Effective Plan Management Starts with a Strong Investment Policy Statement

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The Investment Policy Statement (IPS) for a public defined benefit plan is one of the most important documents in guiding Plan Sponsors with managing retirement assets while fulfilling their fiduciary obligations. A strong fiduciary governance practice calls for reviewing a plan's IPS no less than annually to ensure it remains current and applicable.

A well written IPS should contain several key sections, including:

- Purpose of plan and IPS
- Statement of goals and objectives
- Roles and responsibilities
- Investment strategy
- Manager selection and oversight
- Asset allocation framework

Purpose of Plan and IPS

This section of the IPS confirms that:

(1) The purpose of the plan is to provide retirement benefits to eligible employees.

(2) The purpose of the IPS is to assist those overseeing the plan assets in effectively managing the plan and fulfilling their fiduciary responsibility.

An effective IPS records the processes necessary to manage the plan while highlighting the importance of committee members' fiduciary duties and compliance with applicable state laws.

Statement of Goals and Objectives

The goal of a public pension plan is relatively standard: meeting the benefit obligations of the plan. To achieve this, a return objective to meet or exceed the long-term actuarial return expectation is necessary. It is also important for appropriate risk levels to be considered in the effort to attain the plan's financial and investment objectives. A plan with the sole objective of maximizing returns likely entails significant risk and return volatility, which can hamper the predictability of annual contributions for municipalities and therefore have a detrimental impact on budget planning. The Statement of Goals & Objectives section of the IPS should identify the plan's return objective by outlining investment goals as well as acknowledging the appropriate level of risk.

Roles and Responsibilities

The roles and responsibilities section of the IPS is critical because it clearly articulates who is responsible for specific functions related to the plan. Typical parties involved in the management of a public pension plan, whose roles would be outlined in the IPS, include the representative government body, pension board/committee, investment advisor, plan actuary, investment manager(s) and custodian. Each role plays a crucial part in effective plan management, as the plan cannot run smoothly if all parties' roles are not clearly laid out and followed.

Investment Strategy

The investment strategy section memorializes the overall investment philosophy regarding how plan assets will be invested. This section also stresses that the plan should not simply strive to maximize returns, but instead should seek to achieve returns in a prudent manner commensurate with appropriate risk. Establishing metrics for how to evaluate the investment strategy over time and selecting appropriate benchmarks for this evaluation process should be discussed in this section of the IPS. The IPS could also acknowledge that while short-term volatility may cause the plan to deviate from its goals at certain points in time, maintaining a long-term focus and strategy is imperative.

Manager Selection and Oversight

The manager selection and oversight section of the IPS should document what information drives the investment selection process. Establishing a thoughtful and repeatable process is a critical element for helping boards and committees document a due diligence process in the task of selecting investments. The selection and monitoring process should include a combination of quantitative and qualitative metrics. The ongoing monitoring process also requires a documented approach, explicitly stating how managers are evaluated over time and which benchmarks they are evaluated against. To this end, establishing and implementing a WATCH list criterion is a helpful tool for Plan Sponsors in carrying out their fiduciary obligations with respect to manager oversight responsibilities.

Like the selection and monitoring section of the IPS, a clearly defined set of criteria used to support investment manager termination decisions is essential. Especially important in this decision-making process are quantitative and qualitative details about changes that investment strategies have experienced since the selection decision was made.

Asset Allocation Framework

Once a pension plan's investment objectives and constraints have been identified, an asset allocation that aligns with those specifics can be determined. This framework should be memorialized in the IPS to serve as guidelines for the overall investment of plan assets. The asset allocation framework should be simultaneously specific and broad - specific enough to clearly define allowable asset class ranges, but broad enough to avoid having to modify the IPS or rebalance the portfolio following any minimal deviation from asset class targets or investment strategy adjustments. Also, within this framework it is important to include applicable asset class benchmarks which can be used to both evaluate the individual asset class performance as well as assist in the construction of the plan's overall blended benchmark.

In Closing

Plan Sponsors who follow the above outline should be well on their way to having a well-designed Investment Policy Statement which can help support effective plan management. The path to good plan governance does not end though with the establishment of an IPS. Annually reviewing the statement to ensure accuracy and appropriateness takes time and effort but is nonetheless vital. When a plan has an effective IPS, it serves as a detailed roadmap to be followed, remaining steadily in place to guide committees in the fiduciary duty entrusted to them, even as the committee/board members change through time.

For more information on creating a strong Investment Policy Statement, please contact any of the professionals at Fiducient Advisors.

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