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Investment Policy Statement Considerations

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An investment policy statement is a written document designed to provide a decision-making framework for retirement plan committee members as they manage their fiduciary obligations to plan participants. Outlined below are some pros and cons related to establishing an investment policy statement as well as some factors to consider if you decide to develop one for your plan.

Guidance issued by the Department of Labor under the Employee Retirement Income Security Act of 1974 (ERISA) supports the establishment of a written statement of investment policy to help provide a framework for the exercise of fiduciary oversight. An investment policy statement can help provide a basis for consistent decision making over time. It also may dilute the impact of sudden additions and departures of committee members, many of whom have vastly different understandings of plan composition and construction.

There are pros and cons to developing and maintaining an investment policy statement. A well-written investment policy statement may be helpful to the plan sponsor and investment/retirement committee not only in discharging their fiduciary duties around selecting and monitoring the investment options of the plan, but also in demonstrating the existence of prudent fiduciary process. However, while investment policy statements have received increased interest for retirement plans in light of greater regulatory scrutiny and increased fiduciary oversight, not all plans have one. Some plan sponsors opt not to create an investment policy statement as there is considerable work involved in drafting, maintaining, and adhering to an investment policy statement. Failure to comply with investment policy statement provisions, either operational or substantive, may be construed as a violation of ERISA. The following outlines some of the pros and cons in creating an investment policy statement.

The pros and cons of adopting an investment policy statement

Factors you should weigh prior to adopting an investment policy statement

Pros

- Provides a decision-making framework for fiduciary committees.
- If followed, may assist in demonstrating a prudent fiduciary process; this is often referred to as "procedural prudence."
- Promotes consistency as members of the plan's investment committee change.
- While ERISA does not require an investment policy statement, the Department of Labor has generally promoted it as being consistent with the fiduciary obligations set forth in ERISA.

Feel free to contact your Fidelity representative with any questions.

Cons

- Failure to comply with investment policy statement provisions, either operational or substantive, may be construed as a violation of ERISA.
- Decisions inconsistent with provisions of the investment policy statement could be the basis for claims against the fiduciary.
- Depending on how it is written, the document may require steps that the fiduciary/committee may not wish to take in a given situation.
- There are potential costs and time involved in the development and maintenance of an investment policy statement. The investment policy statement needs to be reviewed and updated over time.
- The mere creation of an investment policy statement will not relieve plan fiduciaries of liability; the investment policy statement must be followed, both operationally or substantively.

Items to consider when developing an investment policy statement

An investment policy statement should take into account the unique characteristics of the plan. In the following pages, we have provided some ideas for developing and implementing an investment policy statement. Many of these ideas come from our own clients who have developed investment policy statements. You should consider any other topics that may be appropriate for your plan. We hope this information will prove helpful to you if you decide to develop an investment policy statement. We encourage you to consult with your plan's attorney regarding this decision and for guidance should you choose to develop an investment policy statement.

Introduction to the investment policy statement

An investment policy statement can serve a variety of purposes, and should therefore be tailored to meet the specific needs of the individual plan. Some investment policy statements clearly articulate the objectives of the statement at the outset, so that the reader has clear expectations regarding what will and won't be covered in the document.

The following are some topics that you may want to include in the introductory part of an investment policy statement in order to better organize the document and to clarify the reader's expectations.

- A brief description of the purpose and objective of the defined contribution plan
- The purpose of the investment policy statement
- Objectives of the investment policy:
  - Provide structure for plan fiduciary decisions
  - Clarify plan sponsor and investment committee responsibilities
  - Articulate intention to comply with ERISA Section 404(c), including the rules regarding qualified default investment alternatives (QDIAs)
  - Describe the structure of the investment option menu
  - Provide investment guidelines for the investment options
  - Describe investment option evaluation criteria

Defining roles and responsibilities

Some plan sponsors have found it useful to describe their own roles and responsibilities with regard to the investment of assets, as well as those of the investment committee (if one exists). In addition, an investment policy statement may also define the makeup of the investment committee and its decision-making process, so it is clear who is selecting and evaluating investment options and how those decisions are being made. This may also include a statement regarding the plan's intention to comply with ERISA Section 404(c) guidelines.

Ideas for potential inclusion in this section:

- Investment committee roles and responsibilities
- Investment committee description
  - Number of committee members
  - Areas of the company/organization represented
- Statement of intention to comply with ERISA Section 404(c)

Investment option evaluation guidelines

A well-defined process for the evaluation of the investment options is prudent. Such a process should be objective, should be implemented on a timely basis, and should use criteria that are consistent with the overall objectives of the plan.

Plan sponsors should be careful about how to describe procedures involving investments that do not meet certain threshold criteria. Such investment options should demand closer scrutiny and a heightened level of communication between the investment provider and plan sponsor.

However, if the investment policy statement states that such investment options will be discontinued as plan options because of the options' inability to meet certain performance criteria, the plan sponsor and/or investment committee must be prepared to consistently honor this commitment. Failure to implement this or any provision of the investment policy statement could constitute a fiduciary breach, as well as place the plan sponsor and/or investment committee on a more precarious legal footing should any litigation be initiated by plan participants.

