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THE BENEFIT POLICY STATEMENT

Designing the Defined Goal

Many plans (although still only about 50 percent nationally) have in place an Investment Policy Statement (IPS) to outline permissible asset classes or investment categories, the "prudent expert" fiduciary criteria, fee analysis criteria, diversification guidelines, and benchmarks to prudently monitor each plan investment.

For a defined contribution plan to deliver a reliable retirement income benefit, it must be more that a collection of good investments governed by the IPS. The IPS does not describe in any meaningful way how the plan participant will obtain an adequate benefit—or even what the benefit should be. In fact, for a participant-directed plan, the IPS is not there for the participant at all, but simply as a way for the plan fiduciary to outline its considerations in determining the investment options that will be made available for the participants to use in constructing their portfolios.

A new governance document is desperately needed: the Benefit Policy Statement or "BPS." The BPS sets forth both the defined goal and accompanying prudent procedures that the plan's discretionary fiduciary (generally the discretionary plan trustee) will implement to increase the likelihood that the plan, as an individual account plan, will provide adequate benefits to participants and their beneficiaries.

The BPS is distinct from the IPS. The IPS addresses plan level investment management; the BPS addresses active steps to be taken by the discretionary trustee to increase the likelihood of success at the individual participant level. Very few defined contribution plans use a discretionary corporate trustee. A directed trustee would not be in a position to implement the required actuarial and fiduciary steps given their "directed" capacity. An example of a benefit goal selected by the plan sponsor is shown below. A formal plan document containing plan design specifications, the IPS, and the BPS should be the primary documents that govern the plan. Currently, the formal plan document is required by ERISA § 402(a)(1) to be in writing. Some may question whether there is a need for

> **Benefit Policy Statement Retirement Income Goal**
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> **Target income replacement is 70% of final average compensation beginning at Social Security Normal Retirement Age with least risky portfolio.**
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> **Social Security Benefit is included.**

ERISA to require additional written governance documents to define goals and accompanying prudent procedures. ERISA encourages the adoption of written policies and procedures that will promote prudent processes and fiduciary standards of care. ERISA §§ 402(b)(1) and 404(a)(1) read as follows:

ERISA 402(b)(1) Funding Policy and Method

Every employee benefit plan shall—

(1) Provide a procedure for establishing and carrying out a funding policy and method consistent with the objectives of the plan and the requirements of this subchapter,

(2) Describe any procedure under the plan for the allocation of responsibilities for the operation and administration of the plan (including any procedure described in section 405(c)(1) of this title),...

ERISA 404(a)(1) Prudent Man Standard of Care

Subject to sections 403(c) and (d), 4042, and 4044 of this Title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

Most 401(k) plans do not define any retirement income target goal—so it is no wonder that the participants also fail to understand the need for a retirement income target goal for themselves. Prudent fiduciaries and plan administrators should be required to outline their views of the income target and the means by which such target can be achieved by their participants. The BPS can be the vehicle through which this information is communicated.

"The fiduciary responsibility to provide an adequate retirement benefit is more than prudent investment management and fee disclosure."[1] Fiduciary compliance is defined and judged in terms of "procedural prudence." That is, in determining whether plan fiduciaries have fulfilled their duty, the end result (such as the level of a plan participant's benefit or an investment option's performance) is not as important as the procedure that the fiduciary employed in monitoring the benefit or in selecting and monitoring the investment options. Prudence is evaluated based on the circumstances at the time of the decision and the process for making the decision—fiduciaries are not guarantors of success.

The BPS should be prepared after consideration by the plan fiduciaries of the financial implications of a wide range of policies, and describes the prudent investment and funding method process that the discretionary trustee and plan sponsor deem appropriate. As mentioned earlier, it does no good to create attractive retirement income shortfall reports, or "gap" reports with even the best data analysis and actuarial practices if the results go unheeded.

Therefore, it is essential that a discretionary plan trustee have a mechanism by which to use the actuarial results to make periodic mid-course adjustments to the program for each participant who has not opted-out of the PPA 2006 defaults. All participants need this information, even those who opt-out of a program to manage it for them via a QDIA default pathway. The BPS outlines steps the plan fiduciaries must follow to provide a process that helps ensure "what must be done actually gets done."

In summary, the BPS aims to outline a prudent investment management process and funding policy method at the participant level. It defines the operational parameters and constraints for a participant's account. In addition it allows a discretionary trustee to implement for each participant an effective investment strategy, actuarial analysis, and funding policy based upon actuarial asset-liability analysis. The goal is to outline prudent procedures to increase the likelihood the plan will provide the benefit goal selected by the participant or as otherwise determined under this BPS.

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[1] Swisher, P. "401(k) Fiduciary Governance: An Advisor's Guide," American Society of Pension Professionals and Actuaries (ASPPA), 2nd Edition © 2009