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Why Your 401(k) Is Worth Suing Over

Sometimes even employers or brokers who know better foist a bad 401(k)/retirement plan on their employees. When they refuse to change, it's time to take them to court.

The biggest reason to sue is over excessive fees: You could be getting ripped off in your plan. Expenses on mutual funds within the plans should be rock-bottom. You can buy an index fund of nearly every big U.S. stock for as low as 0.04 % a year (in the Schwab U.S. Large-Cap ETF). That compares to about 1 percent for the average stock mutual fund.

Yet brokers and middlemen adore 401(k)s. They can get rich over gouging employees with their onerous fees.

For example, Bloomberg Bloomberg News recently reported that brokers grabbed some $324 million from federal employees who transferred money from the government's ultra-low-cost Thrift Savings Plans into expensive IRAs. The cost difference, which will eat up retirees' nest eggs, is huge.

Stock mutual funds charge *50 times* more than the government plan, which charges an average 0.029 percent in annual average fees. That's 29 *cents* for every $1,000 invested, for those doing the math at home. The bitter part of this story? Federal employees could have left their money in the government plan and they would've been fine. Surprisingly the government did nothing wrong and has one of the best retirement plans in the country.

Another recent 401(k) outrage was exposed in a recent settlement between Fidelity Investments Fidelity Investments employees (who filed two class-action lawsuits) and the Boston-based mutual fund giant. (Disclosure: My 401(k) is held in a Fidelity account).

The Fidelity suit alleged "that instead of acting in the best interests of the Fidelity 401(k) plan and Fidelity employees who participated in the plan, Fidelity and certain of its officers chose high-fee Fidelity mutual fund products to benefit Fidelity. The evidence in the complaint indicates that Fidelity repeatedly added funds to the plan with little or no track record, the plan's fees are very high for a multi-billion dollar plan, and Fidelity has failed to follow sound fiduciary practices for multi-billion dollar plans."

According to the settlement agreement, Fidelity will pay its employees $12 million and revise its plan to make a broader selection of Fidelity funds available and some (cheaper) non-Fidelity products. The company admitted no wrongdoing in the suit. Here's Fidelity's response, submitted by company spokesman Vincent Loporchio:

"We provide our employees with a retirement program with a dollar-for-dollar 401(k) match of up to 7% of a worker's salary. This level of match is enjoyed by only approximately 2% of 401(k) plan participants nationwide. In addition, Fidelity has traditionally made annual profit-sharing contributions of at least 10% of each eligible employee's total compensation, which is added to employees' 401(k) accounts.

By the end of 2012 (our last public filing) the total assets in the plan were almost $10 billion – $9,989,230,736. Importantly, Fidelity contributed $466,841,355 for the year–and participants contributed $316,543,198.

We have funds, such as the S&P 500 index, with expenses of 5 basis points (now 2.5 bp). Nearly every type of asset class and fund style that exists is available in the plan.

We believe both lawsuits are entirely without merit. However, litigation imposes substantial costs and we determined that settling these cases is in the best interest of our employees and our business. Since the substantial majority of the $12 million settlement (after costs and expenses) will be allocated to Fidelity employees, we believe that it is better for our employees to receive that financial benefit rather than have the company expend a substantial amount on litigation."

Was Fidelity steering its employees into overpriced funds? Here's what ThinkAdvisor had to say:

" Filed in March 2013 in U.S. District Court in Boston, one of the suits claimed that Fidelity chose only high-fee fund options, exclusively from the Fidelity family of funds, for its 401(k) menu. It also claimed that Fidelity added funds to the plan with little or no track record, and that the overall fees per participant for a plan its size were exorbitant. The plaintiffs claimed total fees for the plan should have amounted to $550,000, when the actual cost to participants was about $15 million."

Should You Sue?

My best recommendation is that you pull together an employee group, compare your plan with similar 401(k)s on Brightscope and see how your program compares.

Then it's time to ask some questions:

* Does your plan offer the lowest-cost index funds?

* Does your fund menu cover U.S. and foreign stocks, bonds and real estate?

* What are the expense ratios on each fund? Your employer must disclose the percentages and how much it eats into your retirement fund.

* Are the fees excessive? My simple benchmark is that passive stock index funds should cost no more than 0.25% annually and even less for bond funds.

* How much are middlemen taking from your fund? All costs for recordkeeping, transfers and commissions should be disclosed. A glaring red flag is whether middlemen are getting revenue-sharing fees. That's money coming out of your pocket.

* You don't want any plan that's charging you "wrap fees" or commissions.

* Are there any conflicts in the plan? Even if your company is in financial services, they shouldn't exclusively offer you in-house funds.They can be the most expensive funds on the market.

* What "share classes" are you offered? Fund companies play this game with classes of shares they offer with letter designations to confuse you into paying fees. The cheapest "institutional" shares should be part of your plan. Even better are exchange-traded funds (without commissions).

All of the major mutual fund houses are furiously competing to lower annual expenses: See the offerings from BlackRock's BLK +0.16% iShares, Schwab, State Street's STT +0.28% SPDRs and Vanguard. So there's no reason to have overpriced funds in your plan. I invest in funds from all of these companies (exept for Schwab).

After having done your comparisons and found alternatives, approach your employer and ask them to act. If they are willing to improve your plan, their right response should be: "we will hire an

independent fiduciary consultant to revise the plan and find lower-cost funds." A fiduciary consultant is bound by law to find the best choices for your 401(k).

What if your employer ignores you or promises action and doesn't deliver? Call a lawyer. Since several employee lawsuits have been filed in recent years, you won't be alone.

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