For this reason, you should ensure that the investment policy statement's references to investment evaluation be written in such a manner that the evaluation criteria and their uses are clear, but also that plan sponsors reserve some discretion regarding their courses of action with respect to investment options that are deemed to be underperforming over time.

Ideas for potential inclusion in this section:

- Investment option evaluation criteria
  - Performance vs. appropriate benchmarks
  - Performance vs. appropriate peer groups
  - Fee levels
- Investment option evaluation details
  - Description of the performance or other behavior that is considered unacceptable
  - Description of how long unacceptable results can occur before action is taken
- Process to follow for options that do not satisfy established criteria
  - Place funds on a "watch list"
  - Contact the investment provider for details about current results and corrective actions
  - Consider replacing the investment option, adding a similar option to the plan lineup, or eliminating the option altogether

Conclusion

An investment policy statement can be an important factor in enhancing the overall success of a retirement plan for both the plan sponsor and the plan participants.

While adopting an investment policy statement may be helpful for a retirement plan investment committee to assist in meeting its fiduciary obligation, not adhering to the investment policy statement could result in claims of fiduciary breach, potentially negating any benefit derived from having the policy statement. Accordingly, keeping the policy up to date and documenting the committee's compliance with the established policy are as important as having a policy. Prior to adopting an investment policy statement, you should commit to meeting this challenge.*

We hope this discussion of the pros and cons of an investment policy statement proves useful. Our purpose is to offer factors that some clients have found to be helpful in considering their investment policy statements, and to allow you to consider whether an investment policy statement could be appropriate for your plan.

Before considering the adoption of an investment policy statement, we encourage you to consult your attorney.

*Fidelity does not provide legal advice, and the information provided above is general in nature and should not be considered legal advice. Consult an attorney regarding your plan's specific legal situation.

Sample of an investment policy statement

If you decide to develop your own investment policy statement for your plan, you may want to reference the provided example. This example is offered only to share some ideas and to show how other companies have developed policy statements.

The following investment policy statement is for illustrative purposes only and should not be construed as a recommendation for any particular investment policy statement or investment option.

Sample: **Statement of Investment Policy**

The purpose of the Plan is to provide eligible employees with long-term accumulation of retirement savings through employee contributions and, if applicable, employer contributions, as well as earnings.

The Plan authorizes participants to direct the investment of contributions among investment options offered under the Plan.

The retirement planning committee for the Plan (the "Committee") is responsible for establishing the investment menu offered to participants under the Plan and for monitoring the menu for the purposes of deciding whether changes are appropriate. This Investment Policy Statement (IPS) is intended to provide a general framework for the Committee in discharging its fiduciary responsibilities in accordance with the Plan and the Employee Retirement Income Security Act of 1974 (ERISA).

General Matters:

- The Committee will endeavor to ensure that a broad range of investment alternatives are made available to participants in accordance with Section 404(c) of ERISA.
- The Committee will review the investment menu on a periodic basis (at least annually) to ensure that it offers sufficient choice and stays current with any relevant investment or regulatory trends.
- The Committee will also ensure that meaningful information and education is provided to all participants to allow informed decisions regarding investment risks, potential returns, and the resulting impact on retirement savings.
- The minutes of the Committee's deliberations shall be recorded to provide a written record of the Committee's due diligence process.

Evaluation of Lineup Structure: The Plan lineup will include a diversified mix of investment options. A sample framework for a plan lineup is shown below. The Committee should evaluate the lineup on a regular basis.

Three-Tiered Lineup Structure

Tier 1: **Offers a one-stop approach for investors who are less comfortable making investment decisions**

Lifecycle as a Default Option*

Tier 2: **Offers a limited, yet flexible, array for investors who wish to build their own asset allocation strategy**

Fixed Income		Domestic Equity			International Equity	Specialty
Money Market/ Stable Value	Bonds	Large Cap Value Mid Cap Value Small Cap Value	Large Cap Blend Mid Cap Blend Small Cap Blend	Large Cap Growth Mid Cap Growth Small Cap Growth		

Tier 3: **Offers broader and more specialized choices for more experienced, knowledgeable, and confident investors**

Expanded Investment Offering

*Other options are available as a default.

For illustrative purposes only.

Evaluation of Investments: The Committee will review the Plan's investment options on a regular basis—at least annually. This review will include (but need not be limited to) the factors listed below. The service provider will be asked to provide Plan data in a format that will support the investment review process. The investment review process can be facilitated by the Plan's investment consultant(s) if this would be deemed helpful by the Committee.

