

## MEMO

TO: Connecticut Retirement Security Board  
DATE: July 31, 2015  
FROM: Mercer  
SUBJECT: Governance, Program Design, Administration, & Enforcement

### Introduction

The Connecticut Retirement Security Board's (CRSB) fundamental tasks are to (a) provide feedback to the State Legislature on whether the proposed auto-enroll IRA program's goals and design features can be accomplished and (b) recommend methods by which such goals and design features should be accomplished. The process of translating policy goals into implementable and enduring legislation requires balancing flexibility to address diverse situations against ambiguity around intentions and the ability to enforce compliance. The CRSB can be very prescriptive and detailed in providing feedback to the Legislature on certain topics and/or can elect to defer some of the more detailed implementation and administration / operating decisions to the legislative process, or to the entity or group that will ultimately implement and oversee the program. The purpose of this memo is to highlight areas in which the CRSB may want to consider differing levels of direction to give the Legislature.

This document is intended to provide a foundation and organizational framework for discussion around the areas of governance, administration, operations, and enforcement. Detailed analysis will be executed for areas where the CRSB requires additional information or different perspectives.

### Governance

The Retirement Security legislation requires the CRSB to recommend a program design that promotes transparency and accountability. Further the program design needs to ensure that any assets held for the plan shall be used for the purpose of distributing individual retirement savings balances to the plan participants and paying the operational, administrative and investment costs associated with the plan. To meet these legislative objectives, the program design must include governance structures, processes and controls.

Fundamentally, governance is about clearly articulating objectives and implementing a framework of guiding principles, decision making structures and processes to ensure that key risks are managed and responsibilities are assigned appropriately to efficiently deliver the desired level of control over a program. In practical terms, a governance framework identifies who does what, how and when they do it, and why they need to do it. The framework must be both relevant and proportionate to the objectives and risks associated with the program and each activity. Within most governance frameworks there are three key bodies, as shown in the table below.

TABLE 1: ROLES AND RESPONSIBILITIES FOR PROGRAM GOVERNANCE

	Governing Bodies	Managing Bodies	Operating Bodies
Role	<ul style="list-style-type: none"> <li>• Establish the organizational structure</li> <li>• Make “big picture” strategic decisions.</li> <li>• Oversee program implementation.</li> <li>• Oversee broader program performance against goals and risks.</li> </ul>	<ul style="list-style-type: none"> <li>• Oversee the implementation of administration and operational decisions.</li> <li>• Oversee and manage the operations.</li> <li>• Are accountable to the governing bodies.</li> </ul>	<ul style="list-style-type: none"> <li>• Make day-to-day decisions (e.g. administration, employer servicing, participant servicing, investment management, custody).</li> <li>• Implement strategy under guidance of managing bodies.</li> </ul>
Examples of detailed responsibilities	<ul style="list-style-type: none"> <li>• Establish vision, strategy, goals and policies.</li> <li>• Design decision-making.</li> <li>• Determine deferral rates &amp; auto-escalation rates.</li> <li>• Delegate day-to-day responsibilities to managing and operating bodies and hold them accountable for performance.</li> <li>• Monitor structure and performance of the program.</li> <li>• Understand fiduciary responsibilities; minimize agency costs.</li> </ul>	<ul style="list-style-type: none"> <li>• Act as advisors to governing bodies.</li> <li>• Devise strategies for achieving objectives and implementing policies.</li> <li>• Design administration and operational processes, as well as controls to ensure program integrity.</li> <li>• Implement and monitor program administration and operations.</li> <li>• Manage and monitor operating bodies.</li> <li>• Accountable for program performance.</li> </ul>	<ul style="list-style-type: none"> <li>• Manage program operations.</li> <li>• Monitor risk.</li> <li>• Manage information systems.</li> <li>• Provide reporting.</li> <li>• Interface with participants and employers.</li> </ul>

### ***Governing bodies***

For the Retirement Security Program (the Program), the legislation will need, at a minimum, to identify a governing body. The legal organization and fiduciary responsibilities will flow from decisions around the program’s legal structure. E.g. if the CRSB elects to establish a group trust within which to custody the IRAs, then the primary governing body will be a Trustee Board. The governing body will be clearly distinct from the State and any liabilities related to carrying out the governance functions will be separate from the State. These points should be considered within the legal analysis.

