DOL Shifts Stance on Brokerage Windows but Questions Remain

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On May 7, 2012, the DOL published Field Assistance Bulletin 2012-02 in which it addressed 38 frequently asked questions (FAQs) concerning the participant-level and plan-level disclosure rules that are now being implemented. The FAQs focused primarily on the disclosures that plan sponsors must make to participants, but contained unanticipated views on the use of brokerage windows that alarmed many sponsors and platform providers. The DOL indicated that a second set of FAQs would be issued dealing with the plan-level disclosure rules. This second round of FAQs has not been released thus far, but on July 30, 2012, the DOL attempted to quiet the growing criticism of its position on how disclosure regarding designated investment alternatives (DIAs) applies to investments available to plan participants through a brokerage window and certain investment platforms.

The original set of FAQs confirmed that plan administrators must provide information on how a brokerage window works by furnishing details regarding investment instructions, account balance requirements, restrictions or limitations on trading, how the window differs from the plan's DIAs, and who participants may contact with questions. Further, all participants, not just those who utilize the window, must receive a general explanation of the fees and expenses that may be charged against a participant's account with the use of the brokerage window, as well as quarterly statements of the specific amounts expended. Under the regulations, these amounts, which cover commissions and similar charges, fall under the category of plan-related information, but expenses of an investment chosen by a participant, such as 12b-1 fees or other fees reflected in the investment's total annual operating expenses, do not need to be included in information disclosed regarding the window's fees, because such fee information pertains to the separate category of investment information relating to the plan's DIAs.

Question 30 of the original release controversially considered the required disclosures where a plan sponsor selects a brokerage window or investment platform consisting of a large number of mutual funds, but does not designate any of the funds on the platform as DIAs under the plan. Question 30 indicated that, even if the funds available through the window or platform have not been identified as plan investments, the DOL may treat them as if they were DIAs in certain circumstances. This would trigger both the obligation to report investment-related information to participants and general fiduciary obligations relating to the prudence of the investment. The DOL favors identification of investment options as DIAs, since the resulting provision of a comparative chart and other information under the portion of the disclosure regulations dealing with investment-related information enables participants to compare the performance and cost of the investments so identified.

Question 30 indicated that the DOL would adopt an enforcement policy under which a brokerage window or platform holding more that 25 investment alternatives would effectively be required to treat some of the investment alternatives as DIAs for disclosure purposes even if they were not actually designated as DIAs. Under this policy, a plan administrator would have been required to make disclosures to participants for at least three investment alternatives that collectively meet the "broad range" requirements under Section 404(c) of ERISA. In addition, disclosure would be required with respect to all other investments on the platform in which at least five participants or beneficiaries were invested on a date not more than 90 days before each annual disclosure. In the case of a plan with more than 500 participants and beneficiaries, the threshold would have been 1 percent of this group.

These rules reflect the DOL's concern that certain plan sponsors would attempt to avoid responsibility for a plan's investments by refraining from the designation of specific funds as DIAs. Plan sponsors and platform providers, however, viewed this as a last-minute change, coming with no warning, that required them to monitor the usage of particular investments. Not only was there insufficient time to revise systems to implement the necessary tracking (assuming this was feasible in the first place given potential daily changes in participant investments), but certain details as to implementation remained unclear. Accordingly, it was not clear when a service provider's obligation to disclose to a plan fiduciary under the 408(b)(2) regulations would arise, given that an investment's status as a DIA would derive from prior utilization.

On July 30, 2012, the DOL issued a revised version of the FAQs in Field Assistance Bulletin 2012-02R, which is virtually the same as the original bulletin, except that Question 30 has been deleted and new Question 39 included to address the issue of investments available through a brokerage window or investment platform that have not been identified as DIAs. The

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revised FAQs drop the discussion of an enforcement policy based on participant usage of particular investments, thus eliminating the requirement of tracking whether usage has reached certain prescribed thresholds. As under the original FAQs, "a plan fiduciary's failure to designate investment alternatives…raises questions under ERISA section 404(a)'s general statutory fiduciary duties of prudence and loyalty." Gone from this statement, however, is the implication that there is a particular "manageable number" of DIAs that must be chosen in order to comply with fiduciary standards.

New Question 39 states that plan fiduciaries of plans with platforms, brokerage windows, or similar arrangements allowing the selection of investments beyond those designated by the plan owe a duty of prudence and loyalty to the participants directing their accounts into such investments. This duty requires fiduciaries to consider "the nature and quality of services provided" in connection with the arrangement. Question 39 indicates that the DOL will determine how best to assure compliance with these general fiduciary standards, possibly through new regulations, in a cost-effective and efficient manner after consultation with interested parties.

For now, the DOL appears to have reaffirmed that the only investments that will be treated as DIAs are those that have been specifically identified as available under the plan. In addition, it has relented on requiring any disclosure of investment-related information with respect to investments that are not DIAs, although the requirements for disclosure of plan-related information remain intact with respect to such investments. ❖

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