

## LEGAL UPDATE

# ERISA Considerations In Using Brokerage Window Investing

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*[Editor's Note: This article is the first installment of a two-part series discussing this topic. This installment describes the legal foundation underlying brokerage window investing and discusses certain fiduciary considerations relevant to evaluating and designing brokerage windows.]*

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." [See, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2021-advisory-council-issue-statement-brokerage-windows.pdf>.]

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

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." [29 C.F.R. § 2550.404c-1(e)(4).]

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." [29 C.F.R. § 2550.404a-5(h)(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. [Field Assistance Bulletin No. 2012-02R (July 30, 2012) (FAB 2012-02R).]

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

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. [FAB 2012-02R, Q39.]

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. [29 C.F.R. § 2550.404a-5(c)(1)(I)(F), 29 C.F.R. § 2550.404a-5(c)(3).] 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 chickenandegg 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. [See, generally, discussion in Advisory Council Report, at p.17.]

### 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. [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).]

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. [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).]

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. [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).]

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. [FAB 2012-02R, Q39.] Fiduciaries will also want to ensure compliance with applicable fee disclosure requirements for plans that offer brokerage windows. [29 C.F.R. § 2550.404a-5(c)(1)(I)(F), 29 C.F.R. § 2550.404a-5(c)(3).]

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. [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), p.5, n.12.]

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? [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).]

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

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