Regardless of the legal structure, the following areas require consideration and a determination as to whether the CRSB wants to provide a specific recommendation to the Legislature on how to proceed

or if the CRSB wants to simply identify a topic as one that the Legislature will need to address in drafting the statutes.

1. Establishing a governing body

Mercer recommends establishing a governing body that is consistent with the legal structure of the program. For example, if the accounts are held in a trust, then a board of trustees should be established. Mercer further recommends that the governing body be independent from other State-managed programs to clearly establish the program as independent from state benefit programs and ensure that there is no recourse to the state or taxpayers.

2. Determining whether the governing body for the implementation phase continues to oversee the ongoing program.

Governance activities for launching and implementing the Program will have different resource and time commitments than ongoing oversight. During the implementation phase, governance oversight and decisions will require expert knowledge around technical investment operations and IRA administration activities, as these areas will be very important for establishing an affordable and well-controlled program. Once the Program is launched, the Managing Body would be expected to assume greater responsibility for overseeing vendors and daily activities with the Governing Body taking a more strategic perspective focused on translating savings into adequate retirement income. For these reasons, Mercer thinks the CRSB should consider recommending a Governing Body composed of representatives from experts in the community through the launch with a shift to a Governing Body that has more representation from stakeholders, such as employers and participants. Essentially, Mercer recommends a functional approach to organizing the Governing Body for implementation, moving to stakeholder or representative approach for ongoing program management.

3. How the governing body members are appointed or elected and their terms.

The current Retirement Security legislation has protocols for appointing current Board members. The Legislature is likely to want to establish the protocols for appointing Board members to the Governing Body and the State has examples in other legislation for how these protocols could be drafted. The CRSB should determine whether to provide a recommendation on the protocols or leave this issue to the political process. The terms of appointment will have an impact on how the Governing Body functions. For example, staggered terms facilitate accumulated knowledge and institutional history to be preserved as the Governing Body evolves. Likewise, a three-year term with forced rotation is sufficient to develop knowledge of the program and be effective in oversight and decision-making without entrenching interests. Mercer recommends that the CRSB consider commenting on specific aspects of the term appointment, length and limits.

4. Whether the composition of the governing body should include representation from various State agencies, participants and/or employers, and/or independent professionals.

The current legislation has the goal of serving a particular segment of the community. While the Governing Body will require some knowledge of the political process and technical experts, Mercer recommends that stakeholders, specifically employers and employees, also have representation on the Governing Body. The CRSB should consider whether to comment on the Governing Body's composition, including the number of people to constitute the Governing Body.

5. The standard of care that the governing body will need to use in executing its duties.

The Program's legal structure should provide some direction with regard to the governing body's required standard of care. If this standard of care is less than a fiduciary acting in the best interests of the program participants, Mercer recommends that the CRSB recommend a minimum standard of care and seek legal counsel advice on the specific language to be used in the recommendation.

6. The mandate and specific duties construed to the Governing Body.

The Governing Body should have a clear mandate aligned with the proposed legislation's policy goals. The specific duties can be stipulated or left for the Governing Body to determine, once it is appointed. The standard of care should provide sufficient guidelines for the Governing Body to execute its responsibilities. The CRSB should consider whether to comment on the Governing Body's mandate and at what level.

7. Whether the Governing Body can outsource or delegate responsibilities.

The Governing Body has ultimate responsibility for the Program. The Governing Body, however, will not have expertise or resources to manage or execute the Program. Mercer recommends that the CRSB provide guidance to the Legislature along the lines of the roles and responsibilities shown in Table 1. Within this guidance, the Governing Body will delegate program management and daily execution to Managing and Operating Bodies, some of whom would be private sector providers.

8. The level of discretion that the Governing Body has in interpreting the legislation and implementing the program and/or specific items or changes that must be brought to the Legislature for approval.

