

What 401(k) Plan Sponsors Need To Know About The Investment Policy Statement

By Ary Rosenbaum, Esq.

When you go to kitchenware, you see so many different types of kitchen tools that you didn't know ever existed. They sell pasta forks and cherry pitters and items you don't really need, but you have to have. When you're a 401(k) plan sponsor, you hear a lot about an investment policy statement (IPS) and how you need one. Yet most sponsors like you don't know what it is and what it does. This article breaks down what an IPS is, what it does, and what it doesn't do.

What is an IPS?

An IPS is what it says it is, it's an investment policy statement. It's a document that sets forth the objectives, restrictions, funding requirements, and general investment structure for the management of the plan's assets, and provides the basis for evaluating the 401(k) plan's investment results. An IPS is all about communication. It sets the 401(k) plan's investment guidelines and procedures to those assisting in the investment process, such as the retirement plan advisors you hire. Most importantly, the IPS provides a guide for making future investment decisions. It sets how investment options are selected and how they get replaced. Having and using the policy statement compels you to be more disciplined and systematic, which improves the odds of meeting the investment goals of the Plan and avoid getting sued.

It's not legally required, but...

One of the strangest things about IPS is that despite all the talk about how you need one, there is nothing in ERISA that says you need one. Just like you don't have to brush your teeth to keep your teeth cavity-

free. So that means while you don't have to have an IPS, you actually desperately need one. The first reason you need one is that if you ever undergo a Department of Labor (DOL) audit these days, they actually ask if you have one. It's not legally required, but if they ask you for it, it means you need to have one. That's why about 87% of all ERISA-covered retirement plans have one. The second reason you need an IPS is that it's part of a prudent fiduciary process, just like how those sugary cere-

in ERISA Section 404(a)(1)(A) and (B). For purposes of this document, the term "statement of investment policy" means a written statement that provides fiduciaries who are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment management decisions...."

You actually have to follow it

Talking about teeth again, remember when after visiting the dentist, you're told that you need to floss? You got out and buy floss, yet you stop flossing after about a week? I do too. An IPS can't be treated like floss, or vitamins, or New Year's Resolutions. It has to be implemented and used. As part of a prudent process of running the fiduciary component of the plan, you actually have to follow the terms of the IPS to the T. Not following the terms of the IPS is a recipe for a disaster because it's a breach of your duty of prudence because you're not doing (replacing and choosing investment options when needed) what you say you would be doing. When you set up rules on how you govern your retirement plan, you actually have to follow them. Quite honestly,

having an IPS that you're not following is worse than not having one and all because it's evidence that you knew you had a fiduciary duty to properly select investment options and you decided not to follow it. The exercise bike that I bought and didn't use is on me, an IPS you don't use on a plan sponsor will cost you in potential litigation or DOL penalties. When it comes to running a retirement plan, the investment results aren't as important as following a prudent process. As part of a prudent fiduciary process of running your retirement plan, you need an IPS and you need to



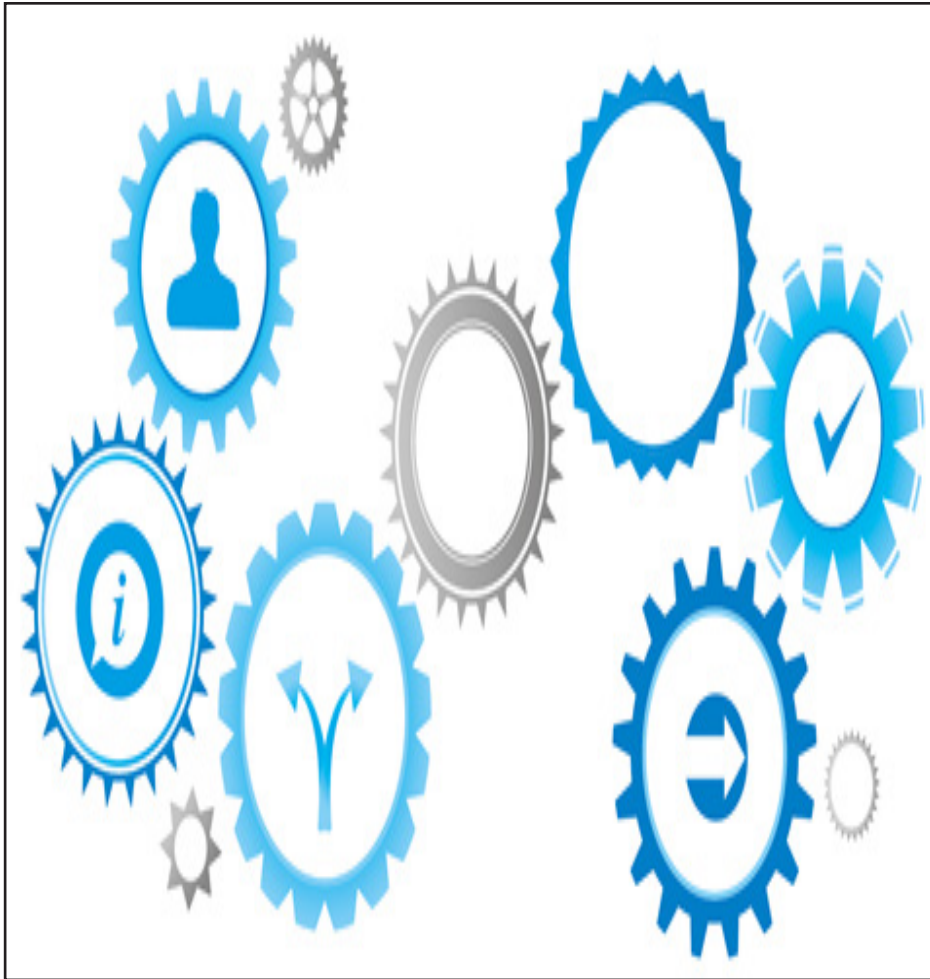
als like Count Chocula were somehow part of a nutritious breakfast. For those scoring at home, a prudent process is; establishing an IPS; diversifying plan assets; making investment decisions with the skill and care of a prudent expert; and avoiding any prohibited transactions. Don't take my word for it, look what the DOL said in Interpretive Bulletin 29 CFP 2509.94-2, "The maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth

