An IPS 'Sets' The Standard

Once adopted, the document must be followed

***Question:** I'm new as an adviser, and while I've read that an investment policy statement, or "IPS," isn't required under ERISA [Employee Retirement Income Security Act], it seems like many of our clients have them. What do I need to know about them?*

ANSWER: ERISA requires that investment fiduciaries adhere to generally accepted investment theories and prevailing investment industry standards. This entails decisions about asset classes, the criteria for the selection and monitoring of investments, the circumstances that may warrant removal and/or replacement of an investment, and more. An IPS can be used to describe the guidelines for this decision-making process.

As stated by the Department of Labor (DOL) in its 2016 guidance, Interpretive Bulletin (IB) 2016-01, an IPS is a "written statement that provides the fiduciaries who are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment decisions …"

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The DOL also said that the determination of the terms of an IPS is an exercise of fiduciary responsibility. The DOL then acknowledged that maintenance of an IPS "designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA."

So, if maintenance of an IPS is consistent with ERISA fiduciary obligations, does the failure to have one constitute a fiduciary breach?

There is one court decision that found this to be the case. In the 1998 decision of *Liss v. Smith*, a New York district court found that an IPS was "necessary to ensure that the plan investments are performing adequately and meeting the [plan's] actuarial, liquidity and other needs." The court then concluded that the statement's absence, coupled with the other acts and omissions of the fiduciaries, constituted a breach of fiduciary duty.

Based upon this decision and the DOL guidance, it's apparent that an IPS is an important way to manage risk by demonstrating compliance with ERISA fiduciary responsibilities. In our experience, most investment advisers for ERISA plans include assistance with preparation of an IPS as a part of their services. And 3(38) advisers, who have discretion over ERISA plan assets, usually develop an IPS for a client's plan as a framework for making investment decisions and demonstrating compliance with their fiduciary duties.

If an IPS is developed, a best practice is that it should, at a minimum, contain:

- A description of the plan's objectives and needs—e.g., compliance with ERISA 404(c) safe harbor rules, satisfaction of qualified default investment alternative (QDIA) requirements, etc.—and guidelines about how the fiduciaries intend to achieve those objectives;
- A description of the allocation of roles among the various fiduciaries with investment authority—e.g., the plan sponsor (or committee), the trustees, the investment adviser and/or the 3(38) investment manager;
- A description of the process for selecting investments, including the types of investments to be included and the criteria for selecting and monitoring the investments;
- A description of the plan's policies, if any, regarding environmental, social and/or governance (ESG) factors and a description of the ESG-related metrics and analyses for such investments;
- A description of the selection and monitoring process for certain types of specific investments, such as target-date funds (TDFs), money market funds, stable value investments, and/or guaranteed contracts; and
- A description of the process for monitoring investments, including circumstances that may warrant placing investments on a watch list or removing and/or replacing them.

Once adopted, the IPS is considered a plan document, and, therefore, the investment fiduciary has an obligation to follow it. If the IPS is worded too rigidly, an investment fiduciary who fails to follow its specific terms will be in breach of his fiduciary duties. However, an IPS can be drafted to provide flexibility for the investment fiduciaries. For example, the document could say that its provisions are guidelines for the fiduciaries to consider but that they are not binding—that instead, the fiduciaries would be expected to use their discretion and judgment in making decisions.

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