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Managing investment responsibilities.
WEIGHING THE OPTIONS—IS AN INVESTMENT POLICY STATEMENT RIGHT FOR YOUR PLAN?

EXECUTIVE SUMMARY

While most plan sponsors must follow essentially the same steps to administer their plan, how they manage their investment oversight role can vary a great deal from plan to plan.

- Different retirement plans can have very different investment objectives.
- There is a broad spectrum of investment solutions that may be employed to meet those objectives.
- Each plan sponsor should consider defining its investment objectives and outlining a strategy for achieving those objectives.

Some plan sponsors create an investment policy statement (IPS) to provide a framework for managing investment decisions. A recent study found that 83% of the surveyed plans had implemented an investment policy statement.[1] Yet, not all plan sponsors believe an IPS is the best vehicle for defining a plan sponsor's strategy for investment oversight.

Following is a brief discussion of some of the factors plan sponsors may want to consider as they evaluate the role of an IPS with respect to their plan.

WHAT ARE THE INVESTMENT RESPONSIBILITIES OF A PLAN SPONSOR?

The plan sponsor (the employer adopting the plan) typically serves as a "fiduciary" for the 401(k) plan or other defined contribution plan adopted by the business. The plan's fiduciaries are responsible for managing the plan, including selecting and monitoring the plan's investment options. When making plan decisions, fiduciaries are subject to strict standards of conduct imposed by the Employee Retirement Income Security Act of 1974 (ERISA). These standards require them to

- Act solely in the best interests of the plan participants and beneficiaries
- Make prudent decisions
- Diversify investments to the extent needed to reduce the risk of large losses to plan assets
- Follow the terms of the plan document
- Ensure that only reasonable fees are paid from plan assets for plan services and investments

Procedural prudence when managing investment responsibilities is key to complying with the ERISA fiduciary rules. A fiduciary is not required to pick the best performing investment option or to make investment decisions subject to one strict standard. Setting objectives,

[1]Deloitte, Annual Defined Contribution Benchmarking Survey, 2015 Edition

developing a due diligence process, consistently following that process, and keeping records of due diligence activities can help satisfy this important fiduciary responsibility.

CAN A PLAN SPONSOR SHARE THEIR FIDUCIARY RESPONSIBILITIES?

A fiduciary can appoint others, such as a plan committee or investment committee, to share the fiduciary role. Many fiduciaries who feel they do not have the knowledge or skills to be an investment fiduciary also hire a financial advisor or consultant to take on some of the fiduciary responsibilities relating to the selection and monitoring of investments. Plan sponsors who engage a financial advisor for investment support may look to one of two types of investment fiduciaries under ERISA.

- Under ERISA Section 3(21), a financial advisor or consultant can serve as an "investment adviser" making investment recommendations, sharing with the plan sponsor the legal and fiduciary responsibility for the selection of the investments. The plan sponsor typically retains ultimate control over the investment decisions.
- Under ERISA Section 3(38), a bank, insurance company, or registered investment adviser may assume the role of an ERISA "investment manager" with full discretionary responsibility for selecting and monitoring plan investments, relieving the plan fiduciary of liability related to investment selection.

WHAT IS AN INVESTMENT POLICY STATEMENT (IPS)?

An IPS is a written policy that defines the plan's strategic vision for the plan's investments and defines the process for evaluating and monitoring investments. Although the objectives and strategies outlined in an IPS may vary from plan to plan, an IPS will typically include

- Criteria and a process for selecting and evaluating investments (e.g., permissible types of investments, performance criteria, fee policies)
- Timing for investment reviews (e.g., quarterly, semi-annually)
- Standards and procedures for adding, changing, and replacing investments in the plan's line-up

IS A PLAN REQUIRED TO HAVE AN IPS?

While an IPS is not specifically mandated by ERISA or other laws, many plan sponsors have found them to be a beneficial tool for documenting investment objectives and describing the due diligence process for selecting and monitoring investments. The Department of Labor (DOL) often requests a copy of a plan's investment policies (in whatever form) when conducting examinations. According to the DOL's Enforcement Manual that provides investigation guidelines for its Fiduciary Investigations Program, "investment policies" are among the plan records that examiners are directed to collect for plans that have been selected for investigation.[2]

WHAT ARE THE POTENTIAL BENEFITS OF AN IPS?

For some plans, the IPS provides a roadmap to follow when making investment decisions. Including an investment review schedule in an IPS provides a structure for the timing and frequency of reviews. Documenting key investment decisions relative to the IPS criteria can be one element for demonstrating how plan fiduciaries are meeting their fiduciary responsibilities to prudently select and monitor plan investments.

An IPS can also help multiple plan fiduciaries for one plan (e.g., plan committee) clarify roles and make certain they are in agreement regarding the investment philosophy and objectives for the plan. It can also provide continuity if there is a change in committee members or other fiduciaries.

WHY DO SOME PLANS CHOOSE NOT TO ADOPT AN IPS?

Not all plan sponsors choose to develop an IPS. One potential reason for not adopting an IPS is the concern that the DOL or participants could use the plan's failure to follow the IPS as proof that fiduciaries failed to prudently manage their investment responsibilities. Adopting an IPS that defines specific investment performance criteria and a due diligence process for selecting or monitoring investments, and not following those guidelines has been the basis of lawsuits alleging a breach of fiduciary duties.[3] **Having an IPS but not following it, some experts believe, may be worse than not having an IPS at all.** Another concern is that ambiguous or vague terms, or authority to take actions not specifically provided for in the IPS, may be subject to interpretation by the courts (which may be inconsistent with how plan fiduciaries have interpreted the IPS and their authority).

