GUIDELINES FOR CREATING AN INVESTMENT POLICY STATEMENT (IPS)

An Investment Policy Statement (IPS) is a formal written document which defines the plan's investment goals and sets the criteria for selecting and replacing investment vehicles.

It should be detailed enough for someone outside the firm to understand easily how investment decisions are made — such as what types of funds may be considered, when and how performance will be evaluated, and what will be done if a fund fails to meet expectations.

While there is no specific ERISA requirement to create and maintain an Investment Policy Statement (IPS), an IPS can provide a fiduciary with a road map for decision-making, as well as establishing long-term investment goals. Creating the IPS should be done in accordance with the Plan Sponsor's legal counsel. The IPS may vary widely from plan to plan, but some common topics covered by the IPS are:

- The purpose and objectives of the plan and IPS
- Overview of the plan
- Investment guidelines, such as what types of investments will be offered
- Guidelines for selecting investments, securities and/or money managers
- Description of duties and responsibilities of the investment committee, custodian/trustee, and/or financial professionals
- Procedures and timetable for monitoring and reporting on the investments and money managers hired
- Key benchmarks for selecting and monitoring investments and money managers

The purpose and objectives of the plan and IPS

- Identify the company name, plan type (401(k), 403(b), etc.) and the initiation date.
- Specify that the plan objective is to save for retirement and any other goals.
- Highlight that the IPS creates a formal written procedure for fiduciaries to use when making plan investment decisions.

Overview of the plan

- Cover items like the asset size of the plan, the number of participants and their demographic characteristics, as well as the plan contribution types (employee and/or employer matching and/or profit-sharing contributions, etc.).
- List any special plan characteristics, like whether the plan is a Safe Harbor plan or offers auto-enrollment.

Investment guidelines

- List and give a basic description of the types of investments to be offered (i.e., Large-cap, Mid-cap, Intermediate Bond, Target-Date, Money Market, Stable Value, Alternative Investments, etc.). Types of vehicles and their number should be appropriate given the size of the plan. The goal is to provide diversification and appropriate asset allocation, not to overwhelm participants with too many choices.
    - Include whether the plan will offer QDIAs.
    - Highlight any special criteria to be used, like socially responsible investing.
- Incorporate whether self-directed brokerage (individual securities, mutual funds, alternatives, etc.) and mutual fund windows (mutual funds only) will be offered.
- Explain whether the plan will try to meet 404(c) rules, with a brief description of compliance goals (quarterly statements provided to participants with regular education and a diversified investment menu, etc.).

IV

Guidelines for selecting investments, securities and/or money managers.

- Describe criteria and benchmarks to be used to evaluate the investment universe and narrow down to choices appropriate for this plan.
  - Common examples include minimum investment manager tenure, what indexes/benchmarks will be used, performance related to peer group and benchmarks, cost compared with peer group, and third-party rankings like Lipper or Morningstar.
- If individual securities will be offered, explain how they will be chosen and any limits placed on their investment. For example, if company stock is offered, will it be available for all contribution types, or will it be offered only in employee matching accounts?
- If target-date funds are to be offered, what time frames are appropriate? The time frames will dictate the asset allocation mix used for each fund. This is also referred to as the "glide path," which is defined as a formula that defines the asset allocation mix of a target-date fund, based on the number of years to the target date.
- If money managers are hired to invest plan assets, outline the criteria used to hire them. Include whether they are expected to be a Plan Fiduciary.
- Include how information on investment fees and expenses will be gathered.

V

Description of duties and responsibilities of the investment committee, custodian/trustee, and/or Financial Professional.

