were not finalized, commission-based advisers should make sure they are disclosing all of their compensation relating to a plan, including compensation paid by a third- party.").

> therefore must obtain sufficient information regarding any fees or other compensation that the [service provider] receives with respect to the Plan's investments...to make an informed decision whether [the service provider's] compensation for services is no more than reasonable.[59]

Even absent final regulations, plan fiduciaries risk being found to have breached their fiduciary duties and have engaged in a prohibited transaction under ERISA section 406(b)(3) if plan service providers do not provide plan fiduciaries with adequate disclosure of the service provider's direct and indirect compensation.

[3] Proposed Section 404(a)/Section 404(c) Regulations

ERISA requires that plan sponsors provide all participants with a summary plan description,[60] account statement,[61] and summary annual report.[62] While these documents may contain some information about plan fees, they are not required to disclose information about plan fees individual plan participants may bear.

Plan sponsors that seek to have their individual account plans qualify for the section 404(c) safe harbor[63] must disclose certain plan fee information to plan participants. Specifically, the current section 404(c) regulations require, among other things, that plan participants be automatically provided with (1) "a description of any transaction fees and expenses which affect the participant's or beneficiary's account balance in connection with the purchases and sales of interests in investment alternatives (e.g., commission, sales loads, deferred sales charges, redemption or exchange fees);"[64] and (2) fund prospectuses.[65] In addition, if the participant requests, plan participants must be provided with, among other things, (1) "a description of the annual operating expenses of each designated investment alternative (e.g., investment management fees, administrative fees, transaction costs) which reduce the rate of return to participants and beneficiaries, and the aggregate amount of such expenses expressed as a

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[59] DOL Advisory Opinion 97-16A. *See also* DOL Advisory Opinion 97-15A for similar language.

[60] ERISA Section 101(a)(1).

[61] ERISA Sections 101(a)(2) and 105(a) and (3).

[62] ERISA Sections 101(a)(2) and 104(b)(3).

[63] Under ERISA, exercising control over plan assets, including investing plan assets, is a fiduciary act, and sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA require that fiduciaries act prudently and solely in the interest of plan participants and beneficiaries. ERISA section 404(c), however, provides an exception to that general rule. Specifically, Section 404(c) provides that in plans permitting participants to exercise control over the assets in their own individual accounts, (1) the participant is not deemed to be a fiduciary by reason of the exercise of such control, and (2) no other fiduciary has any liability for any loss, or by reason of any breach, resulting from such exercise of control.

[64] DOL Reg. Section 2550.404c-1(b)(2)(i)(B)(1)(v).

[65] DOL Reg. Section 2550.404c-1(b)(2)(i)(B)(1)(viii).

percentage of average net assets of the designated investment alternative;"[66] and (2) fund performance history, after deduction of expenses.[67]

The current 404(c) regulations do not require disclosure of fee information in a format that enables participants and beneficiaries to easily compare fee and expenses across investment options. Instead, participants must sift through multiple documents that are not always automatically disclosed to them to compare the fees of different investment options.[68]

Moreover, not all participant-directed defined contribution plans are subject to the 404(c) regulations. The regulations only apply if the plan sponsor wishes to have the plan fall within the 404(c) safe harbor. According to recent Form 5500 data, 54 percent of 401(k) plans — representing 64 percent of 401(k) participants — were classified as 404(c) plans while 87 percent of 401(k) plans — representing 92 percent of 401(k) participants — have participants direct their investments.[69]

In light of these limitations under current law, on July 23, 2008, the DOL proposed regulations that would establish uniform, basic disclosure requirements for participants and beneficiaries in participant-directed defined contribution plans, without regard to whether the plan is a section 404(c) plan.[70] In addition, the proposed regulations would require participants and beneficiaries to be provided with investment-related information in a form that would encourage and facilitate a comparative review among investment options.[71]

The proposed regulations begin with the proposition that in participant-directed individual account plans, plan fiduciaries have a fiduciary duty to ensure, through "regular and periodic" disclosure, that plan participants and beneficiaries understand their rights and responsibilities with respect to investing the assets in their individual accounts, and have enough information about the plan, its fees and expenses, investment options (and any fees and expenses associated with those investment options) to make informed decisions about the management of their individual accounts.[72] In order to satisfy this obligation, plan fiduciaries must provide all participants and beneficiaries who have the right to direct their investments with

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[66] DOL Reg. Section 2550.404c-1(b)(2)(i)(B)(2)(i).

[67] DOL Reg. Section 2550.404c-1(b)(2)(i)(B)(2)(iv).

[68] *See* U.S. General Accountability Office, *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, GAO-07-21, at 18 (Nov. 2006) [hereinafter GAO Report].

[69] *Id.* at 17.

[70] 73 Fed. Reg. 43014.

[71] *Id.*

[72] DOL Prop. Reg. Sec. 2250.404a-5(a); 73 Fed. Reg. 43039.

specific disclosure about "plan related information" and "investment-related" information.[73]

There are three basic types of "plan related" information that must be disclosed: (1) general information about the plan and directing investments; (2) the day-to-day administrative expenses of the plan that are charged to participant accounts; and (3) expenses that apply to a participant's account on an individual rather than plan-wide basis.[74]

With respect to general plan information, the proposed regulations require disclosure of (1) how participants and beneficiaries may give investment instructions; (2) any limitations on such instructions, such as restrictions on transfer to or from a designated investment alternative; (3) the exercise of voting, tender, and similar rights and any restrictions on those rights; (4) the designated investment alternatives available under the plan; and (5) any designated investment managers to whom participants and beneficiaries may give investment instructions.[75]

With respect to administrative expenses, the proposed regulations require that participants and beneficiaries be given an explanation of the "day-to-day" operational expenses of the plan that may be charged against their individual accounts (such as legal, accounting and recordkeeping expenses) and a description of how those expenses will be allocated to participant accounts (such as pro rata or per capita).[76] This information must initially be disclosed on or before the date the participant becomes eligible to participate in the plan, and at least annually thereafter.[77] In addition, the proposed regulations require that participants and beneficiaries be furnished with quarterly statements providing the dollar amounts actually charged during the preceding quarter to the participants' or beneficiaries' accounts for administrative services, and a general description of the services to which the charges relate.[78] The administrative charge does not have to be broken out to disclose the cost for each specific service; one aggregate dollar amount may be reported for the administrative expenses attributable to each individual account.[79]

With respect to individual expenses, the proposed regulations require that participants and beneficiaries be given an explanation of any fees and expenses that may be charged against their individual account for services provided on an individual, rather

[73] DOL Prop. Reg. Sec. 2250.404a-5(b); 73 Fed. Reg. 43039.

[74] DOL Prop. Reg. Sec. 2250.404a-5(c); 73 Fed. Reg. 43039.

[75] DOL Prop. Reg. Sec. 2250.404a-5(c)(1); 73 Fed. Reg. 43039.

[76] DOL Prop. Reg. Sec. 2250.404a-5(c)(2)(i); 73 Fed. Reg. 43039.

[77] *Id.*

[78] DOL Prop. Reg. Sec. 2250.404a-5(c)(2)(ii); 73 Fed. Reg. 43039.

[79] 73 Fed. Reg. 43016.

than plan wide, basis, such as fees for plan loans, qualified domestic relations orders, or fees for investment advice or similar services that are charged on an individual basis.[80] This information must initially be disclosed on or before the date the participant becomes eligible to participate in the plan, and at least annually thereafter.[81] In addition, the proposed regulations require that participants and beneficiaries be furnished with quarterly statements identifying the dollar amount actually charged during the preceding quarter to the individual account for individual services and a description of the services to which the charges relate.[82]

In addition to the plan related information, the proposed regulations require that participants and beneficiaries receive specific information about each of the plan's "designated investment alternatives," including the associated fees, expenses, and performance history for each in a format that allows for comparison across the designated investment alternatives. Like the current 404(c) disclosure regime, some of the information must be provided automatically while other information need only be provided upon request. Unlike the current 404(c) regulations, the proposed regulations require that fund expense ratios and performance history be provided automatically while fund prospectuses need only be provided upon request.

Four basic types of "investment-related information" must be provided automatically on or before the date of eligibility and at least annually thereafter: (1) identifying information; (2) performance data; (3) benchmark data; and (4) fee and expense information.[83]

With respect to identifying information, the proposed regulations require disclosure of (1) the name of each designated investment alternative; (2) a website that is sufficiently specific to lead participants and beneficiaries to supplemental information regarding the investment alternative; (3) the type or category of the investment (e.g., money market mutual fund, balanced fund, large cap fund); and (4) the fund's management type (e.g. actively or passively managed).[84]

For investment alternatives with respect to which the return is fixed (e.g., a guaranteed investment contract), the plan fiduciary must provide both the fixed rate of return and the term of the investment.[85] For investment alternatives with respect to which the return is not fixed (e.g., an equity index fund), the fiduciary must provide the "average annual total return" (expressed as a percentage) of the investment for the

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[80] DOL Prop. Reg. Sec. 2250.404a-5(c)(3)(i); 73 Fed. Reg. 43039.