The Governing Body will require some guidance for discretion in interpreting the Legislature's policy goals and how to meet these objectives in practice. This item is more political and legal in nature. Mercer recommends that the CRSB leave this decision to the Legislature, but highlight that the legislation should make specific provisions to guide the Governing Body.

9. Requirements for the governing body to report to the Legislature and publicly on the program and the details required to be provided.

As with point eight above, this activity is probably more a policy and political decision than one for the CRSB. The CRSB could recommend a minimum of annual reporting to the Legislature.

Once the CRSB decides the areas on which the CRSB wants to make a detailed recommendation and the level of guidance that the CRSB wants to give the Legislature, Mercer will prepare more detailed analysis and recommendations for discussion, as necessary.

### ***Managing bodies***

Managing bodies report into governing bodies and have daily responsibility for managing the program. Potentially the managing bodies may sit within one or more existing agencies or departments of the State that has expertise and experience in savings program administration, operations and investments. Mercer would expect that the State would charge program participants for services; however, this point could warrant further discussion and legal advice on whether this arrangement would put liability onto the State. As part of this discussion, the CRSB should decide whether the recommendation for legislative purposes will recommend a specific group or if the CRSB will provide guidance on the kinds of staff and skills that should be resident within the managing bodies.

Further, the CRSB should consider whether to provide recommendations on the latitude that the managing bodies will have in executing their responsibilities and interpreting the statutes or if this area will be left to the Legislature to determine without advice from the CRSB in designing the program. An alternative approach is for the CRSB to recommend that the Governing Body decide what powers the Managing Body will have in interpreting the mandate and delegating responsibilities to third parties.

Last, but not least, the Managing Body should have accountability to the Governing Body. The Legislature and/or Governing Body can determine the required reporting and transparency. Mercer recommends that the Legislature define the broad responsibilities within the policy goals, but that the Governing Body establishes the mechanisms for executing oversight. Mercer recommends that the CRSB provide guidance on how the Governing Body might execute this activity.

### ***Operating bodies***

Most retirement savings programs, public and private, delegate some or all the daily administration, investments and operations to third-party providers. In this domain, even those organizations that have substantial staff, technology resources and expertise, do not typically manage significant activities in-house at the administrative and operational level. As the CRSB has already discussed, within the contemplated program IRA account custody and administration and investment management can be more efficiently and effectively executed with third parties. The CRSB should determine whether the CRSB wants to recommend an implementation approach to the Legislature or recommend that the governing body have this responsibility. If the CRSB wants to make a specific recommendation, Mercer will prepare the supporting work.

In the event that the CRSB decides to recommend a third party vendor approach, the CRSB should consider whether to take a position on minimum standards for procurement, legal contracts and ongoing operations. The State already has clear guidelines with regard to these activities. However, the Retirement Security program will likely be overseen by an independent governing body and not be part of the State's infrastructure. Additionally, the program parameters should align to the participants' interests, which may be expressed in different terms than existing State programs. For example, part of the procurement guidance may be a generic statement that administrative costs should be minimized, or the recommendation could be more specific in terms of capping costs at a specific target level such as 0.75%, as with the Illinois legislation. The decision for the CRSB is whether to make specific recommendations to the Legislature in terms of codifying the standards, or to leave the Legislature to develop the standards without guidance, or to suggest to the Legislature that the governing body should be given latitude to develop these standards as part of its remit. Once the CRSB has identified which areas require more detailed recommendations, Mercer will prepare additional analysis and recommendations.

### **Operations and administration**

Operations and administration are also critical to successful implementation, cost efficiency and meaningful governance. The CRSB can be very detailed in terms of recommending specific requirements to be legislated or CRSB can provide more general recommendations on key activities and standards of care to be considered by governing and managing bodies. While the CRSB may wish to take up other aspects, the legislature identified three items as requiring specific feedback. Mercer has distilled the critical issues and potential points for consideration in determining how to develop the recommendations on these areas.

