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ERISA Considerations In Using Brokerage Window Investing

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Employees in workplace defined contribution retirement plans often have the option to self-direct investment of their plan accounts by choosing from a menu of designated investment alternatives that have been selected and evaluated by plan fiduciaries.

Retirement plans can also be designed to allow participants to direct investments outside of a plan's designated investment alternatives, such as one would using a broker, through arrangements loosely referred to as brokerage windows.

Plan fiduciaries who follow strict rules under Section 404(c) of the Employee Retirement Income Security Act can avoid fiduciary responsibility for investment losses resulting from investments in designated investment alternatives.

In contrast, the realm of investing employee benefit plan assets through brokerage windows remains largely uncharted territory. Fiduciaries operate under the broad understanding that ERISA Section 404(a) fiduciary duties of prudence and loyalty apply, but with little guidance on how.

In 2021 the Advisory Council on Employee Welfare and Pension Benefit Plans, known as the ERISA Advisory Council, collected constituent testimony and examined "brokerage windows in participant-directed individual account retirement plans that are covered by ERISA to gain a better understanding of their design, prevalence, and usage."[1]

Recently, the ERISA Advisory Council released a December 2021 report recommending limited additional action by the U.S. Department of Labor, despite recognizing the paucity of DOL guidance.

This article discusses the state of the law with respect to brokerage windows, issues identified by the council's investigation, and ideas for how plan fiduciaries can navigate their duties in implementing or monitoring brokerage windows.

Brokerage Windows, Self-Directed Brokerage Accounts and Similar Arrangements

The use of brokerage windows to allow participant-directed investment choices is an invention without regulatory form.

Under ERISA Section 404(c) individual account plans may permit participants to "exercise control over the assets" in their accounts and direct their own investments; if participants exercise such control, "as determined under [DOL] regulations," then plan fiduciaries are not liable for investment losses stemming from the self-directed investment choices.[2]

DOL regulations explain how plan fiduciaries can comply with this standard by offering designated investment alternatives, defined as "a specific investment identified by a plan fiduciary as an available investment alternative under the plan."[3]

The Section 404(c) rules do not refer to or describe brokerage windows. Neither does ERISA.

The DOL indirectly recognized brokerage windows in the Section 408(b)(2) participant disclosure regulations by specifically excluding "'brokerage windows,' 'self-directed brokerage accounts,' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan" from the definition of "designated investment alternative."[4]

Subsequent informal DOL guidance confirmed that brokerage window-type arrangements are not designated investment alternatives and are not prohibited. The DOL further explained that ERISA Section 404(a) fiduciary duties of prudence and loyalty apply.[5]

No additional DOL guidance has been issued, despite a 2014 request for information seeking to understand when, how and why some participant-directed individual account plans allow participants to use brokerage windows in addition to or in place of investment options selected by plan fiduciaries.

No new guidance is expected given the ERISA Advisory Council report.[6][7][8]

Brokerage window arrangements thus exist in a regulatory void, defined by what they are not rather than what they are. Their common factor is that fiduciaries have not designated the particular investments that participants access through them.

Implementing or retaining brokerage windows in ERISA plans remains, however, a fiduciary function subject to the ERISA Section 404(a) fiduciary duties of loyalty and prudence. The factual circumstances in which these arrangements exist — when and how and why they are implemented or retained — can vary widely, creating different fiduciary challenges.

Fiduciary Duties of Loyalty and Prudence in Implementing or Retaining Brokerage Windows

How, then, should fiduciaries approach implementing or retaining brokerage windows?

Fiduciaries should not expect additional guidance from the DOL given that the ERISA Advisory Council collected information and declined to recommend further regulatory or other guidance on brokerage windows generally.

Evaluating Brokerage Window Services

As explained by the DOL, fiduciaries of plans with brokerage windows are "still bound by ERISA section 404(a)'s statutory duties of prudence and loyalty" to "tak[e] into account the nature and quality of services provided" in connection with the brokerage window.[9]

Fiduciaries should thus consider brokerage window services using the same criteria as for other plan services, namely the type of services needed, the quality of the services provided, associated fees and expenses, and record-keeping needs.

Fiduciaries evaluating brokerage window services might consider the following factors:

- Speed and accuracy of effectuating transactions;
- Ease of platform use;
- The timing of notifications; and
- The availability of investment choices.

