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MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

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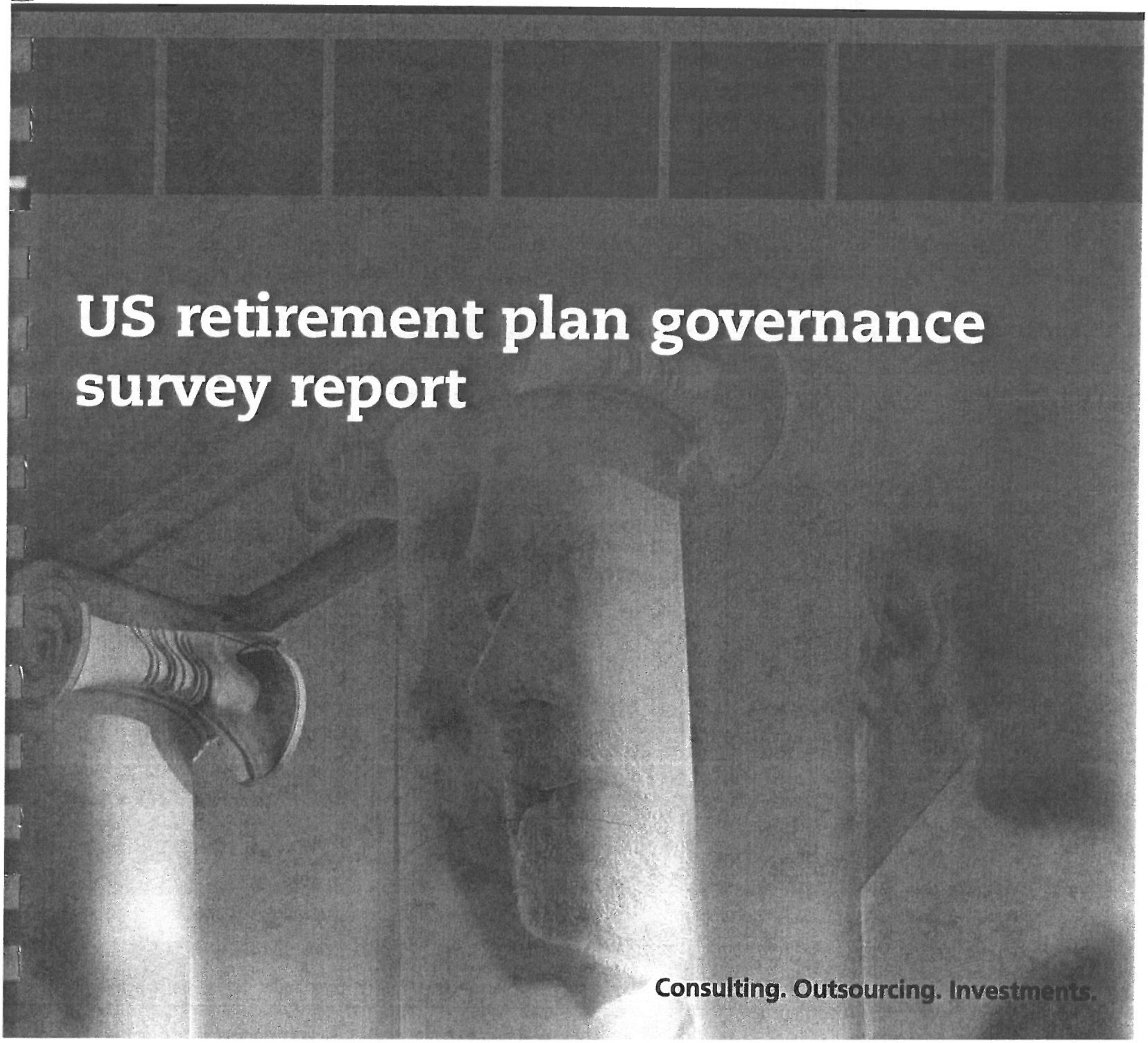
US retirement plan governance survey report



Consulting. Outsourcing. Investments.

Contents

1 Executive summary

Survey goal

Mercer is committed to assisting employers identify best practices in fiduciary risk management and develop their own risk management strategies. To that end, we conducted a survey of US retirement plan governance practices for both defined benefit (DB) and defined contribution (DC) plans. Plan sponsors and fiduciaries may find these benchmarks useful in assessing and shaping their own governance practices.