### ***Crediting participant accounts***

The second item on which the CRSB must comment is the process by which a qualified employer shall credit the employee's contributions to the individual retirement account through payroll deposit. CRSB's recommendations regarding these operational elements can simply recommend an automated payroll function be used and defer decisions regarding the process and controls for funding the accounts until after the vendor is selected. Alternatively, the CRSB can be much more comprehensive and include definitions of eligible compensation, deduction hierarchies, specific deferral rates, deferral limits, timing requirements for moving contributions into the individual's account, and protocols for correcting deferral errors. The CRSB may want to comment on some the more sensitive issues, such as timing around funding, but delegate responsibility for developing more detailed operational requirements to the governing and managing bodies as they implement the legislation.

Mercer's commentary below illustrates the definitions and procedures that employers will need to comply with the State's mandate. For each area, the CRSB should determine the level of guidance needed to fulfill its mandate.

### ***Eligible compensation***

The definition of eligible wages for purposes of employee deferral deductions will need to be communicated to employers. There are several wage types that could exist in the employer's payroll system and there is no standard naming conventions across employers. According to the IRS,

eligible compensation includes wages, salaries, tips, professional fees, bonuses, and other amounts received for providing personal services, which means eligible compensation for an IRA is any amount shown in Box 1 of the employee's Form W-2. The definition also includes commissions, self-employment income, nontaxable combat pay, military differential pay, and taxable alimony and separate maintenance payments. The State's definition of eligible compensation should be consistent with the federal laws.

Prior to processing employee contributions, the employer must set up the IRA deduction rules in the payroll system and indicate what "wage types" should be used for calculating the deferral. The IRA deduction will also need to be factored into the hierarchy of other payroll deductions to ensure that any required deductions are made from the employee's pay before the IRA deduction is made, see next section. The maximum deferral amount will also need to be programmed into employers' payroll systems so deductions are not made in excess of the IRA contribution limits. The employee must withdraw excess contributions by the date that their tax return is filed or they will incur a 6% excise tax. Currently, 10% or less of the Connecticut population would be at risk for incurring an excise tax; however, someone could be penalized. The CRSB should determine how much guidance needs to be in the legislation on this point.

#### *Prioritizing deductions*

The CRSB should consider whether to provide a recommendation to the Legislature regarding guidance for employers on the hierarchy of the auto-enroll IRA deduction among other required payroll deductions. Most workers have regular deductions from their wages. The employer will need to allow many of these deductions to take precedence over contributing to the auto-IRA. Some deductions may already have precedence in existing law. As part of this recommendation, the CRSB should provide guidance on what the employer's responsibility is in the case where remaining wages after deductions are insufficient.

#### *Deferral elections, rates and limits*

Based on survey feedback, the CRSB should consider whether to recommend limits on the frequency and number of rate deferrals changes. For example:

- Deferral rate changes are allowed at any time;
- Employees can stop deferrals at any time, but may only increase/decrease deferral rates on an annual basis during an open enrollment period; or
- Employees can stop deferrals at any time, but may only increase/decrease deferral rates "X" times during a 12 month period

Procedurally, the Retirement Security program will need to provide a mechanism to allow employees to elect deferral rate changes and how those changes will be communicated to the employer to populate in the payroll system. The process and infrastructure required to accomplish this task will depend on the vendor's and payroll providers' capabilities, which are unknown at this point in time. Mercer recommends that the CRSB provide recommendations to the Legislature to ensure that the election and change of deferral rates is handled with the appropriate level of standard of care, but leave the managing bodies to determine the process for implementation and ongoing oversight.

A fundamental governance and operating weakness within the current industry standard IRA structure is that no one other than the participant has the ability to assess whether deferral elections are correctly implemented and amended. Mercer recommends addressing this issue with the appointed legal team, and addressing it within the context of the governance structure.

