

INVESTMENT POLICY STATEMENT



ELEMENTS OF A CLEARLY DEFINED IPS FOR DEFINED CONTRIBUTION PLANS

Today's increasingly complex investment and regulatory landscape places greater pressure on investment committees and other fiduciaries overseeing defined contribution plans. Fiduciaries are not only re-examining their current investment decision-making practices, they are also seeking to ensure that those practices allow for enough flexibility in implementation to maximize the likelihood of investment success, while protecting the plan sponsor from potential litigation. Central to the idea of a well-managed program, a clearly articulated investment policy statement (IPS) serves as the foundation of sound governance and a robust oversight process. In this paper, we summarize the key elements of an IPS and discuss the ways by which "great" policy design can ultimately drive a successful defined contribution plan.

What is an investment policy statement?

An investment policy statement (IPS) is an investment committee specific document designed to provide oversight procedures that govern the investment-related activities of a defined contribution plan. Specifically, the IPS should address the objectives, investment structure and evaluation guidelines of the investment offerings within the plan. A well-rounded IPS should clearly delineate the responsibilities of all parties involved in the plan (e.g., the board of trustees; the investment committee; the investment advisor, which may be an outsourced CIO provider; and the recordkeeper).

ERISA does not mandate that an investment committee have an IPS; however, that doesn't mean it is not needed. In addition to providing guidance on plan management, should the plan ever be audited by the Department of Labor (DOL), one of the first documents the DOL will request is the IPS. Further, DOL Interpretive Bulletin 29 CFP 2509.94-2 specifically discusses the need for an IPS: "...consistent with the fiduciary obligations set forth 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...."

In summary, having an IPS is good practice, but fiduciaries must follow the contents of the IPS to the letter or risk a breach of fiduciary responsibility under ERISA. Therefore, it is also good practice to avoid directives and embed flexibility.

Constructing an IPS should be a dynamic process. While changes to the document should be infrequent, the IPS should be reviewed annually to ensure that all language and content reflect the investment committee's views and fulfill all regulatory requirements. During the initial design process and subsequent reviews, the investment committee should seek input from trusted investment advisors and an external counsel who can help identify additional risks and issues that may not be top-of-mind.

Drafting an IPS can also be an educational experience for investment fiduciaries. Working through issues in the design process can help identify weaknesses and gaps between actual and best practices, and between expectations and reality. The result should be a document that can be easily understood and executed by all relevant parties and that provides clarity in the case of questions regarding investment strategy. (For example, an investment manager change should not automatically necessitate an IPS revision.)

The IPS should be specific enough to provide meaningful guidance but flexible enough to follow while also accommodating for future economic, accounting and regulatory changes without exposing the plan to undue legal challenges. The IPS development process can be like walking a tight rope; fiduciaries must strike a balance between creating a useful document that demonstrates procedural prudence and managing litigation risk by not imposing an obligation on the plan fiduciaries to act in any particular way. To that end, investment committees should consider incorporating additional flexibility into the IPS by adding language to explicitly state that fiduciaries "may consider

criteria not set forth in the IPS to make decisions that differ from those set forth in the IPS and shall be free to deviate from the IPS as they deem appropriate in their sole discretion.”

Vital elements of a “great” investment policy statement

What embodies a “great” IPS? A well-written investment policy statement is typically organized in sections that address these core areas:

1. Purpose and Scope
2. Plan Objectives
3. Definition of Duties
4. Investment Menu Framework
5. Monitoring and Evaluation
6. Participant Communications
7. Acknowledgement

When constructing an IPS, the adage of “less is more” is important to keep in mind. While it may seem like a good idea to write out a very detailed IPS, a high degree of detail can be a mistake. Detailed directives and overly prescriptive language often create an inflexible document that can make it difficult for the investment committee to follow or that can force unnecessary changes to the plan that may not benefit plan participants. An example could be forcing an investment manager change based solely on quantitative criteria that results in performance chasing. As noted above, if the IPS isn’t followed to the letter, it exposes the plan to legal risks due to their breach of fiduciary duty.

Section 1: Purpose and Scope

Typically, the first section in an IPS is “Purpose and Scope.” This section provides an overview and sets the tone for the specific guidelines within the body of the document. It should broadly state the scope of the IPS, its intended purpose and the general objectives of the plan. If an entity has multiple defined contribution plans, listing out all plans that fall under the scope of the policy is important.

Section 2: Plan Objectives

All IPS documents should clearly articulate the objectives of the plan(s). Generally, this would include language such as, “The purpose of the 401k plan is to provide eligible employees with an opportunity to save for retirement.” Often there is a description stating that participant account balances may be composed of employee and employer contributions as well as investment earnings.

Within this section, it is a good idea to acknowledge that different plan participants likely have different investment objectives, time horizons and risk tolerances. As a result, the plan will offer a range of investment options and different asset class exposures designed to span the risk and return spectrum.