Key findings

- The committee structure is alive and well. A non-board committee with general oversight responsibilities was most often cited as the entity with primary responsibility for plan governance.
- Nearly a majority of respondents indicated committee members are appointed by the corporate board or board committee. There was a strong showing for CFOs as voting members of the plan committee, and a relatively low incidence of in-house general counsel serving as a voting member.
- In terms of process, plan committees seem to be on track. Most meet quarterly, keep minutes and operate under written charters.
- Fund performance, legal compliance and investment structure were identified as the most important areas of plan operation or performance to monitor.
- In contrast, monitoring appointed fiduciaries was not identified as high a priority. This raises particular governance concerns, as the Department of Labor (DOL) and federal courts have made clear statements that an appointing fiduciary has a duty to monitor an appointee's performance on an ongoing basis.
- Respondents generally have not removed corporate insiders from committee membership if plan assets were invested in employer stock. However, retaining an independent fiduciary does seem to be a consideration.
- Liberalizing diversification and performing a governance review were the most common changes employers have made in response to Enron and related "company stock drop" litigation.

Point of view

Today, retirement plan sponsors and fiduciaries are under unbelievable scrutiny. Several plan governance issues are high-target areas for participant litigation, including employer stock issues, vendor fee arrangements, fiduciary monitoring and oversight, appropriateness of plan investments and management of assets. Both the IRS and DOL have stepped up random audits and are taking more aggressive positions on retirement plan operations. In addition:

- Insurance premiums are escalating and renewals are more challenging.
- Poor or ineffective governance structures can lead to costly inefficiencies and redundancies with respect to the plan and its operations.
- Poor investment performance will result if the plan's fund line-up isn't rigorously monitored and managed.
- The company and its fiduciaries may be subject to bad publicity and employee distrust stemming from governance failures and damaging media overload on the issues.

The financial exposure facing the company and its officers, directors, managers and staff is real and substantial. These individuals will be held accountable to ensure that the plan is operated according to ERISA's strict fiduciary duties; investment alternatives are prudently selected and monitored; fees are reasonable and communicated effectively; relationships with service providers are well managed and conflicts of interest are avoided; and required disclosures are timely made.

Mercer's point of view is clear: Effective retirement plan governance – with attention to both structure and process – is necessary to manage the risks inherent with offering qualified retirement plans in today's environment.

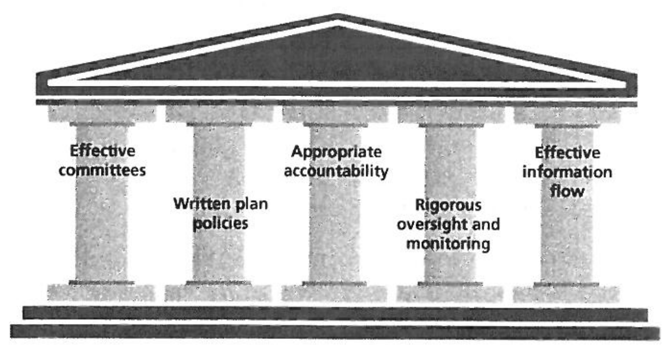
We define governance as the structure, process and controls around the design, management and operation of a retirement program, calculated to manage fiduciary risk and ensure proper delivery of benefits and compliance with applicable law.

An indispensable legal, financial and reputation risk management tool, good governance is a way to proactively:

- Reduce financial exposure from costly litigation brought by participants, beneficiaries and governmental bodies
- Lower personal liability risk to individual officers, directors and fiduciary committee members
- Provide better ability to demonstrate good faith action when undergoing governmental audit scrutiny or litigation
- Promote efficiency and consistency in benefit program administration and deployment of resources generating greater confidence in program integrity
- Facilitate more favorable terms for renewals of D&O and ERISA bonding/fiduciary/E&O insurance coverage
- Provide a path for better investment performance over the longer term

Best practices

Through research and extensive experience helping companies manage their retirement plans and mitigate risks associated with governance problems and fiduciary oversight, Mercer has identified a framework of best practices we present as the Five Principles of Effective Retirement Plan Governance™.



Effective committees
The decisions and activities of a retirement plan committee are crucial to maintaining the plan as an effective employee benefit, as well as to mitigate various risks around sponsoring the plans. A committee responsible for retirement plan administrative or investment oversight will typically be accountable for setting retirement plan policies, delegating and overseeing the performance of delegated functions, and hiring and monitoring the performance of service providers. To operate effectively, the committee members must establish common objectives, receive the appropriate level of training, and have the appropriate framework and processes in place for productive committee meetings.

Appropriate accountability
A clearly defined and documented accountability structure for retirement plan governance functions maps out who is responsible for the various duties pertaining to the retirement plans. With well-defined accountabilities, approvals are made at the appropriate level and tasks are more likely to be handled by someone with the required expertise, thus working toward the success of the plans.

