3 ways to check if your 401(k) plan is wisely managed

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Is your 401(k) plan doing right by you?

That's a good question to ask now that Boeing has settled a nine-year-old class-action federal lawsuit filed on behalf of some 190,000 employees and retirees who accused the Seattle airplane maker of charging excessive investment fees to participants in the $44 billion Boeing Voluntary Investment Plan, the nation's second-largest 401(k) plan.

And it's an especially good question to ask given some of the incriminating statements made in the case, which trade publication BenefitsPro referred to as "notorious."

So what are some ways to tell if your plan is on the up and up?

How risky are the funds in your 401(k)? Plan sponsors are now required, per the Labor Department, to offer plan participants a core set of "plain-vanilla" funds, says Jason Roberts, the chief executive officer of Pension Resource Institute in Prairie Village, Kan. With a core set of funds, investors can create a well-diversified portfolio that also minimizes the risk of large losses.

And the good news is this: 401(k) plan sponsors are now offering participants on average — if you include so-called pre-mixed portfolios such as target-date and target-risk funds as one portfolio — 14 funds, according to an Aon Hewitt analysis of some 144 mostly large defined contribution plans. And the most prevalent asset classes are large-cap equity, international equity, intermediate-term bond and premixed (target-date and/or target-risk), according to Aon Hewitt.

But if your plan sponsor seemingly offers more sector/specialty funds than core funds you might want to ask your plan's fiduciary and investment committee the reasons why. Some 7% of plans surveyed by Aon Hewitt in 2013 offered sector/specialty funds; 25% offered REITs; and 39% offered company stock.

In the Boeing case, the plaintiffs argued that sector funds were too risky to be included in the 401(k); that having those funds on the menu led to a loss of retirement assets to employees and retirees, according to the Retirement Income Journal.

Yes, sector/specialty funds are likely fine if offered to sophisticated investors inside a 401(k) brokerage account, says Brooks Herman, the head of data and research at BrightScope, a San Diego-based research firm. But in the main, specialty/sector funds are probably not so prudent for the average and perhaps unsophisticated investor.

"If you feel like you don't have a sufficiently diverse menu of plain-vanilla asset classes, then I would be concerned," says Roberts. "One, I'm concerned about avoiding large losses in my account, and two, (not having a diverse menu) may be a signal that the plan sponsor is running the plan in a way that suits the business owner and not necessarily the rank and file."

While you’re at it, consider benchmarking your plan’s investment options against other 401(k) plans. FYI: A tool on BrightScope's website allows you to compare your 401(k) plan with industry averages.

Protect your nest egg: Rebalance your 401(k) to avoid risk

Does your plan sponsor monitor fees periodically? The case against Boeing was largely about fees. The plaintiffs alleged in a complaint originally filed in September 2006 that Boeing knowingly let the recordkeeper, CitiStreet, charge employees and retirees excessive fees, according to trade publication Retirement Income Journal.

What’s more, the plan’s fiduciaries apparently weren’t keeping such close tabs on those fees. “We did not monitor the fees or where they went to,” a Boeing fiduciary stated in a 2008 deposition, according to the BenefitsPro report.

To be fair, odds are better these days that your plan sponsor will disclose and monitor fees. The Labor Department now requires them to do so. And, it’s possible that your 401(k) fees won’t be excessive. Read: A Look At 401(k) Plan Fees.

Still, it’s a good idea to ask your employer how often they are reviewing the 401(k) plan’s investment and administrative fees. Plans are required to monitor fees periodically, says Roberts. That could mean just once every two or three years, but it might be enough if there haven’t been any major changes to the funds in the 401(k), or its service providers. Still, Herman says plan sponsors should be reviewing fees at least once a year.

Chris Carosa, the chief contributing editor of FiduciaryNews.com in Rochester, N.Y., also recommends asking whether your “plan sponsor eliminated all funds with conflict-of-interest fees — commission loads, 12b-1 fees and revenue sharing — from its investment options?"

Studies show, says Carosa, that funds with these conflict-of-interest fees underperform anywhere from 1% to 3% vs. funds without similar conflict-of-interest fees.

Does your plan engage in revenue sharing? Ask if your plan sponsor engages in something called revenue sharing, a practice that has advocates on both sides of the debate.

For his part, Carosa says it's best to avoid revenue sharing altogether. “It's one of the few highly unregulated territories of the mutual fund world, that is it's not a required fee disclosure on the mutual fund prospectus,” he says.

Don't let investment fees suck away your savings

Others, however, have a different view of the practice. “Revenue sharing is so ubiquitous that a participant should not view that in and of itself as a red flag,” says Roberts.

In the Boeing case, however, revenue sharing was a big deal. Especially since a fiduciary stated in a 2008 deposition that he “either didn’t know or didn’t care at the time” whether a CitiStreet fund charged 25 or 50 basis points in revenue sharing fees. A fiduciary also stated that he didn’t know “a sprigging thing about revenue sharing.” A basis point is a unit equal to one hundredth of a percentage point.

To be fair, you don’t have to become an expert on revenue sharing. But having a working knowledge could help you earn a greater return on your 401(k) investments.

According to Herman, revenue sharing takes two forms: Sub-transfer agency and 12b-1 or shareholder servicing fees. And these fees, according to a Plansponsor report by Fred Reish, “are paid by mutual funds to 401(k) providers who perform the recordkeeping function for 401(k) plans.”

According to Reish’s report: The fees “are charged against the mutual funds and thereby reduce the participants' investment returns and, ultimately, their benefits. The payments are intended to support transfer agent and shareholder servicing activities by the recordkeeper. That ordinarily would include keeping track of share ownership at the plan and participant account level, conveying information about the mutual fund to the plan and participants, and so on.” Read: Revenue Sharing: What Is It?

The real trick is defining the “reasonableness” of these fees. “And given the lack of transparency here, I don't have a good answer,” says Herman.

For his part, Roberts agrees that it’s not easy to compare investment and administrative fees when plan sponsors are engaging in revenue sharing. But plan participants and sponsors should try to determine as best they can the “value” they receive from the 401(k) service providers, says Roberts. “Fees, costs, in a vacuum are really meaningless,” he says.

If revenue sharing exists, Carosa says, “it's best to allocate such revenue sharing not to the plan directly, but directly back to the participant that is holding that fund that offers revenue sharing.”

This, he says, avoids having only revenue sharing fund holders pay plan expenses while non-revenue sharing fund holders pay little or no plan expenses.

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