Investment Policy Statements

Legal and Practical Considerations

By Sheldon M. Geller

In a May 2015 decision, the U.S. Supreme Court held that a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) who is responsible for the selection of 401(k) plan investment choices has an ongoing duty to monitor those choices and remove imprudent ones from the plan's investment menu (*Tibble v. Edison Int'l*, 13-550).

Risk Mitigation Best Practices

The Supreme Court decision makes clear that fiduciaries tasked with 401(k) plan investment menu fund selection must engage in risk-mitigation best practices, such as the following:

- Establish a 401(k) committee and adopt a committee charter authorizing the selection, retention, and replacement of investment funds.
- Adopt and adhere to an investment policy statement setting forth guidelines for the selection, retention, and replacement of investment funds.
- Conduct regularly scheduled committee meetings at least annually and prepare meeting minutes to record fiduciary decisions affecting plan investments.
- Review annual fee disclosure statements, fund expenses, and service provider fees to determine reasonableness and prepare meeting minutes to record fiduciary decisions affecting plan cost.
- Review the effectiveness of any outside investment advisors, their services and fee arrangement, and the extent to which they assume fiduciary responsibility for plan investment selection.

Investment Policy Guidelines

Committees are advised to document the procedures for the selection and monitoring of investment funds by way of a written investment policy statement. The failure to follow an investment policy statement is evidence of a breach of fiduciary responsibility. Accordingly, it is imperative for committees to follow and apply their investment policy guidelines, including the timely deposit of employee contributions, the review of fee disclosure statements, and the handling of revenue-sharing payments (see Department of Labor Advisory Opinion 2013-03A).

Continuing Fiduciary Duties

This Supreme Court case has added clarity for plan fiduciaries with respect to the duty to select investment alternatives prudently, to monitor investment alternatives prudently, and to remove imprudent investment alternatives. The statute of limitations for a breach of fiduciary duty action runs from a breach of any of these three obligations (see ERISA section 409).

Accordingly, the statute of limitations would not toll an action against a plan fiduciary in cases where a committee fails

to adhere to its investment policy statement. Moreover, the failure to follow an investment policy statement or a departure from its provisions in actual plan operation is likely to be raised in litigation.

Granting Discretion

An investment policy statement should be carefully drafted to grant discretion to the committee to make determinations and to exercise that discretion. Accordingly, committee meeting minutes should document investment fund reviews, the application of investment policy guidelines, and the extent to which the committee did not follow investment policy statement guidelines.

Committee Monitoring

Case law requires committees to regularly monitor vendors and investments and to take into account fee benchmarking and professional opinions on fees and services [see *George v. Kraft Foods Global Incorporated*, 641 F.3d 786 (7th Cir. 2011)]. Tibble further requires a committee to properly manage revenue sharing and to consider institutional funds versus retail funds.

Employer Securities

Recent case law has taken away the presumption of prudence for an employee stock ownership plan fund or an employer stock fund (see *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2014). Accordingly, committees need to watch brokerage window terms with respect to employer securities and consider employer security policies under a 401(k) plan offering self-directed brokerage accounts. Committees also need to watch investment advice agreements regarding employer stock funds, persons who are defined as the fiduciary, and potential prohibited transactions in settlements.

Blackout Notices

Other special rules apply with respect to plan investments, including blackout notices that help protect plan fiduciaries from losses related to participant investment direction [see ERISA section 101(l)]. A qualified change in investment alternative still needs a blackout notice for replacing one fund with a similar type of fund [see ERISA section 404(c)(4)]. These notices do not eliminate the duties related to the selection and monitoring of investment alternatives.

404(c) Safe Harbor

Plan documentation, customarily the summary plan description, must state that the plan is intended to satisfy the ERISA section 404(c) safe harbor in order to extend protection to plan fiduciaries. It is advisable to set forth the safe harbor in the investment policy statement as well to enable the committee to satisfy the safe harbor requirements.

The 404(c) safe harbor requires that participants be allowed to choose from at least three core alternatives with different risk/return characteristics, to change investments at least quarterly or more often for riskier noncore investment alternatives, to diversify elections to minimize losses, and to obtain sufficient information to make informed investment decisions. Plan fiduciaries must make certain that participant disclosures are made, including the distribution of the summary plan description to participants.

Named Fiduciary

A named fiduciary is a fiduciary who is named in the plan document or who, pursuant to a procedure specified in the plan, is identified as a fiduciary. If the committee is a named fiduciary and properly delegates responsibility to a qualified investment manager, it appears that the committee will generally be relieved of direct responsibility for the acts and omissions of the investment manager, provided the committee monitors the delegation prudently and otherwise in accordance with ERISA.

Committees may—and should—defer to the decisions of nonconflicted fiduciaries they appoint (e.g., qualified investment managers and independent named fiduciaries). ERISA's prudence standard is satisfied, substantively and procedurally, if the committee performs an adequate review and analysis before engaging in conduct, entering into a transaction, retaining a service provider, using plan assets to pay a fee, or selecting an investment alternative.

Defensive Posture

Committees must act from a defensive posture, because some courts have held that it is appropriate to be "generous" to the plaintiff plan, resolving doubts in favor of plan participants and against the breaching fiduciary [see *Donovan v. Bierwirth*, 754 F.2d 1049 (2d Cir. 1985); see also *Kim v. Fujikawa*, 871 F.2d 1427 (9th Cir. 1989)].

Loss causation is often an issue in fiduciary litigation. A plan fiduciary is not liable for plan losses unless the loss incurred was caused by a breach of fiduciary duty.

Accordingly, 401(k) plan committees are well advised to engage in a deliberate review and decision-making process, documented in their meeting minutes, pursuant to a charter, and carried out by those individuals and entities designated by the committee. ❑

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