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Assessing the Legal Risks of Brokerage Windows

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Why limit plan participants' investments to a handful of managed funds when they can have an unlimited selection using a "brokerage window"? The answer might depend on your appetite for legal risk.

Brokerage Windows Explained

Brokerage windows allow participants to establish an account that gives them access to virtually any investment under the sun — whether it be a "safe" blue chip stock, or some exotic leveraged commodity-based exchange-traded fund (ETF).

Brokerage windows are traditionally added to retirement plans at the request of senior executives who have considerable investment experience with their personal portfolios. Those participants typically believe they can do a better job on their own, or working with their own investment advisor, than when limited to standard 401(k) plan core options like target date funds.

Plans with brokerage accounts are generally professional services organizations (law firms and doctor groups) where the executives want greater diversity than the core menu of funds.

Available to All

If a highly compensated employee has access to a brokerage window in the 401(k) plan, all plan participants must be given this option as well, although rank-and-file employees rarely select this option. Lower-paid workers generally don't understand brokerage windows and typically don't select it as an option. The U.S. Department of Labor (DOL) is concerned that brokerage accounts aren't monitored by plan committees.

Designated investment alternatives (DIAs) are the standard investment choices in a 401(k) plan. They're subject to extensive performance and related reporting requirements. Investments available through a brokerage window aren't subject to these same requirements — although the DOL has shown interest in regulating this area.

For example, in Field Assistance Bulletin 2012-02, the DOL indicated that some investments available through a brokerage window might be covered by DIA requirements, based on the number of plan participants who chose them. The DOL subsequently revised this bulletin, backing off that assertion. Yet the relevant section of the revised document, Q-39, didn't leave plan sponsors off the hook entirely.

Still on the Hook

ERISA regulations absolve plan sponsors of responsibility for the performance of certain DIA categories identified in those regulations, so long as the process for selecting the investments was prudent. The same principle applies to a sponsor's decision to offer a brokerage window.

The DOL acknowledged that brokerage accounts aren't DIAs, and therefore not subject to the same disclosure requirements. Yet its answer to Q-39 hints at its underlying fiduciary concern and the possible path of future regulation. According to the DOL, a plan fiduciary's failure to designate investment alternatives, such as by offering a brokerage option to avoid investment disclosures under the regulation, raises questions under ERISA's general statutory fiduciary duties of prudence and loyalty.

How's Your Appetite?

Regardless of possible future DOL regulation, fiduciaries' duties when offering a brokerage window option are serious. If offering one harms enough participants such that doing so could be deemed a failure to safeguard plan participants' interests, you may want to think twice.

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