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Did Edison's IPS Fall Down on the Job?

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As lawsuits over share classes move forward, can the investment policy statement (IPS) help the plan sponsor avoid litigation?

The IPS document can address a range of investment concerns from advisers, said Linda Boone, founder, president and chief compliance officer of Lubitz Financial Group, during a recent webinar sponsored by fi360 and IPS AdvisorPro, an fi360 unit. Common issues include clients who are reluctant to revisit their investments after the financial crisis; the adviser's need for a formal process for having such conversations; and a useful, repeatable process to help the ongoing investment conversation.

The document can also be a useful component in an institutional retirement plan, where it can offer a solution to a number of issues in the current environment, Boone says, from greater regulation and increasing fiduciary standards to the demand for more transparency. She points out that this formal and written document—a guide to how to handle money—is not a contract but a directive from the client to the adviser, which documents key understandings and agreements.

Even with the improvements an IPS can bring to the investment process, advisers should not rush to try to make the IPS watertight concerning the specificity of share classes in a plan under the Employee Retirement Income Security Act (ERISA), says Duane Thompson, senior policy analyst at fi360. He points to the widely followed case of *Tibble vs. Edison*, recently designated for partial review by the U.S. Supreme Court, as an important example and warning.

Thompson feels that even with the initial district court ruling that utility company Edison International failed to adequately investigate the availability of institutional share classes for investments on its plan menu, he is not convinced plan fiduciaries should force the issue in the IPS. "Just as an investment fiduciary is asking for trouble by getting too specific about the funds or securities it selects for the plan or retail client other than asset classes, I think it is also problematic if the IPS is overly specific about expenses—such as always seeking the lowest-cost shares," he tells PLANADVISER.

There is no one true way to draft an IPS, according to Thompson. “Each court case is a facts-intensive analysis,” he says, adding that for a host of reasons other investments may be considered prudent. “As a cardinal rule of thumb, though, and as Boone mentioned in the webcast, a plan fiduciary should never put a promise to do something in the IPS that he or she is not sure they will be able to keep.”

Increasing Liability?

It’s commendable for an investment committee to seek institutional share classes, Thompson says. “But if it puts language to that effect in the IPS and ends up not performing the necessary due diligence, or not properly documenting its decisions, then it runs the risk of increased liability,” he cautions. “It’s helpful to note that the appeals court in *Tibble* stated retail class shares are not categorically imprudent, because there are many other relevant factors that a fiduciary must consider in selecting investment options.”

Thompson points out that an IPS drafted in a way that focuses solely on costs may, on its own, be imprudent. “The courts also noted in *Tibble* that nothing in ERISA requires a fiduciary to scour the market to find and offer the cheapest possible fund,” he says. “Conversely, if plan-governing documents or the IPS is silent on cost, that doesn’t mean it’s off the hook. A company may still run the risk of being held in breach for not investigating the availability of institutional class alternatives, IPS or no IPS, if the plan’s investment options are overly expensive when benchmarked to comparable plans.”

Boone notes there is one part of people’s fear of lawsuits that can be addressed easily. The statement must be qualified, Boone says. “It is *not* in fact a good idea to put things in writing—if you cannot deliver them,” she agrees. “If you stipulate what the IPS should do, and you do it, it is a litigation protector.”

She stresses that the IPS should not contain anything the adviser cannot in fact deliver. “In 1990,” she recalls, “we didn’t have rebalancing software.” With nothing more than Excel spreadsheets, it took “forever” to rebalance a portfolio, and so she never included anything about rebalancing in the IPS at the time because she was afraid of being unable to live up to that commitment. When software came to the market that answered this need, she says, she felt confident she could incorporate this into the IPS.

“Frankly, in every client relationship with fiduciary standing an IPS is called for by governing laws,” Boone says.

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