Money and You: Law firm takes corporations to task for high 401(k) fees

by Lynn O'Shaughnessy

Recently, I received an e-mail from a partner at a law firm that would make most human resources directors sweat.

The e-mail came from Jerome J. Schlichter, whose law firm, Schlichter, Bogard & Denton, used to be known for its railroad personal injury cases. But that was before the firm got into a promising new source of litigation that offers more low-hanging fruit than a Sunkist orchard. Last fall, the firm began suing Fortune 500 corporations, contending that the employers are foisting 401(k) plans with excessively high fees on their unsuspecting employees.

In a column last fall, I mentioned the class-action suits filed against such corporate Goliaths as International Paper, Northrop Grumman, Caterpillar, Bechtel Group, General Dynamics and Kraft Foods. Obviously, the corporate defendants have tried to squash the lawsuits. But on March 29, a federal judge in Illinois ruled against Kraft Foods, saying the workers' allegations "easily withstand scrutiny."

Companies, which have been blase about their 401(k) fiduciary duties, should be sweating. The legal skirmishes should only grow more fierce when trial attorneys begin seeing successes. But the momentum isn't only emanating from courtrooms. In a long-overdue move, the U.S. Department of Labor intends to require 401(k) providers and workplaces to improve their fee disclosure. What the government is especially keen on exposing is the indirect compensation generated from workers' accounts, which is essentially passed under the table by such 401(k) players as mutual fund firms, annuity providers, stockbrokers, insurance agents and workplaces.

Meanwhile, a congressional committee recently chaired by Rep. George Miller, D-Calif., carried this provocative title: "Are Hidden 401(k) Fees Undermining Workers' Retirement Security?" I'll give you one guess on what the committee concluded.

Nobody would be picking on corporations and the 401(k) industry if the stakes weren't so high. About 50 million Americans possess 401(k) accounts that collectively contain about $2.5 trillion. That sounds awfully impressive, but the average worker in the private sector has only socked away $28,000.

It's easy to see how American savers have been hoodwinked. When we witness a car wreck, we call 911. If our wallet is stolen, we call the credit card companies. When a 401(k) is gouging us, we ... oh wait, we do nothing. We don't get indignant because the financial hemorrhaging doesn't leave bloody shoe prints. To the naked eye, our 401(k) statements look as dull as an accountant's tie.

Part of the complacency can be attributed to this fact: You don't receive a bill for the costs that somebody is incurring for keeping your 401(k) up and running. Instead, the money is regularly withdrawn from your account, which certainly cuts down on people's curiosity about what's going on. And what's going on is this: The expenses passed along to workers can have absolutely no connection to what the costs actually are. One of the culprits is the bundled 401(k) phenomenon. A package of 401(k) mutual funds for a workplace is routinely assembled to generate so much money that it pays for the investment costs, as well as record keeping and other expenses.

Record keeping, however, is a relatively minor fixed cost that won't go up much every year. Yet as workers pour more money into their accounts, the money generated for this and other fixed costs can soar. A guy who has $100,000 in his 401(k) that charges 2 percent will pay $2,000 for the year, which will be $1,800 more than the guy in the next cubicle, who has only saved $10,000. And yet the services they receive are identical.

Workers, who are stuck investing in annuities within their 401(k) plans, are typically gouged even worse, and it's much harder to find out what the fees are because the insurance industry doesn't have to abide by the same disclosure rules required of mutual fund companies. Insurance fees are typically only revealed in annuity contracts signed by employers.

It's easier to grasp the 401(k) bamboozle by looking at a workplace example provided by Stephen J. Butler, the president of Pension Dynamics Corp., a 401(k) administrative firm, who testified before the House committee during its March hearing. He examined what the fees ideally should be for an engineering or other professional firm with 50 employees that has amassed $3 million in 401(k) assets. He estimated that the annual record keeping and compliance costs would break down to about $130 per employee. When you add in the actual cost of money management, the total plan's yearly cost would be $7,800. But the typical 401(k) vendor would charge this firm $36,500 and some providers would charge $60,000, which represents 2 percent of assets. It's the workers who are shouldering these outrageous fees.

Butler suggests that excessive fees over the past 20 years have reduced the average 401(k) account balance by 15 percent. As awareness of the 401(k) rip-off is beginning to reach workers, Schlichter's law firm appears to be spinning an even wider web. According to Pensions & Investments, a trade publication, the firm has used newspaper ads to encourage workers from other major corporations, such as Motorola, MetLife, AT&T, Bank of America and Merrill Lynch, to share their experiences with their own 401(k) plans. My suggestion to employers is to take a good, hard look at their workplace plans before somebody like Schlichter does it for them.

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