

**Advisory Council on Employee Welfare
and Pension Benefit Plans**

**Report to the Honorable Martin Walsh,
United States Secretary of Labor**

**Understanding Brokerage Windows in
Self-Directed Retirement Plans**

December 2021

NOTICE

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the “Council”). The Council was established under Section 512 of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) to advise the Secretary of Labor (the “Secretary”) on matters related to welfare and pension benefit plans. This report examines brokerage windows in self-directed individual account retirement plans that are covered by ERISA with the goal of gaining a better understanding of their prevalence, usage, and implementation.

The contents of this report do not represent the position of the Secretary or of the Department of Labor (the “Department”).

LIST OF COUNCIL MEMBERS

Glenn E. Butash, Council Chair

James G. Haubrock, Council Vice Chair

William B. Johnsen, Issue Chair

Tearyn J. Loving, Issue Vice Chair

Dave Gray, Drafting Team Member

Edward A. Schwartz, Drafting Team Member

Marcy L. Supovitz, Drafting Team Member

Peter J. Wiedenbeck, Drafting Team Member

Megan Broderick

Julie A. Curtis

John R. Harney

Mercedes D. Ikard

Anthony Marc Perrone

Andrea T. Sellars

ABSTRACT

The 2021 ERISA Advisory Council examined brokerage windows in participant-directed individual account retirement plans that are covered by ERISA. The purpose of the examination was to gain a better understanding of their prevalence, usage, and implementation. The examination focused on: (1) the prevalence of brokerage windows (the number of plans that have them and the extent to which assets are invested in them); (2) which types of plans have brokerage windows; and (3) which plan participants use brokerage windows and in what manner.

In 2012, the Department issued a revised Field Assistance Bulletin that clarified: (1) what information related to a brokerage window needs to be disclosed under the participant-level disclosure regulation; and (2) that a brokerage window is not in and of itself a designated investment alternative. Apart from the specific requirements of the participant-level disclosure regulation, the guidance did not deal with ERISA's fiduciary standards, and there is no additional Department guidance on this issue. To increase the Department's understanding of the prevalence and role of brokerage windows in participant-directed individual account plans, the Department issued a Request for Information ("RFI") in 2014. The RFI focused on why and how often brokerage windows are offered and used in ERISA-covered plans. The Department was interested in whether additional guidance would be appropriate and necessary to ensure that participants and beneficiaries with access to a brokerage window are adequately protected under ERISA. The work of the Council was intended to assist the Department to achieve its goal as stated in the RFI.

ACKNOWLEDGEMENTS

The Council recognizes the following individuals and organizations who provided testimony or information that assisted the Council in its deliberations and the preparation of its report. Notwithstanding their contributions, any errors in the report rest with the Council alone.

Bruce Ashton, Faegre Drinker Biddle & Reath LLP

Jordan Backman, Sony Corporation of America

Lisa Bleier, SIFMA

Alison Borland, Alight Solutions

Angela Capek, Fidelity Investments

Shannon Edwards, TriStar Pension Consulting

Diann Howland, American Benefits Council

Kathleen Kelly, Compass Financial Partners

Phyllis Klein, CAPTRUST

Michael Kreps, Groom Law Group, Chartered

Kevin Mahoney, FinDec Benefit Services

Kent Mason, Davis & Harman

Michelle Murphy, Blue Benefits Consulting, Inc.

W. Frank Porter, Empower

Fred Reish, Faegre Drinker Biddle & Reath LLP

Aliya Robinson, The ERISA Industry Committee

Tim Rouse, The SPARK Institute

Chantel Sheaks, U.S. Chamber of Commerce

Dennis Simmons, Committee on Investment of Employee Benefit Assets Inc.

The Vanguard Group, Inc.

TABLE OF CONTENTS

I.	PRIOR COUNCIL REPORTS	7
II.	BACKGROUND	7
III.	WITNESS TESTIMONY	11
IV.	DATA	31
V.	COUNCIL OBSERVATIONS	42
VI.	RECOMMENDATION	53

I. PRIOR COUNCIL REPORTS

The Council has not previously addressed the topic of brokerage windows in self-directed retirement plans.

II. BACKGROUND

A. Overview

A brokerage window allows participants to invest their account balances held within a self-directed retirement plan in a variety of investments beyond the menu of designated investment alternatives offered directly by the plan. A brokerage window sometimes is referred to as a “self-directed brokerage account” or “self-directed account.” For purposes of this report, a brokerage window refers to these terms as well as any similar plan arrangement.

A brokerage window provides participants with the ability to choose from among additional investment options, which can include corporate stock, mutual funds, bonds, exchange traded funds, and/or options. Brokerage windows vary in the number of investment options that may be available. Plan sponsors may restrict the types of investment options or even exclude specific investments within a type of investment option, such as excluding stock in the plan sponsor or certain types of stock options.

Although brokerage windows have been around since the 1980s, the first guidance on what constitutes a brokerage window was not issued until 2010. In 2010, the Department issued participant disclosure regulations pursuant to ERISA Section 404(a). These regulations define a designated investment alternative, and then in turn define a brokerage window by excluding it from the definition of a designated investment alternative, and stating that a brokerage window “enables participants and beneficiaries to select investments beyond those designated by the plan.”¹ It should be noted that earlier

¹ 29 C.F.R. § 2550.404a-5(h)(4) provides:

Designated investment alternative means any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term “designated investment alternative” shall not include “brokerage windows,” “self-

regulations issued under ERISA Section 404(c) defined a designated investment alternative slightly differently, but make no mention of a brokerage window.²

In response to questions the benefits community asked about the participant disclosure regulations under ERISA Section 404(a), the Department issued Field Assistance Bulletin 2012-02.³ In this guidance, the Department explained how the disclosure requirements apply to investments that are made available through an investment platform but are not specifically designated as investment options under the plan, such as a brokerage window or similar arrangement. The Department stated that if a certain number of participants (five for plans with 500 or fewer participants and one percent for those plans with more than 500 participants) select an investment that is not a designated investment alternative, including through a brokerage window, an affirmative obligation could arise to determine whether that investment should be treated as a designated investment alternative.⁴

In response to concerns raised by the benefits community, the Department issued Field Assistance Bulletin 2012-02R, which removed the controversial prior guidance that could have characterized an investment selected by a few participants through a brokerage window as a designated investment alternative.⁵ The Department then issued a Request for Information in 2014 on the usage of brokerage windows in retirement plans, but ultimately the Department did not issue any additional guidance in the area of brokerage windows.⁶ The RFI included 39 questions that cover definitional issues, plan offerings, participation, selection, information available to fiduciaries, costs, disclosure, the role of advisors, fiduciary duties, and reporting related to brokerage windows.⁷

directed brokerage accounts,” or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

² 29 C.F.R. § 2550.404c-1(e)(4) provides: “A ‘designated investment alternative’ is a specific investment identified by a plan fiduciary as an available investment alternative under the plan.”

³ DOL Field Assistance Bulletin No. 2012-02, May 7, 2012.

⁴ Id. at Q&A 30.

⁵ DOL Field Assistance Bulletin No. 2012-02R, Q&A 39, July 30, 2012 (which replaced Q&A 30 in FAB 2012-02). See also *Moitoso v. FMR LLC*, 451 F. Supp. 3d 189, 207 (D. Mass. 2020) (“This Court sees the withdrawal of guidance as the Department essentially declining to take a position on the issue, though other communications indicate that it may not consider such a duty to exist.”)

⁶ Request for Information Regarding Standards for Brokerage Windows in Participant-Directed Individual Account Plans, 79 Fed. Reg. 49469 (Aug. 21, 2014).

⁷ Id.

B. ERISA Fiduciary Standards

ERISA imposes fiduciary standards for the selection and monitoring of investments that are offered under an ERISA-covered retirement plan and can impose liability for any losses resulting from the selection of those investment alternatives. ERISA Section 404(c) relieves fiduciaries of participant-directed individual account plans from liability for investment losses in certain circumstances.⁸ Liability relief is available only if the retirement plan permits participants to exercise control over the assets in their accounts and only to the extent that the participant in fact exercises such control, as determined under regulations.⁹ In such cases, the participants are not deemed to be fiduciaries by reason of their exercise of control and no person who is otherwise a fiduciary is liable for any loss that results from such exercise of control.¹⁰

In footnote 27 of the preamble to the regulations issued under ERISA Section 404(c) in 1992, the Department points out that “the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA 404(c) plan is a fiduciary function.”¹¹ By negative implication, some interpret this footnote to mean that if there is no “act of limiting or designating investment options”—such as by allowing investments through an unrestricted brokerage window—the fiduciary can receive ERISA Section 404(c) relief. Further, the amendments to these regulations in 2010 state that ERISA Section 404(c) relief “does not serve to relieve a fiduciary from its duty to prudently select and monitor any . . . designated investment alternative offered under the plan.”¹² By indicating that there is a fiduciary duty to prudently select and monitor designative investment alternatives, the regulation suggests that no such obligation applies if investments are unrestricted.

⁸ 29 U.S.C. § 1104(c) (2018).

⁹ *Id.*; 29 C.F.R. § 2550.404c-1(a)(1).

¹⁰ 29 U.S.C. § 1104(c)(1)(A), 29 U.S.C. § 1104(c)(1)(A) (2018).

¹¹ 57 Fed. Reg. 46906, 46925 (Oct. 13, 1992).

¹² 29 C.F.R. § 2550.404c-1(d)(2)(iv) (added by 75 Fed. Reg. 64910, 64946 (Oct. 20, 2010)).

C. Caselaw

The courts have not provided much guidance in the way of clarifying what constitutes a brokerage window or the extent of fiduciary responsibilities associated with a brokerage window. Two recent cases illustrate this point, *Moitoso v. FMR LLC*, 451 F. Supp. 3d 189 (D. Mass. 2020) and *Ramos v. Banner Health*, 461 F. Supp. 3d 1067 (D. Colo. 2020). In each of these cases, plaintiffs sued the fiduciary defendants on the theory that they failed to monitor the funds offered through a mutual fund window.

The plan at the center of the *Moitoso* case offered participants three levels of investments: two designated investment alternatives, a platform of Fidelity mutual funds, and a separate platform of non-Fidelity funds. Fidelity, it should be noted, was the employer and plan sponsor, and most plan assets were invested in Fidelity mutual funds that were not designated investment alternatives. The court was unable to clearly define a brokerage window and declined to determine whether a duty to monitor the underlying investments existed. The court observed that it had “not found a judicial opinion actually analyzing” whether there is a duty to monitor funds available through a brokerage window and noted that “[t]he Department [of Labor] has treated the term very broadly, but only in the preamble to a request for information that lacks the force of law.”¹³ The court then added that “in the absence of other regulations explicitly imposing such a duty [to monitor], it is hesitant to state unequivocally that there either is, or is not, a fiduciary responsibility to monitor self-directed brokerage accounts.”¹⁴ The court decided that what otherwise appeared to be a brokerage window, the access to a wide array of Fidelity funds, was not a brokerage window because the options were limited to the sponsor’s proprietary mutual funds and the ability to trade these funds was provided through the sponsor’s regular retirement plan recordkeeping system, not the brokerage platform that was offered to the public and through which non-Fidelity funds were accessible. The court concluded that because “Fidelity was not offering its funds in the equivalent of a brokerage window, it can face fiduciary liability for its lack of monitoring.”¹⁵

¹³ 451 F. Supp. 3d at 208.