Written policies
Well-run plans have formally documented policies covering topics such as selection and oversight of investment funds, ethical duties and conflicts of interest guidelines, plan funding and accounting, timely benefit communications, benefit design and administration. Policies should be sufficiently detailed so that they guide decision making. These policies generally cover aspects of operating a plan that are not covered or not sufficiently covered by the legal plan document, yet are just as important to successful risk management.

Rigorous oversight and monitoring
Effective governance requires rigorous oversight and monitoring of benefits administration, investment performance and operational compliance, and monitoring of the performance of the appointees who are responsible for those functions. Service provider costs and the quality of their services should be regularly evaluated, and action taken accordingly.

Effective information flow
All parties involved in the governance structure must have appropriate access to relevant, accurate and timely information. Clear lines of communication and reporting protocols must exist among the board of directors, any applicable board committees, non-board committees, plan administration managers, retained experts and advisors, and third-party administrators.

2 Methodology

Mercer contacts were invited to participate in an online retirement plan governance survey in September 2006. The survey invitation was included in a retirement "Update" that provided an overview of the top ten risks facing retirement plan fiduciaries.[1]

Survey design

The online survey was designed to gather information about a broad range of governance issues, addressing both structure and process. The questions were organized into the following sections:

- Respondent and plan characteristics
- Governance overview
- Plan committee
- Board committee
- Policy framework
- Accountability strategy
- Monitoring and oversight practices
- Participant communications

Data analysis

In this report, we summarize the responses, with selected additional analysis to explore certain issues (for example, those that present greater areas of risk) in more depth.

We received 336 individual responses representing 317 organizations. To ensure the integrity of the data and of our analyses, we removed duplicate responses, responses from additional individuals from the same organization, and from those who did not complete a significant portion of the survey questions. As a result, the total number of "qualified respondents" used in our data analysis is 265. Some percentages may not total 100% due to rounding. In the following analysis, blank responses were interpreted as a "no" or negative response where applicable.

In addition, certain questions were presented only to a subset of respondents based on their answers to earlier questions. In those cases, we indicate the total number of respondents per question. For questions that allowed respondents to choose as many answers as applied, we also indicate total number of respondents who answered the question.

[1] The Update was a mass mailing that went to approximately 3,000 companies in various industries, in both the public and private sector. Retirement Updates provide summaries and brief analyses of business-line specific news and developments.

3 Respondent and plan characteristics

The first survey questions collected **demographic information** about respondents.

The majority of respondents represented "for profit" companies. With respect to type of organization, the breakdown of responses is as follows:

Q 3: Type of company	Response total	Response percent
For profit	194	73.2%
Non-profit	52	19.6%
Governmental	13	4.9%
Church	4	1.5%
Not provided	2	0.8%
Total	**265**	**100%**

Just over 70 percent of 265 respondents indicated a **DB plan** was offered at their organization (Q 4a). The breakdown based on number of DB participants was:

Q 4b: DB participants	Response total	Response percent
Less than 1,000	40	15.1%
1,000 – 5,000	71	26.8%
5,000 – 25,000	49	18.5%
More than 25,000	29	10.9%
Not provided	76	28.7%
Total	**265**	**100%**

For the breakdown by total DB assets:

Q 4c: DB assets	Response total	Response percent
Under $75 million	56	21.1%
$75 – $249 million	46	17.4%
$250 – $999 million	47	17.7%
$1 billion and over	37	14.0%
Not provided	79	29.8%
Total	**265**	**100%**

Ninety-seven percent of 265 respondents indicated a **DC plan** (for example., 401(k), 403(b), or profit sharing) was offered at their organization (Q 5a). The breakdown based on number of DC plan participants was:

Q 5b: DC participants	Response total	Response percent
Less than 1,000	56	21.1%
1,000 – 5,000	102	38.5%
5,000 – 25,000	70	26.4%
More than 25,000	24	9.1%
Not provided	13	4.9%
Total	**265**	**100%**

For the breakdown by total DC plan assets:

Q 5c: DC assets	Response total	Response percent
Under $75 million	68	25.7%
$75 – $249 million	67	25.3%
$250 – $999 million	65	24.5%
$1 billion and over	48	18.1%
Not provided	17	6.4%
Total	**265**	**100%**

4 Governance overview and accountabilities

We asked several questions to get a picture of the overall retirement plan governance structure in the respondent organizations.

A critical question to consider in evaluating fiduciary responsibilities is which **person or entity is named as Plan Administrator** in the official plan document.

