

MERCER

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July 24, 2007

Attention: Fee Disclosure RFI
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Ave, N.W.
Washington, DC 20210

Subject:

Request for Information on Fee and Expense Disclosures

Mercer is pleased to submit this response to the Employee Benefits Security Administration's request for information issued April 25, 2007 regarding fee and expense disclosure to participants in individual account plans (the "RFI"). Mercer is a leading global provider of a broad range of human resource advice and solutions, administering more than 1,000 defined contribution (DC) plans in the US with over 1.2 million participants holding more than \$56 billion in assets.

Mercer maintains a policy of pure fee transparency, which enables us to quantify to plan sponsors the costs associated with servicing a plan. Given that fee transparency is at the core of our business, we welcome the opportunity to respond to the DOL's request for information about participant fee disclosures.

Throughout Mercer's long history of administering DC plans, providing effective participant communications and education programs has remained a core part of our service model. Mercer's communications programs move participants along the path towards becoming active managers of their retirement plans.

Mercer recognizes the importance of timely and adequate disclosure of various fees to participants. Mercer wishes to offer EBSA the benefit of our experience with participant communications in proposing ways to provide effective disclosure to participants while providing employers maximum flexibility in how they comply with new disclosure requirements.

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The following are the major considerations we would like to share:

- **Common existing practices should be leveraged.**
- **Fee disclosure should be considered in context with important messages about saving.**
- **Fee disclosure is useful only in the context of broader investment information.**
- **Fee disclosure is most useful in the context of relative fees.**
- **EBSA should limit affirmative disclosure to information important to the investment decision process.**
- **EBSA should give plan sponsors maximum flexibility in the manner in which any required disclosures are made.**
- **EBSA should provide a realistic deferred effective date for any new requirements.**

Major Considerations

Common Existing Practices Should be Leveraged. EBSA should take into account common existing practices before mandating additional disclosures. Disclosure requirements that leverage existing practices will make it possible for plan sponsors and their service providers to achieve compliance on a more timely and cost-effective basis. We expect that, in general, any additional costs to comply with new disclosure requirements will ultimately be borne by plan participants.

As background, below is a description of fee and expense disclosures that Mercer currently provides in its regular course of servicing DC plans:

- Annual gross expense ratios for plan investments are available on plan websites.
- Some clients choose to provide quarterly performance summaries, including annual gross expense ratios, as part of their statement mailings.
- Fund prospectuses are provided to participants following initial investment and are also available for review online. Hard copies are available by request through our call center.
- For certain market segments, information on transaction-related fees, such as loan origination or distribution fees, is generally included in participant enrollment materials. Certain specific transaction fees are also provided when a transaction is requested. (For example, if a participant's investment exchange will result in the fund imposing a short-term trading redemption fee, the fee will be disclosed to the participant, through a "pop-

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up” box (for online transactions) or as a message from a voice-response system or call center representative (for phone transactions.) In addition, transaction-related fees that are incurred are reflected on the participant’s quarterly statement.

- If a plan sponsor chooses to pay for administrative expenses (such as recordkeeping fees) directly from participant accounts, those fees are shown as a deduction or withdrawal on each participant’s quarterly statement.
- Though not part our standard communications strategy, at the request of a plan sponsor, we prepare a communication piece detailing the types of fees that can impact a DC plan, including recordkeeping, investment, and participant transaction fees. This piece does not quantify actual costs other than transaction fees that may apply to that plan.

Fee Disclosure Should Be Considered in Context with Important Messages about Saving.

Fee disclosures are generally part of broader communications provided to participants to assist decision-making about participation in their employer’s plan. Significantly, these messages will not be limited to investment information but will often be directed at other important goals.

The most important message may be to encourage participation in the plan. With the growing reliance on individual savings as the means for funding retirement, increasing participation and contribution rates have been recognized as a crucial Congressional policy goal (evidenced, for example, by numerous provisions of the Pension Protection Act of 2006). This goal is shared by the employer community – a central concern of most Mercer plan-sponsor clients is low levels of plan participation, whether among certain population segments or at large. However, it is often a challenge to draw participants’ attention to plan communications given all that is competing for participants’ time and attention. Account balance information (provided on-line or via paper statements) and plan enrollment materials tend to get the most consideration. If, during the narrow window of participant attention, we do not encourage the act of saving – or worse, discourage savings behavior – information about investments quickly loses relevance.