¹⁴ Id. at 207.

¹⁵ Id. at 210.

The mutual fund window in the *Ramos* case offered participants a choice from among several hundred mutual funds.¹⁶ The court concluded that it need not decide whether defendants were required to monitor specific investments offered through the mutual fund window because the plaintiffs had failed to demonstrate loss causation.¹⁷ The court did not come out and expressly state that the mutual fund window was not a brokerage window, but, when the mutual fund window was discontinued, plan assets invested in the mutual fund window were either mapped into target date funds or, at the participant's request, could be transferred into a Fidelity BrokerageLink account that was not restricted to mutual fund investments.¹⁸

III. WITNESS TESTIMONY

A. Plan Sponsors

The Council heard testimony from several plan sponsor representatives: Chantel Sheaks from the U.S. Chamber of Commerce, Diann Howland from the American Benefits Council, Aliya Robinson from The ERISA Industry Committee ("ERIC"), and Jordan Backman who is the Vice President and Senior Counsel, Benefits & Compensation, at Sony Corporation of America. All plan sponsor representatives testified that the self-directed brokerage window afforded plan sponsors the opportunity to allow participants to customize their portfolios in ways that the standard investment options would not afford. For example, if participants sought to invest in options that supported specific policy goals, such as environmental, social and governance ("ESG") or Sharia investing, those participants would have a greater chance of finding those investment opportunities in the self-directed brokerage window because such investment options would be available, even if few participants elected to invest in them. The plan sponsor representatives noted that their testimony reflected responses and feedback from very large plan sponsors and some law firms.

The plan sponsor representatives also testified that these self-directed brokerage windows are offered not because fiduciaries seek to shirk their fiduciary duty but rather because employees request them.

¹⁶ *Ramos*, 461 F. Supp. 3d at 1082.

¹⁷ *Id.* at 1127.

¹⁸ *Id.* at 1083.

Ms. Sheaks noted that the Chamber of Commerce members reported that most of the individuals who use self-directed brokerage windows “were highly educated individuals who often work in finance, investing, law or engineering.” Ms. Robinson testified that, of the plan sponsors that she surveyed, all consider offering a self-directed brokerage window for the singular reason that participants have requested it. Mr. Backman testified that he believes employers need to offer a best-in-class retirement plan designed to attract and retain talent, encourage participation, provide participants with an easy-to-understand investment line-up, promote investment education, and help achieve retirement readiness. He believes that offering a brokerage window is one of the tools available to help achieve this goal.

The plan sponsor representatives noted that it takes a significant amount of oversight to select and monitor the vendor that provides the self-directed brokerage window, and, when needed, to make the decision to change and transition to a new vendor. Ms. Robinson testified that many of ERIC members reported that they declined to offer self-directed brokerage windows after exercising due diligence for reasons such as it being unnecessary, unsuitable for that particular employer’s population, fees associated with the self-directed brokerage window option, and fiduciary concerns.

Ms. Sheaks did note that some of the issues with a self-directed brokerage window centered around the limited vendor options that may be available to smaller plan sponsors, especially if those smaller plan sponsors were using “bundled services” and did not have the ability to determine whether certain features, *e.g.*, Roth contributions, would be permissible.

Plan sponsor representatives also testified that they believed the Department did not need to regulate brokerage windows further; that there were significant and sufficient regulations already provided by other regulatory agencies such as the Financial Industry Regulatory Authority (“FINRA”) and the U.S. Securities and Exchange Commission (the “SEC”).

B. Consultants

The Council heard testimony from various retirement plan consultants: Kathleen Kelly from Compass Financial Partners, Phyllis Klein from CAPTRUST Financial Advisors, and Kevin Mahoney from FinDec Benefit Services.

Ms. Kelly stated that she views her role as being a co-fiduciary to plan sponsor committees, as it shapes her perspective on all aspects of plan design, including whether to implement a brokerage window option. Ms. Kelly believes that, in certain situations, a brokerage window can be a valuable benefit that allows those participants with a specific need to access a broader array of investment options. Because of the procedural hurdles involved in establishing a brokerage window, however, the risk that less sophisticated participants will inadvertently select investment products that are inconsistent with long-term retirement savings is minimized. She recognizes the challenges of ensuring participants understand the difference in the fiduciary's role with respect to the designated investment alternatives within the core investment menu in contrast with the limited role over a brokerage window. She thinks it should be clear to participants that there is no endorsement from the fiduciary of investments within a brokerage window, and this may be an area where the Department may want to issue further guidance on what is expected of plan fiduciaries in relation to brokerage windows.

Ms. Kelly also testified about the great lengths that fiduciaries undertake to reduce costs of designated investment alternatives for plan participants, *e.g.*, utilizing collective investment trusts or separate accounts. When implementing a brokerage window, these cost management mechanisms are limited. She believes a publication of some sort by the Department could promote understanding that a design of this type may curtail the purchasing power of the plan sponsor. She also thought guidance to fiduciaries regarding what, if any, data should be gathered for purposes of monitoring activity within a brokerage window should be issued by the Department. Any guidance issued, however, should be carefully considered to avoid the unintended consequence of causing plan sponsors to cease offering brokerage windows.

Mr. Mahoney focused his testimony on the design, prevalence, and usage of brokerage windows. According to the Plan Sponsor Council of America's 63rd Annual Survey of Profit-Sharing and 401(k) Plans, 23.2 percent of all retirement plans offer a brokerage window, and nearly 40 percent of those with more than 5,000 participants do. Even though brokerage windows are being offered in many plans, participants do not use them widely – only 1.5 percent of plan assets are invested through brokerage windows.

Mr. Mahoney also discussed the nature and extent of disclosures that participants receive when a participant decides to open a brokerage account through Schwab. These participants receive a welcome kit brochure that outlines the account details (*e.g.*, how to fund the account and how to make transfers) as well as the fees and expenses associated with trading in the brokerage window. The materials include the following language: “This feature makes it possible for you to invest some or all of your account in investments available through the selected brokerage service that are not one of the plan's designated investment alternatives. These investments may include individual stocks, bonds, exchange traded funds, and mutual funds according to your plan sponsor's plan-level elections. Even though a self-directed brokerage account allows for a broader array of investments than you may have available to choose from in your plan's core fund line-up, not all types of investments are available.” The materials go on to state: “If you choose to invest a portion of your account in the self-directed brokerage option, you are responsible for monitoring and reviewing the investment choices you have made. Applicable additional trading fees and restrictions will apply, along with other individual fees. Actual amounts charged to your brokerage account will be listed on your transaction confirmations and periodic brokerage statements that you receive directly from the brokerage service. These fees and charges will not be separately disclosed on your plan account on the plan website or related plan account statements. You should obtain and review the brokerage account disclosure brochure and pricing guide prior to using this service. The plan’s fiduciaries may allow or restrict certain security types or specific securities, but they do not monitor the investments available through the self-directed brokerage account.”

Despite this disclosure, Mr. Mahoney thinks there are three areas to consider when issuing guidance or for brokerage window accounts: (1) disclosures; (2) accessibility; and (3) investment options. While he believes brokerage windows offer greater choice and flexibility for participants, it is important for participants to understand the additional risks associated with them. He believes it is important to have clear language limiting the plan sponsor’s and plan advisors’ fiduciary liability regarding participant investment decisions. Mr. Mahoney also believes accessibility is another important area to consider. It is important that participants have the ability to participate in a brokerage window on a non-discriminatory basis. The third area he believes is important concerns the menu of investment options that are available through the brokerage window. He believes guidance should be kept up to date concerning new investment options emerging (*e.g.*, cryptocurrencies).

CAPTRUST is a registered investment advisory firm that provides services to over 4,600 401(k) and 403(b) plan sponsors. Ms. Klein testified that, of the plans that CAPTRUST advises, 14 percent offer a brokerage window. She stated that her firm does not provide investment advice to assets held within a brokerage window.

Ms. Klein mentioned that she informally asked some of the largest recordkeepers about brokerage windows. She said that she received responses from six of the largest recordkeepers in the industry, and they informed her that approximately 56 percent of the plans that they recordkept offer a brokerage window. They stated that participant usage ranged from .03 percent to 3 percent. The fees charged to brokerage window participants ranged from “no cost” to \$120 per year. Every respondent charges a fee for broker-assisted trades while the majority offer online trading at little to no cost.

Ms. Klein testified that plan sponsors offer a brokerage window to provide broader investment access to participants who are more experienced and sophisticated investors. She thinks plan sponsors believe it is in the best interest of participants to limit the number of options in a core investment menu in order to avoid confusion or choice overload. This construct allows most participants to select from a menu of core funds that have fiduciary oversight by a committee and often by an investment advisor who assists with monitoring the investments and their costs. Plan sponsors are extremely diligent about informing their employees about the use and risk of brokerage windows with some going as far as asking individuals to acknowledge in writing their understanding of the risks and fees. She believes, based on the low usage of brokerage windows and plan sponsors’ willingness to communicate the risk associated with investing through the brokerage window accounts, that it would seem unreasonable to burden plan sponsors with increased fiduciary responsibility.

As part of her consulting services, Ms. Klein acts as a fiduciary for plans and views the decision to add a brokerage window as a fiduciary decision. She does not think that recordkeepers or brokerage providers market or promote brokerage windows; rather, they make them available if asked by plan sponsors.

C. Recordkeepers

The Council heard testimony from representatives of three recordkeepers: Alison Borland from Alight Solutions, Angela Capek from Fidelity Investments, and W. Frank Porter from Empower Retirement. Additionally, David Stinnett from The Vanguard Group submitted written testimony. Collectively, these recordkeeping providers serve more than 102,000 defined contribution plans covering approximately 48 million participants and \$5.3 trillion in plan assets.¹⁹

The recordkeepers provided extensive data regarding the prevalence and usage of brokerage windows on their platforms. This data is summarized in Section IV of this report. Of particular note, Ms. Borland pointed out that the number of plans offering brokerage windows has increased markedly over time. Alight's most recent survey of large plans found that 46 percent offered a brokerage window in 2019, up from 26 percent only ten years earlier and 12 percent in 2001. Fidelity has seen a similar rise, with 23 percent of their plans offering a brokerage window today, compared to 17.4 percent five years earlier.

The data clearly shows that brokerage window adoption is highest among larger employers. Fidelity reported an adoption rate of 50 percent for larger employers²⁰ and 20 percent for smaller employers. On Vanguard's platform, the adoption rate among all plans was 20 percent, while plans with 5,000 or more participants adopted at a rate of 38 percent. Interestingly, Vanguard noted that law firms are particularly inclined to offer brokerage windows – fully 44 percent of their law firm plan clients had the feature, representing 21 percent of all Vanguard plans with brokerage windows.