Q 6: Plan Administrator

	Response total	Response percent
Board-level committee	16	6.0%
Non-board committee	69	26.0%
Officer or manager of HR	44	16.6%
The Board of Directors	16	6.0%
The company	95	35.9%
Other	22	8.3%
Not provided	3	1.1%
Total	**265**	**99.9%**

The most prevalent answer was "The company." This is consistent with what Mercer has seen in older plan documents, but does not represent the current thinking on best practice.

The historical approach of naming the corporate employer as Plan Administrator may have been an attempt to shield individual directors and officers from liability. But in practice the strategy has been ineffective, with courts finding individual liability where an employee, officer, or director has, in fact, performed a plan fiduciary function.

The second most common response, "Non-board committee," represents a more contemporary risk management approach. In fact, "Non-board committee" was tied with "The company" as the most prevalent answer, if plan assets were invested in employer stock. Naming the committee as Plan Administrator clearly identifies the responsible fiduciaries and may be a more effective way of shielding individual officers and directors – who may not have a formal oversight role for the plan – from unintended liability. And courts have been known to look at whether the company is named as Plan Administrator in determining the extent of fiduciary liabilities. Some employers take a two-step approach to get to a similar result – the company may be named as Plan Administrator, with responsibilities specifically designated to a plan committee. But a clear and current written delegation will be necessary for this approach to be successful.

The survey asked respondents which **persons or entities played a role in exercising any authority or oversight for retirement plans**, and which person or entity played the ***primary* role in plan governance**. Here the results were more consistent with what Mercer would identify as best practice:

Q 7a: Persons or entities with any oversight role for retirement plans	Response total	Response percent
Full board	87	32.8%
Board committee	105	39.6%
Non-board committee with general oversight responsibilities	144	54.3%
Separate non-board committee/subcommittee for administration	82	30.9%
Separate non-board committee/subcommittee for investments	93	35.1%
Separate non-board committee/subcommittee for welfare plans	20	7.5%
Separate non-board committee/subcommittee for claims/appeals	32	12.1%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (261 respondents answered this question).

Q 7b: Entity with primary responsibility for plan governance	Response total	Response percent
Full board	29	10.9%
Board committee	54	20.4%
Non-board committee with general oversight responsibilities	125	47.2%
Separate non-board committee/subcommittee for administration	33	12.5%
Separate non-board committee/subcommittee for investments	18	6.8%
Separate non-board committee/subcommittee for welfare plans	2	0.8%
Separate non-board committee/subcommittee for claims/appeals	1	0.4%
Not provided	3	1.1%
Total	**265**	**100.1%**

"Non-board committee with general oversight responsibilities" was the most common answer to both questions. After that we also see a fairly even distribution among "full board," "board committee," "non-board committee for administration," and "non-board committee for investments" for entities with *any* role in plan oversight. But "board committee" was the second most common answer as the entity with primary responsibility (although that response was less common if any plan assets were invested in employer stock).

So a significant number of respondents indicated that the board or board-level committee does play a role in the oversight of the retirement plans. A few observations come to mind. First, in our experience working with organizations, we have seen a move toward better defining the role of the board. While some employers are looking for ways (both structural and procedural) to separate the board from day-to-day fiduciary responsibility with respect to the plan, other employers do choose to maintain a certain oversight role for the board or compensation committee (that is, a committee of the board).

For example, some employers choose to have the board or board-level committee appoint members of the administrative or investment committee that has primary responsibility for the retirement plans. The important thing to remember is that boards that exercise this appointment authority have an ongoing duty to monitor the performance of the appointees. Employers that choose this approach may have a smaller or flatter organization or may think that the very nature of the risks associated with retirement plan management – and the corresponding impact on the company's reputation and bottom line – in fact mandate some level of oversight at the board level. (In section 5, we take a closer look at committee appointments and the role of the corporate board.)

Appropriate accountabilities are a key component of an effective retirement plan governance structure. The survey asked whether **formal written delegations** were in place to document activities assigned throughout the governance infrastructure. As expected, the highest prevalence of written delegations was to service providers. But respondents also indicated they had written delegations in place with staff and appointed fiduciaries.

Q 16: Written delegations to service providers

	Response total	Response percent
Yes	164	61.9%
No	60	22.6%
Not provided	41	15.5%
Total	**265**	**100%**

Q 16: Written delegations to staff

	Response total	Response percent
Yes	108	40.8%
No	101	38.1%
Not provided	56	21.1%
Total	**265**	**100%**

Q 16: Written delegations to appointed fiduciaries (internal or external)

	Response total	Response percent
Yes	120	45.3%
No	85	32.1%
Not provided	60	22.6%
Total	**265**	**100%**

Setting appropriate accountabilities also involves making sure that responsibilities are allocated to individuals or entities with the right expertise. Most respondents have retained an **independent investment advisor** with no relation to the plan sponsor or recordkeeper (Q 17). And the percentages were similar for DC plans (64.7 percent of 241 respondents) and DB plans (69.8 percent of 192 respondents).