Even among those already participating, messages about the importance of savings are crucial. The amount participants contribute to their DC plan has a significantly greater impact on retirement preparedness than how those savings are invested. So while a level of investment information is essential, it must be consistent with, and not undermine, the primary goal of promoting savings. It is our experience, widely shared in the industry, that too much information can lead to confusion and paralysis. Therefore, the depth of information provided to participants

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should not be so excessive as to compromise the main goal of increasing participant contributions.

Mandated fee disclosure must not contribute to the sense, felt by many participants, that saving for retirement is too complex and beyond their capabilities. In our experience, an overly complex enrollment package may intimidate and put off participants from even considering participation. Hence, any mandated disclosure must be easily digestible and not add appreciably to the length or complexity of communications that already serve a number of important, overall goals.

Fee Disclosure is Useful Only in the Context of Broader Investment Information. Modern portfolio theory suggests appropriate asset allocation is the main driver of a successful investment strategy. Our clients share our concern that new disclosure requirements might place an undue emphasis on fees and expenses, which in turn could lead to an overemphasis on fees in making investment decisions and subvert participants' goals for balanced portfolios.

Investment information provided to participants should first focus on the importance of diversification, and then on the characteristics of the investment choices available within the plan. The most relevant information for participants seeking to align their investments in this way includes the asset class, investment objectives and investment style for each investment option. Other major categories of investment information, such as performance, and fees and expenses, will be of varying relevance and importance to DC participants, depending on their circumstances.

For example, for participants with limited financial literacy and few investable assets outside their DC plan, performance and expense information provide little assistance in creating a diversified portfolio. This would be especially true in a plan with an investment lineup that, appropriately, has little or no portfolio overlap. The desired behavior for these participants would be to choose an allocation strategy appropriate to their personal profile and match the plan investments to this strategy based on relevant investment characteristics (with very little reference to fees). The obligation of the plan's investment fiduciary to ensure the expenses are reasonable provides these participants additional protection that their investments are suitable.

At the other end of the spectrum, for participants with retirement assets outside the plan and a higher degree of financial literacy, fund performance and fees become more relevant. In creating

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a balanced portfolio across all retirement assets, participants may choose to place more weight on a given asset class where an investment option carries a lower expense ratio, while de-emphasizing the same asset class in another plan. Expense information might also play a larger role where plans offer two alternate line-ups, one representing actively managed funds and another based on lower-fee index funds. These examples illustrate how fee and expense information can vary in importance as a driver in investment decision-making and how the interplay with other factors can be complex.

Any fee disclosure requirement EBSA considers should emphasize that fees are merely one factor – and probably not the most significant one – for selecting an investment allocation. Considering that plan sponsors have limited space and opportunity to communicate to participants, fee disclosure should not be so onerous to come at the cost of conveying other important investment information. As a specific recommendation, Mercer believes that disclosure of expense ratios should be sufficient and would be most effectively presented in tabular form along with investment performance information. This is a practice that Mercer currently employs.

Fee Disclosure is Most Useful in the Context of Relative Fees. Given the variety and complexity of fund arrangements, participants may not understand how management fees vary by type of investment. Even with a basic understanding, the average participant may not have a sense of what constitutes a reasonable expense ratio for a given type of investment. Our clients have expressed concerns that, faced with an undifferentiated listing of fees, many participants will gravitate towards the lowest-cost investment. If participants make investment decisions solely on the basis of fees as opposed to suitability, this could result in portfolios skewed toward capital preservation investments, generating returns insufficient for building a financially secure retirement. Such a trend would work against the provisions of the Pension Protection Act of 2006 and DOL proposed regulations on qualified default investment alternatives, which extend ERISA Section 404(c) protections to default investments that constitute a diversified portfolio.

In light of this, we believe that disclosure of expense ratios should include contextual information to promote more informed comparisons. This might include a general description of how expense ratios vary depending on the type and style of investment (for example, emphasizing how fees of actively managed funds are higher than index funds). A more complete basis for comparison, though more difficult to provide from a practical and user-friendliness standpoint, would be to include specific benchmarks, indicating the range and median of fees

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typical for each class and style of investment. Such specific benchmarking information not only provides context for evaluating fee information, but could also help shed light on situations where fee levels may be excessive. Any such disclosure should be considered in light of existing industry conventions for identifying and presenting benchmarks.