Fiduciaries should inquire whether providers can provide required general fee disclosure information and required quarterly participant statements detailing actual fees charged.[10] As with the evaluation of any other service provider, fiduciaries should compare fees with comparable service providers.

Fiduciaries must also consider how brokerage window services fit into a plan's design, including related record-keeping needs. Fiduciaries considering logistical needs for a Section 404(c) plan that

has a designated investment alternative menu may find that they are effectively limited to obtaining brokerage window services from their designated investment alternative menu provider.

Relevant facts and circumstances can help guide fiduciaries in addressing chicken-and-egg questions such as how to compare and evaluate fees and services for brokerage platforms where choices are limited by record-keeping needs, and whether the feasibility of managing brokerage windows should be a consideration in comparing and evaluating record-keepers and record-keeping fees.[11]

Designing Brokerage Windows

There are few cases that discuss fiduciary duties related to offering or designing brokerage windows. Some courts have rejected claims that offering a large number of investment options through a brokerage window could itself be a breach of fiduciary duty.[12]

Brokerage windows are often offered alongside curated designated investment alternatives under the Section 404(c) rules. Fiduciaries can establish rules governing brokerage window use, such as setting a maximum percentage of plan account assets that can be invested through the window or limiting the types of available investments.

Fiduciaries should remember, however, that decisions relating to implementing and designing a brokerage window will likely be viewed as fiduciary actions and should consider factors such as suitability for a plan's population and nondiscrimination requirements for qualified plans.[13]

Fiduciaries should make sure that there is a clear distinction between designated investment alternatives in a Section 404(c) plan and investment options available through a brokerage window. Brokerage windows and similar arrangements are defined by not being designated investment alternatives.

Where investments accessed through a brokerage arrangement look more like a menu of designated investment alternatives, however, they may be treated as such and be subject to the same fiduciary responsibilities, whether or not a plan's design so labels them.[14]

Factors such as the number and types of investment options available through a brokerage window, and rules or restrictions on using the window, may transform an intended brokerage window option into an offering of designated investment alternatives, potentially exposing vulnerability if fiduciaries had not evaluated the options in compliance with fiduciary responsibilities.

Fiduciaries may also want to consider how deeply they should inquire regarding fees and expenses related to investments through brokerage windows. Fiduciaries should of course consider administrative-type fees, such as enrollment fees or platform access fees, when evaluating providers.[15] Fiduciaries will also want to ensure compliance with applicable fee disclosure requirements for plans that offer brokerage windows.[16]

ERISA jurisprudence has not yet explored, however, whether fiduciaries have a duty to evaluate fees that they reasonably know could be assessed based on the design of an offered brokerage window platform. Written testimony provided to the ERISA Advisory Council by the U.S. Chamber of Commerce acknowledges the concern that ERISA fee litigation could expand to challenges relating to brokerage window fees and expenses.[17]

Fiduciaries should also recognize that there are few reported court cases addressing fiduciary duties and brokerage windows.

Does the lack of court action indicate low litigation risk or unmeasured litigation risk? Is the scarcity because few plans offer these options, because brokerage window investing is still fairly new or because of difficulties in establishing loss causation?[18]

Fiduciaries may wish to consider this uncertainty in evaluating their risk tolerance.

Disclosure of Fees and Expenses

The one DOL rule that applies to brokerage windows in participant-directed plans is that plan

administrators must describe the availability of brokerage windows that allow for selection of investments beyond designated options and describe and report on any related fees or expenses.[19] [20]

DOL guidance explains that the description should:

- Provide enough information for participants to understand how the brokerage window works, including any rules or restrictions;
- Explain any fees that can be charged directly to participants related to the brokerage window; and
- Provide a statement of fees actually charged.[21]

A general statement regarding potential fees, along with directions on how to obtain more information about fees related to particular investments, ordinarily satisfies the disclosure obligation regarding brokerage windows.[22]

ERISA Advisory Council Testimony and Report

While the council ended up only making a limited recommendation for the DOL to consider further fact-finding, its report and the testimony given to the council illustrate legal and factual concerns and considerations relating to implementing and monitoring brokerage windows.

Reasons for Offering Brokerage Windows

As noted in the ERISA Advisory Council's report, testimony to the council showed that brokerage windows are often offered to give participants who request them broader opportunity to direct their own investments based on their own criteria.

