Nationwide Settlement: One for the Books?

Marcia S. Wagner, Esq.

The proposed $140 million settlement in the case of *Haddock v. Nationwide*, relating to alleged fiduciary violations stemming from the receipt of revenue sharing is, by far, the largest and most substantial of its kind. The settlement was reached after more than 13 years of vigorously contested litigation which, at long last, was scheduled to go to trial in February 2015. While prior settlements in excess fee cases have ranged from $13 million to $35 million, the size of the *Nationwide* settlement needs to be put in context, because this was a not a case where the claim was being asserted against a single plan sponsor. Instead, the plaintiff class consists of the trustees of 24,000 ERISA covered plans that purchased Nationwide annuity contracts or invested through the Nationwide trust platform and were suing Nationwide as a plan provider. On average, the proposed settlement amounts to $5,833 per plan.

Negotiations for this settlement purportedly began in October 2014. In light of the magnitude of the settlement and the associated business implications, Nationwide probably began to think seriously about settling the case when, in January 2014, the Second Circuit Court of Appeals denied its petition to disqualify the district court's certification of a class. This raised the prospect of a long and expensive trial, the outcome of which could not be predicted.

The *Nationwide* case was originally filed in 2001 and alleged that Nationwide's revenue-sharing agreements with third-party nonproprietary mutual fund companies constituted breaches of Nationwide's fiduciary duties under ERISA which resulted in losses to the plans. After much struggle to get the two plaintiff groups (*i.e.*, the "group annuity investors" and the "platform users") certified as a single class for purposes of the litigation, the proposed settlement separates them and divides the proposed settlement amount as follows: $110 million to the annuity contracts subclass and $30 million to the trust platform subclass. These amounts include an, as yet, undetermined amount of expenses and attorney's fees. The proposed settlement sets a cap of $2 million on expenses and $49 million (representing 35 percent of the overall settlement) on attorneys' fees, but these amounts need to be approved by the court.

The case was generally about the revenue sharing that Nationwide received from nonproprietary mutual funds on its investment platform. The plaintiffs claimed that Nationwide was a fiduciary since it selected investment options for plan investment menus and reserved a "unilateral" right to replace investment options. They also asserted that Nationwide violated its fiduciary duties by not revealing the revenue sharing payments and stated that Nationwide engaged in prohibited transactions by arranging for these payments. In the settlement proposal, Nationwide continues to deny these allegations. The plaintiffs' claim that revenue sharing is a plan asset does not appear to be specifically addressed by the settlement. The district court's ruling that a plan asset is any amount, including revenue sharing, received at the expense of plan participants as a result of fiduciary status or the exercise of fiduciary authority remains controversial and has not been reviewed at the appellate level.

The proposed settlement also imposes extensive nonmonetary requirements on Nationwide in the nature of making changes to its business practices, particularly in the matter of disclosures of revenue agreements with mutual funds to be made to plan customers. Of course, under the plan-level disclosure regulations, which went into effect in 2012, providers must disclose this type of income to plan fiduciaries, so it is not clear how much of the disclosures mandated under the settlement are already in place.

One potentially new requirement in the proposed settlement relates to the procedure for changing investment options on Nationwide's investment platform. Nationwide offers a broad array of investment funds from which plan sponsors are able to construct investment menus for their participants. After the plan sponsor selects funds for the plan's investment menu, Nationwide, as is typical practice, retains the right to make changes to the funds selected. According to Department of Labor Advisory Opinion 97-16A, an insurer's ability to change the options available on its platform will not constitute the exercise of discretionary authority or control over the management of a plan or its assets necessary to make the insurer a fiduciary, provided the plan sponsor has the power to accept or reject any changes. Under the DOL opinion, ensuring that the final decision rests with the plan sponsor requires the insurer to provide at least 60 days advance notice of any proposed changes, make full disclosure of any fees (*e.g.*, revenue sharing) the insurer will receive as a result of the change, and give the plan sponsor a reasonable amount of time to reject the changes or terminate the arrangement. In other words, there would be a negative election by the plan sponsor, since silence would be deemed to be acceptance and, as a result, the proposed change would be considered to have been adopted by the plan sponsor.

According to the terms of the proposed settlement agreement, Nationwide will be required to notify plan trustees of any new investment option by mail or electronically. On the other hand, removal or

continued on page 9 ➤

➤ **Legal Update**
continued from page 3

substitution of an investment option that is not necessitated by the actions of a mutual fund requires 30 days advance "written notice" to be provided by Nationwide by mail or electronically. Further, Nationwide cannot implement a removal or substitution until it receives the plan sponsor's affirmative consent. Thus, Nationwide will not be able to use negative elections previously permitted by the DOL opinion under which Nationwide notifies a plan sponsor that it will take action unless it receives a response from the plan sponsor by a specified deadline.

After all of the 401(k) fee litigation, including the proposed *Nationwide* settlement, it should come as no surprise that plan fiduciaries are obligated to evaluate the amount and source of all compensation paid to a service provider and to determine whether such compensation is reasonable. As the *Nationwide* settlement emphasizes, the ability to change a plan's investment line-up by adding, removing, or substituting funds may confer fiduciary status if the plan sponsor does not have the final say on the change. Investment providers, such as Nationwide, must have the ability to manage their investment fund offerings to remain competitive. Plan sponsors rely on the ability of such providers to continually update and improve their investment options as a way of providing a valuable retirement plan for employees. Plan sponsors, however, should review their contracts with their service providers to be aware of the process an investment provider is to follow when modifying a plan's menu. ❖

Marcia S. Wagner is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or Marcia@WagnerLawGroup.com.