The recordkeepers were consistent in their view that the primary reason plan sponsors decide to offer a brokerage window is to keep their core fund lineup simple for the majority of participants while accommodating a small subset of participants who request broader investment opportunities. Common requests include socially responsible funds, religion-compliant funds, specific sector funds, individual stocks, exchange-traded funds (“ETFs”), ladder bonds, and other options that plan sponsors do not believe are appropriate as a designated investment alternative. Witnesses noted that neither

¹⁹ RPA Convergence, *Largest DC Record Keepers* (March 8, 2021), <https://www.rpaconvergence.com/top-10-dc-record-keepers/>.

²⁰ Refers to Strategic, Select, Large and Tax-Exempt markets.

recordkeepers nor brokerage service providers actively market or promote brokerage windows; rather, they make windows available as an accommodation to plan sponsor clients if participant demand warrants their inclusion.

According to the recordkeepers' testimony, plans offer an average of 14 to 17 designated investment alternatives ("DIAs"), counting a target date or target risk series as a single alternative.²¹ This average has been relatively constant for the last decade. One witness observed that plan sponsors seldom trim their core fund lineups when adding a brokerage window. This observation is consistent with the fact that, despite substantial growth in the number of plans offering brokerage windows, the average number of DIAs has held steady for a decade. However, recordkeepers lacked sufficient data to confirm any correlation between the number of DIAs and the existence of a brokerage window.

When asked how plan sponsors choose their brokerage service providers, witnesses indicated that plan sponsors might not choose brokerage services providers. Instead, it is decided by their choice of recordkeeper. Many recordkeepers align with a single provider – either a brokerage firm they own or an unaffiliated firm with whom they partner – because of the “heavy lift” required to connect recordkeeping and brokerage operations (*e.g.*, data integration, money transfers, security oversight, participant communications). In some cases, plan sponsors can choose from a short list of providers but generally cannot “shop” the market. Asked about the fiduciary implications of this circumstance, especially in the absence of choice, witnesses explained that the standard fiduciary practice is to assess the brokerage provider as an integral part of assessing the recordkeeper. That is, rather than viewing brokerage services as a standalone fiduciary consideration, these services are viewed as an essential factor in the decision to hire or retain the recordkeeper.²²

Following is a description of how the typical brokerage window arrangement works:²³

1. A recordkeeper selects and enters into a contract with a brokerage service provider.

²¹ The average number of DIAs varies by recordkeeper. For example, Alight reported 14, Fidelity 15, and Vanguard 17.

²² Some Council members pointed out that the number of brokerage providers that serve the defined contribution plan marketplace is very limited and there are few material differences in their investment offerings, services and costs.

²³ Empower outlined this process in response to the Department's 2014 RFI and it remains the same today.

2. A plan sponsor selects a recordkeeper, taking into account the availability, services, costs and other factors regarding the brokerage service provider.
3. The plan sponsor signs a contract with the recordkeeper and a separate contract with the brokerage service provider.
4. Participants who opt to use a brokerage window sign an agreement with the brokerage service provider.

Costs associated with brokerage windows can be broken into two categories: (1) fees charged by the brokerage provider; and (2) fees charged by the recordkeeper. According to the recordkeeper witnesses, brokerage provider fees are much less today than they were historically because of the prevalence of no-transaction-fee trading, which allows participants to buy or sell a wide range of mutual funds and individual securities without paying any commissions or trading fees. Some brokerage firms charge an annual account maintenance fee (typically \$50), but many do not. In effect, there may be no explicit costs within a brokerage account beyond the underlying expenses of the investments.²⁴ For mutual fund investors, these expenses depend on the fund share class selected by the participant. Most windows offer a range of share classes – including retail, institutional, and retirement share classes – along with online tools to compare expenses. Thus, window users have the ability to choose funds that are no more expensive than DIAs and, in plans with relatively high-cost DIAs, the opportunity to purchase less expensive funds.²⁵

Recordkeepers generally charge brokerage window participants a quarterly maintenance fee in the \$10 to \$25 range, deducted from their “in-plan” account. For example, Alight charges \$20 for each quarter a participant maintains a brokerage account balance. Witnesses indicated that, in virtually all cases, such fees are borne by the window user and not subsidized by other participants. However, when it comes to fees charged for the overall operation of the plan, there are two situations in which cost-subsidization may occur. First, if fees are allocated to participants in proportion to their account balances without counting brokerage balances, the DIA investors directly subsidize the brokerage window investors.

²⁴ Participants may, however, incur fees for using a specific service, such as for wire transfers, broker-assisted trades (vs. online trades) and other participant-initiated activities. In addition, transactional fees may apply for some security types (*e.g.*, options) and certain mutual funds impose short-term redemption fees (such as \$50) for shares held less than 60 or 90 days.

²⁵ Fidelity noted that their brokerage window offers four zero-expense-ratio index funds that are not available for inclusion in any designated plan lineup.

Second, if a plan uses revenue sharing to cover administrative costs, the DIA investors indirectly subsidize the brokerage window investors because only funds on the DIA menu share revenue with the plan (by way of higher-cost share classes).²⁶ The Council noted, however, that cost-subsidization is not unique to plans with brokerage windows and, in fact, may occur in any plan that relies on revenue sharing to cover administrative costs. As a simple example, if a plan's DIA menu includes low-cost index funds, which often do not share revenue, investments in these funds get a "free ride" while other plan options make up the difference through higher-cost share classes. In other words, administrative costs are spread among participants based on the funds they choose, and some participants subsidize the costs of others. Witnesses were not able to provide data on how prevalent these approaches to administrative fees might be, noting only that they see few instances of cost-subsidization, particularly among larger plans, and that plans are increasingly using fee structures that prevent cost-subsidization, such as charging participants flat-dollar fees and eliminating revenue sharing.

About 46 percent of plans that have a brokerage window place varying restrictions on them, according to Alight's research. The most common are: (1) limiting the percentage of a participant's account that can be invested through the window, most often to 50 percent; (2) restricting the window to mutual funds only; and (3) prohibiting investments in employer stock. In addition, essentially all plans disallow investments deemed inappropriate for defined contribution plans, such as municipal bonds and securities on the over-the-counter bulletin board ("OTCBB").²⁷

In all cases, participants who want to sign up for a brokerage account must complete specific paperwork and acknowledge various disclosures. Once the account is opened, participants have the ability to move money from their in-plan account to the brokerage account. They generally cannot deposit contributions directly into the brokerage account. Witnesses opined that the process involved in opening and investing in a brokerage account tends to deter less-experienced investors from pursuing this route. Indeed, demographic data supports this view, as older, higher salaried and higher tenured participants appear much more likely to use brokerage windows than other participants (see Section IV of this report). Notably, Vanguard's median account balance for brokerage participants was about \$264,000—

²⁶ Revenue sharing is the practice of building additional fees into the expense ratio of a mutual fund for the purpose of paying a plan's recordkeeper and other service providers.

²⁷ Securities on the OTCBB are not traded on a major exchange or are penny stocks.

more than 7 times larger than the \$33,000 median for all participants on their platform. Fidelity reported an average account balance of \$456,000 for brokerage participants versus \$112,000 for non-brokerage participants.

Addressing participant disclosures under DOL Reg. Section 404a-5²⁸, witnesses indicated that the recordkeeper and the brokerage window provider generally collaborate to create a single disclosure notice with all required information. The process of distributing notices generally lies with the recordkeeper or plan sponsor who usually provide educational information beyond required notices, such as communications designed to help participants determine whether a brokerage account is a good fit for them and to explain the difference in fiduciary oversight for investment options available through a brokerage account as compared to the plan's DIAs. Participants using brokerage windows also receive prospectuses and other disclosures required under securities laws.

Finally, there was broad consensus among the recordkeeping witnesses that, with respect to brokerage windows, the fiduciary and disclosure rules in place today are appropriate and that no changes or additional guidance are needed. They emphasized that any rule requiring fiduciaries to monitor investments or provide investment-specific disclosures for brokerage accounts would not be feasible, given the open-ended investment environment, and that the disclosure requirements under both Department rules and securities rules are sufficient to fully inform and protect brokerage window participants.

D. Third Party Administrators

Representatives of two third party administration firms ("TPAs") testified before the Council: Shannon Edwards from TriStar Pension Consulting and Michelle Murphy from Blue Benefits Consulting, Inc. These firms provide compliance consulting and administration for smaller plans, most with fewer than 100 participants. Neither firm provides investment-related services or consulting.

Ms. Edwards indicated that, among her firm's 300 clients, 16 offer a brokerage window (excluding plans covering only business owners and their spouses). Ms. Murphy's firm serves about 450 clients,

²⁸ 29 C.F.R. § 2550.404a-5.

with 10 percent offering a brokerage window. At both firms, the majority of plans with brokerage windows offer no DIAs, *i.e.*, the brokerage window is the sole investment option. These brokerage window only plans often have accounts from multiple brokerage firms with multiple financial advisors. This is especially common with professional groups in the medical and legal fields where owners/partners want to work with their personal investment advisors. Brokerage window only structures are also used by small (often start-up) businesses that want to avoid the cost of a recordkeeping platform. Both TPA witnesses indicated that investment-related disclosure obligations played no role in the decision to use a brokerage window only design.

In general, the TPAs felt that plans work well when they offer DIAs along with a brokerage window option and that no additional regulatory standards or other guidance are necessary. For plans where brokerage accounts are the sole investment option, the TPAs suggested introducing a fiduciary requirement to select and monitor a default fund option or a default brokerage firm and advisor so that rank and file participants are not faced with finding their own providers. They said this is particularly important for employees who make no deferrals of their own but are entitled to an employer contribution.

E. Provider Associations

The Council heard testimony from two organizations representing brokerage service providers: SIFMA and the SPARK Institute.

Lisa Bleier testified on behalf of SIFMA. SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers. Ms. Bleier observed that a brokerage window, when combined with a core investment lineup, provides employers and participants with added flexibility with respect to employees' saving for retirement. They also help keep participants engaged in the plan. She stated that employers often add full brokerage windows or mutual fund windows to plans to accommodate participants who desire to customize their portfolio beyond the core lineup. She gave as an example, participants who desire to invest in a "green" investment fund. The presence of a brokerage window would allow those participants to determine for themselves which "green" fund is right for them and would also avoid burdening the plan sponsor with having to research and assess whether to add a

“green” fund (and which one) to add to the core lineup. Brokerage windows thus can help to relieve pressure to add the “investment idea of the month” to the core menu. In this way, a brokerage window keeps the core lineup lean and comprehensible, while allowing participants to satisfy their environmental (or other) concerns by choosing their own fund.

SIFMA opposes regulatory restrictions that would limit brokerage windows. Ms. Bleier stated that she believes that no additional disclosures to plan participants and beneficiaries are required to ensure that they are adequately informed regarding investing through a brokerage window. Under current law, participants receive disclosures from three sources: (1) information about the brokerage window is provided by the plan sponsor; (2) the brokerage platform provider explains fees and expenses associated with the brokerage account and periodically reports amounts actually charged on an individual basis; and (3) required SEC disclosures (prospectus, *etc.*) with respect to individual investments made through the brokerage account are distributed after the fact, but the information contained therein is publicly available. Additional disclosures, in SIFMA’s view, would be duplicative of existing disclosures and burdensome to plans.

