SAPERS & WALLACK

Retirement Report

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Investment Policy Statement Review: Beyond the Obvious

ERISA holds fiduciaries to a standard of prudence when making investment-related decisions for a qualified ERISA plan. The U.S. Department of Labor (DOL) and the courts have largely determined that said standard of prudence can best be determined by a fiduciary's process, or procedures, used in making such decisions. And though a written investment policy statement (IPS) is not explicitly required by ERISA, it is considered a best practice to create, and update, one to assist in guiding fiduciaries in making plan-related investment decisions. The DOL routinely requests a copy of a plan's IPS during investigation. And the courts have regularly looked to the terms of a plan's IPS to determine if fiduciaries undertook a prudent process in making decisions on behalf of the plan.

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The language of an IPS can be a delicate matter. It must be neither too vague nor overly strict. A vague IPS creates no evidence of process. If a court of law cannot determine the actual steps being taken in determining fiduciary action, the IPS is virtually toothless.

EXAMPLE: A client decided to remove the timing conventions for placing an investment on a watch-list and potentially removing a fund from our sample IPS. During investigation, the DOL requested and reviewed the client's IPS. The investigator cited the plan for lack of discernible procedure in their IPS. In the investigator's mind, the plan essentially did not have a prudent process because there was no guidance regarding when a fiduciary was to take an action in regard to an investment offered by the plan.

At the other end of the spectrum, an overly strict IPS serves to limit the flexibility of the plan fiduciaries and may lead to unintended consequences. A strict IPS typically contains a word such as "must." This word leaves little room for decision making on the part of fiduciaries. And if the plan ever, even for a moment, doesn't meet one of the "must" requirements, it is out of compliance with the terms of the IPS, a potential fiduciary breach. An overly strict, or overly detailed, IPS may inadvertently set unavoidable traps for fiduciaries.

EXAMPLE: The recent *Tussey v. ABB* case provides multiple examples of an overly strict/detailed IPS. The plan had adopted an IPS whose requirements were too easily violated. As a result, though the fiduciaries may have been practicing prudent processes, those processes were not reflected in the terms of their IPS. The court strictly construed the terms of the IPS and found that in multiple occasions the fiduciaries violated their duties by failing to follow the letter of their IPS.

As a result, we have routinely reviewed and edited our sample IPS to be reflective of a robust, prudent process for making investment-related decisions for ERISA plans. The goal is that the IPS reflects a process that will lead to prudent investment choices for participants while simultaneously mitigating as much risk to fiduciaries as possible under the law. Ultimately each client's IPS is their own document and should reflect the client's fiduciary philosophies and goals. Thus the sample IPS may be edited to that purpose, or a client may use a fully custom IPS.

DC Plan Participant Perspectives on Risk

This article was originally published by MFS in their 2013 *Participant Pulse*.

Retirement shortfall risk

Participants grossly underestimate what they need to retire.

- The average amount participants estimate they will need to retire is just $515,000.
- The typical participant expects to earn 8% annually, even though, on average, participants have a third of their assets in conservative investments. They also do not see the underperformance of their assets as a major risk to their retirement.

Participants have a long way to go.

- On average, participants have just $84,000 saved for retirement, even though for the average participant retirement is just 21 years away.
- Nearly half – 46% – still view their retirement assets as savings, not investments.

Women, in particular, may be underfunded.

- On average, women have only $68,000 saved for retirement, and their shortfall may be even harder to overcome, given that they are generally more conservative than men, with only 33% of their assets in US or international stocks funds vs. 42% among male participants.
- Women also feel less confident than men that their assets are aligned with their risk tolerance, with only 34% saying they feel confident and 14% saying they are not confident vs. 49% and 8% for those corresponding attitudes among men.
- More women (43%) than men (38%) are open to having someone else make their 401(k) investment decisions for them.

Asset allocations and risk tolerance

Personal risk tolerance levels often are not aligned with asset allocation.

- 41% of the plan participants identify themselves as aggressive investors. But when asked how they would invest a

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hypothetical sum, more than a third — 36% — express a desire to invest conservatively. Their actual allocations to conservative choices (31%) like bond and money market funds — are also higher than would be expected from truly aggressive investors.

- For investors who describe themselves as conservative, 43% have no idea how their 401(k) assets are allocated.

Participants believe the major risks to retirement are outside their control.

- Plan participants view risk factors largely beyond their control – such as a market crash, inflation and Social Security cuts – as the greatest risks to their retirement.
- International stock funds are seen as the riskiest asset class and are considered even riskier than REITs or commodities.
- Bond funds are viewed as the least risky, ranked by participants as safer than money market and stable value funds.

Few participants have taken risk self-assessments.

- Risk assessments may be becoming more commonplace, as the youngest group of investors – Gen Y – are the ones most likely to have taken one.
- For those who have done self-assessments, an overwhelming majority – 94% – view them as helpful.

Differences across the generational divide

Younger participants may be leaning too conservative.