[81] *Id.*

[82] DOL Prop. Reg. Sec. 2250.404a-5(c)(3)(ii); 73 Fed. Reg. 43039.

[83] DOL Prop. Reg. Sec. 2250.404a-5(d)(1); 73 Fed. Reg. 43039-40.

[84] DOL Prop. Reg. Sec. 2250.404a-5(d)(1)(i); 73 Fed. Reg. 43039-40.

[85] DOL Prop. Reg. Sec. 2250.404a-5(d)(1)(ii); 73 Fed. Reg. 43040.

following periods, if available: one-year, five-year, and ten-year, measured as of the end of the applicable calendar year. If the data is not available, the plan must explain that it is unavailable or inapplicable. This data must be accompanied by a statement that an investment's past performance is not necessarily an indication of future performance.[86] The "average annual total return" is defined by reference to standards applicable to open-end management investment companies registered under the Investment Company Act of 1940.[87] In the preamble to the proposed regulations, the DOL specifically invited comments on what problems, if any, the proposed definition would create for investment alternatives that are not registered with the SEC, and invited suggestions for alternative definitions or approaches.[88]

For investment alternatives with respect to which the return is not fixed, the fiduciary must also provide performance data for an appropriate benchmark for one-year, five-year, and ten-year periods.[89]

Finally, the fiduciary must provide the following fee and expense information. For investment alternatives with respect to which the return is not fixed, the fiduciary must disclose (1) the amount and a description of each share-holder type fee (that is, fees charged directly against the participant or beneficiary's investment), such as sales loads, sales charges, redemption fees, account fees, and mortality and expense fees; (2) the total annual operating expenses of the investment expressed as a percentage (e.g., expense ratio); and a statement indicating that fees and expenses are only one factor that should be considered when making investment decisions. For investment alternatives with respect to which the return is fixed, the fiduciary must disclose the amount and a description of any shareholder-type fees that may apply to a purchase, transfer or withdrawal of the investment.[90]

The proposed regulations require that the automatically disclosed investment-related information be presented in a chart or similar format that would assist participants and beneficiaries compare the designated investment alternatives.[91]

In addition to the information that must be provided automatically, the proposed regulations provide that following information must be provided upon request: (1) copies of prospectuses or summaries; (2) copies of financial statements or reports; (3) a statement of share value; and (4) a list of the plan assets comprising the portfolio of

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[86] DOL Prop. Reg. Sec. 2250.404a-5(c)(d)(i); 73 Fed. Reg. 43040.

[87] DOL Prop. Reg. Sec. 2250.404a-5(h)(2); 73 Fed. Reg. 43041.

[88] 73 Fed. Reg. 43017.

[89] DOL Prop. Reg. Sec. 2250.404a-5(d)(1)(iii); 73 Fed. Reg. 43040.

[90] DOL Prop. Reg. Sec. 2250.404a-5(d)(iv); 73 Fed. Reg. 43040.

[91] DOL Prop. Reg. Sec. 2250.404a-5(d)(2); 73 Fed. Reg. 43040.

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each designated investment alternative and the value of each share.[92]

The DOL also proposed to amend the section 404(c) regulations to make the section 404(c) disclosure requirements conform with the section 404(a) disclosure requirements.[93]

Like the proposed section 408(b)(2) regulations, the proposed 404(a)/404(c) regulations were waiting for approval in the Office of Management and Budget on January 20, 2009,[94] and thus fall within the parameters of the President's Chief of Staff's memorandum calling for all proposed regulations, which had not yet been finalized, to be withdrawn and made subject to further review by the appropriate agency or department head.[95] Again, it is not clear when the Obama administration will turn its attention to the proposed Section 404(a)/404(c) regulations or how it might amend the rules.

[4] Summary

For more than a decade, the DOL has focused on 401(k) plan fees and the need for more and better disclosure. In all of its guidance, the DOL has made it clear that it does not object, in principle, to the basic 401(k) model in general, or revenue sharing in particular.[96] It simply wants to ensure that plan fees in general, and revenue sharing in particular, are adequately disclosed.

In recent years, the DOL embarked on three separate initiatives to mandate better disclosure. It revised the Form 5500 requirements to provide for better disclosure to the government. Second, it proposed new regulations under ERISA section 408(b)(2) to mandate greater disclosure to plan fiduciaries. Finally, it proposed regulations under section 404(a)/404(c) to provide for greater and more uniform disclosure to plan participants.

The revised Form 5500 requirements are effective for all annual report filings made for plan years beginning on or after January 1, 2009. Because the proposed section 408(b)(2) and section 404(a)/404(c) regulations were not finalized by the time President Obama took office, they are now in limbo. It is highly likely that new

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[92] DOL Prop. Reg. Sec. 2250.404a-5(d)(4); 73 Fed. Reg. 43040.

[93] See 73 Fed. Reg. 43043-44 (amending 404(c) regulations).

[94] Michael A. Lawson and Andrew L. Oringer, *A Report on Certain Reporting Issues Under ERISA — Disclosure of Fees for Services and Special Issues for Gifts and Entertainment*, Pension Plan Investments 2009 162 (PLI April 13, 2009).

[95] 74 Fed. Reg. 4435 (Jan. 26, 2009).

[96] "The Working Group recognizes that in the DOL's view, revenue sharing does not involve any inherent ERISA violations. To the contrary, many of these arrangements may serve to reduce overall plan costs and provide plans with services and benefits not otherwise affordable to them." Report of the Working Group on Fiduciary Responsibilities and Revenue Sharing Practices.

administration will mandate greater disclosure to plan fiduciaries and plan participants. It is not clear, however, when such rules will go into effect or the final form they will take. Even absent final guidance, however, plan service providers and plan fiduciaries would be well advised to ensure that they provide ample disclosure of plan fees and revenue sharing arrangements, even if they choose not to follow precisely the guidance set out in the proposed regulations.

§ 17.03 401(k) FEE LITIGATION

Since 2006,[97] about thirty different lawsuits[98] have been filed challenging 401(k) plan fees.[99] A single law firm, Schlichter, Bogard & Denton of St. Louis, filed many of the complaints, although other law firms have also entered the fray.[100] Generally, the complaints allege that the plan fiduciaries breached their duties under ERISA "by allowing or causing their plans to pay excessive fees and expenses to service providers."[101] The complaints focus on revenue sharing and contend that the "revenue sharing payments were not properly disclosed and accounted for in determining compensation paid to plan service providers."[102]

Although revenue sharing is the focus of the complaints, some other practices are challenged as well. For example, some complaints allege that there was inadequate disclosure of direct payments from plans to plan sponsors.[103] In addition, some complaints allege that plan fiduciaries acted improperly in their selection of particular investment options, such as selecting a more expensive class of shares when a less

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[97] One case, *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp. 2d 156 (D. Conn. 2006), was filed 2001. In addition, another case, *Mehling v. New York Life Ins. Co*, 248 F.R.D. 455, 2008 U.S. Dist. LEXIS 16968 (E.D. Pa. 2008) was filed in 1999, and settled for $14 million on March 4, 2008.

[98] *See* Jason H. Lee and Alexander P. Ryan, 401(k) Fee Litigation, (May 19, 2009), available http://www.groom.com/documents/401_k_FeeLitigationOutlineMay192009.pdf (identifying 29 different cases including *Haddock*). *See also* Gregory L. Ash, *Lessons from 401(k) Fee Litigation*, ABA Tax Midyear Meeting (Jan. 10, 2009) (noting that 30+ cases are pending challenging DC plan fee practices).

[99] A few of the cases have involved defined contribution plans other than 401(k) plans. *See, e.g.*, Montoya v. ING Life Ins. And Annuity Co., copy of complaint available at http:www.erisafraud.com/Portals/7/documents/ING_Complaint032807.pdf (S.D.N.Y. filed March 28, 2007) (403(b) plan); Daniels-Hall v. National Education Ass'n, 2007 U.S. Dist. Ct. Pleadings LEXIS 5339 (W.D. Wash. July 11, 2007) (same).

[100] *See* Grace Carter and Lee Kissman, *Excessive Fees Litigation Involving 401(k) Plans: Developments to Date and Issues for the Future*, Banking & Financial Services Policy Report 22, 22 (April 2008).

[101] See Steven J. Sacher and Matthew A. Olson, *401(k) sponsors become targets: ERISA actions center on their fee arrangements with retirement plan consultants*, National L. J. (Jan. 8, 2007).

[102] Andree M. St. Martin, 401(k) Fee Litigation, PLI Pension Plan Investments 2008: Current Perspectives 119, 126 (May 1, 2008).