Tim Rouse, Executive Director of the SPARK Institute, testified before the Council. The SPARK Institute represents defined contribution plan recordkeepers, mutual fund companies, brokerage firms, insurance companies, banks, consultants, and investment managers. Member firms collectively administer retirement accounts covering more than 100 million Americans. SPARK surveyed its members to ask why brokerage windows are offered in plans they administer. Mr. Rouse emphasized that brokerage windows provide a valuable “noise reduction” tool that satisfies a tiny but vocal minority of plan participants. A brokerage window option allows sponsors to maintain a core menu of designated investment alternatives providing diversified access to all major asset classes (in some cases using both active and passive investment strategies), uncomplicated by offerings with special features that appeal to few participants.

SPARK conducted an eight-question survey, obtaining responses from the 16 largest recordkeepers, which collectively represent about 90 percent of the overall retirement account universe. All those recordkeepers offered plan sponsors the option of including a brokerage window as an investment alternative. Recordkeeper sales presentations to plan sponsors point out that offering a brokerage

window is not necessary and can add costs. Only 13.5 percent of plans handled by these recordkeepers offer a brokerage window and just over 2 percent of participants with access to a brokerage window choose to use it, meaning overall only about 0.3 percent of defined contribution plan participants ($2\% \text{ of } 13.5\% = 0.27\%$) have investments in a brokerage window. The average brokerage window account balance is \$334,263, almost three times greater than the overall 401(k) plan average.

Other survey results show that none of the 16 large recordkeeper respondents handles a plan with only a brokerage window as the sole investment vehicle. While none of their plans currently allows direct investments in cryptocurrency, Mr. Rouse noted that brokerage windows in some plans could be used to invest in mutual funds with cryptocurrency exposure.

F. Investment Fiduciaries

The Council heard testimony from Dennis Simmons and Michael Kreps, who both testified on behalf of the Committee on Investment of Employee Benefit Assets (CIEBA). CIEBA is a trade association representing many of the nation's most experienced investment fiduciaries, including managers of more than 110 of the largest pension funds and 401(k) plans. Members manage more than \$2 trillion of assets on behalf of more than 17 million participants.

CIEBA testified that 54 percent of members responding to a 2019 survey offered some form of brokerage window in their plans, but only about 2.8 percent of plan assets were invested through brokerage windows. There has been little change in the percentage of CIEBA members offering brokerage windows or in participant utilization of brokerage windows over the last five years.

Observing that 401(k) plans cannot be all things to all people, Mr. Simmons testified that a brokerage window option was offered in plans managed by CIEBA members to keep participants with specialized investment needs or preferences in the plan, such as faith-based limitations on investments and social policy preferences. The brokerage window provides an outlet to satisfy special needs or preferences while allowing plans to keep their lineup of designated investment alternatives at a manageable size.

CIEBA cautioned against imposing additional burdens on plan fiduciaries with respect to brokerage windows, such as new monitoring or disclosure obligations. Members currently make sure that participants understand fees associated with brokerage windows and provide disclosures relating to investments made through brokerage windows. Mr. Simmons also noted that many plans managed by CIEBA members impose additional safeguards (or “speed bumps”) to protect participants, including limiting investments through the brokerage window to mutual funds (a mutual fund window) and limiting the portion of a participant’s retirement account balance that may be invested in the brokerage window (20 percent or 50 percent being commonly selected caps).

G. Attorneys

The Council heard testimony from Kent Mason, a partner with the Washington, D.C. law firm Davis & Harman LLP who testified in an individual capacity during the June meeting and thereafter he testified during the August meeting as outside counsel to the American Benefits Council. During the August meeting, the Council also heard from Fred Reish, a partner, and Bruce Ashton, a senior counsel, with the law firm Faegre Drinker Biddle & Reath LLP.

In 2012, Mr. Mason participated in public policy discussions regarding Q&A-30 in Field Assistance Bulletin (FAB) 2012-02. He believes, at present, the Department already has provided sufficient guidance on brokerage windows to serve the needs of plan sponsors and to protect plan participants. He is concerned about the potential for additional guidance or requirements from the Department related to brokerage windows to have an adverse effect on the ability of plan sponsors to offer brokerage windows. His overall view is that additional regulation of brokerage windows is not needed, and the existing level of regulation is sufficient. Mr. Mason sees a “happy medium” between not overwhelming participants with large core investment menus and allowing flexibility for the small minority of people who want a brokerage window. He feels the current retirement plan environment regarding brokerage windows allows core menus to be manageable and understandable for the vast majority of plan participants.

Mr. Mason noted that the imposition of greater fiduciary responsibilities to monitor and evaluate brokerage window investments – and possibly to provide additional investment-specific disclosures – would be administratively unworkable for most plan sponsors. In his view, plan sponsors and

participants would be affected adversely if new fiduciary or disclosure requirements force plan sponsors to unwind their brokerage windows. He stressed that care must be taken to ensure that any new guidance or requirements with respect to brokerage windows would not produce unintended consequences for other types of retirement plans.

Mr. Mason elaborated further with the following views: The Department should maintain the current definition of “brokerage window” which he sees as effective and clear – working well and not in need of amendment. Brokerage windows are an important tool for plan sponsors that can benefit all participants, whether they utilize the feature or not. The potential concern that plan sponsors may use brokerage windows perhaps to avoid fiduciary disclosure obligations is not a significant factor, he said. He does not see this activity as a current, real-life concern. He also believes that small business owners might not be willing to offer retirement plans if brokerage windows are not available.

Mr. Mason noted that Q&A-30 of FAB 2012-02 proposed requiring disclosures for investments held within brokerage windows, and Mr. Mason continues to see this concept as not viable, given the limited applicable tracking and monitoring systems that are available in today’s marketplace. At best, based on limited feedback that he obtained from a few recordkeepers, such tracking and monitoring would be very challenging and largely unworkable. While the core menu for a given retirement plan is “blessed” by the employer, it is understood within the retirement plan community that investments within brokerage windows are not “blessed” by the employer. Consideration of changes in the area of brokerage windows should not be a priority of the Department. The Department should focus its time and resources in “other areas that are real problems.”

In response to various questions from members of the Council, Mr. Mason shared the following: He is glad that Q&A-30 was retracted and happy to see that the Department issued the 2014 RFI because it means the Department remains open to learning about this topic. He has not seen data regarding observations of plans with brokerage windows versus those without, but if that is reviewed in the future, apples-to-apples comparisons regarding size and scope of plans would be important. Regarding the possibility that some plan sponsors might use only brokerage windows for all plan investments, he does not view such arrangements as potentially dubious efforts to avoid fiduciary disclosure obligations. As for the use of brokerage windows in qualified retirement plans versus non-qualified retirement plans,

Mr. Mason sees no relevant problem. Hypothetically, if brokerage windows were limited to non-qualified plans and not allowed within qualified plans, he feels it might hurt the simplicity of qualified plan menus and disincentivize small company owners to sponsor qualified retirement plans.

When asked for his thoughts on restrictions that are applied by employers on brokerage windows, he responded that in some cases, they are helpful, but in other cases they are unnecessary. He feels the appropriateness of restrictions on brokerage windows depends on the specific workforce of a given organization. When asked, he could think of no particular example of improper use of brokerage windows that is prevalent and bothersome to him, but he noted the importance of monitoring for potential negative activity in the future. Finally, when asked if best practices from the Department might be helpful on this topic, he recommended against it because, in his view, issuance of “best practices” often leads to overly long checklists and regulatory “overkill.” He thinks that such an approach would be counterproductive. If anything, he believes that general guidance would be more useful and productive.

Mr. Reish opened by sharing his opinion that additional guidance is needed but not in the form of regulations. Perhaps some clarification of some regulations could be done in an interpretative fashion. By guidance, he meant primarily via tips and best practices. He did not think there was widespread abuse that would require a whole regulatory project, but instead he thinks there is a lack of guidance for plan sponsors.

He spoke about two things that he said are very closely related, but that are not the same thing. The first is the decision to have a brokerage window. There is no guidance at present on what process fiduciaries need to go through to make that decision. Generally, his view is that if you take what would otherwise be a fiduciary decision and you hardwire it into a plan document, it is still a fiduciary decision to decide whether the implementation of that provision would be prudent. New fiduciaries need to look at the characteristics of their workforce and decide whether to have a brokerage window in the plan because he thinks there are participants who lack the knowledge or the experience necessary to use a brokerage window.

The Department should consider providing education to participants to inform them that there is no monitoring and no prudent selection of the investments available through a brokerage window and that there is risk that you could make an investment mistake. For publicly traded companies, they are very concerned about the trading activity of their own stock inside a brokerage window. He thinks there may be concern about highly speculative investments in a brokerage window, and there should be some responsibility to look inside a brokerage window and exclude certain investments.

The second issue relates to the process of selecting and monitoring the brokerage window provider. There is some guidance on that from the Department, but FAB 2012-02R²⁹ tends to be vague.

Although he believes the very large plan market is fairly sophisticated, in the mid-market or the small plan market, there tends to be a broker dealer associated with a given recordkeeper, which is the one that ends up being selected without a comparative analysis. There should be at least some understanding that a comparative analysis is required when selecting the brokerage window provider. The Department also should listen to participant complaints. He believes there is an issue about whether there is any obligation to look at the participant activity. Mr. Reish raised this as an issue, and not as a recommendation.

With regard to defining a brokerage account, Mr. Ashton recommends that the Department provide guidance because there is currently little guidance on this issue. He does not think the guidance needs to be regulatory, but it could be more in the nature of tips or a field assistance bulletin. He referenced the *Moitoso* and *Ramos* cases.³⁰ In the *Ramos* case, the court basically said, because this is a brokerage window, the fiduciaries do not have to monitor the underlying investments. He raised these two cases because he feels that they illustrate that there is not much guidance in this area. He believes it would be appropriate and necessary to provide this kind of guidance to define what is a brokerage window.

Mr. Reish expressed concern that, for example, 25 investment options in a 401(k) plan that are designated investment options potentially could be labeled as a brokerage window. As such, they would

²⁹ DOL Field Assistance Bulletin No. 2012-02R, July 30, 2012.

³⁰ *Moitoso v. FMR LLC*, 451 F. Supp. 3d 189 (D. Mass. 2020); *Ramos v. Banner Health*, 461 F. Supp. 3d 1067 (D. Colo. 2020).

no longer be designated and, therefore, there would no longer be any fiduciary responsibility for those investment options. In his view, many would say this situation in which a window is restricted to 25 investment options still would represent a core investment lineup.

Mr. Ashton then talked about designated investment alternatives and brokerage accounts and some of the issues he sees under ERISA Section 404(c).³¹ When the Department issued Field Assistance Bulletin 2012-02, there was a Question 30 that suggested that, if a plan offered a brokerage account, some of the investment options inside of the brokerage account could be designated investment alternatives subject to fiduciary monitoring.³² Because of pushback, the Department issued Field Assistance Bulletin 2012-02R.³³ The Department removed Q&A 30 and replaced it with Q&A 39 that said there are no designated investment alternatives inside a brokerage account.³⁴ The Department also stated that a plan fiduciary's failure to have any DIAs to avoid investment disclosures under the regulation raises questions under the fiduciary duties of ERISA Section 404(a).³⁵

Mr. Ashton further expressed concern with ERISA Section 404(a)(1)(D)³⁶, which says that the fiduciaries have to follow the terms of the plan, assuming consistency with the provisions of ERISA. There needs to be guidance discussing brokerage windows in the hardwired context. In the *Dudenhoeffer* case³⁷, it is suggested that the duty of prudence trumps the provisions of the plan document.

