SECTION ONE
Why Plan Sponsors and All Fiduciaries Need a Formal Process for Writing Their Investment Policy Statement

Chapter 1

ERISA AND THE CHALLENGE OF FIDUCIARY RESPONSIBILITY

The landmark Employee Retirement Income Security Act of 1974, or ERISA, protects the assets of millions of Americans so that funds placed in retirement plans during their working lives will be there when they retire. This act is a federal law that sets minimum standards for retirement plans in private industry.

ERISA requires retirement plans to provide participants with information about the plan, including important information about plan features and funding. It also requires accountability of plan fiduciaries. ERISA generally defines a fiduciary as anyone who exercises discretionary authority or control over a plan's management or assets within the plan, including anyone who provides investment advice to the plan. Fiduciaries who do not follow the principles of conduct may be held responsible for restoring losses to the plan. Courts may take whatever action is appropriate.

Writing an Investment Policy

The U.S. Department of Labor enforces Title I of the Employee Retirement Income Security Act (ERISA), which, in part, establishes participants' rights and fiduciaries' duties. This guide addresses one crucial fiduciary duty in particular—the writing of an investment policy—and gives the reader an example of how to structure a policy, how to write the policy, and why it's so critical.

Anyone who is a trustee, sponsor, or who otherwise exercises any authority or control over any type of employee-benefit plan is a *fiduciary.*

And, while the contents of ERISA are immense, it is our intention to help plan sponsors, trustees, and advisors fulfill their fiduciary obligations by offering a simple step-by-step process. This process will show plan sponsors, and their advisors, how to design an investment policy that will aid in the selection of plan participants' investment options; how to write an IPS; and how to establish a thoughtful monitoring process that will ensure the process is being prudently executed.

Employer-sponsored profit sharing, 401(k), and other defined-contribution plans were designed to attract, retain, and motivate employees, while also accumulating and preserving individual retirement funds for workers. In order to accomplish these human-resource goals, someone, or some group, has to be responsible, and with that responsibility comes a legal obligation. We call these responsible people *fiduciaries*. Anyone who is a trustee, sponsor, or who otherwise exercises any authority or control over any type of employee-benefit plan is a fiduciary.

What Is a Fiduciary?

The ERISA definition of a fiduciary[3] is as follows:

- Person(s) who exercises any discretionary authority or control in management or administration of the plan or its assets.
- Person(s) who renders investment advice for a fee or other compensation (may or may not include brokers).
- Those named as plan sponsors, trustees, investment advisors (who are paid a fee), and plan administrators.

Even though there are an estimated 6 million fiduciaries in the United States today responsible for managing trillions of dollars of

[3] Center for Fiduciary Studies.

investable assets, a large percentage of these fiduciaries may not be aware of just what their fiduciary duties include. How could that be? Well, for nearly 20 years we have had strong investment markets and enjoyed a period when most investors made money and few complaints were registered. Consequently, there was little need to scrutinize the list of fiduciary obligations. But things are very different today. Yesterday's fiduciary may have been *aware* of Section 404(c) "safe harbor" regulations that outline the specific actions plan sponsors can take to limit their personal liability—but had little motivation to put them in place.

The critical first step in building a structure for ERISA conformity is to write and implement an investment policy statement (IPS). This single action is crucial to ensuring that you, your company, and/or your committee are in compliance and protecting your personal liability.

Fiduciary Liability

Today's knowledgeable fiduciaries are not just required to—but motivated to—stay abreast of the regulations and follow them to the letter. They understand that the rules to which they must adhere are governed by the U.S. Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation. And, with the current volatility in the financial markets, coupled with corporate malfeasance seen at numerous companies, and the historical concentrations of company stock in 401(k) plans, participants who experience losses are upset and looking for someone to blame. Plan sponsors are a logical target. The Center for Fiduciary Studies estimates that there were over 15,000 ERISA-related actions (civil actions and arbitration cases) brought against plan fiduciaries in 2002—representing an 11.7 percent increase over the prior year.

There are steps a plan sponsor (fiduciary) can—and must—take to protect themselves from personal liability and assist in compliance with their responsibilities. The critical first step in building a structure for ERISA conformity, and the one we focus on in this book, is to write and implement an investment policy statement (IPS). This single action is crucial to ensuring that you, your company, and/or your committee are in compliance and protecting your personal liability.

Developing an IPS for your defined-contribution plan is a key component of fulfilling a plan sponsor's fiduciary responsibilities. Current estimates indicate that less than 50 percent of all defined-contribution plans have an IPS, due primarily to a lack of understanding about why one is important, and how to prepare it. This book will help you structure one, if you don't already have one. Or, if you do have one, it will provide you with a simple reference for reviewing your existing plan to make sure it encompasses all of the key issues of compliance.

PLEASE NOTE: While it's my hope that this book will be of value to plan sponsors, plan trustees, and investment advisors, it does not offer legal advice, legal opinions, or investment advice. It was written strictly to help fiduciaries with the common language needed to create a clear and understandable IPS.