- Fewer than half (only 44%) of Gen Y investors, who have time on their side, consider themselves aggressive investors. Even among those who do, they pick a conservative option when asked to select a hypothetical investment.
- More than half of the Gen Y investors (55%) consider 401(k) assets savings rather than investments — a higher number than those who take this conservative view among Gen X investors (only 42% consider their plan assets as savings) and boomers (44% of whom have this view).

Younger investors don't recognize there may be a problem.

- Gen Y investors have more than a third of their 401(k) assets (35%) in the most conservative investments — stable value, money market and bond funds. Their allocation is comparable to boomers' average allocations (36%) to these types of funds.
- Compared with other generations, more Gen Y investors (49%) are confident that their 401(k) assets are aligned with their risk tolerance. 46% of Gen X investors feel that way, and only 35% of boomers do.

Inflation ranks as Gen Y's biggest concern.

- When Gen Y investors were asked to assess the greatest risks to their retirement, inflation was cited most often (by 26%). Two factors within their control, not saving enough (18%) and not starting early enough (15%), rank much lower among Gen Y participants' perceived risks.
- Younger investors also have a lower estimate of what they will need to retire – averaging only $483,000 vs. boomers' estimate of $500,000 – even though they hope to retire at a younger age than either Gen X or boomers estimate their retirement age will be.

Gen Y investors are more interested in investment services and products.

- More Gen Y participants (68%) express interest in tools and resources to help them make investment decisions than do Gen X investors (64%) or boomers (60%).
- More than half of Gen Y investors – 54% – are willing to have 401(k) decisions made for them, a much higher percentage than the 41% of Gen X and 34% of boomer investors who want such help.

The Six Categories of Fiduciaries

A plan may have one or more fiduciaries. Each of the fiduciaries may have different responsibilities, and many individuals/committees serve in multiple fiduciary roles. Here is a simplified list, along with brief definitions, of each category of fiduciary:

- **Named Fiduciary:** This party should be named in the plan document and is considered the plan's primary decision maker. This fiduciary may be either an employee of the sponsor, or an independent party that, absent delegation otherwise, has the duty to control, manage and administer the plan. Every plan must have a named fiduciary. It is not uncommon for the named fiduciary to also serve as plan administrator and trustee for a plan.

- **Plan Administrator:** Not to be confused with pension administrator or a hired third-party administrator (TPA), this fiduciary is responsible for the plan's government filings, making required disclosures to participants, hiring service providers and fulfilling other responsibilities set forth in the plan document.

- **Trustee:** The person(s) recognized as having exclusive authority and discretion over the management and control of plan assets.

- **Investment Manager:** A fiduciary with full discretionary powers for selecting, monitoring and replacing plan investment options, as defined by ERISA Section 3(38).

- **Investment Advisor:** A limited scope ERISA 3(21) advisor who does not have explicit discretionary control over plan assets, but may exercise a certain level of influence over the operation of the plan by way of providing investment advice/monitoring services. This fiduciary must still meet the fiduciary standards set forth in ERISA.

- **Other Fiduciaries:** Other individuals, including members of various plan-related committees appointed by the named fiduciary, as well as others whose actions may dictate fiduciary status, may fall within the definitions of fiduciary under ERISA. Thus it is important to not only monitor those individuals who are explicitly named as fiduciaries in writing, but also those who have a high likelihood of undertaking fiduciary actions on behalf of the plan.

In all cases, the plan sponsor retains the authority to remove and replace any fiduciary, even if he/she has delegated day-to-day responsibilities to others. As a result, the sponsor/named fiduciary retains the responsibility to monitor any persons to which he/she has delegated responsibilities on an ongoing basis.

What Constitutes Proper Documentation of Retirement Plan Committee Meetings?

With most retirement plans, the fiduciary responsibility of selecting and monitoring the plan's menu of investments is designated to a retirement plan investment committee. This committee usually includes financial officers and human resources officers of the employer. The committee meets periodically (anywhere from annually to quarterly) to consider agenda items including investment due diligence, fees and services of plan providers, status of plan goals, etc.

From a fiduciary perspective, it is just as important to properly document these meetings as it is to hold the meetings. Proper documentation serves as proof that the committee's responsibilities are being prudently executed. Often plans question the degree of documentation necessary. Below are a few suggestions of what the retirement plan investment committee meeting minutes should include:

- A listing of all parties present with identification of roles (committee member, guest, advisor, provider representative, attorney, accountant, etc.)

- A description of all issues considered at the meeting: fund performance of investments offered, participant communication/education initiatives, plan demographic and provisional review, investment policy statement review, market summary and other topics as appropriate to achieving and maintaining a successful plan

- Documentation of all materials reviewed during the meeting

- Documentation of all decisions made and the analysis and logic supporting each decision

- Identification of any topics to be continued in subsequent meetings

For more information, contact your plan consultant.

Communication Corner: Tax Saver's Credit

This month's employee memo is titled, "401(k) Plan Notice: Get the 'Credit' You Deserve!" This memo reminds participants that they may be eligible for a valuable incentive, which could reduce their federal income tax liability by contributing to the company's retirement plan.

Call or email your plan consultant if you have questions or need assistance.