From a legal perspective, in this section of the IPS, it is appropriate to state that plan participants bear the risk of investment results from the options they choose, along with the associated asset allocation. The plan does not take on this risk. While participants bear the investment risk, the investment committee has a fiduciary responsibility to ensure the plan is well managed and will act in the best interest of plan participants. The IPS should state that the plan will always be managed in compliance with ERISA and all other applicable laws and regulations.

Section 3: Definition of Duties

It is important for the IPS to clearly state the duties of all involved parties, so that they are aware and may effectively fulfill their obligations. The parties listed may include:

Board of trustees

Typically, the board has the ultimate fiduciary responsibility for the plan’s management. The board is responsible for ensuring that appropriate policies governing the management of the portfolio are in place, as well as implemented. Typically, the board delegates responsibilities to an investment committee for ongoing monitoring and implementation of the plan.

Investment committee

The investment committee is responsible for creating and implementing the investment policy. In addition, the investment committee is responsible for reviewing and approving plan structure, the investment choices offered and the investment strategy (i.e., hiring investment managers or an outsourced CIO provider to implement the strategy). The committee is responsible for monitoring performance on a regular basis to ensure compliance with the IPS. Additionally, it must ensure that the fees charged to plan participants are competitive and reasonable.

Investment Advisor

Articulating the role of an investment advisor is critical. The agreement with the advisor establishes the breadth and depth of the scope and level of fiduciary responsibility. Within the IPS, advisor responsibilities include, but are not limited to, the following:

- Meet regularly with the investment committee to review performance of the investment funds within the context of the IPS.
- Recommend modifications to the IPS, objectives, or guidelines for investment funds, as appropriate.
- Advise the investment committee on modifications to the investment menu offered to plan participants, when applicable.
- Notify the committee of any material changes to the organization, investment teams or investment process.
- Conduct regular reviews of the fees related to plan investments.

In the case of an OCIO provider, who assumes co-fiduciary responsibility along with the investment committee, they may perform a much wider range of duties, which depend on the delegated level of discretion (e.g., determining the investment menu, selecting managers, and actively managing the portfolio). Generally, there is an investment management or services agreement between the plan and the OCIO provider.

The OCIO should provide a comprehensive solution that includes assuming the fiduciary liability for the selection of the underlying investment managers. It is important to be clear on where the responsibility for those relationships lies. Depending on the scope of services and level of discretion accorded to the outsourced provider and other parties, there may be additional roles to define.

Investment managers

The duty of investment managers is to implement the strategy for which their services have been retained. For example, a global equity manager would be responsible for investing in stocks across the breadth of the global opportunity set.

Trustee/recordkeeper

While the trustee and recordkeeper are often the same organization, sometimes these functions will be separate and the main responsibilities for each should be spelled out in the IPS. At a high level, some of the key responsibilities include:

- Maintain the plan and provide asset safe keeping
- Allocate and transfer the plan assets as directed by the plan participants
- Make payments from the plan to participants or beneficiaries as directed
- Provide a written accounting of all cash flow movement and market values
- Provide an annual 5500 reporting package
- Report performance of all investment options
- Provide statements to participants

Section 4: Investment Menu Structure

All investment policy statements should clearly articulate the investment objectives of the plan and outline the investment committee’s philosophy in plan design. With plan participants having a wide range of investment objectives and differing circumstances, a robust plan design that covers the risk and reward spectrum is important. Policy language around the use of actively managed and/or passively managed investment offerings are typically included in this section. In addition, the defined contribution industry has seen a noticeable increase in “white labeling” investment options to streamline investment menus and help reduce participant confusion. If the white labeling of investments is utilized by the plan, that should be noted.

In recognition that participants possess varying degrees of investment sophistication and different investment preferences, this section should be used to describe the

tiered investment menu structure. While participants can invest in more than a single tier, each tier is designed to allow for varying investment approaches. Descriptions of each tier should be included in the IPS. The following provides additional detail around these tiers:

Tier 1 (target date funds, target risk funds, managed accounts)

Tier 1 investments are often thought of by participants as the “do it for me” approach to investing. The participant may choose from a comprehensive, pre-mixed lifecycle fund that offers a complete and diversified portfolio based on age, anticipated date of retirement, or risk tolerance. In addition, a Tier 1 investment offering is often the default investment option for the plan and the IPS should reference its designation as the Qualified Default Investment Alternative (QDIA).

Tier 2 (active and/or passive core funds)

Tier 2 investments are appropriate for participants who may wish to construct their own investment portfolios. As part of this offering, the plan should make available a core menu of single asset class options or white label funds. Options in this tier should include a diversified mix of asset classes with different return and risk characteristics. The broad asset classes made available to participants may change over time, but each investment option should be evaluated based on its appropriateness in a well-diversified portfolio.

Exhibit 1: Example of Tier 2 investment offerings

ASSET CLASS	BENCHMARK
U.S. Large Cap Equity	Russell 1000 Index
U.S. Small Cap Equity	Russell 2000 Index
Non-U.S. Equity (Developed and Emerging Markets)	MSCI ACWI ex-US Index
Core Fixed Income	Bloomberg US Aggregate Bond Index
Stable Value	Citigroup 1 to 3 Month T-Bill Index

Tier 3 (self-directed brokerage account)

A self-directed brokerage account is recommended when an investment committee feels it’s appropriate to offer more sophisticated investors with options outside of the Tier 1 and Tier 2 investment menus. If offered, language in this section should emphasize that the investment committee makes no judgement or attestation about the appropriateness or suitability of its inclusion in a participant’s asset allocation strategy. The responsibility of monitoring and assessing the suitability of the investments in a Tier 3 option rests solely on the participant.