The CRSB should also consider whether it wants to comment on the operational requirements for deferral rate processing to the Legislature or recommend that the managing body be given discretion over the development of the processes and procedures. Examples of elements on which the CRSB could comment are:

- A requirement and process for the employee to notify the employer of their election
- A requirement and process for the employee to elect deferral rate changes or to discontinue their deferrals
- Documentation requirement such as the completion of a Salary Withholding Agreement
- Timing requirements for implementing employee deferral rate changes (e.g., within 2 payroll periods of change request)

Retirement industry standard is to only allow employees to elect a percent of pay and not a flat dollar amount. In addition, part-time employees with fluctuating income may not have sufficient income in a given payroll period to process a flat-dollar deferral elections. To reduce complexity and potential for confusion, we suggest conformity to industry norms by allowing only percentage deferral elections. Mercer believes that the CRSB should also recommend that the Legislature allow covered employers to set a maximum deferral rate subject to a restriction, e.g., allow employers to set a maximum deferral rate, so long as the maximum is not less than 50%. This approach will allow employers to avoid problems with certain payroll systems that could arise when pay is insufficient to cover all of the employee required withholdings. In ERISA plans, deductions generally follow the hierarchy shown below:

1. Health and welfare deductions
2. Voluntary benefits
3. Garnishments
4. Child support
5. Spousal support
6. Unpaid taxes

### *Funding deferrals*

To prevent employer abuse, the Legislature should define what constitutes timely funding of employee deferrals (e.g., 30 days for Simple IRA plans, 7 business days following pay date for small employer plans); otherwise there is no standard or benchmark for enforcement. In addition, the Legislature should establish guidelines and rules for making employees “whole” when an employer fails to fund their deferrals in a timely manner or not at all. Mercer suggests that the standard that applies to Simple IRA plans (30 days) may be appropriate, as the Retirement Security program will cover many small employers who may not have the resources or automated solutions to fund deferrals within tighter timeframes. The US DOL provides an on-line calculator that may be used to determine interest payments on late funding of qualified plan deferrals. The State may want to look



into the feasibility of adapting that resource as a standard for correcting late deferrals. As with funding periods, a clear legislative standard will help enforcement.

The CRSB further should consider whether to recommend a process and remediation for failure to fund deferrals. Mercer believes that the enforcing agent will be in a better position to develop guidelines around the operational steps, but the CRSB may wish to recommend a specific position.

### *Errors and corrections*

Based on experience with qualified retirement plans, we know that deferrals processed through payroll are prone to many types of administrative errors. For example, qualified 401(k) plans generally have processes and controls for the following:

- Failure to start automatic deferrals on a timely basis (missed deferral opportunity)
- Deferral withheld from ineligible compensation
- Deferral calculated incorrectly (wrong deferral %)
- Deferral processed as pre-tax rather than after-tax
- Failure to follow employee election to stop or change a deferral election
- Deferrals posted to wrong IRA account

The DOL and IRA have many pre-approved correction methods to address these errors. For example, the State could provide employers with the same pre-approved methods for correcting payroll errors. Because most of these issues relate to the daily functioning and control of the program and should evolve to keep pace with changes in the payroll and administration industries, Mercer recommends that the CRSB recommend to the Legislature that policies, procedures and controls be implemented in accordance with a standard of care, but that the managing and governing bodies be left to determine the appropriate way to implement these controls.

### *Streamlined enrollment*

The CRSB must comment on the process for a streamlined enrollment of new participants, including automatic and voluntary enrollment. The CRSB should also consider whether auto enrollment should occur only following the initial hire of an employee, or whether there should be periodic re-enrollments on an annual basis (or some other time period) for those employees who initially opt out of, or later drop out of enrollment. This guidance should also include how re-hired employees will be treated if they previously opted out of the program.

The processes supporting streamlined auto-enrollment will be influenced by the role played by third-party vendors. IRA vendors do not typically support employer enrollment processes. We think it likely that the optimal solution will involve a master administrator who provides a website that allows employers to establish IRA accounts for new employees and submit funding for employee deductions. Most likely employees will interact directly with their employer for deferral elections and to opt-out of automatic enrollment. Established vendors will require technology builds and will incur costs to meet the program's operating requirements. Detailed theoretical discussions with vendors are possible; however much of the operating and implementation points will be unknown until the legislation is in place. The CRSB needs to decide what kind of additional analysis to do on vendor operations to

appropriately comment and what level of recommendations the CRSB wants to make. Mercer recommends that the CRSB agree that streamlined enrollment is important and make it a key program element, but defer to the managing and governing bodies for implementation decisions.

