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Largest Ever ERISA Fee Settlement Reached

In a record setting \$140,000,000 settlement, Nationwide Financial, the third largest writer of 401(k) plans, has put an end to a class action suit alleging it received undisclosed revenue sharing payments from mutual funds in violation of ERISA. After defending the case for more than 13 years, the settlement brings an end to one of the original revenue sharing cases, and provides yet more guidance on what plan fiduciaries should do to protect themselves.

A Whale of a Case

In *Haddock v. Nationwide*, retirement plan clients alleged that Nationwide breached its fiduciary duty by keeping revenue sharing it received from nonproprietary mutual funds offered through their recordkeeping platform. The plaintiffs argued that the revenue sharing Nationwide received were plan assets that should have been returned to the plans, and that Nationwide's failure to disclose the refunds resulted in kickbacks, which are prohibited under ERISA. The lawsuit also claimed that Nationwide specifically chose to include nonproprietary mutual funds with high management fees in order to generate higher revenue sharing payments. Not only did the plaintiffs seek a full refund of the management fees, they also sought all profits Nationwide received from their plans.

After more than a decade of procedural jockeying, the case was on the way to trial. Seeing many other recordkeepers lose similar cases over the last few years, Nationwide ultimately determined they would settle the suit. The settlement itself presents some very interesting results. Not only is \$140,000,000 the largest monetary settlement in an ERISA fee case, but the \$51,000,000 in attorney's fees and court costs is staggering, evidencing how truly expensive it can be to litigate an ERISA case. As part of the settlement, Nationwide agreed to sweeping changes on its disclosure and fund selection practices, providing much more detailed disclosure of fees and revenue-sharing payments including detailed notices of fund changes. In addition, they will now provide the opportunity to transfer from certain investment products to products that credit the plan in the form of reduced asset fees.

Lessons Learned

At this point, revenue sharing should be on every fiduciary's radar. The U.S. Department of Labor and recent litigation are clear, plan fiduciaries are obligated to apprise themselves fully of the amount and source of all service provider compensation wherever it is derived, and must evaluate if that compensation is both necessary and reasonable. It is important to remember that it is not necessarily the outcome of the evaluation that is important, rather the documentation of the prudent process of how the decision to implement revenue sharing was made, and how those payments will be handled. Another important takeaway garnered from these cases is to be cognizant of the types of share classes your plan offers. Revenue sharing is commonly derived from retail share classes and while

ERISA does not preclude a fiduciary from selecting retail share classes, the courts have said that fiduciaries must at least consider institutional shares because of their significantly smaller expense ratios.

In the end, for many fiduciaries, revenue sharing comes down to making a choice between whether, and to what extent, the participants should pay the general expenses of administering the plan, and if the headache and risk of revenue sharing is worth it. Many fiduciaries believe that the expenses of administering a plan are essentially business expenses that should be absorbed by the employer, while others believe that the participants should pick up the costs. An emerging approach, and arguably the best from a fiduciary risk perspective, is to select mutual funds with zero revenue sharing and charge a per participant fee. This allows all participants to equally share in the costs of the plan administration and avoids the litigation risk revenue sharing presents. If you have not considered these issues or have any questions, please contact your Lockton Retirement Services Team.

Fiduciary Risk Management: Compliance Services
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