Mr. Ashton believes there is responsibility related to the selection of the provider and potentially with respect to the selection of how the brokerage window account is setup. He did not suggest any particular approach but suggested that guidance that clarifies this issue would be very helpful to both plan sponsors and participants.

³¹ 29 U.S.C. § 1104(c) (2018).

³² DOL Field Assistance Bulletin No. 2012-02, Q&A 30, May 7, 2012.

³³ DOL Field Assistance Bulletin No. 2012-02R, July 30, 2012.

³⁴ Id. at Q&A 39 (which replaced Q&A 30 in FAB 2012-02).

³⁵ 29 U.S.C. § 1104(a) (2018).

³⁶ 29 U.S.C. § 1104(a)(1)(D) (2018).

³⁷ *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014).

In response to questions, Mr. Reish said that the decision to add a brokerage window to a plan is a fiduciary decision. Regarding plans that have a brokerage window only but no designated investment alternatives, he said the issue is whether it is prudent. He gave examples of retirement plans with brokerage windows only. Common examples of this type commonly include plans that cover all doctors or law firms. Most of these participants could be considered financially experienced, however, rank and file employees can be inexperienced. He thinks if the Department said through soft guidance that they have concerns about that situation, it would be appropriate.

A secondary issue relates to ERISA Section 404(c)³⁸. He pointed out that if you read ERISA Section 404(c), it just notes investment alternatives, suggesting they do not have to be designated, or perhaps suggesting they could be in a brokerage window account, which then suggests that the average participant knows how to go find them in a brokerage window account. He finds that problematic because ERISA Section 404(c) was drafted in another era, decades ago.

Regarding fiduciaries' comparison of the cost of the brokerage platform itself versus the cost of the underlying investments, Mr. Reish shared his view that comparative analysis is a part of any prudent process. He thinks a plan sponsor does not know if a cost is reasonable unless it knows what market costs are. Regarding the cost of investing in a brokerage window, he sees two issues. In terms of the threshold costs for having a plan, his sense is that they are actually quite low, and it should not be an issue. A comparative analysis is necessary to establish reasonableness, based on what is charged in the industry. The same applies to the cost of plan investments, which would typically be, for stocks and bonds, a commission, and the classes of the mutual fund.

Mr. Ashton added that a plan sponsor also should look at the trading costs, *e.g.*, whether there is a charge for maintaining the brokerage account. He feels it would be helpful if there was guidance suggesting that these are some of the issues that plan fiduciaries need to review. Mr. Reish added, however, that he does not think it is practical for a plan committee to look at every cost charged

³⁸ Id. at § 1104(c).

everywhere in the brokerage window account, but there should be a basic understanding based on comparative analysis.

Mr. Reish responded to a question about potential concern that requesting “tips” from the Department could be used for enforcement and audit, and thus essentially becoming regulations. He thinks that consultants, advisors, and service providers would educate the Department’s responses about tips or best practices. He hopes that the Department would not use them as an audit tool or an investigatory tool. Perhaps there could be a disclaimer indicating that such tips are not official guidance and could not be used to assert that plan sponsors are committing fiduciary violations.

Regarding Mr. Reish’s observation that plan sponsors currently have fiduciary responsibility to oversee designated investment alternatives but none of the investments held within a brokerage window, he was asked what some practical measures might be. He emphasized education. A brokerage window account, in his opinion, is appropriate for some employees, but not for others, and an education campaign could go a long way for these individuals. He noted that certain investments create tax problems, *e.g.*, margin accounts. One potential approach he noted, but did not feel it should be mandatory, was to monitor participant behavior by getting a report from the provider on how participants are using the brokerage window accounts. He also discussed the possibility of looking at the volume of activity. He cautioned that oversight should not go too far and instead should focus on identifying patterns to ascertain whether participants are investing prudently.

With respect to fee disclosures, Mr. Reish said the Government Accountability Office came out with a fee disclosure report that suggested the Department could improve the current fee disclosures.³⁹ A plan administrator should provide participants and beneficiaries a statement of the dollar amounts of fees and expenses that actually were charged during the preceding quarter. He was not suggesting necessarily that the current disclosures are wrong. He thought an investigation of what is going on could lead to improvements.

³⁹ See Government Accountability Office, “401(k) Retirement Plans: Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them”, GAO-21-357 (July 2021).

Regarding trading volume and whether these accounts are being used for day trading, or investments in a very small number of stocks, Mr. Reish spoke of a slippery slope because fiduciaries cannot decide whether somebody is investing prudently. One does not know what other assets are held outside of the plan by a participant. He thought perhaps the monitoring could be limited to see if there is a troubling pattern and not focus on any individual participant.

IV. DATA

In its 2014 Request for Information, the Department sought to gain a better understanding of self-directed brokerage windows in individual account plans governed by ERISA.⁴⁰ Among the information the Department sought was demographic information regarding participants who use brokerage windows, the share of account balances invested through brokerage windows, and evidence regarding investment “decision-making” of participants who used brokerage windows. In addition to the verbal testimony that the Council heard during the two days of witness testimony, the Council received written testimony from the witnesses and the public, and the Council conducted its own research. This section summarizes this information below by source. Each source has been broken down into the following three categories, where applicable: prevalence (*e.g.*, statistics on number of plans that have a brokerage window and trends, the types of plans, size of plans/assets, industries that use them, and reasons for adding/keeping brokerage windows within plans), usage (*e.g.*, statistics on number of participants who have access to the brokerage window and use it and characteristics of brokerage users), and implementation (*e.g.*, restrictions placed on windows and disclosures provided to participants).

⁴⁰ Request for Information Regarding Standards for Brokerage Windows in Participant-Directed Individual Account Plans, 79 Fed. Reg. 49469 (Aug. 21, 2014).

A. Fidelity Investments⁴¹

1. Prevalence

- Fidelity administers brokerage windows for 5,328 plans, which equates to 23 percent of the defined contribution plans on its recordkeeping platform.⁴²
- Plan adoption rate of brokerage windows has been increasing (17.4 percent at the start of 2016) and is highest among large employers and in certain industries, including legal services, physicians, and airlines.⁴³
- Fidelity offers brokerage windows for nonqualified plans provided that it serves as trustee of an associated rabbi trust, and 10 percent of the “assetized” nonqualified plans for which Fidelity provides recordkeeping services adopt the brokerage platform.⁴⁴

2. Usage

- The typical participant using a brokerage window is older, higher-paid, and has a larger account balance than plan participants that invest only in the plan’s designated investment alternatives; the rate of participant utilization of brokerage windows has remained steady at about 2.9 percent since 2015, and on average they invest \$256,000, or 56 percent of their retirement plan balance, through their brokerage windows.⁴⁵

⁴¹ Written statement of Angela Capek submitted to the Council in connection with testimony on August 26, 2021.

⁴² Id. at p. 3.

⁴³ Id.

⁴⁴ Id. at p. 8.

⁴⁵ Id. at p. 5.

- Since 2019, younger participants have increased their utilization of brokerage windows⁴⁶; while the average brokerage window investor has 9 holdings, 46 percent of positions held in all BrokerageLink accounts are held in only one account.⁴⁷

3. Implementation

- Fidelity offers three brokerage window investment packages, with 79 percent of plans using an expanded option allowing broad access to mutual funds, ETFs, and individual securities, while 17 percent use a mutual fund only option and 4 percent allow investment in either mutual funds or ETFs, but plan sponsors are allowed to further restrict available investments by blocking specific securities (*e.g.*, employer stock) or security types.⁴⁸
- Most plans using Fidelity's brokerage platform have adopted a \$500 minimum for initial account opening and subsequent transfers and 94 percent of plans allow participants to invest 95 percent or more of their account balance through their brokerage window.⁴⁹
- No fees are charged to open a brokerage window, and most mutual funds, ETFs, and stocks trade commission free, but transaction fees apply in the case of certain types of investments, such as options and certain bonds, notes and CDs.⁵⁰
- Fidelity may impose a brokerage window maintenance fee only in those plans that pay for recordkeeping through revenue sharing, to ensure that participants using a brokerage window contribute toward recordkeeping costs; this pricing arrangement is most prevalent with small employers and accounts for 40 percent of plans using

⁴⁶ Id. at p. 6.

⁴⁷ Id at p. 7.

⁴⁸ Id at p. 4.

⁴⁹ Id.

⁵⁰ Id. at p. 8 and Fidelity BrokerageLink Commission Schedule.

brokerage windows, and almost always entails an annual account maintenance fee of \$100.⁵¹

- Mutual fund share classes available through a brokerage window may be retail or institutional, but do not include a retirement share class.⁵²
- Disclosures and notices provided to brokerage window participants are extensive, including a 9-page participant agreement and 3-page commission schedule (copies submitted in conjunction with Ms. Capek's written statement), and most materials contain a risk disclosure advising participants to "compare investments and share classes that are available in your plan's lineup with those available through BrokerageLink".⁵³

B. The Vanguard Group, Inc.

The Vanguard Group prepares a report each year based on the 1,700 qualified defined contribution plans (1,400 clients) with 4.7 million participants for which Vanguard directly provides recordkeeping services.⁵⁴ The Vanguard Group also provided a 3-page summary, submitted to the Council on July 15, 2021.⁵⁵

1. Prevalence

- 3 percent of plan assets were invested in brokerage accounts in 2020.⁵⁶

⁵¹ Id.

⁵² Id.

⁵³ Id. at p. 9-11.

⁵⁴ Vanguard, *How America Saves 2021*, at https://institutional.vanguard.com/content/dam/inst/vanguard-has/insights-pdfs/21_CIR_HAS21_HAS_FSreport.pdf.

⁵⁵ Vanguard, *The Brokerage Option in DC Plans* (research note, May 2021) (3-page summary submitted to the Council July 15, 2021).

⁵⁶ Vanguard, *supra* note 51, at Figure 55.

- 20 percent of all plans overall offered a brokerage window, but fully 38 percent of plans with 5,000 or more participants offered brokerage windows.⁵⁷
- Based on a smaller universe of retirement plans with assets of \$50 million or less, consisting of 15,423 plan sponsors with more than 700,000 participants at year-end 2020, 1 percent of assets were invested in brokerage accounts, but 4 percent in health care industry plans and 3 percent for law firms, and 11 percent of the smaller plans overall offered a brokerage window.⁵⁸

2. Usage

- 33 percent of all participants had access to a brokerage window, but less than 0.5 percent of all participants used it.⁵⁹
- Based on the smaller universe of retirement plans with assets of \$50 million or less, consisting of 15,423 plan sponsors with more than 700,000 participants at year-end 2020, only 2 percent of participants who were offered a brokerage window used it.⁶⁰

3. Implementation

- 19 percent of plans offering brokerage windows restrict the window to mutual funds only, while 50 percent allow participants to choose mutual funds, ETFs, fixed-income securities, or equities.⁶¹

⁵⁷ Id. at Figure 62.