Investment advice/managed accounts

This section is recommended only if the plan offers investment advice (i.e., managed accounts). Managed accounts are an advisory service that participants may elect, which provides individualized asset allocation advice for a fee, generally utilizing funds from the plan's existing core menu. If managed accounts are offered, the language should convey that managed accounts are an optional service that participants have access to in addition to the investment offerings made available under the plan. The IPS should state that the managed account service is provided by a third-party service provider and indicate the name of the provider.

Section 5: Monitoring and Evaluation

Ongoing review of a plan's investment options is a critical step in the IPS process. There has been an increase in lawsuits brought by participants claiming improper management of their defined contribution plan. Having well-articulated guidelines for the investment committee to follow can be very helpful in a lawsuit or audit. While it is important to have a policy in place, it is far more important to ensure the policy is followed.

When evaluating the Tier 1 and Tier 2 menu performance, the IPS should clearly state which market benchmarks are to be used for each investment option and if applicable, which peer universe. Given the unpredictability of financial markets and varying lengths of market cycles, language in the IPS should acknowledge that short-term fluctuations in returns may cause variations in both absolute and benchmark relative performance. As a result, best practice would be for the investment committee to take a longer-term view in evaluating the performance of each investment option. Reviewing results should include an evaluation of both quantitative and qualitative criteria, with the latter considering characteristics such as the level of conviction in the portfolio management process and depth and quality of investment professionals.

While the investment committee should review results on a frequent basis (e.g. quarterly), it should leave itself the flexibility to avoid unnecessarily replacing an investment

option simply because benchmark relative performance has fallen below an index on a three- or five-year basis. Underperformance could simply be due to the investment style being out of favor with the market. While flexibility in the investment committee's evaluation is important, ensuring that reasons for an investment option's underperformance or overperformance is memorialized in the meeting minutes is imperative. In the event of a plan audit or when participants claim mismanagement, thorough documentation demonstrates that the investment committee followed a clear process in the monitoring and evaluation of the investment menu.

In addition to performance evaluation, the investment committee should also include guidelines with a focus on evaluating expenses borne by plan participants, such as investment management fees. The investment committee should confirm on a regular basis that all costs associated with the management of the plan are reasonable. Investment management expense for each investment option should be competitive relative to respective peers considering portfolio characteristics, account size and investment style.

Section 6: Participant Communications

The IPS should contain a section outlining the committee's philosophy towards participant education. A well-designed defined contribution plan will not be able to live up to its full potential if participants are not educated on their benefits as well as options. It is important for committees to think about the nature and frequency of participant education.

Section 7: Acknowledgement

Typically, the last section in an IPS is the acknowledgement section, which is signed by an authorized individual from the investment committee with copies distributed to all parties. The acknowledgment statement can be as simple as: The committee considered and approved this Investment Policy Statement on XX date.

Conclusion

Having a well-defined and clearly articulated IPS is vital in today's challenging investment and regulatory landscape. The IPS fulfills a vital role in helping to lay the foundation of an investment committee's overall governance structure and ensuring that all fiduciaries fulfill their obligations. Writing a "great" IPS is often an iterative process; it demands engagement and thoughtfulness from each fiduciary. Russell Investments strongly believes that such a level of care will result in an oversight protocol that is more integrated and better aligned with the needs of the investment committee and the beneficiaries of the plan.

QUESTIONS?

Call Russell Investments at **800-426-8506**
visit russellinvestments.com/DC

ABOUT RUSSELL INVESTMENTS

Russell Investments is a leading global investment solutions partner providing a wide range of investment capabilities to institutional investors, financial intermediaries, and individual investors around the world. Since 1936, Russell Investments has been building a legacy of continuous innovation to deliver exceptional value to clients, working every day to improve people's financial security. Headquartered in Seattle, Washington, Russell Investments has offices worldwide, including: Dubai, London, New York, Paris, Shanghai, Sydney, Tokyo, and Toronto.

IMPORTANT INFORMATION

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates Management, L.P., with a significant minority stake held by funds managed by Reverence Capital Partners, L.P. Certain of Russell Investments' employees and Hamilton Lane Advisors, LLC also hold minority, non-controlling, ownership stakes.

Frank Russell Company is the owner of the Russell trademarks contained in this material and all trademark rights related to the Russell

trademarks, which the members of the Russell Investments group of companies are permitted to use under license from Frank Russell Company. The members of the Russell Investments group of companies are not affiliated in any manner with Frank Russell Company or any entity operating under the "FTSE RUSSELL" brand.

Copyright © 2023 Russell Investments Group, LLC. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an "as is" basis without warranty.

First used: February 2020. Revised: April 2023.

AI-29719-04-26