A DISCUSSION OF DEFINED CONTRIBUTION PLAN FEES, ONE PLAN SPONSOR'S PERSPECTIVE

Reed Elsevier

Reed Elsevier, Inc.

Salary Investment Plan

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BACKGROUND

Reed Elsevier Inc. is the U.S. subsidiary of London-listed Reed Elsevier PLC and Amsterdam-listed Reed Elsevier NV. It is a leading provider of professional information solutions and data in the science and medical, legal, risk management and business to business sectors. Those in the U.S. may be most familiar with the Company's Lexis-Nexis division. Reed Elsevier's 401k plan has over 23,000 participants with approximately $1.4 billion in assets.

THE PROBLEM

Lack of transparency and resultant scrutiny around fees related to investments and investment products have plagued the U.S. retirement industry for a decade. To this end, special attention has been paid to defined contribution plan fees. These include payments made from assets of a plan for investment management services, 12b-1 fees, finders' fees and revenue-sharing arrangements.

Also under the magnifying glass: the disclosure of fees to employers and employees. Concerns on the level of disclosure, a matter looked into by the Department of Labor, swirl around the amount of fees, who pays them and how equitable the different payment methods are.

THE CASE STUDY

NEPC spoke with Lynn Formica, Director, Debt Capital Markets & Investments at Reed Elsevier Inc. Ms. Formica is a member of the Investment Committee responsible for the 401k Plan's investments and oversight, including fees. Formica, a 20-year company veteran, discussed with us changes the Company made to its 401k Plan in 2010. These include charging participants a direct fee to participate in the program (approximately $12.50 per quarter). Prior to the switch to direct fees, the Reed Elsevier Plan, like the majority of 401k plans, utilized funds which offered revenue-sharing as the primary means to offset the plan's administrative costs.

REED ELSEVIER, INC. SALARY INVESTMENT PLAN – BASED ON THE INTERVIEW WITH LYNN FORMICA

We asked Ms. Formica to walk us through the decision process to go to a per-capita approach.

Q. Lynn, can you tell us about your Plan and pricing, and the reasons for switching to a per-capita approach?

A. The Salary Investment Plan is the primary retirement benefit for Reed Elsevier's new hires. The Plan had good investments and competitive expense ratios, but perhaps too many funds. We wanted to simplify the investment choices for participants. We decided to move to a four-tiered approach comprising: i) a passive target date fund tier; ii) a passively-managed fund tier; iii) an actively-managed fund tier and iv) a brokerage window. At the time, we'd heard of only a couple of other companies doing this.

It came to our attention in the process of a record keeper search that there were funds in the Plan that had revenue-sharing arrangements that hadn't been disclosed to us fully, these were institutional funds without 12b-1 fees. As we dug deeper, we found that it was difficult to determine exactly what the revenue-sharing arrangements were. Given that we were interested in providing fee transparency to our participants, we decided to pursue the use of non-revenue-sharing funds. When we reached out to our fund managers, some of them offered such funds while others did not. As we looked at the impact of revenue-sharing on our participants it became clear that revenue-sharing wasn't equitable. Participants in different funds were paying very different percentages of their assets toward Plan costs. For example, the Plan had a large balance of assets in target date funds and these funds were paying one of the highest revenue-sharing rates in the Plan, while some other funds had zero revenue-sharing. This was not optimal or equitable.

It did take some convincing for the Benefits and the Investment Committee to move away from a revenue-sharing approach and agree to charge participants' accounts directly for record keeping. To illustrate the revenue-sharing problem, I did an analysis of participants with different account balances in the Plan (for instance, $10,000, $60,000, $100,000). Depending on assumptions of where participants with the same account balances were invested, one could pay anywhere from 0% to 0.37% annually towards Plan costs. On a $60,000 balance that translated to $0 to $186 a year, while the actual cost to record keep their accounts was closer to $50 per participant per year. It was clear that people in certain funds were paying more than their fair share of Plan costs.

In the end, everyone agreed that record keeping costs should not be paid through asset-based charges (pro rata fees). Record keeping fees are not driven by how large an account balance you have; they are driven by the cost of maintaining your record - making that cost fairly easy to quantify. Therefore, we decided to charge participants a quarterly account maintenance fee. It's not a large amount and it's fully transparent - participants see it on their statements as a line item.

When we fully moved the Plan to non-revenue-sharing funds, we unfortunately had to eliminate some funds we liked that didn't offer non-revenue-share options. In fact, there were asset classes, like large cap equity, where it was difficult to find non-revenue-sharing funds; we learned a lot in this process.

Q. When you went live, how many questions did you get from your 24,000 participants?

A. About twenty, and I was told that they were questions, not complaints. Keep in mind that we provided numerous communications, as well as education and training of customer service people, explaining the change.

Q. Would your opinion change about charging a per head fee if you had no employer-matching contributions in the Plan?

A. No.

Q. Would your opinion change if the fee per participant was a lot higher? Yours is a large plan with considerable economies of scale and low record keeping costs. Your quarterly charge of $12.50 per account seems manageable. What if this charge was higher, say $30 a quarter, or $50 a quarter, or more?

A. That might be a problem, but it doesn't change the basic equation that record keeping costs have to be paid in some way and if not via a per participant charge, participants would pay it through higher expense ratios.

Q. What if you had auto-enrollment?

A. We had auto-enrollment but we removed it because we wanted to help people who help themselves. Our employer-matching contributions increase with the percentage of salary contributed and tenure.

Q. Would you consider your benefits philosophy to be conservative or progressive?

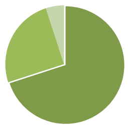
A. We are more on the progressive side. We were the beta test client for one of the first advice products. We've offered brokerage for a very long time. We fully removed company stock many years ago.