[103] Gregory L. Ash, *401(k) Plans in the Cross-Hairs*, Spencer Fane Britt & Browne LLP 2 (March 2007).

expensive class of shares was available [104] or offering actively managed mutual funds rather than index funds.[105]

Common to the complaints is an argument that expenses and payments were not adequately disclosed and thus the plan fiduciaries could not rely on ERISA Section 404(c) for protection.[106]

This Article will not attempt to discuss all of the pending cases.[107] Rather, this Article will focus on two decisions, *Haddock v. Nationwide Financial Services*[108] and *Hecker v. Deere*,[109] which may be viewed as bookends representing the range of possible dispositions of these cases.

In *Haddock*, the Federal District Court for the District of Connecticut bent the rules of civil procedure and invented new ERISA law regarding the definition of plan assets to permit the plaintiffs' complaint to survive a motion for summary judgment. In *Hecker*, in contrast, the Seventh Circuit Court of Appeals liberally applied the rules of civil procedure and rejected the Secretary of Labor's interpretation of her Section 404(c) regulations to uphold the district court's decision to grant the defendants' motion to dismiss with prejudice.

[1] Haddock v. Nationwide Financial Services[110]

[a] Facts and Procedural Posture

In *Haddock*, the trustees[111] of a number of 401(k) plans brought suit against Nationwide claiming that Nationwide violated its fiduciary duties under ERISA Section 404(a)(1)(A) and (B) by contracting with and retaining "revenue-sharing payments" from mutual funds and their affiliates.[112] In addition, the trustees alleged that the contracts and retention of revenue sharing payments constituted prohibited

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[104] Sacher and Olson, *supra* note 101.

[105] St. Martin, *supra* note 102 at 126

[106] Sacher and Olson, *supra* note 101; Ash, *supra* note 103 at 3.

[107] For a summary of the pending cases and their current dispositions, see Lee and Ryan, *supra* note 98; *ERISA Plan Fees Cases Face Uphill Battle After Seventh Circuit Ruling*, 36 BNA Pension & Benefits Reporter 589 (March 10, 2009) [hereinafter "*Uphill Battle*"].

[108] 419 F. Supp. 2d 156 (D. Conn. 2006).

[109] 556 F.3d 575 (7th Cir. 2009).

[110] 419 F. Supp. 2d 156 (D. Conn. 2006).

[111] The complaint in *Haddock* was filed in 2001, years before Schlichter, Bogard & Denton initiated the current spate of litigation, and differs from many of the pending cases in that it was filed by plan trustees, rather than by plan participants. Nevertheless, it is part of this body of litigation because it addresses the same basic issue of whether revenue sharing violates ERISA.

[112] 419 F. Supp. 2d at 158.

transactions under ERISA Section 406(b).[113]

Haddock involved a fairly typical 401(k) investment arrangement. Nationwide, as the plans' investment provider, offered the 401(k) plans the option of investing in a variety of mutual funds through variable annuity contracts.[114] For group annuity contract holders, Nationwide offered a selection of funds, and the plans chose a subset of those funds to be available as investment options for plan participants.[115] Plan participants then made their individual investment decisions, selecting among the available funds.[116] For individual annuity contracts, Nationwide offered a selection of funds, and individual participants chose to make their investments among the funds offered by Nationwide.[117]

Nationwide also retained the authority to delete and substitute mutual funds from its list of investment options "if, in the judgment of [Nationwide], further investment in the shares of a Fund should become inappropriate in view of the purposes of the Contract."[118] At this stage, Nationwide's authority was apparently limited to deleting and substituting mutual funds that had already been approved by the plans.[119]

The plans and participants did not invest directly in the mutual funds.[120] Instead, they invested in one of two Nationwide "variable accounts," which were unit investment trusts that held assets from multiple plans and participants.[121] The variable accounts were divided into numerous sub-accounts, with each sub-account corresponding to a particular investment option available under the annuity contracts.[122] Nationwide purchased or sold interests in the mutual funds to reflect the sub-accounts' combined allocations.[123] Once the mutual funds received the funds from the sub-accounts, the mutual funds combined those funds with funds received from other investors.[124]

Nationwide allocated "accumulation units," or "shares" of the corresponding

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[113] *Id.*

[114] *Id.* at 159–160.

[115] *Id.* at 161.

[116] *Id.*

[117] 419 F. Supp. 2d at 161.

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.*

[122] 419 F. Supp. 2d, at 161.

[123] *Id.*

[124] *Id.*

sub-accounts to the plans and participants to the reflect the amounts contributed to a particular mutual fund.[125] The accumulation units reflected the total amount of money the plans and participants invested in the variable account or sub-account, and value of the accumulation units fluctuated with the value of the mutual funds held by the sub-accounts.[126]

In the early to mid-1990s, Nationwide "implemented a system under which mutual funds ma[d]e payments to it based on a percentage of the assets that plans and participants invested in mutual funds through Nationwide."[127] It is this system of payments, which Nationwide refers to a "service contract payments" and the plan trustees call "revenue sharing," that the plan participants challenged.

On March 7, 2006, the district court denied Nationwide's motion for summary judgment. The court held that, viewing the evidence in the light most favorable to the plaintiffs, a reasonable fact finder could find that (1) Nationwide was a fiduciary;[128] (2) the revenue-sharing payments constituted plan assets under a functional approach;[129] and (3) Nationwide engaged in a prohibited transaction by receiving the revenue sharing payments.[130]

[b] Analysis of Court's Opinion

In holding that a reasonable fact finder could find that the revenue-sharing payments constituted plan assets, the court bent the rules of civil procedure and invented new ERISA law. The plan trustees argued that the revenue-sharing payments were plan assets because "(1) they would not have been made but for the Plans' investments through Nationwide, (2) Nationwide did not contract with the Plan to receive the payments despite the opportunity to do so, and (3) the payments could be used for the benefit of the Plans and the participants."[131]

The court rejected the plan trustees' functional approach, and instead applied its own novel functional approach to determine whether the revenue sharing payments were plan assets. Under the court's functional approach, "'plan assets' include items a defendant holds or receives: (1) as a result of its status or its exercise of fiduciary discretion or authority, and (2) at the expense of plan participants or beneficiaries."[132]

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[125] *Id.*

[126] *Id.* at 162.

[127] 419 F. Supp. 2d, at 162.

[128] *Id.* at 164–67.

[129] *Id.* at 167–71

[130] *Id.* at 171.

[131] *Id.* at 168.

[132] 419 F. Supp. 2d, at 170.

The court noted that there was no evidence to support the second prong of the test, and admitted that "[o]rdinarily the absence of evidence supporting an essential element of plaintiffs' claim would be fatal at summary judgment."[133] Nevertheless, the court permitted the plan trustees' claim to survive the motion for summary judgment because "Nationwide's motion is almost entirely based on questions of law, and because [the court] adopted a functional approach different than that proposed by the Trustees."[134]

In holding that the revenue sharing payments could constitute plan assets, the court disregarded ERISA Section 401(b)(1).[135] Although ERISA does not explicitly define the term "plan assets,"[136] it suggests that in some instances, it may be appropriate to "look through" a plan's investment in a separate legal entity and treat the underlying assets of that entity as plan assets subject to ERISA's fiduciary rules.[137] Nevertheless, ERISA Section 401(b)(1) makes it clear that the look through rule does not apply to the underlying assets of a mutual fund.[138] The DOL regulations[139] limit "the applicability of the look through rule to investments in entities that do not produce or sell a product or service or when the entity's product or service relates to the investment of capital."[140]

The 2007 ERISA Advisory Council's Working Group on Fiduciary Responsibilities and Revenue Sharing Practices recommended that the DOL issue guidance to clarify that "revenue sharing is not a Plan asset under ERISA unless and until it is credited to the Plan in accordance with the documents governing revenue sharing."[141] Although

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[133] *Id.*

[134] *Id.* at 171.

[135] In addition, the court's construction creates a circularity because a fiduciary is defined as someone who exercises authority or control over plan assets and the first element of the plan asset definition is fiduciary status. *See, Nationwide Wins One, Loses One In Fee Litigation: Troubling Definition of Plan "Assets" Survives*, Spencer Fane Publications (Oct. 4, 2007).

[136] For a discussion of the Department of Labor's guidance on defining plan assets and the rules that should apply to the allocation of revenue sharing payments once they have been returned to the plan, see Stephen J. Migausky and Marcia S. Wagner, *A Meditation on the Definition of Plan Assets*, 39 ASSPA Journal 1 (No. 1 Winter 2000).

[137] ABA Section of Labor and Employment Law, Employee Benefits Law 644-45 (2d ed. 2000) (citing ERISA Sections 3(21)(B) and 401(b) and (c)).

[138] "In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such a security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company." ERISA Section 401(b)(1).

[139] DOL Reg. Sec. 2510.3-101.