Regarding **how committee members are chosen or appointed**, nearly a majority of respondents indicated members are appointed by the corporate board or board committee.

Q 10a: Committee member appointment		
	Response total	Response percent
Appointed by board or board committee	130	49.1%
Named (e.g., by title) in plan document	26	9.8%
Appointed by Committee Chair	18	6.8%
Appointed by an officer of the corporation or other non-board individual	50	18.9%
Other	30	11.3%
Not provided	11	4.2%
Total	265	100.1%

The most prevalent written response indicated that committee members are appointed by the CEO. Respondents also wrote in that committee members are named by title in a committee charter or are voted on by existing committee members.

The high number of "board or board committee" responses raises particular governance concerns. In the past few years, the DOL and federal courts have made clear statements that an appointing fiduciary has a duty to monitor an appointee's performance on an ongoing basis. Often, board members are not aware that their appointing authority makes them fiduciaries to the plan and its participants. Responses to the next survey question suggest that over three-quarters of boards that appoint committee members also **monitor committee performance** (Q 10b: 78.5 percent of 130 respondents). However, boards would be well served to pay close attention to the frequency and diligence of the monitoring function. Receiving a cursory report once a year will not be as helpful to the board as more regular or more detailed updates, for example. While courts and the DOL have noted that an appointing fiduciary doesn't have to micro-manage the appointee, there must be procedures in place so that on an ongoing basis the appointing fiduciary may review and adequately judge whether the appointee is meeting its obligations.

In terms of process, it's important that the **schedule for committee meetings** match the committee's purpose.

Q 13: Meeting frequency		
	Response total	Response percent
Annually	15	5.7%
Monthly	17	6.4%
Quarterly	154	58.1%
Semi-annual	39	14.7%
Other	27	10.2%
Not provided	13	4.9%
Total	265	100.0%

For committees with oversight of DB or DC plan investments, a regular meeting no less often than quarterly is highly advisable, because that coincides with the availability of detailed investment reporting. However, more frequent meetings may be needed to deal with rapidly changing conditions. Meeting at least quarterly also has certain advantages under DOL regulations for committees (or subcommittees) that decide benefit appeals. ERISA plans with a named fiduciary that is a committee or board of trustees which holds regularly scheduled meetings at least quarterly may delay appeal decisions until the next board meeting following receipt of a request for review. The meeting schedule generally will depend on the number of benefit claims and the need (under plan or DOL rules) to process those claims on a timely basis. Although faster decision making is required for certain disability and health claims.

In an encouraging sign, over ninety percent of respondents indicated that plan committees followed the best practice of maintaining **minutes of their meetings**.

Q 12: Meeting minutes		
	Response total	Response percent
Yes	242	91.3%
No	12	4.5%
Not provided	11	4.2%
Total	265	100.0%

Minutes and other documentation of formal committee meetings can help establish a record to show that the committee has met its duties of prudence and loyalty, from both procedural and substantive standpoints. Of course, the committee should be sensitive to the fact that minutes may be reviewed by corporate auditors, governmental auditors, or adverse parties in litigation.

Roughly 76 percent of respondents report that there is a **written charter** setting forth the committee's responsibilities and authority.

Q 12: Written charters

	Response total	Response percent
Yes	201	75.8%
No	49	18.5%
Not provided	15	5.7%
Total	**265**	**100%**

An issue to consider – although not readily adaptable to a quantitative survey – would be about the *quality* of an existing charter. A written charter serves as a valuable resource for a governance committee – a way to document structure and responsibilities, and set out parameters to guide process and decision making. But a charter that's out-of-date, too short on detail, or too prescriptive can actually defeat the purpose and detract from effective plan governance.

The survey asked about the resources that committee members use for legal advice, and about how the members stay current on emerging issues. The most popular arrangement for providing **legal advice to the committee** is engaging outside counsel from the same firm that advises the plan sponsor. The second most popular response has the committee engaging outside counsel unrelated to the firm that advises the plan sponsor. This puts the committee – obligated to act in the best interests of participants, not the company, when performing fiduciary functions – in a position to show they sought and received independent advice.