- List and explain roles of all fiduciaries and/or any fiduciary committees, outlining who is responsible for what. Some plans may have a few different committees, third-party firms or individuals taking on fiduciary roles.
  - Highlight who makes investment menu decisions, as well as who hires and fires managers. You may want to use work titles to assign roles and build the committee rather than employee names, so that you do not have to change the IPS in case of employee turnover or money manager change.
  - Answer whether the Financial Professional will be a Plan Fiduciary.
- Outline the custodian's duties, typically: safekeeping of securities, reporting plan holdings and transactions, collecting dividends and interest, and making trades.
- If separate accounts are used, include the responsibility to account for soft dollars, and to vote all proxies, for example.

VI

Procedures and timetable for monitoring and reporting on the investments and money managers hired.

- Build on the prior three sections to explain the formal, periodic, and consistent process used to evaluate plan investments and all those hired to make plan investments. Arguably the most important part of the IPS is to explain the timing and structure of these prescribed investment review meetings.
- Include the frequency of review meetings and list the topics to be covered at each meeting. Some plans cover different topics at meetings throughout the year. For example, some plans review investment, recordkeeping and custody fees annually, but investment performance quarterly.
- Some plans may want to include an annual educational reminder of fiduciary duties and roles in a meeting, to ensure everyone remains fully informed.
- List any investment reports and/or information needed, as well as the timeframe reports should cover (quarterly vs. annual vs. 10-year data, etc.). Include who gathers the investment information and/or who prepares investment performance reports if any consolidated or summary reports are to be used.
- When assessing fees and expenses, make sure to include review of the latest 408(b)(2) disclosure report. Evaluate any finder's fees, 12b-1 fees or other forms of compensation received by the plan, money managers, investment firms, recordkeepers, consultants, financial professionals, custodians and/or fiduciaries. Are fees being paid and calculated as per signed agreements and/or written documentation (for example, recordkeeping and/or investment management agreements)?

Investment review sample agenda:

Review current plan objectives and company and participant demographics.

Cover current market and economic conditions.

Discuss investment objectives and whether they are still relevant given participant demographics and market conditions.

Assess investment selection benchmarks and criteria. Review whether what is outlined in IPS is still appropriate.

Examine investment menu, fund performance (based on your benchmarks discussed below), and costs. Remember to make sure QDIA and/or 404(c) requirements are met, and check to make sure the time frame and associated glide path for each target-date fund is appropriate.

Analyze the current investment watch list to determine whether to add or delete investments from the watch list and/or the plan.

Evaluate the plan services like recordkeeping and administration, custody, separate account managers, fiduciary advisors, etc. to ensure the plan is operating as expected.

Assess the reasonableness of plan and investment fees and disclosures, like the 408(b)(2) and the 404(a)(5) disclosures.

Document all decisions made and what changes are needed, especially related to the investment watch list and plan fees. Include whether more information is needed on any topic, and if so, when will the issue be re-evaluated? List who will be responsible for following up on needed changes, and the timetable for the change.

VII

Key benchmarks for selecting and monitoring investments and money managers

- List the metrics and criteria used when evaluating the investment performance of plan investments.
  - As discussed on page 40, common examples include minimum investment manager tenure, what index benchmarks will be used for each type of investment product, performance compared to peer group and benchmark, cost compared to peer group, adherence to style and risk statistics, and third-party rankings like Lipper or Morningstar.
  - Clarify what time periods are to be used for benchmarks, for example, annual, three-year, five-year, 10-year and/or since inception performance results. You may want to give consideration for time periods beyond one and three years to allow for flexibility given the realities of market and economic uncertainties.
  - Include a review of organizational changes at money managers that may impact investment philosophy. Investments and managers may experience style drift or may become too closely correlated with other plan investments, which may harm plan diversification goals.
- Explain the process if an investment does not compare favorably after these metrics are employed. Describe which metrics cause an investment to be put on the "watch list" and how quickly, as well as how long an investment may remain on the watch list before removal.

Final thought: Any procedure established in the IPS must be followed. Don't set up a process so complicated or limiting that the plan is unable to follow it completely.

Notes:

For Financial Professional or Plan Sponsor use with plan participants.

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