[140] Migausky and Wagner, *supra* note 136, at 1.

[141] Report of the Working Group on Fiduciary Responsibilities and Revenue Sharing Practices.

the DOL has not yet issued such specific guidance, in the premable to the updated Form 5500 regulations, the DOL did state "The fact that revenue sharing payments charged against the assets in an investment vehicle are required to be reported on Schedule C or disclosed under the alternative reporting option would not, by virtue of the reporting requirement alone, make those revenue sharing payments plan assets under the plan asset regulation or under ordinary notions of property rights."[142] Without referring to the *Haddock* decision, the Seventh Circuit Court of Appeals in *Hecker v. Deere* cited ERISA Section 401(b)(1) in support of its holding that revenue sharing fees are not plan assets.[143]

[2] *Hecker v. Deere*[144]

[a] Facts and Procedural Posture

In *Hecker v. Deere*, three plan participants filed a class action suit against the plans' sponsor, Deere & Company ("Deere"), the plans' recordkeeper and directed trustee, Fidelity Management Trust Company ("Fidelity Trust"), and the investment advisor for the mutual funds offered as investment options under the plans, Fidelity Management & Research Company ("Fidelity Research").[145] The plaintiffs alleged that the defendants violated their fiduciary duties under ERISA in two separate ways: (1) by providing investment options with excessive fees and costs; and (2) by failing to disclose adequately the plan's fee structure to plan participants.[146]

Like Haddock, Deere involved a fairly typical 401(k) investment arrangement. Specifically, Fidelity Trust served as trustee to Deere's two 401(k) plans, advised Deere about the investments to include in its 401(k) plans, administered the participants' accounts, and maintained the plans' records.[147] Each plan permitted participants to invest in 23 different Fidelity mutual funds, a Deere stock fund, two investment funds managed by Fidelity Trust, and a brokerage account option, BrokerageLink, that allowed participants to invest in 2,500 non-Fidelity mutual funds.[148] Plan participants made their own investment decisions, limited only by the requirement that they invest in a vehicle offered by their plan.[149]

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[142] 72 Fed. Reg. 64744 (Nov. 16, 2007).

[143] 556 F.3d, at 584 ("Once the fees are collected from the mutual fund's assets, they become Fidelity's assets-again, not the assets of the Plan.").

[144] 556 F.3d 575 (7th Cir. 2009).

[145] *Id.* at 578.

[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] 556 F.3d, at 578.

Fidelity Research served as the investment advisor for 23 of the 26 investment options available under the plan.[150] Each fund offered by the plans charged a fee, calculated as a percentage of assets held by the investor.[151] All of the Fidelity funds were available on the open market for the same fee.[152]

The plan participants alleged that Fidelity Research shared the revenue it earned from the mutual fund fees with Fidelity Trust, and Fidelity Trust, compensated itself through those fees rather than charging Deere a direct fee for its services.[153] In their second amended complaint, the plan participants contended, "the fees and expenses paid by the Plans, and thus borne by Plan participants, were and are unreasonable and excessive; not incurred solely for the benefit of the Plans and the Plans' participants; and undisclosed to participants. By subjecting the Plans and the participants to these excessive fees and expenses, and by other conduct set forth below, the Defendants violated their fiduciary obligations under ERISA."[154]

The district court dismissed the plaintiffs' complaint for failure to state a claim and the plaintiffs appealed.[155] In the first appellate decision to address the issue of revenue sharing, the Seventh Circuit of Appeals affirmed.

[b] Holding

The first substantive issue[156] the circuit court addressed was whether Fidelity Trust and Fidelity Research were functional fiduciaries with respect to the selection of investment options, the structure of fees, or the provision of information regarding the fee structure.[157] The court found that plaintiffs' allegation that Fidelity Trust "played a role" in selecting the plans' investments did not transform the company into a

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[150] *Id.* at 579.

[151] *Id.* at 578.

[152] *Id.* at 579.

[153] *Id.*

[154] 556 F.3d, at 579.

[155] *Id.* at 578.

[156] The first issue the court addressed was whether the trial court erred in considering documents outside the pleadings in dismissing the complaint for failure to state a claim. The court found that the trial court did not err in considering seven summary plan descriptions (SPDs), two SPD supplements, the Trust Agreement between Deere and Fidelity Trust, and three fund prospectuses retrieved from Fidelity's website for the limited purpose of showing what Fidelity disclosed to plaintiffs. *Id.* at 582–83.

The court also addressed another procedural question after it considered the plaintiffs' substantive claims. Specifically, the court rejected the plaintiffs' claim the district court abused its discretion in denying plaintiffs' Rule 59(e) motion to present newly discovered evidence to show that Deere did in fact turn over critical decision making authority to Fidelity. *Id.* at 590–91.

[157] 556 F.3d, at 583–84.

functional fiduciary. The court declared, "Many people help develop and manage benefit plans — lawyers and accountants, to name two groups — but despite the influence of these professionals we do not consider them to be Plan fiduciaries."[158] Relying on the plaintiffs' concession in their complaint that Deere had the "final authority" in selecting investment options, the court rejected the plaintiffs' claim that Fidelity Trust and Fidelity Research were "functional fiduciaries" responsible for making disclosures and selecting plan assets.

The court prohibited the plaintiffs from raising a "tardy" argument that Fidelity Trust was a *de facto* fiduciary. The court found that the plaintiffs' complaint limited its allegations to those claiming that Fidelity Trust "played a role" in the decision-making process and thus the plaintiffs gave the defendants no notice that they might argue that Fidelity Trust in fact exercised final decision-making authority.[159] According to the court, the defendants would have been "highly prejudiced" if the plaintiffs had been able to shift their argument to claim that Fidelity Trust was a *de facto* fiduciary.[160]

The court then rejected the plaintiffs' claim that Fidelity Research, and possibly Fidelity Trust, were fiduciaries because they exercised discretion over the disposition of the Plans' assets by determining how much revenue Fidelity Research would share with Fidelity Trust.[161] Without citing *Haddock*, the court flatly rejected *Haddock*'s holding that revenue sharing payments could constitute plan assets; the court held that fees drawn from the assets of mutual funds are not plan assets.[162]

The court then turned to the plaintiffs' claims that Deere breached its fiduciary duties (1) by failing to inform plan participants that Fidelity Trust received money from the fees collected by Fidelity Research, and (2) by limiting investment options to Fidelity Research funds, and thus only offering investment options with excessive fees.[163] With respect to the first, duty to disclose, claim, the court found that Deere satisfied its duty by disclosing the total fees for the funds and directing the participants to the prospectuses for information about the fund-level expenses.[164] The court was not particularly troubled by the fact that the SPD supplements suggested that Deere was paying the administrative costs when the costs were in fact being paid by the participants through the revenue sharing system. "While Deere may not have been behaving admirably by creating the impression that it was generously subsidizing its

[158] *Id.* at 584.
[159] *Id.*
[160] *Id.* at 575.
[161] *Id.* at 584.
[162] 556 F.3d, at 584.
[163] *Id.* at 584–88.
[164] *Id.* at 585–86.

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employees' investments by paying something to Fidelity Trust when it was doing no such thing, the Complaint does not allege any particular dollar amount that was fraudulently stated."[165] The court held that Deere had no duty to disclose any information about the internal sharing of revenue between Fidelity Trust and Fidelity Research.[166]

With respect to the second claim, the court found that "no rational trier of fact could find, on the basis of the facts alleged in [the] Complaint, that Deere failed to satisfy" any duty it may have to furnish an acceptable array of investment vehicles.[167] In so finding, the court emphasized the fact that the plans offered 26 investment options, including 23 retail mutual funds, as well as 2,500 non-Fidelity mutual funds through BrokerageLink.[168]

The court then turned to the defendants' section 404(c) defense. The court found that "even if [the court] underestimated the fiduciary duties Deere had to its participants," ERISA Section 404(c) offered an alternative ground for dismissing the case.[169] Recognizing that a trial court should not normally base a Rule 12(b)(6) dismissal on an affirmative defense, the circuit court found that the trial court did not err in basing its dismissal of the plaintiffs' claims on ERISA Section 404(c) because the plaintiffs explicitly anticipated an ERISA Section 404(c) safe harbor defense and "put it in play."[170] Restricting its analysis to plaintiffs' specific challenges, the circuit court saw "no plausible allegation that the Plans do not comply with [ERISA Section 404(c)]."[171]

The court described the central question as whether "the imprudent selection of mutual funds with excessively high fees falls within the safe harbor."[172] The court declined to address the "abstract question" of whether the safe harbor applies to the selection of investment options for a plan.[173] The court held that even if section 404(c) "does not shield a fiduciary from an imprudent selection of funds under every circumstance that can be imagined, it does protect a fiduciary that satisfies the criteria of [Section 404(c)] and includes a sufficient range of options so that the participants have control over the risk of loss."[174] According to the court, "any allegation" that the

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165 *Id.* at 585.