### *Required disclosures*

Although not covered in the required elements for analysis, the CRSB should consider whether to make recommendations around disclosures. For example, with a Simple IRA the trustee or provider must give the employee with a disclosure statement at least 7 days before the IRA is established. If the statement is not provided until the date the employee's IRA is opened, the employee must be given at least 7 days from that date to revoke the IRA. The statement should explain when and how the employee can revoke the IRA, and include the name, address, and telephone number of the person to receive the notice of cancellation. This explanation must appear at the beginning of the disclosure statement. Mercer recommends that legal counsel also has input into the CRSB's recommendations around employer and vendor disclosures.

### **Enforcing the statutes**

The Legislature has directed the CRSB to consider plan design elements to ensure qualified employers participate in the mandatory auto-enrollment for covered employees. The CRSB must also consider processes for crediting participant accounts. Both these activities will require enforcement mechanisms that should be credible and have integrity. Aligning enforcement to the program's policy objectives will require legal opinions regarding the sufficiency of existing laws to empower the entity or agencies tasked with enforcement. As with the governance approach, the following areas require consideration and a determination as to whether the CRSB wants to provide a specific recommendation to the Legislature on how to proceed or if the CRSB wants to simply identify a topic as one that the Legislature will need to address in drafting the statutes.

- The entity responsible for enforcement.
- The relationship between the enforcement entity and the Legislature and/or governing bodies, if applicable, including reporting and accountability.
- Compliance and enforcement goals, e.g. the balance between compliance promotion and compliance monitoring.
- Compliance requirements, such key activities and time periods and whether to expressly include such parameters in the legislation. For example, the CRSB could recommend that employers have a time period within which contributions must be remitted on behalf of employees.
- Legal processes for assessing penalties and remediation.
- Approaches for organizing the enforcement activities, e.g. employee complaint driven or proactive audits.

### ***Employer eligibility***

The Legislature asked the CRSB to opine on the process to determine the eligibility of an employer, employee or any other individual to participate in the plan and to ensure mandatory participation by any qualified employer that does not offer an employer-sponsored retirement plan to its employees.

As a first step, on July 8th, the Subcommittee discussed the definitions that should be incorporated into the statutes.

To address the “process” portion of “ensuring mandatory participation” the data constraints and state agency responsibilities need to be considered. Mercer understands that data privacy prevents the Connecticut Department of Labor (CDOL) from releasing information other than to public servants executing their public duties. We suspect that in practice this restriction means that data cannot be released to third-party vendors to facilitate enforcement. There are three options for handling the data constraints. First, the CRSB might recommend a particular government department or agency act as the enforcement arm, e.g. the CDOL or the Connecticut Department of Revenue Services or another suitably positioned entity. Second, the CRSB could cite the impediments and challenges in implementing this portion of the program and recommend legislative changes with regard to data privacy, specifically to allow CDOL to share information with the relevant vendor(s). Third, the CRSB could recommend that the statutes require the entity charged with implementing the legislation ensure the process for enforcement exists and provide some standard of care language, leaving the decisions around enforcement to the governing body.

If the CRSB wants to recommend one of the first two options, some guidance to Mercer as to the desired level of specificity would be useful. For example, the CRSB can recommend one of the government entities handle enforcement and provide enforcement guidelines in terms of timing, penalties, appeals processes and legal resources for enforcement actions, but leave the entity to determine precisely what data to review, how often to assess and what staff / technology is needed. The CRSB could recommend adopting an enforcement approach that is similar to one already being executed in the State. For example, the Paid Sick Leave Act (PSLA) relies on employee complaints to begin a compliance review process. A complaint-based process has simplicity, but raises questions about whether lower income workers will complain about their paychecks not being reduced or know enough to complain if they have not been properly educated. Mercer recommends assessing the feasibility of employers self-reporting to the State (similar to 5500 reporting) to certify timely funding of employee deferrals and support self-reporting with a gap analysis.

Illinois and Massachusetts have left the “process” of identifying non-compliant employers to the discretion of enforcing agencies (Departments of Revenue and Attorney General, respectively), but have been very specific with regard to who owns the enforcement responsibilities, the parameters and timing for enforcement, and the process for enforcement. Mercer believes this point is a critical one that bears detailed discussion.

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