Q 11: Legal advice to the committee

	Response total	Response percent
Legal advice is provided by in-house general counsel	45	17.0%
Legal advice is provided by in-house attorney other than general counsel	26	9.8%
Committee engages outside legal counsel from same firm that advises the plan sponsor	104	39.2%
Committee engages outside legal counsel from different firm than advises the plan sponsor	65	24.5%
None	15	5.7%
Not provided	10	3.8%
Total	**265**	**100%**

A healthy majority of respondents said they have **requirements or procedures in place to provide committees with informational updates on changes in law** or regulations. A little over one-third have procedures in place to provide **regular updates on fiduciary responsibilities** and one-quarter conduct **new committee member orientation** or initial training for new fiduciaries.

Q 15: Training and updates

	Response total	Response percent
New committee member orientation or initial training for new fiduciaries	66	24.9%
Regular updates on fiduciary responsibilities	104	39.2%
Informational updates on changes in law or regulations	168	63.4%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (183 respondents answered this question).

6 Policy framework

With respect to plan policies, survey responses indicate that prevalence of **written policies** – a key principle of effective plan governance – depends on the type of policy:

Q 14: Policies in place

	Response total	Response percent
Benefit design policy	79	29.8%
Benefits administration policy	93	35.1%
Defined contribution plan investment policy	188	70.9%
Defined benefit plan investment policy	153	57.7%
Payment of plan expenses policy	94	35.5%
Conflict of interest/ethics policy	122	46.0%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (243 respondents answered this question).

Q 14: Policies under consideration

	Response total	Response percent
Benefit design policy	24	9.1%
Benefits administration policy	15	5.7%
Defined contribution plan investment policy	28	10.6%
Defined benefit plan investment policy	15	5.7%
Payment of plan expenses policy	19	7.2%
Conflict of interest/ethics policy	14	5.3%

Note that respondents could choose as many answers as applied, so the sum of the response percents does not equal 100 percent (243 respondents answered this question).

Respondents report a fairly even balance between internal and external methods to assure **adherence to plan policies**.

Q 19: Adherence to plan policies

	Response total	Response percent
Internal audit of activities	142	53.6%
External audit of activities	158	59.6%
Other	12	4.5%
None	28	10.6%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (242 respondents answered this question).

The written responses to this question provided some specifics about other measures being used. For example, respondents say they rely on their DC provider, management oversight, or committee checks and balances to ensure policy compliance.

These responses suggest an opportunity to improve current practice. Having policies in place is important, but having policies that aren't followed in practice may be just as problematic as not having policies at all.

7 Monitoring and oversight practices

Governance litigation in recent years has brought monitoring practices to the forefront. According to survey respondents, committees or Plan Administrators identified the following **areas of plan operation and performance as the most important to monitor**:

Q 18: Monitoring priorities

	Response total	Response percent
Investment manager/fund performance	190	71.7%
Compliance with current law	148	55.8%
Investment structure and asset allocation	133	50.2%
Operational compliance and administration	91	34.3%
Service provider costs, performance, appropriateness	81	30.6%
Benefit competitiveness and adequacy	51	19.2%
ERISA Section 404(c) compliance	51	19.2%
Participant usage levels and indicators of satisfaction/dissatisfaction	40	15.1%
Appointed fiduciaries/delegated activities	33	12.5%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (245 respondents answered this question).

Not surprisingly, fund performance, legal compliance and investment structure were the top answers. There was a relatively low showing for monitoring of appointed fiduciaries/delegated activities. This is consistent with Mercer's experience, but unfortunately not consistent with best practice.

The survey asked whether certain events or practices had taken place in recent years and, if so, **whether participants received a written communication**:

Q 20: Event occurrence	Response total	Response percent
Change in fund investment expense ratio	96	36.2%
Change in fund manager structure	127	47.9%
Announcement of SEC investigation of fund	32	12.1%
Adoption of fund redemption fee (or other trading restriction)	104	39.2%
Action by plan sponsor against frequent trading participants	86	32.5%
Change in fees that affect participant accounts	82	30.9%
Action by committee to place a fund on "watch" or "probation"	108	40.8%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (211 respondents answered this question).

Q 20: Event communication	Response total	Response percent
Change in fund investment expense ratio	84	31.7%
Change in fund manager structure	101	38.1%
Announcement of SEC investigation of fund	32	12.1%
Adoption of fund redemption fee (or other trading restriction)	105	39.6%
Action by plan sponsor against frequent trading participants	85	32.1%
Change in fees that affect participant accounts	79	29.8%
Action by committee to place a fund on "watch" or "probation"	38	14.3%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (211 respondents answered this question).

