



This presentation was originally given by:

Lory A. Liberty, Director
Victory Capital Management
Investment Management Client Services

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For questions about this material contact Lory at:

[1-877-660-4400](tel:1-877-660-4400)

Investment Policy Guidelines for Your DC Plan

Lory A Liberty, Director
Victory Capital Management
Investment Management Client Services

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What I'd Like To Leave You With

- Realizing the importance of establishing and maintaining an Investment Policy for your 401(k) Plan.
- An understanding of the characteristics of an Investment Policy.
- A framework for fund selection and ongoing evaluation.
- A jump start for Your Investment Policy Guideline.
- And, to remember – one size does not fit all.

The Need for Investment Policy Guidelines

- 401(k) assets are surpassing defined benefit assets in many instances and the importance of monitoring these assets increases.
- Plan Sponsor's fiduciary responsibilities do not disappear just because participants have investment discretion.
- An exercise that will prompt you to document or explain how and why investment options were selected?
- Guidelines will exist where sound logic rules the decision making rather than emotion.
- During an audit the DOL is likely to ask to see it.

Components – Investment Policy Guidelines

1. Definition of Purpose
2. Investment Structure and Objectives
3. Selection Criteria
4. Monitoring and Evaluation
5. Other Information

1. Definition of Purpose

Describe Your Intent

- State purpose of policy:

"Provide the structure for a disciplined objective and consistent approach to the investment fund selection process and to create realistic guide lines by which the selected funds can be monitored on an ongoing basis."

- May include IRS ERISA code adherences:

"Plan intends to comply with the general principles of Section 402(b)(1) of ERISA, one of which is to provide the Plan's participants or beneficiaries with the opportunity to exercise control over the assets in their respective individual accounts";

If complying with ERISA Section 404(c), policy should describe how the requirements are met.

2. Investment Structure and Objectives

Describe Your Objectives

- It is the intent of the plan to offer participants a broad range of investment choices with materially different investment characteristics (e.g. risk, return, market segment, asset class).
- Help provide plan participants with the opportunity to better attain their goals while considering their own time horizons, risk tolerance, return expectations, asset allocation and diversification needs.
- It is the intent of the Plan to offer investment choices for a wide spectrum of investors whose objectives are typically classified as conservative, moderate or aggressive.

2. Investment Structure and Objectives (cont'd)

Describe Your Objectives

- The investment funds will broadly have fund objectives of growth, income or asset preservation.
- Participants will be able to freely choose among any and all of the funds available in the Plan.
- Preservation of capital, aversion to unnecessary risk and achievement of investment returns equal to or greater than specified benchmarks describe the overall, guiding philosophy of the Plan.
- Include any particulars on company stock.

2. Investment Structure and Objectives (cont'd)

Describe Your Structure

May specify Core Options (may include descriptions)

- Stable Value / Money Market
- Fixed Income
- Balanced / Lifestyle
- Domestic Large Cap Equity (may include passive)

May specify Non-Core Options (may include descriptions)

- Domestic Mid Cap Equity
- Domestic Small Cap Equity
- International / Global
- Specialized (ie. Tech, real estate, converts, high yield, healthcare)

2. Investment Structure and Objectives (cont'd)

Potential phrases to consider include:

- “The Plan’s fiduciaries currently consider the following assets classes as core options and have made them available:”.
- “The Plan’s fiduciaries may make available “non-core” investment funds from the following asset classes: ”.
- “Different management styles (value, growth, neutral) within the categories should also be considered during the investment process”.

3. Selection Criteria

Describe Your Criteria

- The criteria are meant to be used collectively as a basis for selecting the specific funds within the Plan. While one parameter may hold more importance over another, it is not the intent to have an individual criteria act as the sole basis of the selection decision.
- The Plan's fiduciaries recognize prevailing market conditions may cause slight variations in the prioritizations and weighting characteristics.
- Within a specific asset class the parameters will be compared to peers and appropriate benchmarks where applicable.

3. Selection Criteria (cont'd)

Describe Your Criteria

- When choosing the individual investment funds available under the Plan, each option should be evaluated for risk, return and reliability parameters. (List all criteria applicable across asset classes.)
- Each option should be evaluated for (not all inclusive)
 - Readily available market data
 - Clearly stated investment objective
 - Firm / Manager experience (if new, consider prior record)
 - Performance history
 - Risk / Return considerations
 - Permissible investments
 - Expenses

3. Selection Criteria (cont'd)

Additionally, the following considerations will be reviewed for:

- Domestic equity:

 - Market capitalization

 - Median market cap

 - Sector concentration and weightings

 - Percentage of non-US securities

 - Adherence to style

- Fixed income:

