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Employee Benefit Plan Review

Ask the Expert

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Brokerage Windows

Q My company is considering providing a brokerage window through our 401(k) plan. What implications should we be considering for our plan fiduciaries?

A A brokerage window is an optional feature of a 401(k) plan that allows enrolled participants to invest their account balances in a variety of investments beyond the limited menu of the designated investment alternatives offered through the plan. Brokerage windows provide plan participants with a greater breadth of investment options and potentially greater flexibility to compose asset allocations. For example, the core investment menu of a 401(k) is typically limited to 20-30 investment options, whereas a brokerage window can provide access to thousands of additional investment options. These alternative options are often attractive to sophisticated investors and/or participants who wish to invest based on their religious or ethical principles.

A brokerage window may be unrestricted in that any investment option available through the brokerage window provider's platform (including stocks, bonds, mutual funds, exchange-traded funds, alternative investments and digital assets) could be available to plan participants. However, plans may restrict the universe of investments available through the plan's brokerage by setting parameters around the types of investments that participants may access, e.g., limiting the brokerage window to mutual funds only. As a result, brokerage windows often vary in the number of investment options that may be available to participants. The opportunity to invest in these additional options allows participants to customize their portfolios in ways that standard investment alternatives on a plan's core investment menu generally do not afford. Nevertheless, this flexibility and customization can be intimidating and/or confusing for less experienced participant investors and, as such, should be accompanied by detailed materials explaining the brokerage window's benefits and risks.

In general, fiduciaries under the Employee Retirement Income Security Act (ERISA) are responsible for the selection and monitoring of investments that are offered under an ERISA-covered plan and can be liable for any losses resulting from a breach of fiduciary duty in the selection of those investments, even if participants are permitted to direct the investments of their own retirement accounts. Generally, under ERISA, a fiduciary is relieved of liability for the individual investment decisions participants elect for themselves.

A plan's brokerage window implicates ERISA's fiduciary obligations and standards.

In 2012, the Department of Labor (DOL) reiterated that ERISA does not absolve fiduciaries of their duty to select and monitor "designated investment alternatives" offered on a plan's core investment menu. However, in subregulatory guidance, the DOL clarified that a brokerage window would not qualify as a designated investment alternative. Therefore, there is no fiduciary duty to monitor or evaluate the underlying investments that plan participants make through the brokerage window, and the investments are not subject to investment-specific disclosures under ERISA Section 404(a)(5).

Nevertheless, plan fiduciaries are bound by ERISA's fiduciary obligations with respect to the brokerage window, which includes "taking into account the nature and quality of services provided in connection with . . . the brokerage window, self-directed brokerage account or similar plan arrangement."[1] In practice, this means that fiduciaries must prudently and loyally select and monitor any brokerage window providers that they choose to make available through the plan. This includes evaluating things such as services, fees and conflicts of interest.

In 2022, the DOL published subregulatory guidance on cryptocurrency.[2] In this guidance, the DOL advised plan fiduciaries that if they allow investments in cryptocurrency, digital assets or other similar products, the fiduciaries must be prepared to explain how such investments meet their duties of loyalty and prudence on an ongoing basis. The DOL specifically stated it was concerned not only about direct cryptocurrency investments but also about other products that allow cryptocurrency investments, specifically brokerage windows. In this piece of subregulatory guidance, the DOL's pronouncements with respect to brokerage windows are contrary to its prior positions.

Finally, it is important to consider the implications of being classified as a fiduciary. Should a plan fiduciary breach their duties and/or responsibilities, that individual fiduciary can be held personally liable for any losses to the plan resulting from the breach. As a result, companies should consult a benefit plan expert and legal counsel before deciding to offer a brokerage window in order to ensure compliance with all current laws, guidance and interpretations.

Notes

1. DOL Field Assistance Bulletin No. 2012-02R, Q&A 39 (July 30, 2012).
2. DOL Compliance Assistance Release No. 2022-01 401(k) Plan Investments in "Cryptocurrencies" (March 10, 2022).

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