**BEST PRACTICE**

# Investment Policies Governing Assets in a Deferred Compensation Plan (2004) (CORBA)

**Background**. Many governments offer a deferred compensation plan to their employees. In operating these plans, governments act as fiduciaries. Because deferred compensation plans shift investment risk to the plan participant, GFOA recommends that governments provide employee education about the management of the investment risk.

Some governments have established an investment policy that governs assets in the deferred compensation plan. Such an investment policy offers a number of advantages to the government and its plan participants:

- Investment policies are a clear demonstration of fiduciaries' due diligence;
- They are a communication tool for conveying investment goals and priorities to interested parties;
- They strengthen the internal controls of the government and the plan.

Like any financial policy, a deferred compensation investment policy is a governing document in which the governing board and other key stakeholders formally set broad policy parameters. Detailed guidance about implementation of the investment program may be contained in the investment policy or other documents, such as investment procedure manuals and agreements with third parties.

**Recommendation**. The Government Finance Officers Association (GFOA) recommends that state and local entities establish and adhere to a formal investment policy governing assets in a deferred compensation plan, and that it be approved by the plan sponsor. Such a policy should be viewed as a long-term governing document.

The development of the investment policy must be made within the framework of the legal restrictions set forth in state and/or local statutes as well as those established by common law and fiduciary standards. Within this context, GFOA recommends that the investment policy contain the following elements:

- Statement of purpose – this statement articulates the rationale for having the policy, as well as the investment goals for the plan;
- Roles and responsibilities – this identifies the roles and responsibilities of key decision makers, including the governing board, the chief executive officer, the recordkeeper, and other external investment professionals;
- Standard of care – this identifies the standard of prudence that the decision makers are expected to meet in carrying out their responsibilities (e.g., prudent person or prudent expert), including the selection and retention of investment managers;

- Scope of investment options:
    - The policy establishes a broad range of investment options so that plan participants can develop a portfolio suited to individual preferences and risk tolerance;
    - The options range from low risk/low return to high risk/high return;
    - The plan sponsor addresses the duplication among investment options.

- Reporting and monitoring:
  - The policy defines the frequency and manner in which external and internal parties report investment results;
  - Performance of an individual investment option or fund is measured against a peer group and/or a market index;
  - Regulatory compliance, including disclosure of pending investigations, is monitored;
  - Changes in the staffing and organization of the underlying investment funds are reviewed;
  - Changes in investment style and investment process are tracked;
  - Cost of investment options is monitored.

Investment policies should be reviewed annually, with more exhaustive reviews occurring as needed.

**<u>References</u>**


- GFOA Best Practice, "Retirement and Financial Planning Services*," 2003.*
- GFOA Best Practice, "Pension Investment Policies*"2003.*
- *A Public Employee's Guide to Retirement Planning*, Second Edition, GFOA.


Approved by the GFOA's Executive Board on March 26, 2004.