Is an Investment Policy Statement right for you?

An investment policy statement (IPS) is a written document that formally details an investment plan's decision making process. Additionally, an IPS reflects how investment decisions are related to the plan's specific goals and objectives. Investment policy statements generally include investment objectives, timeframe for review of investment performance, responsibilities of individuals involved with the plan's investments, guidelines for modifying the investments offered, and fund managers replacement processes. Moreover, the creation of an IPS implies that the Plan is subject to the fiduciary requirement of Part 4 of Title I of ERISA; and, if appropriate, that it is intended to comply with ERISA Section 404(c).[1]

The most detailed discussion of investment policy statements is contained in the Department of Labor Interpretive Bulletin 94-2. The bulletin states, "Maintenance of statements of investment policy is not specifically required under ERISA. The Department, however, believes that such statements serve a legitimate purpose in many plans by helping to assure that investments are made in a rational manner and are designed to further the purposes of the plan and its funding policy."[2]

Under ERISA section 404(a)(1)(B), there is the requirement that a fiduciary exercise "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent investor acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[3] Thus, the investment policy statement is a demonstration of the fiduciary exercising these responsibilities.

Benefits of an Investment Policy Statement

Creating an investment policy statement has practical advantages for the plan sponsor. An IPS clarifies the plan's investment-related objectives and provides clear communication of plan investment procedures to participants. An IPS also gives structure for evaluating investment performance. Furthermore, investment policy statements keep the sponsor from inadvertently making impulsive or arbitrary decisions while ensuring continuity in decision making as plan fiduciaries change.

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[1] "Investment Policy Statement," Technical Answer Group, Inc., 2008
[2] "Investment Policy Statement," Technical Answer Group, Inc., 2008
[3] "ERISA Fiduciary Responsibility and Liability," Dechert LLP, 2013

Additionally, in the event that an investment turns out to be unfavorable, a written investment policy can demonstrate that the investment was reasonable and prudent at the time it was made, and that the goals of the plan were considered.

Concerns with having an Investment Policy Statement

The Profit Sharing/401k Council of America explains that the concern with having an IPS is that plan fiduciaries might not execute exactly the procedure specified by their written investment policy statement, or that the execution of the process might not be sufficiently documented by plan fiduciaries.[4] Furthermore, ERISA defense attorney and former ASPPA Vice President Sheldon Smith cautions sponsors and advisors on the danger of failing to follow one's own process: "If your client is…not about to follow what you've put down in writing for them to follow, all you're doing is creating a roadmap for the plaintiff's lawyer."[5] Therefore, having a written process that is not followed subjects the plan sponsor to greater liability than if an investment policy statement had never been adopted.

Conclusion

Pete Swisher, Senior Vice President of Pentegra Retirement Services, states that "ERISA does not explicitly require a written governance process or investment policy, but the need for written procedures can be inferred from the basic duty of prudence and the need to document one's action."[6] Thus, implementing an investment policy statement is ultimately justifiable. However, an investment policy statement with too much detail of processes may create legal breaches if the plan sponsor fails to perform every step in the process.

For large plans, it is appropriate to include thorough processes requiring significant attention to detail. Conversely, smaller plans should simplify their written procedures to ensure the critical functions are consistently accomplished. As a result, plan sponsors will balance what is responsible against the risk of building a 'roadmap for the plaintiff's lawyer'.

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[4] "Investment Policy Statements," Profit Sharing/401k Council of America, 2009
[5] "401(k) Fiduciary Governance: An Advisor's Guide," Pete Swisher, 2009
[6] "401(k) Fiduciary Governance: An Advisor's Guide," Pete Swisher, 2009