166 *Id.* at 585–86.

167 556 F.3d, at 586.

168 *Id.*

169 *Id.* at 587.

170 *Id.* at 588.

171 *Id.* at 589.

172 556 F.3d, at 589.

173 *Id.*

174 *Id.*

2,500 mutual funds available through BrokerageLink "did not provide the participants with a reasonable opportunity to accomplish the three goals outlined in the regulation,[175] or control the risk of loss from fees, is implausible."[176] Thus, "[g]iven the numerous investment options, varied in type and fee, neither Deere nor Fidelity (assuming for the sake of argument that it somehow had fiduciary duties in this respect) can be held responsible for those choices."[177]

[c] Analysis of Court's Opinon

There are a number of troubling aspects to the Deere decision. First, in rejecting plaintiffs' claim that Deere violated its fiduciary duty by limiting the investment options to Fidelity Research funds, the court never once mentioned process. It simply declared that "the undisputed facts leave no room for doubt that the Deere plans offered a sufficient mix of investments for their participants."[178] "It has long been the law that prudence is measured largely by the process used by the investing fiduciary to select the investment.... [The court's] analysis stands 30 years of case law on its head."[179]

In interpreting ERISA's fiduciary duties narrowly and the ERISA section 404(c) safe harbor broadly, the opinion suggested that a plan sponsor could be granted immunity in selecting its investment options even if it made its selections by throwing a dart at a list of possible investments, as long as it ultimately offered participants a sufficiently wide range of investment options.[180] By focusing on the broad array of investment options,[181] rather than the process that led to their selection, the decision may encourage plan sponsors to "eschew the legitimate design choice that involves a

[175] The regulations three goals are (1) to be able to materially affect potential return and degree of risk in the investor's portfolio; (2) to be able to choose from at least investment alternatives each of which is diversified and has materially different risk and return characteristics, and (3) to be able to diversity sufficiently so as to minimize the risk of large losses. 556 F.3d, at 589–90.

[176] *Id.* at 590.

[177] *Id.*

[178] *Id.* at 575.

[179] *Uphill Battle*, *supra* note 107.

[180] *Id.* (noting that according to plaintiffs' attorney, Gregory Y. Porter, "under the Deere decision, a fiduciary 'can choose funds by throwing darts without any regard to expense, manger reputation, the bargaining power of a large pension plan, or any other criteria a fiduciary should consider."). *See also* Nevin E. Adams, "IMHO: 'Winning Ways?" (Feb. 19, 2009), available at http://www.planadviser.com/compliance/article.php/3708 (Stating that if he were giving advice based on the Deere decision, he would "advocate giving participants LOTS of fund choices — via a brokerage window if possible," and would tell plan sponsors that they "won't have to worry about being prudent in the selection of the fund options for the plan because, according to the [Deere] decision, th[e Section 404(c)] safe harbor applies" to the decision regarding the selection of funds.).

[181] The opinion began by noting that the plans offered "a generous choice of investment options." 556

smaller targeted group of funds in favor of the broader, open-ended menu."[182] Indeed, in reporting on the decision, one firm advised, "to the extent that a 401(k) plan does not have an investment portal, plan sponsors and administrators should immediately consider addition of such an optional investment vehicle."[183]

The most troubling aspect of the court's opinion is its apparent rejection of the Secretary of Labor's interpretation of her own regulations. Although the court declined to address the "abstract question" of whether the section 404(c) safe harbor applies to the selection of investment options for a plan,[184] the court found that the safe harbor did apply to the selection of investment options in that case. Contrary to this view, the preamble to the section 404(c) regulations states that "the act of designating investment alternatives" and "the ongoing determination that such alternatives and managers remain suitable and prudent investment alternatives for the plan" are fiduciary functions "to which the limitation on liability provided by section 404(c) is not applicable."[185] Footnote 27 to the preamble "reiterates that because such selections are not a direct and necessary result of any participant direction, fiduciaries to 404(c) plans are not relieved of liability for any failure to prudently select investment options under the plan and 'to periodically evaluate the performance of such vehicles to determine ... whether [they] should continue to be available as participant investment options."[186]

In holding that Section 404(c) provided the defendants with immunity in the selection of investment options in that case, the *Deere* court cited[187] *Langbecker v. Electronic Data Systems Corp.*[188] In *Langbecker*, a divided panel of the Fifth Circuit held that a Section 404(c) defense may apply to a claim brought on behalf of a plan that the plan fiduciaries breached their fiduciary duties by including company stock as an investment option in a 401(k) plan.[189]

Although *Deere* and *Langbecker* reject the Secretary of Labor's interpretation of her

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F.3d, at 578. It then referred to the range of investment options at least three more times in the course of the opinion. *See Id.* at 586 & 590.

[182] *Uphill Battle*, *supra* note 107.

[183] Seventh Circuit Rules on Fiduciary Duties Related to 401(k) Fees, Thompson Hine ERISA Litigation Update Advisory Bulletin (Feb. 2009).

[184] 556 F.3d, at 589.

[185] 57 Fed. Reg. 46922 (Sept. 16, 1991).

[186] Brief of the Secretary of Labor, Hilda L. Solis, As Amicus Curiae in Support of Panel Rehearing 6 (filed March 20, 2009), quoting 57 Fed. Reg. 46924 n.27.

[187] 556 F.3d, at 589.

[188] 476 F.3d 299 (5th Cir. 2007).

[189] *Id.* at 310–13.

Section 404(c) regulations, shortly after the *Deere* decision was rendered, the Federal District Court for the District of New Hampshire found that the Secretary's interpretation should be granted deference and held that plan fiduciaries were not entitled to a section 404(c) defense against claims that the fiduciaries should not have included company stock fund as an investment option.[190] In its unpublished opinion, the court offered the following reasons for adopting the Secretary's interpretation of the section 404(c) regulations:

> First, section 404(c) is unclear as to whether it can be used to bar a claim based on a fiduciary's designation of investment options. Second, section 404(c) requires the DOL to adopt regulations explaining when a participant or beneficiary has sufficient control over his assets to be subject to a section 404(c) defense. [ERISA Section 404(c)(1)(A).] Third, the DOL's implementing regulations are themselves unclear as to whether section 404(c) applies to a fiduciary's decision to designate investment options. Fourth, the DOL reasonably determined in the preamble to its regulations that losses which result from a fiduciary's designation decision are neither a "direct" nor a "necessary" result of a participant's exercise of control over plan assets. Finally, both the Supreme Court and the First Circuit have recognized in similar circumstances that an agency's reasonable interpretation of its own regulations in a regulatory preamble is entitled to deference.[191]

On March 20, 2009, the Secretary of Labor filed an amicus brief[192] in support of the plaintiff's petition for rehearing of the *Deere* case on the grounds that (1) the court rejected the Secretary's interpretation of her own 404(c) regulations without addressing the deference that should be given to the Secretary; and (2) that the possible ramifications of the court's decision are more far-reaching than the court may realize. At the time this article went to press, the court had not yet decided on the plaintiffs' petition for rehearing.

Although the Deere decision suggests that a plan sponsor need not exercise

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[190] *In re Tyco International, Inc.*, 2009 U.S. Dist. LEXIS 30609 (D.N.H.).

For a similar holding by a district court in a decision rendered before *Hecker*, see *Kanawi v. Bechtel Corp.*, 590 F. Supp. 2d 1213, 1232 (N.D. Ca. 2008) ("The DOL has taken a clear position that section 404(c) does not from a party from liability for claims of imprudent selection of Plan investment options. This position comports with commonsense.")

[191] Id. at 17–18

[192] On the same day that the Secretary of Labor filed her amicus brief, a number of industry groups also filed a joint amicus brief asking the court to rehear the case. The industry groups included AARP, the National Senior Citizens Law Center, the Pension Rights Center, Fund Democracy, Inc., and the Consumer Federation of America. A group of five law professors also filed a separate amicus brief in favor of rehearing the case. *Seventh Circuit Receives Four Requests to Rehear Controversial Deere Decision*, 36 BNA Pension and Benefits Reporter 700 (March 24, 2009).

prudence in selecting plan investment options, a prudent plan sponsor would be well-advised to heed the Department of Labor's view that such a decision is not entitled to Section 404(c) immunity, at least until there is a final resolution on this issue.[193]

[3] Summary

Since 2006, about thirty different lawsuits challenging 401(k) plan fees have been filed. It is too soon to tell how the cases will ultimately resolved.

Undoubtedly, the 401(k) fee cases will cause employers to take their fiduciary obligations seriously and carefully scrutinize fees, expenses, and revenue sharing.[194] Whether they will have a greater impact remains to be seen.