Q. What comes next for your program?

A. The next thing is figuring out an income solution.

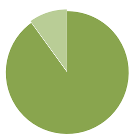
Thank you, Lynn.

DEFINED CONTRIBUTION PLAN FEES



- Investment
- Record keeping
- Other

PAYING RECORD KEEPING FEES



- Revenue sharing
- Pro rata, per capita, other method

RECORD KEEPING FEES, A FIDUCIARY RESPONSIBILITY

We believe record keeping vendor relationships should be evaluated by plan sponsors every 3 to 5 years or at the end of every contract term. Fees should be monitored and discussed annually.

UNDERSTANDING DEFINED CONTRIBUTION PLAN FEES AND EXPENSES

The Federal law governing private-sector retirement plans, the Employee Retirement Income Security Act (ERISA), requires that those responsible for managing retirement plans - fiduciaries - carry out their responsibilities prudently and solely in the interest of the plan's participants and beneficiaries. Among other duties, fiduciaries have a responsibility to ensure that the services provided to their plan are necessary and that the cost of those services is reasonable.

NEPC DEFINED CONTRIBUTION PLAN & FEE SURVEY

NEPC's Defined Contribution Consulting Practice conducts an annual Plan & Fee Survey ('Survey') to help fiduciaries understand the fees and pricing structure of their defined contribution plans. We initiated the survey seven years ago to ensure that revenue-sharing receipts (and internal record keeping transfers) were captured and evaluated. In our 2012 Survey we reported that fees related to retirement accounts hit a record low because of a steep drop in record keeping fees.

By way of background, record keeping costs are the second largest component of defined contribution plan total fees. They are costs related to the monitoring of participant transactions and the maintenance of their accounts, records and statements. They represent about a third of total plan costs, more for smaller programs, less for larger programs with economies of scale.

When discussing the 2012 Survey, we messaged to clients that they should take advantage of the dramatic fall in prices by reviewing their record keeper relationships. We also shared that another important conversation is trending - the allocation of record keeping and administrative expense - who pays the record keeping fees and how equitable the different payment methods are.

PAYING RECORD KEEPING AND ADMINISTRATION FEES

It is by far the prevalent practice to pay record keeping and administration fees in whole or part through revenue-sharing on plan investments. Ninety-nine plans participated in our 2012 Survey, and nearly ninety percent of them had some amount of revenue-sharing embedded in plan investments. The weighted average revenue-sharing across plans in the survey was 0.13%. In nearly every one of those plans, revenue-sharing amounts differed by plan fund, meaning the record keeping costs of the plan are borne differently by participants as a function of their assets and the funds they invest in. Some participants may pay a lot, while others with low asset balances or investments in funds with no revenue-sharing may pay little or nothing.

OTHER METHODS OF PAYING RECORD KEEPING AND ADMINISTRATION FEES

More than ten percent of the plans participating in our 2012 survey had no revenue-sharing in their programs. Aside from the company bearing the record keeping and administration fees, other method of applying that expense to participant accounts included:

- Pro rata or asset-based fees: Under this approach a level asset-based fee is applied daily, quarterly or annually against participant account balances. Any revenue-sharing received may be credited back to the funds or participant accounts. This method is progressive, participants with higher asset balances pay more towards the cost of plan record keeping and administration than participants with lower asset balances.

- Per capita fees: Under this approach participants are charged a uniform quarterly or annual fee to participate in the program. As above, any revenue-sharing received may be credited back to the funds or participant accounts. This method is regressive, it hits lower asset balance participants harder.

- Combination: Some sponsors strike a balance by charging both pro rata and per capita fees, or instead of crediting revenue-sharing back to the funds or participant accounts, retaining the revenue-sharing and assessing lower pro rata or per capita fees.

VIEWS FROM THE FIELD ON ALLOCATING FEES

In an October 2010 white paper titled, "Allocating Fees Among Participant-Directed Plan Participants", Fred Reish of Reish & Reichter comments that the failure by fiduciaries to engage in a prudent process to consider an equitable method of allocating plan costs and revenue-sharing would be imprudent and a breach of fiduciary duty. He expressed the view that all participants should pay the same proportionate amount of plan expenses (i.e. the progressive method), taking into account the revenue-sharing, if any, and that fiduciaries should be cautious if participants invested in certain funds subsidize a plan's recordkeeping fees.

In the March 2012 *Tussey v. ABB, Inc.* ruling, the U.S. District Court for the Western District of Missouri commented if a plan sponsor opts for revenue-sharing as its method of paying for record keeping services, it must not only comply with its governing plan documents, it must also have gone through a deliberative process for determining why such a choice is in the Plan's and participants' best interest. The Court commented about the "progressivity" of revenue-sharing and whether participants with greater assets should pay more for Plan record keeping services, finding no evidence in this case that progressivity is in the best interest of all Plan participants.

In an April 27, 2012 client advisory letter titled, "The Next Frontier in Fiduciary Oversight Litigation", Troutman Sanders commented that significant issues were raised and not resolved about revenue-sharing in the ABB case. They advise plan fiduciaries consider a variety of options in the allocation of record keeping expenses to fiduciaries, including hard wiring the allocation method in the plan document. In so doing, fiduciaries will move the allocation of recordkeeping fees from their responsibilities to the company's acting as settlor.

NEPC VIEW

Defined contribution plan fees have been in the spotlight for years and we don't see that changing. The high profile plaintiff suits against large 401k plans will continue to wind their way through the courts and make headlines. Plan fiduciaries have an obligation under ERISA to ensure that the fees of a plan are reasonable for the services provided. While the use of revenue-sharing to offset record keeping and administration fees is the prevalent practice and not imprudent per se according to ERISA attorneys, we see (and advise) sponsors to consider moving to other methods as record keeping systems and technologies allow.

For More Information:

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