

Rise In 401(k) Lawsuits: Understand Your Plan



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Personal Finance

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401(k) lawsuits are on the rise, with a record number of lawsuits in 2020. Hefty fees, expensive options with low returns, limited investment options, and draconian terms attached to the 401(k) plans all characterized the proposed class-action lawsuits. As this trend continues in 2021, it is important to understand the basis of these lawsuits, and what to look for to ensure your plan is benefiting you.

Multimillion-Dollar Settlements

The number of Employee Retirement Income Security Act (ERISA) lawsuits in 2020 doubled the number of ERISA lawsuits in 2018 and had an 80% increase from 2019. Last month, CDI Corp. in Philadelphia was ordered to pay \$1.8 million to settle a class-action

lawsuit that claimed there was no system to evaluate its 401(k) plan's investment options, leading to plans only offering actively managed, expensive funds. This settlement benefited more than 4,000 people covered by the \$247 million retirement plan.

CDI Corp. joins a growing list of firms facing proposed class actions lawsuits by retirement plan participants decrying the exorbitant fees. Several employers, such as Cerner Corp. and Quest Diagnostics, have been sued multiple times over plans being too expensive, and companies like Russell Investment Management, LLC continue to be sued over poor-performing 401(k) plans.

More than 90 class-action lawsuits challenging 401(k) fees were successfully launched in 2020. Most firms have agreed to multi-million-dollar settlements in response to proposed class-action lawsuits.

The Lawsuit Factors

According to Bloomberg Law, the trend of 401(k) lawsuits can be accredited to the maturing body of law under the Employee Retirement Income Security Act, new tools available to plaintiffs' attorneys, and the COVID-19 pandemic.

New databases and advisors have developed revolutionary ways to investigate the true fee levels of retirement plans. Previously, it was challenging to uncover the fee levels associated with retirement plans. Now, plaintiffs' lawyers have access to innovative tools that reduce the information asymmetry to help them lodge potent complaints with higher merits. The plaintiffs' bar is becoming more creative in gathering statistics and information.

The global pandemic is partially responsible for the recent uptick because it incentivized participants and retirees to take an even greater interest in their retirement savings. People began to make inquiries about their investment plans and their associated fees. Before the pandemic, an average of four 401(k) fee cases was being filed monthly. By the summer of 2020, at least a dozen suits were being filed per month.

401(k) Plan Investment Options

The proposed class-action lawsuits challenged the range of investment options, hefty fees, and the terms attached to the retirement plans. These factors offer insight into what makes an outstanding 401(k) plan.

The ideal retirement plan carries a diverse range of investment options, including low-cost stock funds, low-cost target-date funds, and several bond index funds. Some plans may include “actively managed” funds where a portfolio manager actively manages or trades the positions but frequently cannot match the performance of their correlated index. Be wary of a 401(k) plan with no low-cost funds because they might prove expensive in the long term.

Fee Structures

It is important to focus on the fee structure of a retirement plan, especially the expense ratio. The ideal expense ratio is 0.20% or less, while anything above 1% is indefensible and usually is representative of “revenue sharing”. Revenue sharing is defined as a deliberate overcharge at the expense ratio level used to pay the vendors of the plan such as a third-party administrator, record keepers, brokers, or financial advisors. These hidden overcharges come in the form of eroded returns and have been at the heart of a great deal of these 401k lawsuits. These fees are difficult to uncover and are typically buried deep within the Service Provider 401k Fee Disclosure Document, form 408(b)2.

A 401(k) plan with a total “all-in” fee, where total costs are expressed as a percentage of assets in the plan, between 0.50% to 1% is typically okay, depending on the size of the plan. The Department of Labor requires employers to monitor these fees and failure to do so is considered a fiduciary breach that can result in stiff fines and penalties. High expense ratios with revenue sharing fees built-in can lead to a significant negative impact on an individual's bottom line over the lifetime of the investment.

Understanding Your 401(k) Plan

Ideally, only the Internal Revenue Service should limit the amount of money you can contribute to your 401(k) fund. This year, for instance, you can contribute a maximum of **\$19,500** to your 401(k) and a further **\$6,500** in catch-up contributions if you're over 50 years old. Many people choose to max out their plans, but some companies tend to set limits lower than the IRS guideline.

Given that your financial future is dependent on retirement savings, it is imperative to understand every aspect of your 401(k) plan. A survey completed by the National Association of Plan Participants revealed that 42% of retirement plan participants believed there were no fees associated with their plans and 89% of participants could not calculate their plans' fees.

Consider asking questions to fully understand how the plan works before committing. **The fund's administrators should give a proper investor education to all employees to ensure confidence about the plan.**

Conclusion

The rate of companies settling 401(k) lawsuits indicates that companies have been enrolling their workers on flawed retirement plans. With these facts in mind, you should evaluate your employer-provided 401(k) on four merits: expense ratio, restrictions, investment options, and investor education. Addressing these factors can help you pick a retirement plan that enables you to build a generous nest egg for your golden years.

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