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Workers Come Out Winners Even After 401(k) Lawsuits Are Losers

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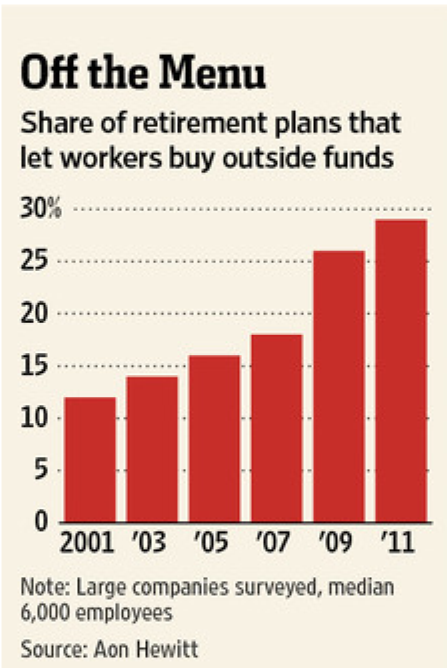
Few workers are happy with the performance of their 401(k) plans in recent years but how much blame should be placed with employers?

Not much, according to recent court rulings in which companies including Bank of America Corp., Exelon Corp. and Unisys Corp. racked up legal victories over workers who contended their retirement plans steered them toward costly investments.



But the litigation is having ancillary effects: Experts say the cases are prompting employers and regulators to reshape 401(k) plans to provide more investment choices and better disclosure about fees.

The recent court rulings are the most high-profile to date in the roughly three dozen lawsuits filed over the past several years challenging 401(k) plans, the main retirement vehicle for millions of Americans that collectively hold $3 trillion in assets.

The cases typically hinge on the way 401(k)s are packaged and marketed. In many plans, companies hire an outside investment firm to run the plan. Instead of being paid directly, those firms take a cut of the fees associated with the investments. Critics charge that those arrangements obscure—and ultimately inflate—costs for workers.

The suits can hinge on seemingly small differences in investment fees, generally amounting to one percentage point or less of investment balances each year. But because of the large dollar amounts in 401(k) plans and the decades employees spend saving, there can be millions in profits at stake for fund firms, according to court documents, and a sizable chunk of workers' retirement nesteggs.

Employees of Edison International won a victory last year when a federal district court sided with workers claiming that the company's 401(k) fees were excessive. And the recent court losses haven't discouraged new suits. Indeed, in one high-profile case, Ameriprise Financial Inc., itself a company that sells financial advice, is facing a lawsuit accusing it of favoring its own funds in its 401(k) plan over investments with better track records.

Some legal experts believe conflicts between the Edison ruling and more recent ones foretell a protracted legal battle. "Eventually the Supreme Court will get involved," predicts Boston-based lawyer Marcia Wagner, who specializes in employee-benefit law.

Edison, which has appealed its case, says it is "committed to providing a wide array of high-quality investment options" in its 401(k) plan. Ameriprise called the suit it faces a "copy cat" and plans to "vigorously defend it."

Despite conflicting judgments, many in the 401(k) industry credit the recent lawsuits with helping spur a new set of Department of Labor disclosure rules targeting the same compensation arrangements.

Among changes being implemented next year: Plan packagers will have to tell employers how much they deduct from investment fees to run plans, making it easier for these companies to compare costs. Workers will also get charts designed to make it easier to compare fees among funds and evaluate administrative costs.

At the same time, many employers have begun to tweak plans voluntarily. The number of large 401(k) plans that offer investors access to a "brokerage window," which gives workers a wide range of mutual funds in addition to those on the plan's menu, climbed to 29% this year from 26% in 2009, according to a biennial survey by pension consultant Aon Hewitt. Plans have also been adding index funds, especially in areas beyond large-company U.S. stocks like fixed income and international stocks, Hewitt finds.

The index fund "influx is not just because of the cost, but because of the lawsuits," says Hewitt analyst Pamela Hess. "Because they are cheap, nobody can say you are doing the wrong thing."