 - Credit quality

 - Duration or maturity

3. Selection Criteria (cont'd)

Additionally, the following considerations will be reviewed for:

- **Balanced:** (additional criteria may apply if using Lifestyle funds)

Equity style preference (value, growth, blend)

Above stated criteria for equities and fixed inc

Portfolio composition for equity, bonds and cash

International exposure

- **Global / international:**

Percentage emerging market exposure

Percentage US exposure

Country allocation and regional exposure

4. Monitoring and Evaluation

Describe Your Monitoring / Evaluation Process

- Monitor at regular intervals and or as circumstances warrant.
- Choice of a relevant benchmarks is an important diagnostic tool and valuable measure of comparison. It helps to better understand what each fund is doing and promotes prudent decisions. (state subject to change)
- A high level of review of performance should be undertaken quarterly, recognizing parameters may move in and out of acceptable ranges for short periods of time, keeping in mind the impact to long-term performance.

4. Monitoring and Evaluation (cont'd)

Describe Your Monitoring / Evaluation Process

- An in depth analysis should be undertaken at least annually to review each fund.
- Replacement decisions should be based on a cohesive evaluation of all the parameters and the parameters should be compared to peers and appropriate benchmarks where applicable.
- The criteria identified during the initial selection process should be utilized for ongoing analysis. Differences would primarily be identifying what are now acceptable ranges.

4. Monitoring and Evaluation (cont'd)

Describe Your Monitoring / Evaluation Process

- The Plan fiduciaries intend to review the following for **all** of the funds, with the exception of stable value:
 - Style drift (natural vs unnatural)
 - Significant changes in fund management
 - Significant organizational news
 - Short-term and Long-term performance
 - Risk-adjusted performance
 - Risk measures and volatility
 - Concentrations that affects overall risk
- Additionally, the following considerations will be reviewed for...
 - list the individual asset categories
 - specifics listed in the selection process.

4. Monitoring and Evaluation (cont'd)

Detail the criteria you will review, consider:

- Recall that a plan does not have to offer the most outstanding investment options in each category, but rather *quality* options that are expected to perform favorably when compared to peers and or any stated benchmarks.
- Continue to carefully monitor the investment fund for an agreed upon period of time for certainty that any perceived shortcomings are neither temporary or erroneous and that removal is warranted.
- Reconsider the investment needs of the Plan participants to determine if the removed fund should be replaced by a similar fund or if an entirely different type of fund should be offered.

4. Monitoring and Evaluation (cont'd)

Detail the criteria you will review, consider:

- The Plan fiduciaries may decide to replace or remove a fund based on lack of participant interest rather than shortfalls. Consideration should be given to the overall Plan's investment categories to determine if the lack of interest was in the fund or in the investment category.
- Document and retain written record of decisions made and steps taken.
- Criteria should be detailed where you can easily eliminate funds that do not meet your standards. However, find a balance in providing guidelines but not making the statements so detailed that the specificity backfires on you.

5. Other Information

Include information unique to your plan:

- Plan Characteristics:

 - Self directed brokerage accounts

 - Mutual fund window

- Voting Rights.

- Conflicts of Interest.

- Policy Review.

5. Other Information

Include information unique to your plan:

- Participant communication strategies. It is the intent of the Plan fiduciaries to provide communication and education on a continual basis. To accomplish this Participants will receive or have access to:

Quarterly statements

Financial newsletters and fund factsheets

Asset allocation models

Account via client service center, VRU or internet

Ability to transfer, change deferrals and elections

Enrollment meetings and general group meetings

Retirement seminars

Advice

5. Other Information

Include information unique to your plan:

- Recordkeeping and administration issues.
- Plan fiduciaries responsibilities:

Periodic review of the policy itself

Selecting core investment options

Selecting the overall Plan's asset categories

Evaluating and monitoring the selected funds

Add / replace funds within selected categories

Reviewing overall Plan expenses are reasonable

Document / retain a written record of the decisions

In Summary – Benefits of Investment Policy Guidelines

- Helps fulfill an important fiduciary function of setting investment selection and evaluation criteria to monitor the Plan on an ongoing basis.
- Provides a paper trail which should allow for a better defense in litigation.
- Negates second-guessing and reduces the possibility of inappropriate decisions.
- Ensures continuity when there is committee turnover.
- During a routine audit, the DOL is likely to ask to see it.

Another Approach

Describe guidelines using a “paragraph” approach

- Purpose
- Plan Characteristics
- Risk/Return Considerations
- General Limitations
- Asset Classes Eligible for Investment
- Fund Objectives
- Monitoring
- Performance Measurement
- Policy Review