8 Defined contribution risks and employer stock issues

DC Risks

Both **investment and mortality risks** are factors in the ultimate provision of benefits under DC plans.

The survey asked about the steps that respondents are considering to help employees cope with these risks:

Q 5d: Steps to address risk – being considered

	Response total	Response percent
Managed accounts (where the employer would have additional fiduciary exposure incident to selection of the third-party vendor)	39	14.7%
Annuity distribution options where the employer takes on more fiduciary exposure (for example, by actively engaging in providing the annuity investment option either as an ongoing investment choice or at termination/retirement)	19	7.2%
Annuity distribution options that should not add fiduciary exposure (for example, arrangements that allow participants to access a competitive annuity market through a third party)	51	19.2%
Employer managed investments (where employees would not be able to participant direct some part or all of their account balances)	15	5.7%

Note that respondents could choose as many answers as applied, so the sum of the response percents does not equal 100 percent (121 respondents answered this question).

Q 5d: Steps to address risk – in place

	Response total	Response percent
Managed accounts (where the employer would have additional fiduciary exposure incident to selection of the third party vendor)	36	13.6%
Annuity distribution options where the employer takes on more fiduciary exposure (for example, by actively engaging in providing the annuity investment option either as an ongoing investment choice or at termination/retirement)	16	6.0%
Annuity distribution options that should not add fiduciary exposure (for example, arrangements that allow participants to access a competitive annuity market through a third party)	15	5.7%
Employer managed investments (where employees would not be able to participant direct some part or all of their account balances)	11	4.2%

Note that respondents could choose as many answers as applied, so the sum of the response percents does not equal 100 percent (121 respondents answered this question).

The next survey question asked whether respondents had plans to deal with additional fiduciary exposure if any of the above steps were in place or under consideration:

Q 5e: Steps to address fiduciary exposure	Response total	Response percent
Change governance structure (for example, set up separate committee to deal with DC investments)	26	9.8%
Negotiate with service provider to accept fiduciary responsibility in contract	47	17.7%
Step up fiduciary education efforts for committee/plan administrator	47	17.7%
Increase levels of fiduciary insurance	9	3.4%
Appoint independent fiduciary to manage plan investment issues	14	5.3%
Hire an investment and/or subject matter expert to advise the plan fiduciaries	60	22.6%
Note that respondents could choose as many answers as applied, so the sum of the response percents does not equal 100 percent (96 respondents answered this question).		

Employer stock

One of the highest areas of risk – and most likely target for litigation – involves the inclusion of employer stock in a retirement plan that's subject to ERISA.

To set the stage, the survey asked whether any **plan assets were currently invested in employer stock**:

Q 8a: Plan assets in employer stock	Response total	Response percent
Defined benefit plan assets are invested in employer stock	16	6.0%
Defined contribution plan company match is made in employer stock	32	12.1%
Employer stock is offered as an investment option for defined contribution plan assets	74	27.9%
We offer an ESOP	23	8.7%
No plan assets are invested in employer stock	166	62.6%
Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (260 respondents answered this question).		

If respondents indicated that any assets are invested in employer stock, the survey asked several questions to learn what changes organizations may have made in response to the "company stock drop" cases that became the highest profile ERISA litigation in recent years. Numerous class actions lawsuits have been brought alleging employer breach of fiduciary duties with regard to employer stock held in 401(k) plans (for example, Enron, WorldCom, Global Crossing). A single stock fund represents an undiversified investment subject to sudden and dramatic market value fluctuations. If participants incur substantial losses as a result of plan investments in an employer stock fund, the actions of the plan administrator, the committee, and other potential fiduciaries (for example, corporate officers and directors) will be scrutinized for possible breaches of their duty to place the participants' interests ahead of the corporate interest.

Allegations of a fiduciary's perceived conflicts of interest can complicate and exacerbate ERISA claims involving employer stock funds. Participants have questioned whether a fiduciary's loyalty to the corporation overshadowed ERISA duties to plan participants. For example, did the perceived conflict cause a reluctance to divest the plan of employer stock when it was no longer a prudent investment option, or to disclose bad news about the corporation's stock? As a result, some employers have chosen to remove corporate officers from membership in the plan committee that oversees the employer stock fund in the plan. This type of change may make it less likely that a fiduciary committee member will be in possession of material inside information about the employer or its stock.

The first survey question on this topic produced interesting results. Over 60 percent of respondents indicated they had not removed and are not considering removing **corporate insiders (a.k.a. Section 16 officers) as committee members** (percentage based on 94 respondents – this question was asked of those who indicated that plan assets were invested in employer stock).

