



**Investment Policy Checklist
for Assets in a
Deferred Compensation Plan**
Government Finance Officers Association
Committee on Retirement and Benefits Administration

This document is a checklist for the development or amendment of an investment policy for assets in a deferred compensation plan. It should be construed neither as containing an investment policy itself, nor as establishing mandatory items for inclusion in an investment policy. Rather, the checklist is a document that recommends items for *consideration* by plan sponsors who are commonly responsible for the investment policy statement. We suggest plan trustees use this document in conjunction with advice from investment advisors and other professionals who regularly provide input on the plan's investment policy.

The basis for this checklist is the Government Finance Officers Association (GFOA) Recommended Practice, "Investment Policies Governing Assets in a Deferred Compensation Plan (2004)". We encourage GFOA members to provide feedback on this document, as it is intended to be updated periodically to reflect evolving views in the field of retirement plan administration.

The GFOA Committee on Retirement and Benefits Administration thanks committee members Keith Overly, Karl Greve, and Linda Herman, committee advisers Howard Pohl and Kathy Harm, and GFOA manager Nick Greifer for developing the checklist. We also recognize member Merv Timberlake for his earlier contribution to the document.

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I. Introduction

Plan sponsors may consider the following items for inclusion in an introductory section of the investment policy.

- Mission statement
 - The fundamental mission of the plan (e.g., to provide retirement benefits to plan participants, either as a supplement to another retirement plan or as the primary plan); and
 - Exclusive purpose – investment solely in the interests of plan participants and beneficiaries, for the exclusive purpose of providing retirement benefits to plan participants and beneficiaries.
- Reference to federal, state, or local law or administrative decision creating plan
- Intended beneficiaries of the plan (e.g., the plan is created for certain employees and beneficiaries)
- Scope of policy (e.g., limited in application to plan assets)
- Annual review of the investment policy, with more exhaustive reviews occurring as needed

II. Investment Objectives

Plan sponsors may consider the following items for inclusion in the section of the investment policy that identifies the investment objectives of the program.

Comment [TRC1]: This is analogous to the second section of the GFOA Cash Mgt Inv Policy, entitled "general objectives."

The investment objective is to enable a participant or beneficiary to exercise control over assets in his/her individual account, by providing investment options:

- Each of which is diversified;
- Each of which has materially different risk and return characteristics;
- Which in the aggregate enable the participant or beneficiary, by choosing among them, to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary; and
- Each of which, when combined with other investment options, tends to minimize the overall risk of a participant's or beneficiary's portfolio through diversification.

The plan sponsor will review investment options to avoid duplication.

III. Roles and Responsibilities

Plan sponsors may consider the following items for inclusion in a section of the investment policy that defines the roles and responsibilities of the governing board, internal staff, and external professionals.

Governing Board

- General duties – The Governing Board has the responsibility of establishing and maintaining broad policies and objectives for all aspects of the plan operation.
- Investment-related duties – The Governing Board will review and approve the development or revision of the following documents:
 - The Investment Policy
 - Review of agreements between the plan and external investment professionals
 - All other issues of investment policy not specifically enumerated here.
- Standard of care – The standard of care applied to the Governing Board shall be the *prudent person/expert/investor*¹ standard [select one] and shall be applied in the context of managing an overall portfolio.

Internal staff

- General duties – A Chief Executive Officer (CEO) is appointed by, and serves at the pleasure of the Board. The CEO is responsible for planning, organizing, and administering the operations of the plan under broad policy guidance and direction from the Board.
- Investment-related duties – The CEO, with the assistance of _____ (staff and/or investment consultants), monitors the performance of the investment options; ensures that funds are invested in accordance with Board policies; studies, recommends, and implements policy and operational procedures that will enhance the investment program

¹ State or local laws may define these terms. In general, under the prudent *person* standard, investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived. Under the prudent *expert* standard, investment shall be made with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person 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. (Source: Cornell Law, US Code Title 29, Chapter 18, Subchapter 1, Subtitle B, Par 4, Section 1104) The prudent *investor* standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust. Under the prudent investor standard, investments are evaluated as to their suitability for the investor's portfolio, rather than as individual investments; trustees may choose to invest in any investment that plays an appropriate role in achieving the risk/reward objectives of the trust and that meets other characteristics of prudent investing. Diversification and the use of modern portfolio theory are central to the prudent investor standard.

of the plan; and ensures that proper internal controls are developed to safeguard plan assets.

- ❑ Standard of care – The standard of care applied to staff shall be the *prudent person/expert/investor*² standard and shall be applied in the context of managing an overall portfolio.

Money managers

- ❑ General duties - Money managers will select, buy, sell, and loan specific securities pursuant to the investment strategy, as defined in a prospectus, contractual agreements, and/or this investment policy. Discretion is delegated to the managers to carry out investment actions as directed by the plan.
- ❑ Standard of care – The standard of care applied to money managers shall be the *prudent expert* standard and shall be applied in the context of managing an overall portfolio.
- ❑ Acknowledgement of fiduciary obligations – If feasible, money managers will acknowledge in writing that they are fiduciaries of the plan.
- ❑ Communication – Money managers will communicate with the plan sponsor, record keepers, and/or plan participants on a periodic basis to report investment performance.

Investment consultants

- ❑ General duties – The investment consultant will assist the plan sponsor in the selection of record keepers and/or money managers, and the measurement of qualitative and quantitative investment performance by money managers as defined in Section V and VI of this policy.
- ❑ Standard of care – The standard of care applied to an investment consultant shall be the *prudent expert* standard.
- ❑ Acknowledgement of fiduciary obligations – The investment consulting firm will acknowledge in writing that it is a fiduciary of the plan.
- ❑ Communication – On at least a quarterly basis, the investment consultant shall communicate with the Governing Board and/or staff to review the performance of the money managers, money manager organizational changes, and other topics as needed.