Also, an IPS may not always reflect current trends and changes in investment approaches.

HOW IS AN IPS CREATED?

Drafting an IPS will likely require plan sponsors to engage someone who has investment expertise and is skilled in understanding the fiduciary responsibilities regarding retirement plan investments. Many plan sponsors tap into their financial advisor or consultant to draft the IPS. An ERISA attorney is another potential resource.

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[2] Department of Labor, Enforcement Manual, General Operational Procedures, Enforcement Programs, Fiduciary Investigations Program dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement/oe-manual
[3] Tussey v. ABB, Inc., No. 12-2056 (8th Cir. 201

Plan sponsors who decide that an IPS is appropriate for their plan may want to keep a couple of principles in mind.

FLEXIBILITY. In defining the investment selection criteria in an IPS, consider the desired amount of flexibility to enable plan fiduciaries to adjust investments to adapt to changes in the market and employee demographics. For example, when defining the number of investment options, language that says the plan will have sufficient options to ensure it is meeting participant needs rather than stating a specific number of options may be easier to manage. This will allow plan fiduciaries to add or remove options as the plan's needs and market conditions change. Using terms like "may" or "typically" rather than "will" or "must," where appropriate, may also help preserve flexibility.

DOCUMENTATION. Plan fiduciaries should keep records of the investment reviews, such as committee minutes, to demonstrate that they followed the criteria set forth in the IPS.

WHAT ELEMENTS SHOULD BE INCLUDED IN AN IPS?

An IPS will vary depending upon the needs and objectives of each plan. Following is a list of topics that are likely to be included in an IPS.

- **Investment philosophy and objectives**—Includes a discussion of the goals, expectations and risk tolerance levels of the plan and its participants, including
  - A discussion of the classes of investments that will be included in the plan
  - A general discussion of the risk, return and cost features of investments that will be offered
  - May include identification and role of the plan default investment, including the role of the plan's Qualified Default Investment Alternative (QDIA), if applicable
- **Criteria for selecting investments**—Includes criteria for selecting specific investment options such as:
  - Types of assets and asset classes to be offered
  - Performance requirements
  - Acceptable fees and costs
  - Options for measuring investment performance (e.g., benchmarking)
  - Frequency of investment reviews
- **Process for monitoring investments and investment managers**
  - Criteria for placing on watch list and to potentially remove or replace

Following is a list of additional topics that a plan sponsor might consider including in an IPS.

- **Objectives for the plan**—Identifies the purpose of the plan (e.g., to help employees save for retirement) and a high level statement of the plan's general investment objectives
- **Purpose of the IPS**—A statement explaining that the IPS is intended to guide and assist the plan's investment fiduciaries in their decisions and ensure they are discharging their fiduciary duties under ERISA
- **Roles and responsibilities of parties**—Describes the roles of the parties involved in administering the plan and managing plan investments and assets. If included in an IPS, care should be taken that the description does not overcommit roles and responsibilities, misstate the law, or contradict plan documents.
- **Acknowledgement of ERISA standards**—May be a stand-alone component or incorporated into other sections
  - General acknowledgement of ERISA fiduciary standards and intent to comply
  - A statement of intent to delegate fiduciary investment responsibility to participants and comply with ERISA 404(c), where applicable
- **Participant communication and education regarding investments**
  - The intent to provide participant investment education and the plan to deliver it
  - The goals of the participant education program

WILL THE IPS NEED TO BE UPDATED PERIODICALLY?

The IPS itself should be reviewed periodically. As a business grows and evolves, the plan objectives or the needs of employees who participate in the plan may change. Changes in the financial industry such as new investment products or new retirement plan regulations may also warrant modifications to an IPS.

Plans that adopted an IPS several years ago may want to review the criteria they are using for selecting and monitoring the plan's default investment. In recent years, a growing percentage of plan assets are being allocated to the plan default investment by participants who are automatically enrolled or who lack investment expertise and rely on the default investment designated by the plan sponsor. This makes selection of a default investment an important investment decision for plan fiduciaries. Many plan sponsors choose an investment that satisfies the DOL's Qualified Default Investment Alternative (QDIA) rules, which provide certain fiduciary protections. Plan sponsors might consider adjusting their IPS to address the QDIA requirements and any additional criteria for selecting and monitoring the default investment (e.g., criteria for evaluating target date funds).

Like the initial development of the IPS, plan sponsors may be well-served by tapping into the expertise of a financial advisor, consultant, or ERISA attorney to assist with any IPS updates.

QUALIFIED DEFAULT INVESTMENT ALTERNATIVES (QDIAS) SIDEBAR

QDIAs provide plan sponsors fiduciary relief with respect to default investments. If an investment meets the QDIA requirements and the participants receive proper notice, the plan sponsor will be relieved of fiduciary liability for the performance of the investment. If the plan sponsor does not offer a QDIA, they retain investment responsibility for plan participants who do not make investment elections.

Three investment vehicles can be used as a QDIA:

- Life-cycle or target date funds (TDFs)
- Professionally-managed accounts
- Balanced funds

A capital preservation product (e.g., a money market fund) may be used as a QDIA for new participants, but only during the first 120 days of participation.

SUMMARY

A well-crafted IPS can provide plan sponsors a roadmap for making prudent investment decisions. Plan sponsors must remember, however, that failure to follow the IPS has been the basis for many lawsuits alleging breach of fiduciary duties. To determine whether their plan would benefit from an IPS, plan sponsors should

- Evaluate their current investment due diligence process
- Weigh the benefits of an IPS against the potential risks
- Consult with an investment professional or ERISA attorney regarding the steps to take to draft an IPS

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