follow its terms. Anything else is a breach of fiduciary duty.

Less is more

I once worked for an ERISA attorney who thought more was more. I remember when a client needed a required amendment for a change in the law and I wanted to use the model amendment drafted by one of the document drafting companies. Rather than charging \$500 for the amendment, she wanted something custom-created that would net her thousands more in fees. She was the type of attorney who wanted something stated in 10 lines when it could have been stated in three. When it comes to an IPS, you may have the notion that a long highly detailed

IPS is the way to go. Like most assumptions when it comes to retirement plans, you'd be wrong. Writing a highly detailed IPS is a mistake if it creates an inflexible document that you can't follow. If you don't follow the IPS as discussed in the previous paragraph, you've breached your fiduciary duty. An inflexible IPS is something that may have too much detail that needs to be updated constantly like naming the current investment options in the plan. Another mistake in providing too much detail is naming the people who are responsible for the fiduciary process of the plan instead of just citing their position title. Naming individual members of the retirement plan committee from 10 years ago in the IPS who aren't part of the committee today is a glaring error that shows you're not up to the task as a plan sponsor. On the flip side, an IPS shouldn't be vague enough that there isn't a set guideline on what needs to be done with investment options of the plan and the structure of oversight. Like the story of Goldilocks, you need an IPS that's just right, striking a balance that provides enough information and structure, but not too much that



it can't be followed. Rather than listing the specific investment options in the IPS, describe the range and type of investment strategies that are allowable. Your IPS needs to set down the rules, but too many rules that can't be followed is a mistake. Like the Constitution, the IPS needs to be a living, breathing, and flexible document.

Let your financial advisor draft it

I live by one cardinal rule that I let the experts handle certain things and your financial advisor is the expert that needs to draft the IPS. If you don't have a financial advisor, you need to get one because of the heavy legal responsibility you have by being a plan fiduciary. If you have a financial advisor and they have drafted the IPS, you need to make sure on a consistent basis (at least annually) whether the investment options still fit the framework set forth by the IPS and whether the IPS still fits the needs of your own investment objectives as plan sponsors.

It's only one part of the puzzle.

Like everything else when it comes to running a 401(k) plan, an IPS is just one part of the puzzle in properly managing

your plan. You still need to make sure the plan document is up to date, that the plan is being operated according to its terms, the annual 5500 filing is done, that fees are reasonable and that the compliance testing is complete and accurate. Even when it comes to the fiduciary component of the plan, an IPS is not your Golden Ticket or get out of jail free card. If the participants direct their own investments, an IPS isn't the only thing that will minimize your liability for their losses under ERISA §404(c). You need to provide enough information to plan participants so that they could make informed investment decisions.

An IPS or Morningstar profile can't do that, so you need to make sure that they get at the very least, some type of investment education. If you don't provide education, the IPS won't save you from being liable for investment losses from plan participants.

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The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

<http://www.therosenbaumlawfirm.com>
Follow us on Twitter @rosenbaumlaw