Brokerage windows are sometimes offered to expand availability of investment alternatives in connection with reducing or limiting designated investment alternative menu options and are generally used by a small percentage of participants in plans with designated investment alternative menus, who are typically older with larger account balances.[23]

The report also recognized that some small employers sponsor retirement plans with no designated investment alternatives, where brokerage accounts are the only means for directing investments, and that such plans tend to have lower overall costs.[24] Fiduciaries can review the council's report and testimony to better understand the circumstances under which brokerage windows have been offered and have worked to benefit participants.

Adequacy of Disclosures and Risk of Overburdening Sponsors or Overwhelming Participants

The ERISA Advisory Council report took heed of testimony discouraging the council from recommending additional disclosure requirements and warning of the risk of increasing burdens on sponsors.

Witnesses had opined that the participant-level disclosure regulation, the DOL's 2012 field assistance bulletin on fee disclosures, and disclosures required by the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority are working effectively to provide the necessary guidance to plan sponsors and to adequately inform and protect participants and beneficiaries who invest through brokerage windows.

The council also recognized that brokerage windows can be a key factor in persuading small business owners to establish retirement plans and expressed concern that small employers could be

discouraged from offering retirement plans if the burdens of offering brokerage windows increased substantially.[25]

The council's report makes it significantly less likely that the DOL will issue additional regulatory disclosure obligations for plans with brokerage windows, potentially making the option more attractive to sponsors.

Acknowledgment of Limited Fiduciary Guidance on Brokerage Windows

The ERISA Advisory Council report summarized concerns about the lack of guidance relating to brokerage windows, but concluded that additional regulatory guidance was not warranted. The council acknowledged the lack of a viable definition, the absence of fiduciary monitoring, the potential for participants incurring additional fees or expenses, and the possibility of increased investment risk.[26]

Some witnesses had suggested that the DOL should clarify fiduciary responsibility with respect to brokerage window design, monitoring and potential investment losses, although they had not called for regulatory action.[27]

By not recommending further action, the council essentially ensured uncertainty related to offering brokerage window options.

Recommendation That DOL Perform Fact-Finding on Brokerage-Window-Only Plans

The ERISA Advisory Council recommended additional fact-finding with respect to retirement plans that offer a brokerage window without any designated investment alternatives, also called brokerage-window-only plans.[28] Some witnesses had expressed concern about the lack of a default investment option or adviser to assist less investment-savvy participants in brokerage-window-only plans.[29]

The report did not identify specific concerns but noted that participants in small plans without designated investment alternatives and without a default brokerage window provider were left with having to find their own means of investing retirement plan assets.[30]

Possible Impact of Hughes v. Northwestern University

In January in Hughes v. Northwestern University, the U.S. Supreme Court emphasized that fiduciaries have an ongoing duty to monitor each designated investment option independently, without considering other available options.[31] The court noted that the plans at issue had offered over 400 choices during the relevant period.

A presumably unintended consequence of this decision could be that designated investment alternative menus may shrink, leaving fewer investment options for fiduciaries to monitor. Testimony to the ERISA Advisory Council suggests that, even before Hughes, sponsors sometimes provided brokerage windows in tandem with reducing or limiting the number of designated investment alternatives offered.

The Supreme Court's clarification that fiduciaries have a duty to independently monitor offered designated investment alternatives, coupled with the ERISA Advisory Council's recommendation to refrain from additional rulemaking, could encourage sponsors to offer fewer designated investment alternatives and expand available investments options through brokerage windows instead.

Takeaway

Fiduciary evaluation of brokerage window arrangements is subject to the same broad fiduciary standards governing all ERISA fiduciary decisions. The DOL's lack of formal guidance is buffered by its recognition that brokerage windows are not prohibited. Fiduciaries can explore how such arrangements might enhance opportunities for their plans within the bounds of their fiduciary responsibilities.

Given the ERISA Advisory Council's report, fiduciaries should not expect additional DOL regulatory

action or informal guidance.

Fiduciaries considering implementing or retaining brokerage windows should engage in thoughtful consideration of relevant factors, including the characteristics of a plan's population and any designated investment alternatives offered. They should document their deliberations and support for their conclusions.

Careful adherence to compliance with existing fiduciary responsibilities should provide some comfort to fiduciaries evaluating brokerage window options in the absence of regulatory guidance.

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[1] https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2021-advisory-council-issue-statement-brokerage-windows.pdf.

[2] ERISA § 404(c)(1)(A), (29 U.S.C. § 1104(c)(1)(A)).