EBSA Should Limit Affirmative Disclosure to Information Important to the Investment Decision Process. In light of concerns expressed above about crafting disclosure in a way that promotes – and does not undermine – sound decision making regarding savings and investment, EBSA should distinguish between information that must be affirmatively provided to participants and information that must be available upon request.

An example of where this distinction should apply is the disclosure of payments from fund investment managers to administrative service providers for services provided to the plan on behalf of the fund (i.e., revenue sharing). Such fees are typically used by the administrative service provider to offset fees that it would otherwise charge the plan. It is essential that fees paid to each provider be reasonable in the aggregate. However, the details of *who* receives which portion of the expenses should not be required as an affirmative disclosure to participants – since that information would not impact the participants’ investment decisions. As the court stated in the recent decision in *Hecker, Duane, and Riggins v. Deere & Company et al.*, “In assessing the likely return on an investment the fees netted against the return are certainly relevant, but knowing the subsequent distribution of those fees has no impact on the investment’s value.”¹ As such, if EBSA mandates disclosure of this information, the responsible parties should be allowed to meet this obligation by making the information available on request.

EBSA Should Give Plan Sponsors Maximum Flexibility in the Manner in Which Any Required Disclosures are Made. It is Mercer’s practice to communicate with participants at many points across a range of media and formats. Depending upon factors such as participant population and plan complexity, we find that certain formats are more effective than others for conveying different messages and information. Accordingly, we would recommend that plan sponsors be given ample flexibility in determining how to provide any newly required disclosures. The following examples showcase both the need for flexibility, and the industry’s capability to address participant needs in various situations through messaging that combines printed and on-line media, rather than simply relying on one or the other exclusively.

¹ (W.D. Wisc. 2007)

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As described above, Mercer currently includes a mutual fund's annual gross expense ratio on participant websites. This data is generally updated on a monthly basis. Providing this data on the internet is cost-effective and ensures that the information is accurate and up to date. This becomes important when changes occur, such as the addition of a new fund or a change in a fund's expense ratio.

The creation and delivery of print enrollment kits or ongoing printed investment material incorporating performance and fee information (beyond regular quarterly statements) is not currently supported at Mercer as uniform standard practice. The cost of developing and distributing such materials is a significant impediment (typically requiring considerable manual processing). More importantly, these pieces can quickly become outdated, as expense ratios change frequently and performance data becomes stale quarterly. The information could quickly become inaccurate for participants not making decisions at the time an enrollment kit is first received. In addition, such materials make it more challenging for plan sponsors and providers to communicate changes to a fund lineup, which is a normal course of business for plan sponsors seeking to provide their participants with the best available investment options.

Instead, we suggest that, given the prevalence with which investment transactions are performed over the internet, on-line posting of expense ratio data should be considered a viable means of fulfilling disclosure obligations even where other general enrollment and investment information is provided in printed form. Where participants lack access or choose not to use the internet, they could be directed to contact the plan sponsor or service provider to receive a copy of the current expense and performance information. This manual back-up process, though costly at the individual level, is likely to be less costly in the aggregate, since it will largely be an exception to the on-line process. Moreover, internet usage correlates highly with those who may be most interested in obtaining the performance and expense information.

EBSA Should Provide a Realistic Deferred Effective Date for Any New Requirements.

Even if new requirements permit providers to leverage existing practices, any new disclosures are likely to require updates to systems and procedures as well as many standard communications. We ask that EBSA consider deferring the effective date of any requirements to account for these efforts, well beyond the typical 60 to 90 days following publication of final rules. Without knowing what the requirements might be, it is impossible for us to offer a reasonable estimate of the lead time needed for implementation. Accordingly, if EBSA proposes

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any new disclosure requirements, we respectfully suggest that the proposal include a request for comments from the provider community on the amount of time that would be needed to implement the proposed requirements (once they are in final form).

* * *

We appreciate the opportunity to share with you this information along with our comments and concerns. We would be glad to discuss any questions you may have.

Respectfully submitted,



Jeffrey M. Miller

President – Outsourcing