In *Haddock v. Nationwide*, one of the first decisions rendered in this spate of litigation, the Federal District Court of Connecticut bent over backwards to keep the plaintiffs' complaint alive. In so doing, the court suggested that it was willing to look beneath the surface and take a close look at revenue sharing arrangements and the current 401(k) business practices.

In *Hecker v. Deere*, in contrast, the Court of Appeals for the Seventh Circuit bent over backwards to affirm the district court's dismissal of the plaintiffs' complaint with prejudice. The court was persuaded that the 401(k) plans at issue operated within the parameters of the marketplace and was unwilling to consider a challenge to prevailing business practices. The court suggested that the marketplace can and should dictate how 401(k) plans should operate, and any additional fee disclosure mandates must come from the DOL or Congress.

§ 17.04 LEGISLATIVE PROPOSALS

In November 2006, the Government Accountability Office (GAO) issued a report on the disclosure of 401(k) plan fees.[195] The report found that the majority of 401(k) plan fees come out of participants' accounts[196] and plan participants do not understand that

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[193] *See Implications of the Deere Decision*, BrightScope Blog (Feb. 19, 2009) ("Until the differences between the court's interpretation and the DOL's interpretation get resolved, for the sake of prudence I imagine most plan sponsors will continue to subscribe to the DOL interpretation.")

[194] Jeffrey Rickman, *401(k) Fee Cases: The New "Hot" Area for Litigation*, Georgia Employment Law Letter (Feb. 2008) ("But the recent burgeoning of lawsuits in this area should make you reassess your own 401(k) plans. Among other things, you should monitor plan and fund expenses to ensure you have negotiated the best deal for participants. You should also ensure that expenses connected to plans are supported by clear, accessible documentation."); Sacher and Olson, *supra* note 101 ("At the very least the fee cases will increase fiduciary diligence and scrutiny of fees, expenses and revenue sharing.").

[195] GAO Report, *supra* note 68.

[196] *Id.* at 13.

the fees affect the value of their individual accounts.[197] The report recommended that Congress amend ERISA to (1) require all plan sponsors of individual directed plans to disclose fee information on each investment option to participants in a way that facilitates comparison among investment options, and (2) "explicitly" require plan service providers to disclose to plan sponsors the compensation they receive from other service providers, such as revenue sharing and third party fees.[198]

Following the release of the GAO report, in March 2007, the House of Representatives Committee on Education and the Labor Force held the first of a series of hearings on retirement plan fees and expenses.[199] Those hearings led Representative George Miller, Chair of the House Committee on Education and Labor, to introduce H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007.[200] Described as the "high watermark" in requiring additional disclosure,[201] the bill was intended to simplify 401(k) fees and make them more transparent to participants and beneficiaries.[202] Representative Miller has been quoted as saying the DOL's proposed regulations would continue to permit financial firms "to hide many fees" and introduced H.R. 3185 with the intent of introducing legislation that goes well beyond the DOL's proposed requirements.[203] Bradford C. Campbell, assistant secretary for the DOL's Employee Benefits Security Administration testified at a hearing held by the House Education and Labor Committee on the bill in October, 2007.[204] Campbell urged Congress to rely on the DOL to improve disclosure through its regulatory projects rather than enacting new legislation.[205]

Using the 401(k) Fair Disclosure for Retirement Security Act of 2007 as a

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[197] *Id.* at 17.

[198] *Id.* at 29. The Report also recommended that the DOL issue regulations requiring plan sponsors to report a summary of all fees paid out of plan assets or participant accounts, listing the fees by type. *Id.*

[199] U.S. Congress. House. House Education and Labor Committee. *Rep. George Miller Holds A Hearing On Hidden 401(k) Fees*. 110th Cong., 1st sess., 6 March 2007. The March hearing focused principally on the GAO report. Martha Priddy Patterson, *Creating Employee-Managed Retirement Plans in a Self-Service World: 401(k) Plans' Condensed History*, 17 Thompson's 401(k) Handbook Newsletter 3 (Feb. 2008).

[200] H.R. 3185, 110th Cong., 1st sess. (2007)

[201] Andree M. St. Martin, *Key 401(k) Plan Disclosure Bill Introduced*, Pension, Profit-Sharing, Welfare, and Other Compensation Plans 255, 259 (ALI-ABA Oct. 4–6, 2007).

[202] *See DOL Proposes Fee Disclosure Amendment*, 17 401(k) Handbook Newsletter 9 (Feb. 2008).

[203] Richard Loebl, *Reporting & Disclosure Fees for 401(k) and Other Plans — Coping with the New Regime*, 2008 Joint Fall CLE Meeting (Sept. 13, 2008).

[204] U.S. Congress. House. House Education and Labor Committee. *H.R. 3185, The 401(k) Fair Disclosure for Retirement Security Act of 2007*. 110th Cong., 1st sess., 4 October 2007.

[205] *See DOL Proposes Fee Disclosure Amendment*, 17 401(k) Handbook Newsletter 9 (Feb. 2008).

blueprint,[206] Representative Richard Neal introduced H.R. 3576, the Defined Contribution Plan Fee Transparency Act of 2007,[207] on October 7, 2007, and Senator Tom Harkin introduced S. 2473, the Defined Contribution Fee Disclosure Act of 2007,[208] on December 13, 2007.

None of the plan fee disclosure bills introduced in the 110th Congress were enacted. Senator Harkin and Representatives Miller and Neal introduced substantially similar bills early in the 111th Congress. Specifically, Senator Harkin introduced S. 401, the Defined Contribution Fee Disclosure Act of 2009,[209] on February 9, 2009. Then, on April 21, 2009, Representative George Miller introduced H.R. 1984, the 401(k) Fair Disclosure for Retirement Security Act of 2009. Finally, just before this Article went to press, Representative Neal introduced H.R. 2779, the Defined Contribution Plan Fee Transparency Act of 2009, on June 9, 2009. This section will discuss this proposed legislation and the hearing held on H.R. 1984, the 401(k) Fair Disclosure for Retirement Security Act of 2009.

[1] S. 401, The Defined Contribution Plan Fee Disclosure Act of 2009

Senator Harkin's bill, the Defined Contribution Plan Fee Disclosure Act of 2009, combined aspects of the proposed section 408(b)(2) regulations as well as aspects of the proposed section 404(a)/404(c) regulations. Specifically, like the proposed section 408(b)(2) regulations, Senator Harkin's bill requires disclosure to plan administrators, and like the proposed section 404(a)/404(c) regulations, Senator Harkin's bill requires disclosures to plan participants. Senator Harkin's bill, however, goes beyond the requirements of the proposed regulations. Unlike the proposed regulations, the bill requires that all plan fees be broken down into four separate categories: (1) investment management, (2) recordkeeping and administration, (3) sales charges, and (4) other.

With respect to disclosure to plan administrators, the bill requires, among other things, that service providers disclose: (1) the services that will be provided,[210] (2) the entities that will be performing the services (including affiliated or third party providers),[211] and (3) the expected total annual charges — expressed either as a percentage of assets or dollar amount[212] — (broken down into four categories: (a) investment management, (b) recordkeeping and administration, (c) sales charges,

[206] *Id.*

[207] H.R. 3567, 110th Cong., 1st sess. (2007).

[208] S. 2473, 110th Cong., 1st sess. (2007).

[209] S. 401, 111th Cong., 1st sess. (2009).

[210] S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(1)).

[211] *Id.*

[212] S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(2)).

including commissions and charges for advisory services, and (d) other).[213] In addition, the service provider must disclose (1) any payments the service provider receives from unaffiliated persons in connection with the provision of services to the plan,[214] and (2) any financial or personal relationships with the plan sponsor, plan, or other service provider if the relationships result in a material benefit to the service provider.[215] Where services are provided to the plan without charge or at a discount, the service provider is required to disclose the extent to which consideration is otherwise obtained by the service provider by means of charges against the accounts of the participants or beneficiaries.[216]

With respect to disclosures to plan participants, the bill requires, among other things, that plan administrators provide plan participants with advance notice of the investment options under the plan,[217] including information about the investment objectives, risk level, historical return[218] and an investment comparison chart comparing the potential service fees[219] with a breakdown of costs into four categories: (a) fees that vary depending on the investment option, (b) fees that are assessed as a percentage of total assets regardless of the investment option, (c) administration and transaction-based fees, including plan loan origination fees, possible redemption fees, and possible surrender charges, and (d) other fees.[220]

[2] H.R. 1984, The 401(k) Fair Disclosure for Retirement Security Act of 2009

Representative Miller's bill, H.R. 1984, the 401(k) Fair Disclosure for Retirement Security Act of 2009,[221] is similar, though not identical to Senator Harkin's bill. Like Senator Harkin's bill, it would require disclosure to both plan administrators and to plan participants and would require that all plan fees be broken down into four separate categories.