[3] 29 C.F.R. § 2550.404c-1(e)(4).

[4] 29 C.F.R. § 2550.404a-5(h)(4).

[5] Field Assistance Bulletin No. 2012-02R (July 30, 2012) (FAB 2012-02R).

[6] 79 Fed. Reg. 49,469 (Aug. 21, 2014).

[7] Advisory Council on Employer Welfare and Benefit Plans, Report to the Honorable Martin Walsh, U.S. Secretary of Labor, "Understanding Brokerage Windows in Self-Directed Retirement Plans" (Dec. 2021) (Advisory Council Report).

[8] See, Moitoso v. FMR, LLC, 451 F. Supp.3d, 189, 208 (D. Mass. 2020) (surveying the state of the law and noting "significant lack of clarity regarding the duties a fiduciary owes with regard to the funds within a brokerage window.").

[9] FAB 2012-02R, Q39.

[10] 29 C.F.R. § 2550.404a-5(c)(1)(i)(F), 29 C.F.R. §2550.404a-5(c)(3).

[11] See, generally, discussion in Advisory Council Report, at p.17.

[12] See Larson v. Allina Health System, 350 F. Supp. 3d 780, 801–02 (D. Minn. 2018) (finding that plaintiff did not state a breach of fiduciary duty claim based on a plan offering three hundred investment options in a mutual fund window; collecting the cases).

[13] I.R.C. 401(a)(4)); Treas. Reg. §§ 1.401(a)(4)-1, 1.401(a)(4)–4 (requiring that investment options be offered equally to all participants in a plan).

[14] See, Moitoso, 451 F. Supp. 3d at 209-210 (finding that characteristics of access to sponsor's proprietary funds through a dedicated internal plan link was dissimilar to access offered to a broad variety of investment options through a separate brokerage window service, and similar to access offered to designated investment vehicles, so that it was not a "similar arrangement" to be treated the same as a

brokerage window).

[15] FAB 2012-02R, Q39.

[16] 29 C.F.R. § 2550.404a-5(c)(1)(i)(F), 29 C.F.R. §2550.404a-5(c)(3).

[17] Statement of the U.S. Chamber of Commerce to 2021 ERISA Advisory Council on Understanding Brokerage Windows in Self-Directed Retirement Plans (June 24, 2021) (Chamber of Commerce Statement), page 5, footnote 12.

[18] See, e.g., Ramos v. Banner Health, 461 F. Supp. 3d 1067, 1127-1128 (D. Colo. 2020) (finding that plaintiffs had not established loss causation in connection with claims related to investments offered through a mutual fund window).

[19] 29 C.F.R. § 2550.404a-5(c)(1)(i)(F).

[20] 29 C.F.R. § 2550.404a-5(c)(3).

[21] FAB 2012-02R, Q13, Q29, Q39.

[22] FAB 2012-02R, Q13.

[23] See. e.g. Advisory Council Report beginning at p. 31; Chamber of Commerce Statement, at p. 3; Testimony on Behalf of Fidelity Investments Before the Advisory Council on Understanding Brokerage Windows in Self-Directed Retirement Plans (Aug. 26, 2021), at p. 3; and Testimony on Behalf of American Benefits Council for

the ERISA Advisory Council on Understanding Brokerage Windows in Self-Directed Retirement Plans (Aug. 26, 2021), at p. 3.

[24] See. e.g. Advisory Council Report beginning at p. 45.

[25] See, e.g., Testimony of Kent A. Mason, partner, Davis & Harman LLP, to the 2021 ERISA Advisory Council (June 24, 2021), at pp. 6-7; and Testimony of Lisa Bleier of SIFMA to the 2021 ERISA Advisory Council (Aug. 24, 2021), at pp. 2-3.

[26] Advisory Council Report at pp. 43-54.

[27] See, e.g. Advisory Council Report at 26-31; Testimony by Fred Reish and Bruce Ashton, Faegre, Drinker, Biddle & Reath LLP, before the 2021 Advisory Council (Aug. 27. 2021), at pp. 2-3.

[28] Advisory Council Report at p. 45-46.

[29] Advisory Council Report at p. 20-21.

[30] Advisory Council Report at p. 46.

[31] Hughes v. Northwestern Univ., 2022 U.S. LEXIS 622, __ S.Ct. __, (2022). See also Tibble v. Edison Int'l, 575 U.S. 523, 530 (2015).