⁵⁸ Vanguard, *How America Saves 2021 Small Business Edition*, at https://institutional.vanguard.com/assets/pdf/has-small-business/21_VRPA_How_America_Saves_SB.pdf at Figure 23.

⁵⁹ Vanguard, *supra* note 51, at Figure 71.

⁶⁰ Vanguard, *supra* note 55, at Figure 23.

⁶¹ Vanguard, *supra* note 51, at Figure 3.

- 38 percent of plans offering a brokerage window impose a cap on the participant account balance that may be invested in the brokerage window (most commonly at 50 percent), but 62 percent impose no cap.⁶²
- Participants who use a brokerage window invest on average half of their account balance in the brokerage window.⁶³
- The most common investments held in the brokerage window are individual stocks followed by mutual funds and ETFs, held by 50 percent, 41 percent, and 31 percent of brokerage window participants, respectively.⁶⁴

C. Alight Solutions^{65,66}

The data from Alight Solutions was drawn from a survey of 240 U.S. plan sponsors that employ 8.5 million workers. Of the respondents, 60 percent had 10,000 or more U.S. employees, and 64 percent were publicly traded.⁶⁷

⁶² Id. at Figure 3.

⁶³ Id. at Figure 4.

⁶⁴ Id. at Figure 6.

⁶⁵ In 2017, the benefits outsourcing department of Aon Hewitt was acquired by Blackstone and rebranded as Alight Solutions. Alight provides cloud-based human-resource support services including payroll, health benefits, retirement benefits, and employee communications for large companies in the U.S. and around the world. Alight is the largest independent recordkeeper of employer-provided retirement plans, both defined benefit and defined contribution. Alight went public in July 2021 through a merger with a special purpose acquisition company (SPAC).

⁶⁶ Alight, 2019 Trends & Experience in Defined Contribution Plans, as presented in written testimony of Alison Borland before the ERISA Advisory Council, June 24, 2021. The full report from which most of the data presented to the Council was drawn is proprietary information available for purchase from Alight at <https://alight.com/research-insights/2021-universe-benchmarks>. References to the full report and to Alison Borland's testimony are denoted as "Report" and "Statement," respectively.

⁶⁷ Id. at p. 99-100.

1. Prevalence

- 46 percent of plans offered brokerage windows and another 2 percent planned to add a brokerage window.⁶⁸
- In 2019, on average 4 percent of plan assets were invested in brokerage windows.⁶⁹

2. Usage

- The percentage of plan participants using a brokerage window (and the average brokerage window balance) generally increases with age, salary, and job tenure.⁷⁰
- In 2020, 2.4 percent of participants used a brokerage window and on average half of their plan account balance was invested in the brokerage window.⁷¹

3. Implementation

- 54 percent of plans offering a brokerage window impose no significant restriction on the portion of a participant's balance that may be invested through the brokerage window (another 19 percent of plans limit participants to investing half of their account balance in the brokerage window).⁷²
- 60 percent of plans offering brokerage windows allow full brokerage options, including individual stocks and bonds in addition to mutual funds and ETFs.⁷³

⁶⁸ Id. at p.98; Statement p. 7.

⁶⁹ Id. at p. 88.

⁷⁰ Id. at Statement, p. 5-7. One noteworthy exception is that percentage utilization by age fell back from a maximum of 3.7 percent among participants ages 50-59 to 2.9 percent among those aged 60 or older (Statement p. 6).

⁷¹ Id. at Statement, p.8.

⁷² Id.

⁷³ Id.

D. Charles Schwab & Co., Inc.

For many years, the brokerage firm, Charles Schwab & Co., Inc., has published quarterly reports that provide a great amount of detail regarding utilization of brokerage windows in plans that are recordkept by its affiliate, Schwab Retirement Plan Services, Inc. The reports, titled “The Schwab Self-Directed Brokerage Account Indicators” (“Indicators Report”), are publicly available on Schwab’s website.⁷⁴ The reports include certain demographic information for participants with a Schwab self-directed brokerage account in their Schwab-recordkept plan and regarding such participants’ investment activity – asset allocations, number of holdings, top holdings, and trading frequency. The reports, unfortunately, do not reveal the percentage of participants’ plan account balances invested in the brokerage window as opposed to the plans’ “core” fund lineup. Nonetheless, given the size of Schwab’s client-base and the wealth of information in the Indicators Reports, the reports provide a significant data set for the Department to review with respect to the usage of brokerage windows. The information below comes from the Indicators Report for the quarter ending June 30, 2021, which shows aggregated information for 174,000 participants who have a brokerage window account balance of at least \$5,000 (but less than \$10 million).⁷⁵

- The average brokerage window account balance was \$348,183, with higher balances for those who have an investment advisor. The average balance for those brokerage window users who have an investment advisor (18.5 percent of brokerage window users) was \$550,127 while those who do not have an investment advisor (81.5 percent of brokerage window users) have an average balance of \$302,000.⁷⁶
- Brokerage window users skewed heavily towards men – with males representing 76.5 percent of participants vs. 23.5 percent females.⁷⁷

⁷⁴ See <https://workplacefinancialservices.schwab.com/resources-events/sdba-indicators> (accessed Nov. 11, 2021).

⁷⁵ Q2 2021 Indicators Report, at p. 10.

⁷⁶ Id. at pp. 2 & 3.

⁷⁷ Id. at p. 4.

- The largest segment of brokerage window users were so-called Gen-Xers (participants ages 41-56) who represented 44.5 percent of all brokerage window participants. Baby Boomers (ages 57-74) were the next-highest group at 31.9 percent followed by Millennials (ages 29-40) at 17.7 percent.⁷⁸

The table below shows the demographics of brokerage windows users over a six-year period of Indicator Reports.⁷⁹

	6/30/2015	6/30/2016	6/30/2017	6/30/2018	6/30/2019	6/30/2020
Males	n/a	n/a	n/a	75.5%	76.2%	76.3%
Females	n/a	n/a	n/a	24.5%	23.8%	23.7%
Avg. Age	49	50	50	51	51	51
Age band ⁸⁰						
Age 20-39	19.0%	18.1%	17.7%	--	--	--
Age 40-49	27.7%	27.4%	27.1%	--	--	--
Age 50+	53.3%	54.5%	55.3%	--	--	--
Age 26-37 ("Millennials")	--	--	--	11.0%	12.6%	14.7%
Age 38-53 ("Gen-X")	--	--	--	40.4%	41.6%	43.0%
Age 54-71 ("Baby Boomers")	--	--	--	41.2%	39.1%	36.1%

n/a = not included in report

⁷⁸ Id.

⁷⁹ Indicator Reports for Q2 2015 through Q2 2020, available at <https://workplacefinancialservices.schwab.com/resources-events/sdba-indicators> (accessed Nov. 11, 2021). *passim*.

⁸⁰ In the reports for 2015-2017, age cohorts were as follows: 20-39, 40-49, and 50+. Starting with the 2018 report, the labels "Millennials" *etc.* were affixed, and the age bands were as follows: age 26-37, 38-43, and 54-71.

- Participants had an average of 12 holdings in their brokerage window accounts. The largest category of holdings was equity securities, at 36.8 percent. The next largest category was mutual funds, at 30.4 percent, followed by exchange-traded funds (ETFs), at 19.6 percent. Cash accounted for 11.8 percent of holdings and fixed income investments accounted for only 1.4 percent of holdings.⁸¹
- Among individual equity securities, the top five holdings were: Apple, Tesla, Amazon, Microsoft, and Nvidia.⁸²

The table below shows the top five individual equity holdings over the same six-year period shown above.⁸³

6/30/2015	6/30/2016	6/30/2017	6/30/2018	6/30/2019	6/30/2020
Apple	Apple	Apple	Apple	Apple	Apple
Berkshire Hathaway	Facebook	Amazon	Amazon	Amazon	Amazon
Facebook	Berkshire Hathaway	Facebook	Berkshire Hathaway	Berkshire Hathaway	Microsoft
Bank of America	Amazon	Berkshire Hathaway	Facebook	Microsoft	Tesla
General Electric	General Electric	Bank of America	Netflix	Facebook	Berkshire Hathaway

- Among mutual fund holdings, the top five “fund families” were: Vanguard, Schwab, DFA (Dimensional Fund Advisors), T. Rowe Price, and Fidelity; notably, with one exception, the top five funds were all index funds: Schwab S&P 500 Index, Schwab Total Stock Market Index, Vanguard 500 Index, Vanguard Total Stock Market Index. The exception was the PFG American Funds Growth Strategy fund.⁸⁴

⁸¹ Q2 2021 Indicator Report, at pp. 4 & 5.

⁸² Id. at p. 4.

⁸³ Indicator Reports for Q2 2015 through Q2 2020, available at <https://workplacefinancialservices.schwab.com/resources-events/sdba-indicators> (accessed Nov. 11, 2021). *passim*.

⁸⁴ Q2 2021 Indicators Report, at p. 4.

The table below shows the top five mutual fund holdings over the same six-year period shown above.⁸⁵

6/30/2015	6/30/2016	6/30/2017	6/30/2018	6/30/2019	6/30/2020
Schwab S&P 500 Index	Schwab S&P 500 Index	Schwab S&P 500 Index	Schwab S&P 500 Index	Schwab S&P 500 Index	Schwab S&P 500 Index
Schwab Total Stock Market	Schwab Total Stock Market	Schwab Total Stock Market	Schwab Total Stock Market	Schwab Total Stock Market	Schwab Total Stock Market
PIMCO Income	PIMCO Income	PIMCO Income	PIMCO Income	PIMCO Income ⁸⁶	Vanguard 500 Index
Vanguard 500 Index	Metropolitan West Total Return	Pacific Financial Core Equity	DFA US Core Equity	DFA US Core Equity	Vanguard Total Stock Market
Oakmark International	Vanguard 500 Index	DFA US Core Equity	Vanguard 500 Index	PIMCO Income ⁸³	PIMCO Income

- The top five ETFs were also market-oriented or index funds (as opposed to, *e.g.*, sector funds): Vanguard Total Stock, SPDR S&P 500, Invesco QQQ (a NASDAQ-100 index fund), Vanguard S&P 500, and Schwab's US Broad Market fund.⁸⁷
- Participants held, on average, slightly more than 12 positions in their brokerage window during the quarter.⁸⁸
- Participants made just under 14 trades during the quarter.⁸⁹

⁸⁵ Indicator Reports for Q2 2015 through Q2 2020, available at <https://workplacefinancialservices.schwab.com/resources-events/sdba-indicators> (accessed Nov. 11, 2021). *passim*.

⁸⁶ Among the top five mutual fund holdings of participants at June 30, 2020, participants held two different class shares of the PIMCO fund.

⁸⁷ Q2 2021 Indicators Report, at p. 4.