With respect to the disclosure to plan administrators, the bill requires, among other things, that the service provider disclose (1) the services that will be provided and (2) the total expected annual charges — expressed as a total aggregate dollar amount,

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213 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(b)(1)).

214 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(c)(1)(A)).

215 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(c)(1)(B)).

216 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(e)).

217 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 112).

218 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 112(b)).

219 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 112(c)).

220 S. 401, Sec. 2(a)(2) (adding 29 U.S.C. Sec. 112(c)(2)).

221 H.R. 1984, 111th Cong., 1st sess. (2009).

although it may also be expressed as a percentage of assets[222] (broken down into four separate categories: (a) administrative and recordkeeping, (b) transaction fees, (c) investment management, and (d) other fees.)[223] In addition, the bill requires the disclosure of (1) any payments the service provider receives from unaffiliated persons in connection with the provision of services to the plan, including any payments received for including certain investment options as part of a menu of investment options,[224] and (2) any personal and financial relationships with the plan sponsor, plan, or other service provider if the relationship results in material benefit to the service provider.[225] Where services are provided to the plan without charge or at a discount, the service provider is required to disclose the extent to which consideration is otherwise obtained by the service provider by means of charges against the accounts of the participants or beneficiaries.[226]

With respect to disclosure to plan participants, the bill requires, among other things, that plan administrators provide plan participants with advance notice of the investment options under the plan,[227] including the investment objective, risk level, and historical return,[228] and a plan fee comparison chart comparing the potential fees[229] with a breakdown of fees into four categories: (a) fees that vary depending on the investment option, (b) fees that are assessed as a percentage of total assets regardless of the investment option, (c) administration and transaction-based fees, including plan loan origination fees, possible redemption fees, and possible surrender charges, and (d) other fees.[230]

In addition to imposing the disclosure requirements discussed above, the bill would also amend ERISA 404(c) to provide that a plan must include at least one low cost passively managed index fund in order to qualify for the 404(c) safe harbor.[231]

[3] H.R. 2779, The Defined Contribution Plan Fee Transparency Act of 2009

Representative Neal's H.R. 2779, the Defined Contribution Plan Fee Transparency

[222] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(3)).

[223] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(1) & (2)).

[224] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(6)(1)(A)).

[225] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(6)(1)(B)).

[226] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(a)(8)).

[227] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(b)(1)).

[228] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(b)(2)(B)).

[229] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(b)(3)).

[230] H.R. 1984 Sec. 2(a)(2) (adding 29 U.S.C. Sec. 111(b)(3)(B)).

[231] H.R. 1984 Sec. 3.

Act of 2009,[232] differs from Harkin and Miller's bills in that Neal's bill would impose disclosure requirements through an amendment to the Internal Revenue Code rather than through an amendment to ERISA. Substantively, however, Representative Neal's bill is not significantly different from the other two bills. Like Senator Harkin's bill and Representative Miller's bill, Representative Neal's bill requires that disclosure be made to both plan participants and plan administrators, and that bundled providers break down their fees.

With respect to disclosure to plan administrators, Senator Neal's bill requires service providers to provide (1) a detailed and itemized list of all the services to be provided under the contract,[233] (2) an estimate of total fees,[234] and (3) a schedule of any transaction charges the participants may face.[235] Bundled service providers must separate the fees charged under the contract into fees for investment management and fees for administration and recordkeeping and must disclose any amounts that will be paid to intermediaries or other third parties.[236] Service providers must also disclose whether they expect to receive payments from third parties in connection with providing services to the plan, and if so, must name those parties and the amount expected to be received from each.[237] Providers are also required to disclose whether they may benefit from the offering of proprietary investment products or those of third parties[238] and whether the investment products offered to the plan are available at other price levels.[239]

With respect to disclosure to plan participants, the bill requires employers to provide employees with two separate disclosures regarding plan investments and fees. First, prior to enrollment and once a year thereafter, the bill provides that for each of the plan's investment alternatives, the employer must disclose (1) the investment alternative's investment objective, risk and return characteristics, and investment manager,[240] (2) whether it is actively or passively managed, and the difference between these investment styles,[241] (3) its returns over the prior 1, 5, and 10-year

[232] H.R. 2779, 111th Cong., 1st sess. (2009).

[233] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(B)).

[234] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(d)(I)(A)).

[235] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(C)).

[236] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(d)(2)(D)).

[237] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(d)(2)(E)).

[238] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(d)(2)(F)).

[239] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980I(d)(2)(G)).

[240] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(ii)(I)).

[241] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(ii)(II)).

periods[242] in comparison to a benchmark,[243] and (4) fees and expenses in connection with the purchase or sale of interests in the investment alternative.[244] The bill also requires employers to disclose the annual operating expenses for each investment alternative and whether the fees pay for services beyond investment management.[245] In addition, participants must be advised about any separate fees that will be charged for plan administration[246] as well as a notice of any separate charges for other plan services.[247] In addition to the initial and annual disclosure described above, each quarter, employers must provide participants with information about the investments they have selected and the fees applicable to their accounts.[248] The quarterly notices must describe the investment alternatives in which the participant was invested and the percentage of the participant's account each alternative represented,[249] the risk and return characteristics of each alternative,[250] and whether the alternatives were actively or passively managed.[251] With respect to fees, the quarterly notices must describe the annual operating expenses for each investment alternative,[252] any sales charges for the alternatives the participant has selected,[253] separate charges for plan administration,[254] and any deductions for participant-initiated services.[255]

[4] Hearing on H.R. 1984, The 401(k) Fair Disclosure for Retirement Security Act of 2009

On April 22, 2009, the Subcommittee on Health, Education, Labor and Pensions of the House Committee on Education and Labor held a hearing on Representative Miller's H.R. 1984, The 401(k) Fair Disclosure for Retirement Security Act of 2009.[256] In his prepared opening remarks, Representative Robert Andrews, Chair of the House Subcommittee on Health, Labor and Pensions declared, "The lack of

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[242] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(ii)(IV)).

[243] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(ii)(V)).

[244] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(ii)(VI)).

[245] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(iii)).

[246] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(iv)).

[247] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(2)(B)(v)).

[248] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)).

[249] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(v)(I)).

[250] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(v)(III)).

[251] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(v)(II)).

[252] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(v)(IV)).

[253] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(vi)).

[254] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(ii)).

[255] H.R. 2779, Sec. 2(a) (adding 26 U.S.C. Sec. 4980H(e)(3)(B)(iii)).

[256] U.S. Congress. House. House Education and Labor Committee. *Rep. Robert E. Andrews Holds A*

transparency in the 401(k) system is unacceptable and must end now."[257]

There was general agreement among the individuals who testified at the hearing that there is a need for fee transparency. Agreement, however, ended there.

Some of the witnesses supported the bill's requirement that vendors break out fees for bundled services in a uniform manner rather than simply reporting the total cost. For example,[258] Alison Borland, a Retirement Strategy Leader with Hewitt Associates, declared that "Plan fiduciaries cannot fulfill their obligations without clear and concise fee disclosures from service providers."[259] She said that fees should be broken out for various services and disclosed in a manner that allows for ready and consistent comparison.[260] She pointed out that Hewitt found that unbundling fees helped one employer cut plan costs almost in half, from .30 percent of plan assets to .16 percent of plan assets.[261] She asserted that separate disclosure of investment management and administration fees is particularly important.[262]

Julian Onorato, CEO, Expert Plan, Inc., testifying on behalf of the Council of Independent 401(k) Plan Recordkeepers (CIKR), the American Society of Pension Professionals & Actuaries (ASPPA), and the National Association of Independent Plan Advisors (NAIRPA), also applauded the bill's requirement that plan fees be broken down and reported in a uniform manner. He contended that large vendors want to report a single fee for competitive reasons. If bundled service providers are not

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Hearing on the 401(k) Fair Disclosure For Retirement Security Act of 2009. 111th Cong., 1st sess., 24 April 2009.

[257] Chairman Andrews Statement At Subcommittee Hearing on H.R. 1984, 401(k) Fair Disclosure for Retirement Security Act of 2009 (April 22, 2009), available at http://edlabor.house.gov/hearings/2009/04/401k-fair-disclosure-for-retir.shtml.

[258] Kristi Mitchem, testifying on behalf of Barclays Global Investors, and Mercer E. Bullard, President and Founder of Fund Democracy and Assistant Law Professor at University of Mississippi, also favored the bill's requirement that service providers make specific disclosure, by fee category, in a clear and comparable manner. *See* Statement of Kristi Mitchem, Managing Director, Head of US Defined Contribution, Barclays Global Investors, N.A., Before the Committee on Education and Labor, U.S. House of Representatives , at 5–6 (April 22, 2009); Testimony of Mercer E. Bullard, President and Founder, Fund Democracy, Inc. and Associate Professor of Law, University of Mississippi School of Law before the Subcommittee on Health, Employment, Labor, and Pensions Committee on Education and Labor, U.S. House of Representatives, at 26–32 (April 22, 2009).

