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403(b) PLAN FEE DISCLOSURES – ARE YOU READY?

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The continuously evolving ERISA 403(b) market which absorbed extraordinary regulatory change just a few years ago will again face game-changing new rules. Fee disclosures are the hot topic among plan sponsors, service providers and participants involved in ERISA-covered 403(b) plans. Starting July 1, 2012, service providers must provide detailed compensation disclosures to plan sponsors to ensure the service arrangement is "reasonable" under ERISA Section 408(b)(2). Then, starting August 30, 2012, plan sponsors must furnish detailed fee disclosures to participants to meet their fiduciary obligations under ERISA Section 404(a). Are you ready to comply? Have you considered the impact this will have on your current processes and resource needs?

WHAT IS CHANGING?

Plan committees and other fiduciaries have expanded responsibilities under both sets of rules:

- Vendor disclosures (408(b)(2)): Fiduciaries must ensure they receive the required information from all covered service providers, report delinquent disclosures to the Labor Department, then carefully review services, costs and potential conflicts of interest to determine whether contract terms are reasonable.
- Participant disclosures (404(a)): Fiduciaries must provide detailed communications about investment options, fees and expenses to participants who direct their own investments. Even if a recordkeeper or other vendor is preparing the participant notices, fiduciaries are ultimately responsible for notice content and timely delivery.

WHAT IS INCLUDED IN THE DISCLOSURES?

In accordance with Rule 408(b)(2) certain investment advisers, recordkeepers, consultants and other covered service providers must disclose their compensation to the plan's responsible fiduciaries. The reports must describe the services provided and disclose any direct or indirect compensation that the provider, an affiliate or a subcontractor reasonably expects to receive. The reports may be hard to decipher because of complications inherent in recordkeeping and revenue sharing arrangements.

Rule 404(a) requires plan sponsors to provide four main disclosures to participants on an annual basis.

- General plan disclosure: Identifies fund options and investment managers, explains how participants give investment instructions, and describes voting rights and transfer restrictions.
- Administrative expense disclosure: Outlines what fees may be charged to individual accounts for plan-wide services (beyond what's reflected in an investment's operating expenses).
- Individual account expense disclosure: Shows what fees may be charged against accounts for individual services, such as loan fees, investment advice fees and redemption fees.
- Investment disclosure: Provides a comparative chart of investment options that includes performance metrics, benchmark comparisons and fund fees.

In addition to these annual disclosures, participants must receive quarterly statements of the amounts actually charged to their account for plan-wide and individual services.

LIKELY IMPACT TO PROCESSES AND RESOURCE NEEDS

The extent to which plan fiduciaries are compliant with the new ERISA 404(a) rules will be dependent on their ability to coordinate delivery to all eligible participants working with current and legacy providers, and to verify the receipt and accuracy of the disclosure statements provided by their plan's service providers. (Certain legacy contracts frozen before 2009 may be carved out from the disclosure regime.) The new regulations will likely place renewed emphasis on the need for strong governance, heightening demand for services related to education, consulting, co-sourcing, and documentation.

IDEAS FOR CONSIDERATION

Consider consolidation: Most plan sponsors have already worked through vendor and fund consolidation as plans were established to replace individual contracts. But the new regulations should cause sponsors to consider further consolidation in the number of funds to make monitoring more manageable. Creating a segmented fund lineup (such as, core funds, supplemental funds, and mutual fund window) may also help. Fiduciaries may want to be cautious about mutual fund windows in the wake of recent Labor Department guidance that has stirred much controversy.

Analyze costs: Benchmarking analysis can be used on an ongoing basis by sponsors to ensure that the plan's participants are receiving optimal service at reasonable cost. Moreover, benchmarking can be used to monitor and evaluate all fees associated with the plan, including vendor fees, administrator fees and consulting fees.

Educate, educate, educate: It is imperative that fiduciaries educate themselves regarding the new rules and the implications related to them as there are stiff consequences if Labor Department rules are violated. At the same time, putting into place an employee education program to ensure that participants have a comprehensive understanding of the plan can be beneficial. However, education is only one step towards being fully compliant.

Focus on governance: Implementation of a strong governance structure is equally as important as education. Key questions for fiduciaries to consider include: Does it make sense to raise the oversight of the investment program to the investment committee, given their knowledge of investments? Should the committee look to engage a specialized consultant to review the plan? Who should the consultant report to? What level of expertise resides on the committee to address the issues at hand? How should the decision-making process be documented?

Coordinate with vendors: It is of utmost importance that sponsors receive timely reports from vendors for two reasons. First, a vendor's failure to meet its 408(b)(2) obligations would render a service arrangement unreasonable, exposing both the vendor and the fiduciary to liability for ERISA prohibited transactions. Second, fiduciaries need vendor input to meet their independent obligation to deliver accurate and timely disclosures to participants. Thus, strategic vendor coordination is essential. By developing comprehensive information-sharing protocols and compliance timetables, fiduciaries will be equipped to track incoming disclosures and other time sensitive material – not only to meet this summer's deadlines but also to meet disclosure and oversight obligations going forward. Coordination also offers the benefit of establishing expectations between the sponsor and vendor. Vendors furnish the sponsor with set delivery dates for disclosures and commit to a method of delivery as part of the coordination process.

Ask for help: Clearly the fiduciary responsibilities of the plan sponsor are substantial. Practical solutions exist to assist in simplifying the process.

For further information about how Mercer can help with your 403(b) plan challenges, please contact:

Sue Crosby
Partner
Tel: +1 212 345 9264
Email: sue.crosby@mercer.com
www.mercer-hammond.mercer.com

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your local Mercer office or visit our web site at:
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