⁸⁸ *Id.*

⁸⁹ *Id.*

The table below shows the number of positions, position type, and number of trades made over the same six-year period shown above.⁹⁰

	6/30/2015	6/30/2016	6/30/2017	6/30/2018	6/30/2019	6/30/2020
Number of positions	9.7	9.4	9.2	9.7	10.0	10.5
<i>Positions by type</i>						
Equities	28%	27%	28%	29.6%	28.9%	30.2%
Mutual Funds	39%	38%	37%	37.9%	37.6%	33.1%
ETFs	14%	14%	16%	16.8%	17.6%	17.7%
Cash and equivalents	17%	19%	17%	13.2%	12.6%	16.6%
Fixed income	2%	2%	2%	2.5%	3.3%	2.5%
Number of trades	5.8	3.4	3.9	6.3	6.5	14.0

E. NEPC, LLC⁹¹

Based on 2019 year-end data pertaining to 142 defined contribution plans with \$191 billion in aggregate assets covering 1.8 million participants, 60 percent of large plans offer a brokerage window, which is up from about 19 percent in 2005.⁹²

V. COUNCIL OBSERVATIONS

As noted in the Abstract section of this report and also in the Council's May 26, 2021 Issue Statement, the 2021 Council set as its primary task to conduct a factual investigation surrounding brokerage windows in self-directed retirement plans in order to: (1) update and supplement information that the

⁹⁰ Indicators Reports for Q2 2015 through Q2 2020, available at <https://workplacefinancialservices.schwab.com/resources-events/sdba-indicators> (accessed Nov. 11, 2021). *passim*.

⁹¹ NEPC 2020 Defined Contribution Progress Report, at <https://f.hubspotusercontent00.net/hubfs/2529352/2020%20DC%20Plan%20and%20Fee%20Survey/2020%20NEPC%20DC%20Plan%20Progress%20Report.pdf>.

⁹² Id. at p. 3.

Department received from stakeholders regarding such windows – their prevalence, usage, *etc.* – and also (2) based on this investigation, make recommendations to the Department with regard to issues identified.

The Council’s factual findings are set forth fully in the Data section of this report. What follows below is a description of issues/subtopics identified in the course of this investigation and with respect to which the Council had considerable discussion and debate. These issues or subtopics, discussed more fully below, are: (A) whether the Department should issue guidance with respect to the definition of “brokerage window”; (B) whether the Department should examine further “brokerage window only” (“BWO”) plans, *i.e.*, plans that have no “designated investment alternative” within the meaning of DOL Reg. Section 2550.404a-5⁹³; (C) whether the Department should require the fiduciaries of plans that offer self-directed brokerage accounts as part of the plan to disclose to participants the risks associated with investing through a brokerage window; and (D) whether the Department should undertake an educational campaign regarding brokerage windows in self-directed individual accounts plans (*e.g.*, what is a brokerage window, what costs can you expect to incur investing through a brokerage window, what is the role of the plan sponsor, what risk does a participant take on when investing through a brokerage window, *etc.*).

As described and for the reasons set forth more fully below, the Council has only one recommendation for the Department – that the Department consider further studying the topic of BWO plans.

A. Whether to Issue Guidance Regarding the Definition of Brokerage Window

The Council engaged in a significant amount of discussion regarding whether there was a need for the Department to define exactly what constitutes a brokerage window. As noted above, DOL Reg. Section 2550.404a-5(h)(4) defines a default investment alternative (“DIA”), and then in turn defines a brokerage window by excluding it from the definition of a DIA. It states that the definition of designated investment alternative, “. . . shall not include ‘brokerage windows,’ ‘self-directed brokerage accounts,’

⁹³ 29 C.F.R. § 2550.404a-5.

or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.”

Some Council members thought that additional guidance would be helpful to the ERISA community – pointing to the *Moitoso* case as an example of what happens without a clearer definition, *i.e.*, employers and others are subjected to the costs and uncertainty of litigation, with courts (potentially) issuing differing decisions on the subject.

However, most Council members did not believe that guidance in this area was needed. In this regard, the Council observed that the marketplace seemed to be functioning well. Although not all plans offer brokerage windows, a sizeable percentage do, and, aside from the *Moitoso* case and the *Ramos* case, in which the court concluded that the platform at issue was a brokerage window and therefore not subject to the disclosure requirements of DOL Reg. Section 2550.404a-5, there was little indication that employers and others, in general, struggle with the question of what a brokerage window is.

That said, and as discussed in “B.”, below, the Council did recognize, and recommends, that the Department consider further fact-finding relating to “brokerage window only” plans. The majority of the Council does not, however, believe that that fact-finding requires the Department first to issue guidance with respect to the definition of a brokerage window.

Many witnesses felt that the market has defined, and the ERISA community knows and understands, what a brokerage window looks like and how it is supposed to operate. One witness, however, noted that brokerage windows are defined by what they are *not* rather than by what they are, and felt that it is important for the Department to define exactly what is considered a valid “brokerage window/account” under ERISA. Therefore, based on the testimony, one Council member stated that it could be helpful for the Department to offer additional guidance, especially as the prevalence of brokerage window use increases and data shows an uptick in Millennials investing through brokerage windows. The Council member offered that a brokerage window could be simply defined as an arrangement implemented in ERISA plans that provides an opportunity for participants to invest assets with an entity or organization that is subject to SEC rules and regulations, and/or subject to FINRA standards. This simple definition

could also serve as guidance to fiduciaries concerning their responsibility in the selection and monitoring of these entities.

B. Whether to Undertake Further Fact-Finding with Respect to Brokerage Window Only Plans

The Council heard testimony regarding the use of “brokerage window only” (“BWO”) plans, *i.e.*, plans that have no designated investment alternatives and brokerage accounts are the sole investment option. These types of plans primarily are limited to the smaller plan market – plans that cover fewer than 100 employees and, many times, fewer than 25 employees. Often the BWO approach allows these smaller employers to offer a 401(k) plan to their employees because plan recordkeeping costs typically are less than the costs under a fully “bundled” service approach.

Although the Council did not hear any evidence that establishes there is a “problem” regarding BWO plans, the Council heard testimony suggesting there may be areas of potential concern regarding their use. Because BWO plans do not offer designated investment alternatives, inexperienced employees may be disadvantaged with a sub-optimal experience. Participants in BWO plans also may have limited features available to them as contrasted to the features available to participants in plans serviced through institutional recordkeepers and other plan service providers (*e.g.*, features such as loans, auto enrollment, and auto deferral increases may not be available.)

One of the concerns mentioned in the 2014 RFI was whether BWO plans were being promoted to avoid the investment level information that is required in the participant disclosure regulations. Plan sponsors are required to provide this investment level information on any DIA offered under a plan, but this information is not required to be provided on investments made through a brokerage window. The Department had concern back in 2014 about whether there was promotion of the idea that, if you establish a BWO plan, a sponsor could avoid the additional detailed investment disclosure. The Council notes that it heard no evidence that suggests employers are using BWO plans to avoid the disclosure requirements under DOL Reg. Section 2550.404a-5.⁹⁴

⁹⁴ 29 C.F.R. § 2550.404a-5.

The Council did hear from one consultant who said that maybe, when the participant disclosure regulations first came out, there might have been some consultants or advisers who thought a BWO plan could allow employers to avoid the disclosure regulations. He did not think there were consultants or advisers who currently take this position and thought this concern was a nonissue. The Council heard from another consultant who did not think that recordkeepers or brokerage providers market or promote brokerage windows but rather just made them available only if asked by plan sponsors.

One potential area of concern that the Council observed is when a BWO plan does not designate a default brokerage window provider. This type of situation seems to arise in small plans in which participants use their own brokerage provider because the plan sponsor does not designate a brokerage window provider under the plan. This could hinder a financially inexperienced employee from deciding to participate in the plan because he or she may not have the knowledge, desire, or comfort to select a brokerage provider. Although it is generally understood that there is no fiduciary obligation to oversee the underlying investments, it is unclear to what extent plan sponsors are involved in overseeing the cost and quality of brokerage services when each participant is required to choose their own brokerage firm.

C. Whether to Mandate Disclosure Regarding Investment Risk

The Council considered and debated at length whether the risks associated with investment through a brokerage window warrant additional required participant disclosures. The costs and benefits of increased mandatory disclosures might vary depending on the specific risk under consideration. Three major risks are particularly salient: (1) absence of fiduciary monitoring; (2) possible lack of adequate diversification; and (3) possible additional fees or expenses.⁹⁵ These risks are described and summarily evaluated below.

⁹⁵ A possible delay in access to investment-specific information for those without electronic access arguably presents another risk, but it is one that many Council members considered de minimis. Under the participant-level disclosure regulation, plans have a duty to provide specified investment-related information – including performance data, benchmarks, fee and expense information, and internet links – with respect to each DIA automatically and in advance of the participant's ability to direct investments. 29 C.F.R. § 2550.404a-5(d). No such disclosure duty applies to investments available through a brokerage window, although pursuant to federal securities laws the security issuer supplies certain information (annual reports, prospectuses, proxy statements, *etc.*) once the investment is made. This difference in ease of access to investment-specific information at the point of decision-making presents a risk that participants might make less well-informed choices with respect to brokerage window investments. A Council member noted that major brokerage providers have integrated

As will be explained, most Council members concluded that, on balance, the limited marginal benefits that might be obtained by requiring additional disclosures would be outweighed by associated costs. Many members also believe, based on witness testimony and sample disclosures provided by a witness, that a disclosure regime is prevalent practice for major recordkeepers and brokerage window providers. A minority of members, however, supported recommending that the Department consider additional required disclosures. These members believed that costs associated with carefully crafted disclosure mandates could be contained sufficiently such that the disclosures might yield positive—albeit limited—net benefits. Some members noted, however, that, based on testimony and sample disclosures provided by a witness, a robust disclosure regime is a prevalent practice for major recordkeepers and brokerage window providers; as such, additional disclosures are unlikely to yield any meaningful value.

1. Absence of Fiduciary Monitoring

DIAs offered under a participant-directed defined contribution plan intended to meet the requirements of the ERISA Section 404(c) safe harbor must be prudently selected and monitored on a regular basis by a plan fiduciary.⁹⁶ ERISA's general duty of loyalty and prohibited transaction rules also apply to construction of the plan's menu of designated investment alternatives.⁹⁷ In contrast, a brokerage window is not a DIA for purposes of disclosure of investment-related information under the participant-level disclosure regulation.⁹⁸ Investments accessible through a brokerage window are not routinely monitored by plan fiduciaries, and most experts conclude that, except perhaps in extraordinary circumstances, plan fiduciaries are not obligated to monitor brokerage window investments nor do their fiduciary duties apply with respect to those investments.⁹⁹ Consequently, retirement plan participants might invest through a brokerage window without understanding that no one is keeping tabs on the safety and performance of their investments. A clear notification that the participant is entirely on his or

fund information and research into the digital experience to assist participants in evaluating investment options prior to the participant making a decision to invest.

⁹⁶ 29 C.F.R. § 2550.404c-1(d)(2)(iv), -1(e)(4).

⁹⁷ Id. at § 2550.404c-1(d)(2)(ii)(E).

⁹⁸ DOL Field Assistance Bulletin No. 2012-02R, Q&A-29.

