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AN OPEN LETTER TO THE 401(k) COMMUNITY

July 29, 2013

In the last several weeks, 6,000 sponsors of 401(k) plans received letters from a Yale law professor that many have read as inflammatory and threatening. The letters assert that the plan sponsor may have breached its fiduciary duties or is operating a "potentially high cost plan," but they are based on outdated and incomplete information. They fail to take into account the focus on fees and expenses that has resulted in reduced costs in many plans in recent years.

Many of the letters say that the sponsor's plan is "worse" than thousands of other plans, and say that the findings will be released to major newspapers and disseminated via Twitter with a hashtag for the particular plan. (In light of adverse publicity, we understand the professor has backed off this position.)

We have reviewed a number of the professor's letters as well as the report of his study. Based on our work for plan sponsors, as well as recordkeepers and other service providers, our conclusion is that plan sponsors should not rely on his letters and study. Instead, they should engage in a prudent process to evaluate the services to their plans and participants, the compensation of service providers, and the costs of those services as well as the costs of the plan's investments.

Our analysis is explained in the memorandum that accompanies this letter. The key points in the memorandum are:

- In our experience, most plans are well-managed. Fiduciaries generally take their jobs seriously and act prudently in selecting services and investments and in managing costs. This observation leads to a mathematical anomaly: if we assume that 80% of plans are prudently managed, the fiduciaries of a plan in the 70th percentile are acting prudently. (We are not suggesting that 80% is the correct number; perhaps it is 70% or some other percentage, but the concept is the same.) On this basis, suggesting that the fiduciaries of a plan with costs above the median are breaching their duties is incorrect, just as it would be incorrect to suggest that out of 1,000 Yale professors, 500 are "below average."

- The analysis does not take into account plan design variations or the type, quantity and quality of plan services. Fiduciaries are not required under ERISA to obtain the lowest cost, only to ensure that plan costs are reasonable in relation to the services provided. Often those services help participants achieve a better retirement outcome.

- The data is for the 2009 year; as a result, it is outdated and stale. Much has happened since then. Many plan sponsors, either following their receipt of the ERISA 408(b)(2) disclosures from "covered service providers" or in anticipation of receiving

them, have already reduced plan costs from 2009 levels. For these plan sponsors, the letters and analysis are moot.

- Some of the data is from 5500 filings. As the Government Accountability Office has reported, the 5500 was not intended to be a comprehensive database of plan fees, and it is difficult for plan sponsors to use 5500 data for that purpose. It is also common knowledge in the retirement industry that the integrity of data on 5500's is, in many cases, suspect. As our memorandum documents, the use of 5500 data can produce inaccurate or misleading results.

- The analysis of fund fees is based on index funds. A plan consisting only of index funds that do not pay revenue sharing would benchmark well under the professor's methodology. However, it is commonly accepted that the use of actively managed funds is prudent. In addition, the study does not fully consider revenue sharing. Revenue sharing – which is sourced in the expense ratios of plan investments – is used to reduce the costs that would, in most cases, be paid out of the plan and charged to participant accounts. As a result, if the mutual funds did not pay revenue sharing, service providers would add a charge to plans for recordkeeping and other participant services; either way, participants would pay for these services.

In our opinion, the letters and study do not support the assertion that plan sponsors are breaching their duties under ERISA. That said, plan sponsors do have a fiduciary duty to prudently monitor plan and investment expenses. If they have not compared their costs to market data in the last two or three years, they should do that now...particularly in light of last year's 408(b)(2) disclosures.

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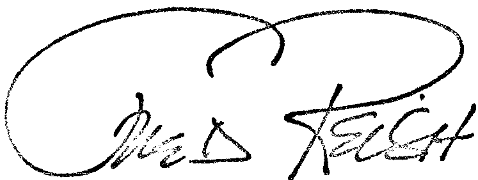
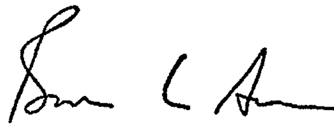

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