Compliance Watch

The Importance of Having and Following a Plan's IPS

An IPS is only as good as the fiduciary's follow-through.

By Ian Kopelman

The last column discussed *Tussey v. ABB, Inc.*, in which a Missouri federal district court held that 401(k) plan fiduciaries were liable for more than 35 million dollars in plan losses for excessive fees due to fiduciary breaches, which resulted in large part from their failure to follow the plan's investment policy statement (IPS). The case is significant not only because it is one of the first successful excessive fees lawsuits, but because it emphasizes the importance of having and following a plan's IPS.

Why an IPS is Important

First, it should be noted that ERISA does not include a statutory requirement that each plan have a written IPS and did not create the concept of a formal written investment policy. The concept arises from the fiduciary duty of prudence that applies under both ERISA and the common law of trusts and is referred to in interpretive bulletins issued by the Department of Labor. A copy of the Plan's IPS is also usually requested as part of any DOL audit of a plan.

A written investment policy provides specific guidelines and directions for the responsible fiduciary. Complying with the policy's requirements allows the investment fiduciary to demonstrate its prudence. Obviously, it behooves the wise ERISA fiduciary to adopt a written investment policy or IPS. Further, as the *Tussey* case illustrates, once an IPS has been adopted it must be followed. Just as following the IPS is a way to demonstrate prudence, failing to do so can be a clear demonstration of imprudence.

For these reasons, it is generally agreed that while an IPS is not legally required by ERISA, it is key to ensuring compliance with the ERISA's fiduciary responsibility rules and minimizing the risk of fiduciary liability. A properly drafted IPS provides the plan sponsor and fiduciaries with a road map for the proper investment of plan assets. It sets forth specific investment objectives for the plan and investment options, standards for meeting those objectives and a mechanism for monitoring the performance of investments and plan service providers. If the plan provides for participant direction of investments, the IPS often is the most logical place to lay out the necessary elements for Section 404(c) protection from liability for participants' choices. It can also be a vehicle for outlining the overall purpose of the plan and the plan's fiduciary structure and allocating investment responsibilities.

What to Include in an IPS

A well-written IPS should:

1. Describe the purpose and general investment objectives of the plan;
2. Identify and allocate responsibilities among the fiduciaries and other parties responsible for selecting, monitoring and managing plan investments;
3. Describe the asset classes of investments options to be offered under the plan and specific factors and criteria for selecting investment options, such as risk and return characteristics, expenses and benchmark comparisons;
4. If employer stock is offered as an investment option, describe any limits or standards for its inclusion;
5. Describe standards for investment performance and criteria for measuring performance;
6. If the plan permits participants to direct investments and intends to comply with Section 404(c):
   - state that the plan intends to comply;
   - list the number of investment options offered under the plan and the asset classes for each option;
   - describe method and criteria for selecting options, including fees,

and for monitoring and replacing funds, if necessary;
- describe investment education and other information offered to participants in connection with investment options;
- describe any restrictions on particular options; and
- describe the process and standards for selecting a qualified default investment arrangement;

7. Describe the methods and criteria for selecting, monitoring and, if necessary, replacing plan investment service providers;
8. Describe standards for accounting for and managing investment expenses; and
9. Describe how often investment performance will be reviewed and the review process (including the use of outside investment consultants).

Other IPS Guidelines

An IPS may also include a summary of the plan's provisions, participant demographics and/or overall administrative structure. If a plan offers participants investment advice, the IPS needs to include a description of the advice services and criteria and standards for the provider.

While everyone agrees that an IPS is essential, not everyone agrees on how it should look or how long it should be. An IPS may be as short as three pages or as long as 10 pages or longer. Some believe that a short, general IPS without specific guidelines might not provide the same level of fiduciary protection as a longer, more detailed IPS. However, this only holds true for the fiduciary that follows the plan's IPS. As stated above, a long, complicated IPS that Plan fiduciaries do not follow can be used to assert a breach of fiduciary duty — even in cases where a breach would not otherwise been deemed to have occurred. On the other hand, while a detailed IPS can be a tool for fiduciary risk management and an operating manual for the plan's fiduciaries, this approach *only* works if the plan's fiduciaries read the IPS, keep it up to date and follow it. As evidenced by the *Tussey* decision, a fiduciary that ignores and/or violates the plan's IPS doesn't get any protection at all, and worse, may be deemed to have committed a breach solely because the IPS was not followed.

Conclusion

PSCA and others offer free samples of a 401(k) plan IPS. IPS samples ranging from the general to the extremely detailed are readily available. In short, there is no excuse for a fiduciary's failure to take advantage of the potential protection offered by an IPS. Just remember that establishing an appropriate IPS for your plan means more than just adopting a written statement. An IPS is only as good as the fiduciary's follow-through. A fiduciary that adopts an IPS and then fails to follow its rules may end up like the defendants in *Tussey*.

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