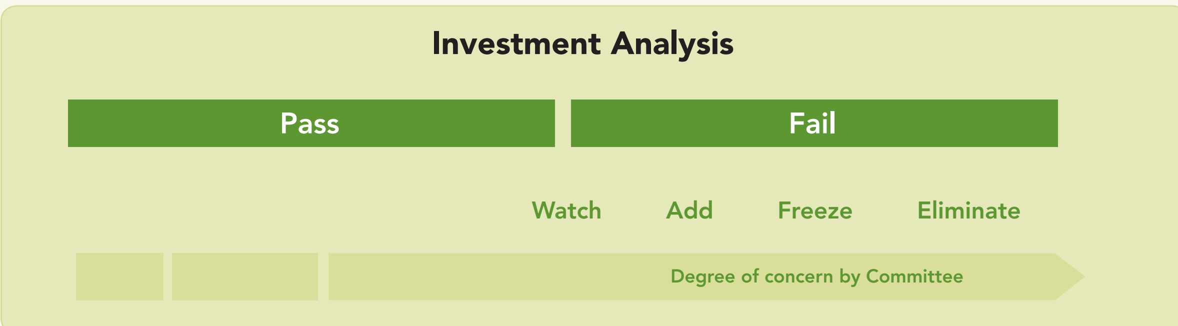
The performance of each investment option will be compared against recognized appropriate indexes and within universes of investment managers and investment options with similar styles. Investment options will also be evaluated for fees and the stability of investment management. The review will focus on the following criteria:

- Net returns greater than the benchmark over three years, five years, and full market cycle
- Performance among the top 50% of peers over three- and five-year periods
- Fees below the average for the most appropriate peer group
- Portfolio manager with tenure of three years or more

If an investment option should fail to satisfy the above criteria, or should some other material change prompt concerns as to the appropriateness of continuing to offer that investment option under the Plan, the Committee may consider whether to take any one or a combination of the following actions:

- **Watch:** Establish an official probationary period during which the Committee continues to monitor the performance of the investment option.
- **Add:** Supplement the investment option with one or more alternative investment option(s) for that category.
- **Freeze:** Maintain the investment option, but stop new participant contributions.
- **Eliminate:** Remove the investment option from the Plan. Map assets to a similar investment or to the Plan's default investment option.

Investment Option Analysis



Other investment criteria: The above analysis structure works well for most investments in a plan. However, there are several instances where investments will not fit neatly into this framework. Thus, it is important for the Committee to consider additional or different factors when evaluating certain investments. The following are common examples of investments requiring a different point of view, whether the Committee has included them in the current menu or may consider doing so in the future.

Index funds (if available): The goal of an index fund is to closely mirror the performance of a predetermined index at a reasonable cost. Thus, fees and relative performance versus an appropriate index are the most important factors to consider. Fees should be low versus other passively managed investments with a similar mandate. Performance should track closely to that of the index. An index fund's performance should not differ widely from the performance of its benchmark, minus fees. Performance versus peers and management structure should be discounted, if considered at all.

Lifecycle evaluation (if available): Lifecycle funds present a unique evaluation challenge because of the changing asset class allocation over time. Peer group comparisons are not always reliable, as the asset allocation of lifecycle funds within a single peer group can vary widely. Further, there is currently no recognized set of industry-standard indexes for lifecycle funds. Finally, because much of a lifecycle fund's performance can be attributed to its asset allocation model, traditional performance comparisons often do not tell the entire story. Thus, lifecycle fund evaluation should follow a somewhat different model.

- Performance: Lifecycle funds may be compared to a composite index that approximates its asset allocation model. This provides the best available performance comparison. Most major lifecycle mutual fund providers include such a composite index in their prospectus. Performance will be compared over various time periods, with an emphasis on long-term results.
- Asset allocation: The asset allocation model of a lifecycle fund should be evaluated periodically. There should be a clear philosophy behind the model, a demonstrated process in executing the model, and a strong investment team/organization to support the entire process.

Expanded fund offering—self-directed brokerage (SDB) features (if available): A plan brokerage feature can offer participants access to a broad universe of investments outside the Plan's core lineup, either as a broad universe of mutual funds or to include individual securities as well.

Evaluation of fees: The Committee will perform an evaluation of fees on at least an annual basis. The Committee will review the reasonableness of the fees incurred by the Plan and confirm that the Plan and its participants are receiving a fair value in exchange for the fees rendered. The Plan administrator can assist the Committee in evaluating fees.

Proxy voting policy: Proxy voting for mutual fund shares shall be passed through to participants in accordance with the Plan. (*Note:* A small number of plans don't pass through proxies on mutual fund designated options.) Proxy voting for securities held in a portfolio managed by an investment manager subject to ERISA shall be handled by the investment manager consistent with its fiduciary responsibilities under ERISA and the investment guidelines governing the account.

Sample Meeting Minutes—XYZ Company

Date:

Committee members attending:

Guests attending:

1. Evaluation of Investment Options

a. Review of performance

b. Portfolio manager changes, if any

c. Fund fees (expense ratios)—any significant changes?

2. Actions Taken by the Committee

a. Funds placed on Watch—note the time period, if determined

b. Funds Frozen and/or Removed—note the time period and to which alternative investment option(s) future contributions have been mapped. Also note the mapping for remaining balances. For example, Fund XYW will be frozen and future contributions will be mapped to Fund ABC. The fund will remain frozen until December 31, 20XX, at which time the fund will be removed and the remaining balances will be mapped to Fund ABC.

c. New funds added—are the new funds replacing existing underperforming funds, or being added to fill a perceived gap in the current menu?

3. Other Topics Covered

4. Next Steps

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Consult an attorney regarding your plan's specific legal situation.

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