² See previous footnote

Plan participants

- ❑ Duties – Each plan participant has the responsibility to construct and manage portfolios based upon his/her own unique investment preferences and risk tolerances, using the investment options available to the participant. As long-term investors, each plan participant is obliged to avoid excessive short-term trading that may have an impact upon other plan participants or fund shareholders.

Record keeper

- ❑ Duties – The record keeper will maintain individual participant investment account records and provide participants and beneficiaries with sufficient information to manage their investments. The services may include: enrollment, education, advice, exchanges, transfers, periodic individual statements and distributions.
- ❑ Standard of care – The standard of care applied to the record keeper shall be the *prudent expert* standard.
- ❑ Acknowledgement of fiduciary obligations – The record keeper will acknowledge in writing that he/she is a fiduciary of the plan.
- ❑ Communication – The record keeper will provide plan participants with reporting on investment valuations for each investment option, on a daily basis for electronic reports and quarterly basis for mailed reports.

IV. Scope of Investment Options

Plan sponsors may consider the following items for inclusion in the section of the investment policy defining investment options for plan participants.

- ❑ The plan hereby establishes a range of investment options to meet plan objectives as defined in Section II of this Investment Policy Checklist, and to enable plan participants to develop a diversified portfolio suited to individual preferences and risk tolerance.
- ❑ To create an appropriate fund line-up that a) encourages employee participation, b) avoids undue complexity, and c) provides diversification, the plan sponsor should evaluate the number of investment options to make available to participants.

Plan sponsors may consider the tiered structure illustrated below as one example.

Investment options are categorized into three tiers, to recognize that plan participants have varying levels of engagement in the investment process. Plan participants may invest in one or more tiers.

Tier	Approach	Level of Participant Engagement
I	Portfolio constructed of a single lifestyle or lifecycle fund	Little engagement required by plan participant; it may be considered as a default fund if no affirmative selection is made by the participant
II	Portfolio constructed of actively managed or indexed core funds	Medium level of engagement
III	Portfolio constructed of actively managed or indexed non-core funds	Maximum level of engagement

The options range from low risk/low return to high risk/high return.

Tier	Investment Offering	Investment Category	Passive Benchmark
I	Lifestyle or lifecycle fund (one option only)	Single fund diversified across all major asset classes (e.g., x% stock, y% bond)	
II	Fund a	Domestic bond	
	Fund b	Domestic stock – Large cap	
	Fund c	Domestic stock – Small cap	
	Fund d	International Equity	
	Fund e	Other	

	Fund f	Other	
III	Fund 1	Special-focus fund (e.g., sector fund, real estate fund, socially responsible fund, etc.)	
	Fund 2	Special-focus fund (e.g., sector fund, real estate fund, socially responsible fund, etc.)	
	Fund 3	Special-focus fund (e.g., sector fund, real estate fund, socially responsible fund, etc.)	

V. Reporting / Performance Monitoring

Plan sponsors may consider the following items for inclusion in the section of the investment policy that addresses performance monitoring and reporting on investment results.

- The purpose of monitoring and reporting on investment performance is for the plan fiduciaries to (a) monitor compliance with the investment policy and applicable law, (b) assess the performance of money managers retained by the plan, and (c) make determinations about retaining a fund in the plan.

Interim investment reporting. On an interim basis (e.g., quarterly) the Governing Board shall receive the following information:

- An outline of current strategy and investments;
- Portfolio performance versus the assigned benchmark index and peer group;
- A summary of the largest holdings;
- Portfolio composition relative to each fund's asset allocation policy or prospectus; and
- Company staffing and organization, to ensure that the fund organization is stable and adequately supports fund management.

Annual investment reporting. On a yearly basis, the Governing Board shall receive the following information:

- A review of performance versus assigned benchmarks for the most recent quarter end, for one-, three-, and five-year periods ending with the most recent quarter, and for the most recent period if not a quarter end. Performance versus assigned benchmarks will be reported net of fees;
- A summary of the portfolio's diversification and fundamental characteristics; and
- An analysis of the portfolio by sector.

Other reports. Other reports that may affect future investment results will also be reported in a timely manner. Such reports include but are not limited to:

- Changes in investment style (style drift);
- Fund fees, to ensure that they are in line with peers and do not have an inordinately negative impact on net-of-fee performance. Certain cost components will be disclosed (e.g., 12b-1 fees, and disclosure of revenue sharing/rebates between investment managers, record keepers, and/or plan sponsors);

- Regulatory and legal compliance, including disclosure of pending investigations (e.g., regarding market timing and late trades); and
- Immediate notification of staffing changes or events affecting plan providers that could have a significant impact upon the plan.

VI. Investment Selection and Termination

Plan sponsors may consider the following items for inclusion in the section of the investment policy that addresses investment selection and termination.

A fund will be selected, terminated, or added to a watch list based upon the reporting criteria identified in Section V of this policy and other criteria. Such criteria include, but are not limited to:

- Investment performance relative to benchmarks
- Adherence to or deviation from investment strategy
- Fees
- Regulatory and legal compliance
- Company staffing and organization
- Avoidance of duplication among investment options (i.e., within a Tier)
- Turnover ratio
- Diversification among securities (e.g., largest holdings are not a disproportionately large part of portfolio)
- Sector diversification

In the event of fund termination, plan sponsors will transfer plan assets, if feasible, to a fund having similar investment objectives.