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The New York Times | http://nyti.ms/1QyvF7v

BUSINESS DAY

Intel Lawsuit Questions Place of Hedge Funds in Retirement Plans

Fair Game

By GRETCHEN MORGENSON NOV. 20, 2015

“We push the boundaries.”

That’s how Intel Corporation, the respected Silicon Valley computing giant, describes its role as an innovator and creator of value for shareholders, customers and society.

But pushing boundaries in another area — oversight of its $14.6 billion employee retirement plans — is bringing Intel unwanted scrutiny. Big bets on hedge funds and private equity in those plans drew a lawsuit late last month from a former employee, Christopher M. Sulyma. He contends that these investments have increased risks and costs in the retirement portfolios, hurting plan participants.

The lawsuit against Intel and members of its board who oversee the plan’s operation and investments is the latest in an increasingly successful line of actions brought against companies offering 401(k) plans to their workers. These cases have argued that the retirement plans were being run in a manner inconsistent with fiduciary requirements.

While each lawsuit against a 401(k) plan sponsor varies, most involve high and often hidden fees levied on participants.

The case against Intel has a different twist. At its heart is this question: Should hedge funds, private equity portfolios and commodities be anywhere near a 401(k) plan?

For the professionals who run public pensions, these kinds of investments are ubiquitous. They are far less common in 401(k) plans, which are aimed at individual employees and typically limit investment choices to mutual funds that hold publicly traded stocks and bonds.

An Intel spokesman declined to comment on the litigation. But the company's approach to its retirement plan as laid out in the suit certainly was atypical.

For example, rather than hiring an outside firm to create a plan consisting of low-cost mutual funds, the nine portfolios in the Intel plan were devised by the company's investment committee. This committee, which included an Intel director and the company's treasurer, chose the specific vehicles, which included mutual funds, hedge funds and limited partnerships, that would be used to achieve plan participants' goals and determined asset allocations.

Earlier this year, Intel changed it operations, handing over the retirement plan oversight to AllianceBernstein. The heavy reliance on alternative investments appears to have continued.

The company has two main defined contribution retirement vehicles, the Intel Retirement Contribution Plan and the Intel 401(k) Savings plan.

The lawsuit contends that two groups of Intel employees paid higher costs and lost hundreds of millions in income they would otherwise have received investing in plain vanilla funds.

One group invested in certain Intel target-date funds. The other concentrated on Intel's Global Diversified fund, the asset allocation model that directed money to various vehicles and included an unusual cluster of hedge funds and other alternatives. Intel made inadequate disclosures about these instruments, the lawsuit contends, leaving participants unable to make an informed decision about "whether investing in these particular hedge funds and private equity funds was prudent."

Unlike many 401(k) plans that allow employees to choose their investments, the Intel plan often made those decisions for them. For example, until 2015, the lawsuit said, Intel employees in the Retirement Plan who were under 50 years old were automatically placed in the Global Diversified fund.

As a result, that fund was the sole investment available to "the overwhelming majority of participants" in Intel's retirement plan, the lawsuit said. By 2013, almost 37 percent of the Global Diversified fund's allocation was in hedge funds, private equity and commodities.

In addition, participants in the 401(k) savings plan who failed to make a selection were automatically enrolled in a target-date fund that corresponded with their ages, the lawsuit said. Many of these funds were also heavily invested in alternatives.

Back in 2005, Intel employees were in a plain vanilla plan, investing primarily in large-capitalization stocks in the Standard & Poor's 500. Then the company began diversifying into small-capitalization stocks, emerging-markets securities, fixed-income and alternative investments like commodities futures, hedge funds and private equity.

Recently, the investments in hedge funds and private equity have grown significantly.

Intel declined to discuss its approach to 401(k) oversight or to make available directors who monitored the investments.

But a March 2014 internal Morningstar report on the Global Diversified Fund said Intel's investment committee expected adding alternative investments would reduce volatility in the portfolio and generate higher performance.

The fund fell short of those goals, the report said. Its one-year return as of March 31, 2014, for example, was a full percentage point below its benchmark, according to the report.

Bill Parish, a registered investment adviser at Parish & Company in Portland, Ore., is a big fan of Intel and owns its shares for his clients. In an interview, he characterized Intel's retirement plan as "great" but said it would be even better if it jettisoned the hedge funds.

Last year, in an email to Andy D. Bryant, Intel's chairman, Mr. Parish expressed his concerns about those investments in the retirement plan. Mr. Bryant responded by saying he would forward the criticism to the appropriate Intel officials, according to the email.

"My perspective, regardless of whether it is prudent diversification, is it doesn't make investment sense," Mr. Parish said. "It would be better for Intel to eliminate hedge funds altogether because they don't meet the standard with respect to financial disclosure. They're too opaque."

Indeed, fund filings with the Labor Department indicate that Intel designated as difficult to value fully $1 billion of the $12 billion in fair value of overall retirement account assets at the end of last year. They are known in accounting parlance as Level 3 assets, and the stated value of these investments is based on significant "unobservable inputs," Intel said. In other words, the values are estimates.

Some are in vehicles that cannot be sold anytime soon. Around $830 million in plan assets consist of "nonmarketable limited partnerships" in real estate, energy and venture capital, fund filings show.

"These are closed-end funds, which are not eligible for redemption until a date in the future that currently cannot be determined," Intel's filings state. "The liquidation of these investments is likely to occur at different times over the next 10 years."

Gregory Y. Porter at Bailey & Glasser in Washington is one of the lawyers representing Mr. Sulyma, who remains an Intel plan participant. Mr. Porter said he believes the case is significant not only for Intel employees, but also as a warning for retirement account holders elsewhere who may be receiving calls from their brokers to invest in risky strategies involving hedge funds or private equity.

"We've seen a heavy marketing push over the past couple of years into what the industry calls 'liquid alternatives,' a mutual fund wrapped around a hedge fund or other illiquid investment," Mr. Porter said in an interview. "This might give people pause about investing in these products."

A version of this article appears in print on November 22, 2015, on page BU1 of the New York edition with the headline: 401(k) Plans That Wager on Danger.