[259] Testimony on Behalf of Hewitt Associates LLC by Alison T. Borland, Retirement Strategy Leader, Before U.S. House of Representatives Committee on Education and Labor Subcommittee on Health, Employment, Labor, and Pensions Hearing on 401(k) Fair Disclosure for Retirement Security Act of 2009, at 4 (April 22, 2009)

[260] *Id.*

[261] *Id.* at 5–6 (referring to "Company X").

[262] *Id.* at 4.

required to break down the cost of services, they may claim that they can offer retirement services for free while independent service providers must disclose their cost of providing services. "Of, course, there is no 'free lunch,' and there is no such thing as a free 401(k) plan.... By breaking down plan fees into only three simple categories — investment management, recordkeeping and administration, and selling costs and advisory fees — we believe plan sponsors will have the information they need to satisfy their ERISA duties," Mr. Onorato said.[263]

Larry Goldbrum, General Counsel for the SPARK Institute, objected to the bill's requirement that fees be broken down and reported in a uniform manner. He asserted, "Not all fees fit neatly into categories and no single form or methodology can adequately address the diversity of products and service structures without favoring one segment of the industry over others."[264] He contended, "Market forces, industry best practices, the threat of litigation, and the threat of regulatory enforcement actions should drive industry behavior instead of legislative mandates. The SPARK Institute believes that ultimately the bundled versus unbundled disclosure debate is more about companies with different product structures, service models, product and service capabilities, and pricing structures debating about market forces and competition than alleged defects in disclosure of employer-sponsored retirement plan fees."[265]

Similarly, in a written statement, the ERISA Industry Committee (ERIC) also objected to a uniform breakdown of fees. According to the statement, "ERIC believes that the requirement to provide individual costs in specific categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract."[266] Moreover, ERIC contends that it would costly and unduly burdensome to disclose detailed costs and could "force the public disclosure of proprietary information regarding contracts between service providers and plan sponsors."[267]

Robert Chambers, testifying on behalf of the American Benefits Counsel, raised

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[263] Statement by Julian Onorato, CEO of ExpertPlan, Inc., on behalf of CIKR, ASPPA, and NAIRPA, Comments Presented to the Committee on Education and Labor Subcommittee on Health, Employment, Labor and Pensions, United States House of Representatives, 401(k) Fair Disclosure for Retirement Security Act of 2009, at 5 (April 22, 2009).

[264] Testimony of Larry H. Goldbrum, Esq., General Counsel, The SPARK Institute Before the United States House of Representatives Subcommittee on Health, Education, Labor and Pensions Regarding "401(k) Fair Disclosure for Retirement Security Act of 2009," at 3 (April 22, 2009)

[265] *Id.* at 4.

[266] Written Statement of the ERISA Industry Committee Before the U.S. House of Representatives Education and Labor Committee in the Hearing on The 401(k) Fair Disclosure for Retirement Security Act of 2009, at 4 (April 22, 2009)

[267] *Id.*

concerns about employers' liability. He noted that there has been a great deal of plan-related litigation lately and contended that employers should be protected against additional unnecessary litigation resulting from new disclosure legislation.[268] Among the specific concerns he raised was potential liability in the event an employer disclosed information provided by service providers that turned out to be inaccurate, and the possibility that employers might make minor, inadvertent mistakes in disclosures to participants.[269] Chambers asked that plan sponsors be protected from liability in such situations.[270] Chambers also questioned the utility of unbundling for purposes of disclosing costs to plan participants.[271]

Chambers and Goldbrum also questioned the bill's requirement that plans include a low cost passively managed index fund to qualify for limited liability under ERISA Section 404(c).[272] ERIC also objected to this requirement in its written statement.[273]

[5] Summary

At the time this Article went to press, three bills mandating greater disclosure of 401(k) plan fees had been introduced in the 111th Congress. All of the bills were similar, though not identical, and would require that bundled service providers break down their fees and disclose them in a uniform manner.

When hearings were held on similar bills in the 110th Congress, representatives of the DOL urged Congress to let the DOL improve disclosure through its regulatory projects rather than through legislation. Representative George Miller criticized the DOL's proposed regulations for permitting firms to continue to hide too many fees. Unlike the proposed legislation, the proposed regulations would not require bundled service providers to break down all fees.

It is too soon to tell whether any of the proposed bills will be enacted during the 111th Congress. Representative Miller has expressed a great deal of interest in seeing such legislation enacted. Whether he will succeed in light of the strong objections of large bundled service providers remains to be seen.

§ 17.05 CONCLUSION

Undoubtedly, 401(k) plan fees are important. Over a twenty year period, a one

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268 Testimony of Robert G. Chambers on behalf of American Benefits Counsel Before the Subcommittee on Health, Education, Labor and Pensions of the U.S. House of Representatives Education and Labor Committee for the Hearing on The 401(k) Fair Disclosure for Retirement Security Act of 2009, at 3-4 (April 22, 2009)

269 *Id.* at 4–5.

270 *Id.*

271 *Id.* at 5.

272 See Chambers Testimony, at 5–6; Goldbrum Testimony, at 5.

273 ERIC Statement, at 7–8.

percentage point increase in annual fees can reduce a participant's account balance by 17 percent.[274]

Moreover, there is universal, or almost universal, agreement that plan fees should be transparent. Consensus, however, ends there.

One of the most contentious issues in the plan fee debate is whether bundled service providers should be required to break their fees down. Not surprisingly, bundled service providers object to breaking down their fees. They contend that it would be costly and of little value. Critics, in contrast, assert that a uniform breakdown of fees is essential to permit a meaningful comparison between investment products.

Another significant issue in the 401(k) plan debate is the level of disclosure that should be provided to plan fiduciaries versus the level of disclosure that should be provided to plan participants. Notwithstanding the Seventh Circuit Court of Appeals's decision in *Hecker v. Deere*,[275] almost everyone agrees that selecting investment options is a fiduciary obligation, and plan fiduciaries should be provided with sufficiently detailed plan fee information to enable plan fiduciaries to compare plan fees in selecting investment options.

How much plan fee information should be disclosed to participants, however, is subject to considerable debate. Currently, plan participants pay most plan fees; yet most plan participants are unaware of the fact that they pay any plan fees. Critics of the current system contend that participants can and should be provided with detailed information about the fees they pay. Others argue that providing detailed information to plan participants would be costly and of little value. At best, participants would ignore the information; at worst, they would be paralyzed by too much information.

There is much truth to the SPARK Institute's assertion that at its very heart, the plan fee controversy is a dispute about the propriety of the business model underlying the current retirement system. The SPARK Institute asserts that the marketplace works to regulate service providers' behavior and ensures that services providers are not making undue profits from retirement plans.

While the market may limit service providers' profits, it is not clear that the market is really working. In its white paper, The Case For Employer-Sponsored Retirement Plans: Fees and Expenses, the Spark Institute declares that "the fees agreed to by employers who sponsor retirement plans and charged to American workers who participate in those plans are fair and reasonable *when considering all of the services*

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[274] *See* GAO Report, *supra* note 68, at 7 (noting that an individual account with a $20,000 balance and a net return of 6.5 percent per year will grow to about $70,500 in 20 years while increasing fees by one percentage point to reduce the net return to 5.5 percent per year will result in the $20,000 account balance only growing to $58,400 over 20 years.).

[275] For a discussion of the *Hecker v. Deere* decision, see Section 17.03[2] *supra*.

that are provided."[276] Its list of services commonly provided includes "record keeping — including 24-hour access to account information" and "phone/call center support with representatives available to assist participants for at least 10 hours per day."[277] Are those services, and other services not listed, such as daily investment transfers, really necessary? Would plan participants demand those services if they realized they were paying for them?[278]

Perhaps more importantly, and more fundamentally, 401(k) plan fees include the cost of employee education. If participants knew that they were paying to be educated on how to invest their plan assets, would they, and should they,[279] demand that we return to a system where experts invest retirement savings rather than requiring individuals to direct their own individual accounts?

Mandating full unbundled disclosure of plan fees could fundamentally change the retirement world as we know it. What would take its place, however, is not clear.

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[276] The SPARK Institute, Inc., *supra* note 19, at 5 (emphasis added).

[277] *Id.* at 7.

[278] Some legal experts and other expert fiduciaries have concluded modern services for individual account plans are sold to plan sponsors as a need to justify the platform that in turn justifies additional fees. Statistics show not only that these new costs place a heavy strain on participant accounts, but that participant-direction itself has proven to be a costly failure, hurting millions of future retirees.

Matthew D. Hutcheson, *supra* note 2, at 377.

[279] For arguments against participant-directed plans, see Hutcheson, *supra* note 2; Susan J. Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave Participants to their Own Devices*, 11 Cornell J. L. & Pub. Policy 361 (2002).