Q 8b: Removing corporate insiders on committees	Response total	Response percent
Removed corporate insiders as voting members	10	10.6%
Considering whether to remove corporate insiders	14	14.9%
Neither	58	61.7%
Committee did not include corporate insiders as voting members	7	7.4%
No committee in place	5	5.3%
Total	**94**	**99.9%**

This is not only at odds with best practice, but is also contrary to Mercer's experience with organizations. Certainly, many employers find that they may need to keep certain corporate officers as committee members to ensure the committee is staffed with people with the appropriate expertise. However, that's usually a decision that's made *after* considering the risk management pros and cons of having officers on the committee. Reviewing committee membership with an eye toward managing potential conflicts of interest is normally one of the first considerations for employers who offer employer stock as a match or an option for participant-directed investments.

Another curiosity came in response to the survey question about whether organizations **appointed or considered appointing an independent fiduciary** to monitor issues relating to employer stock in the plan (percentage based on the 94 respondents who indicated that plan assets were invested in employer stock).

Q 8c: Independent fiduciaries	Response total	Response percent
We have retained an independent fiduciary	11	11.7%
We're considering whether to retain an independent fiduciary	36	38.3%
We considered and rejected the idea	27	28.7%
Not provided	20	21.3%
Total	**94**	**100%**

A little over one-third indicated they are considering whether to retain an independent fiduciary, and over 11 percent said they already have. This is interesting for several reasons. First, regarding industry trends, many of the reported engagements where employers have retained an independent fiduciary to manage plan investments in employer stock involved employers facing certain distress situations – for example, bankruptcy or high-profile governmental investigations of alleged fraud or misconduct. Second, retaining an independent fiduciary can be a costly undertaking, and one that still leaves the employer in a position where potential conflicts of interest have to be managed.

For example, if a plan committee appoints an independent fiduciary, do the committee members have an obligation to share information with the independent fiduciary? What are the options if there's disagreement with the independent fiduciary's recommendations?

The responses of those who considered and rejected the independent fiduciary idea can be categorized into a few general groupings. Some respondents said they thought the level of employer stock in the plan did not pose a risk – for example, that the stock fund was frozen to new investments or was not a significant percentage of plan assets. Others cited focused communications they had issued or plan design changes that were under consideration as attempts to mitigate potential risks. And others indicated that retaining an independent fiduciary would not significantly remove the issues – as one respondent put it: "We don't see an independent fiduciary adding value to the plan or its participants and don't see adequate fiduciary protection for the committee." But the most common response was that respondents felt their existing governance structure and controls provided adequate protection.

The next survey question on employer stock took a closer look at some of the options employers may consider to mitigate risk. The responses were consistent with Mercer's experience with organizations and reflect the **changes employers have made in response to the Enron litigation** and related lawsuits (percentage based on the 94 respondents who indicated plan assets were invested in employer):

Q 8d: Changes following "company stock drop" cases

	Response total	Response percent
Clarified plan document provisions on company stock to reaffirm plan design/settlor nature of decision	14	14.9%
Eliminated company stock fund as a plan investment option	3	3.2%
Prohibited new contributions into company stock fund	4	4.3%
Performed governance review or periodic self-audit	27	28.7%
Liberalized diversification rules on elective deferrals	13	13.8%
Liberalized diversification rules on employer contributions	39	41.5%
Introduced a cap on how much stock individual participant could hold in plan account	7	7.4%
Other	16	17.0%

Note that respondents could choose as many answers as applied, so the sum of the response percents exceeds 100 percent (76 respondents answered this question).

Some respondents noted that they "always had liberal diversification rules" or already had a cap on amounts that could be held in an employer stock fund. Others indicated they changed a match from stock to cash, or lowered an existing cap or limited new contributions into an employer stock fund. Others are still considering options, including removing employer stock as an investment option.

This is also a reminder that effective plan governance is not just about process or procedure. Some of the options listed above are design in nature, but will serve to manage fiduciary exposure by managing the amount of employer stock in play.

9 Conclusion

We'd like to thank the many individuals who responded to our survey, representing plan sponsors and fiduciaries across a broad spectrum of US industries.

Mercer has an ongoing commitment to assessing emerging best practices in retirement plan governance and helping employers manager the risks associated with retirement plan operation in today's environment.

To learn more about how Mercer's governance and compliance team can work with you to reduce the risk of administering your retirement plans, please contact your local Mercer consultant.

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For further information, please contact your local Mercer office at:

1255 23rd Street NW
Suite 250
Washington, DC 20037
+1 202 263 3950

Or visit our website at:
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