⁹⁹ Id. at Q&A-39.

her own with respect to brokerage window investment decision-making and is assuming all risks might alert a participant who is not a knowledgeable investor, or will not have the time to devote to regular oversight of the portfolio, that investment selection could jeopardize the participant's standard of living in retirement. The notification could also emphasize that retirement savings generally involves investments for the long term and that frequent trading and popular investment trends (*e.g.*, day trading or meme stocks) may exacerbate risks of loss.

The Council heard testimony that there are two primary providers of the brokerage services offerings through plan administrators, Fidelity and Schwab, and such notices are currently used by large brokerage platform providers.¹⁰⁰ A standardized disclosure statement (model language) similar to these notices might be incorporated as a required component of brokerage-window-related disclosures.¹⁰¹ Some witnesses were open to additional required disclosures, so long as new obligations did not extend to reporting investment-specific information pertaining to the enormous possible range of brokerage window investments.¹⁰² Disclosure timing could be aligned with participant receptivity to the information, by issuance when opening a brokerage window and perhaps at certain meaningful times thereafter.¹⁰³

Data and testimony indicate that brokerage windows are now utilized by only a small proportion of eligible plan participants and that brokerage window users tend to be longer-tenure employees having higher than average plan balances. These characteristics are often associated with higher levels of investment experience or financial sophistication, limiting the marginal benefit of such risk disclosure. In addition, if the required disclosures were too detailed, or were incorporated into other longer documents, then the small target audience might ignore them as just more legal boilerplate. These

¹⁰⁰ See, for example, Fidelity's "Important Notice" to BrokerageLink users, set forth at page 10 of Angela Capek's August 26, 2021, prepared statement.

¹⁰¹ 29 C.F.R. § 2550.404a-5(c)(1)(i)(F).

¹⁰² See for example pages 4 and 5 of the written statement of Chantel Sheaks submitted to the Council in connection with testimony on June 24, 2021; page 3 of the written statement of Kathleen Kelly submitted to the Council in connection with testimony on June 25, 2021; page 6 of the written statement of Kevin Mahoney submitted to the Council in connection with testimony on June 25, 2021; and page 7 of the written statement of Fred Reish and Bruce Ashton submitted to the Council in connection with testimony on August 27, 2021.

¹⁰³ When a participant proposes to invest a large proportion of his account balance in the stock of a single corporation might be an example, but creating the processes to monitor such actions and issue the notice would substantially increase disclosure costs.

considerations persuaded a majority of the Council that the likely benefits of a required notice concerning the absence of fiduciary oversight is, under current conditions, likely outweighed by its costs, including litigation costs.

2. Possible Lack of Adequate Diversification

Under a participant-directed defined contribution plan intended to meet the requirements of the ERISA Section 404(c) safe harbor, a participant must be able to choose from at least three investment alternatives. Each of the alternatives must be diversified and must have materially different risk and return characteristics, such that the participant is given a reasonable opportunity to diversify his investments, taking into account the portion of his account over which he is permitted to exercise control.¹⁰⁴ In contrast, current law allows a participant utilizing a brokerage window to put his entire plan balance in a single risky position.

A reminder could highlight the importance of diversification – both among asset classes and individual investments – in potentially mitigating the risk of losses that could occur from investing in a single, high-risk investment option. The reminder could assist participants in crafting an investment portfolio that is appropriate for their investment objectives. The disclosure might gain increased effectiveness if it contained a couple of brief examples based upon actual performance results of certain sectors or asset classes in recent market downturns. As with the absence of fiduciary monitoring of brokerage window investments, such a standardized disclosure statement (model language) could be readily incorporated as a required component of brokerage-window-related disclosures.¹⁰⁵ Disclosure timing could be aligned with participant receptivity to the information, by issuance when opening a brokerage account and perhaps at meaningful times thereafter.¹⁰⁶

¹⁰⁴ 29 C.F.R. § 2550.404c-1(b)(3)(i)(B), (C).

¹⁰⁵ Id. at § 2550.404a-5(c)(1)(i)(F).

¹⁰⁶ When a participant requests transfer of a large proportion of his account balance from the plan's DIAs into the brokerage window might be an example, but creating the processes to monitor such actions and issue the notice would substantially increase disclosure costs.

The risk created by inadequate diversification is mitigated in several circumstances. Some plan designs allow only a portion (for example, 50 percent) of the participant's total retirement plan balance to be invested through a brokerage window. The assets invested in diversified DIAs reduce the urgency of diversifying brokerage window holdings. Other plans offer a mutual fund window only. Because mutual funds—even sector funds focused on a particular industry—are diversified among individual investments, the mutual fund window design also reduces the urgency of diversifying brokerage window holdings. Even in the extreme case of a participant who is allowed to invest his or her entire plan balance in a single stock, the participant may have investments in other vehicles—such as IRAs or after-tax investments—that provide diversification. What matters in terms of risk exposure is the diversification of one's portfolio as a whole, but a participant's investments outside the plan are unknown. These considerations, combined with the limited utilization of brokerage windows and possible greater financial sophistication of brokerage window participants, convinced the majority of the Council that the benefits of a required warning concerning diversification are likely not cost-justified at this time.

While the forgoing consideration reduces the marginal benefit that might be gained from a disclosure highlighting diversification, some Council members believed that the costs of supplying a brief standardized disclosure would be low enough to justify Department consideration of such a mandate. These members noted that many plans offer unrestricted brokerage windows and believe that the prospect of diversification through investments outside the plan is unrealistic for the overwhelming majority of participants. Other members noted, however, that the data, as described in the report above, show that the percentage of participants utilizing a brokerage window is low and those that do utilize such a window have significantly higher account balances and income on average; as such these members do not conclude that the prospect of diversification of assets outside the plan is unrealistic for these participants.

3. Possible Additional Fees or Expenses

The participant-level disclosure regulation requires automatic reporting (upon the participant becoming eligible to direct investments and at least annually thereafter) of shareholder fees (*e.g.*, commissions, sales loads, redemption fees) and annual operating expenses (expressed as an expense ratio) for each

DIA the return of which is not fixed.¹⁰⁷ That regulation also requires automatic reporting (upon the participant becoming eligible to direct investments and at least annually thereafter) of individual expenses, including fees associated with brokerage windows, and quarterly statements specifying fees for individual services actually charged to the participant's account.¹⁰⁸ Because an investment made through a brokerage window is not a DIA, investment-related fee and expense reporting is not required. Some Council members observed, however, that this information usually is readily available online via the brokerage provider's digital experience.

For example, mutual fund investments made through a brokerage window could be limited to high-expense-ratio share classes, compared to mutual fund share classes available on the plan's investment menu (among the plan's lineup of DIAs). A brief notice highlighting this fact, which might illustrate the long-term cumulative impact on retirement savings of apparently small differences in annual expenses, might induce caution among participants inclined to use a brokerage window to access their favorite brand of mutual funds.

Yet there are several factors that weigh against an urgent need to highlight expenses. First, such notices are currently used by large brokerage platform providers.¹⁰⁹ Second, the Council heard testimony that Fidelity, one of the two large platform providers, offers zero-expense-ratio funds on its platform.¹¹⁰ With no-fee trading, it is sometimes possible to obtain lower investment expenses through a brokerage window than by utilizing the plan's DIAs. Third, a notice directing attention to share class expense ratios would necessarily be incomplete. It would have no application to costs associated with brokerage window investments in individual stocks, bonds, *etc.*, nor would it address the impact of other relevant expenses, such as sales commissions.¹¹¹ The Council heard testimony, however, that sales commissions

¹⁰⁷ 29 C.F.R. § 2550.404a-5(d)(1)(iv).

¹⁰⁸ *Id.* at § 2550.404a-5(c)(3).

¹⁰⁹ See, for example, Fidelity's risk disclosure set forth at page 10 of Angela Capek's August 26, 2021, prepared statement, which contains the following: "You should compare investments and share classes that are available in your plan's lineup with those available through BrokerageLink, and determine the available investment and share class that is appropriate for your situation."

¹¹⁰ Page 8 of the written statement of Angela Capek submitted to the Council in connection with testimony on August 26, 2021.

¹¹¹ The notice could remind participants of the potential impact of transaction-based fees, but unlike annual operating expenses they do not lend themselves to easy quantitative comparison.

for online equity trading have been eliminated by nearly all major brokerage providers. This incompleteness might be viewed by some as misleading or encouraging participants to accord undue emphasis to one factor among a multiplicity of relevant considerations. These considerations, combined with the limited utilization of brokerage windows and possible greater financial sophistication of brokerage window participants, convinced the Council majority that the benefits of a required notice relating to fees and expenses are likely not cost-justified at this time.

Overall, it is well to keep in mind that poor investment decision-making is not limited to brokerage windows. Participants can just as easily make bad choices from among the core fund lineup—for example, by allocating one’s account among multiple target date fund vintages, or by concentrating assets in a money market fund or small cap equity fund. Some participants may be exposing themselves to undue risk by investing their retirement assets through a brokerage window, but the Council did not receive testimony that it is an issue that affects a large number of participants. The Council did not receive any testimony or data on the risk associated with investing retirement assets through a brokerage window. Accordingly, the Council majority concluded that Department action in this area, if justified at all, should not be a priority. Other members believed, however, that action is not warranted as the preponderance of the testimony indicates that information concerning fees and expenses, where applicable, are made readily available to participants using a brokerage window.

D. Whether the Department Should Undertake Its Own Education Campaign

The Council heard testimony that suggested in general that the brokerage market has defined the offerings and operations of brokerage windows, that current plan sponsors understand the offerings and rely on their plan administrators for the most part to vet and assess brokerage window providers, and that plan participants utilizing the options are generally older, longer tenured, more highly compensated than other participants, and they understand the brokerage option. Therefore, additional education is not needed at this time. Witness testimony also indicated that the brokerage window option is a growing offering, has greater interest by more plan participants, and in particular, has greater interest by younger generations.

Due to the growth in interest in brokerage windows by more participants and the hopeful expansion of retirement plans under The Setting Every Community Up for Retirement Enhancement (SECURE) Act, pooled employer plans (“PEPs”) and multiple employer plans (“MEPs”), one Council member expressed concern about the potential emergence of new players/providers in the market and the increased pressure that is likely to emerge for opportunities for plan participants to invest in newer investment classes. The Council member thought that additional clear guidance and education about any brokerage window option would be needed. In the member’s view, this would be helpful to ensure that fiduciaries understand their responsibilities, the market understands and is prudently practicing what needs to be done, and that plan participants understand the plan sponsors’ role in making brokerage windows available, what they are, the risks and cost of them, and how to access and use them.

Data from Schwab (see Section IV(D) of this report) indicate that, with respect to investments in equities securities, which presents participants with higher volatility compared to diversified funds, participants in brokerage windows are predominantly investing in familiar-named, large-cap companies.

The Council had discussion regarding pros, cons, and potential resolutions about possible educational efforts. Topics included ease to administer, identification by plan sponsors and plan participants of potential current issues, technology to assist the pursuit of such measures, consistency with general interest in providing more education to defined contribution plan participants, young plan participants, plans that are brokerage window only, potential risk disclosures, and potential lack of oversight of investments held within brokerage windows. While there was debate amongst Council members and points made about the potential merits of recommending an educational campaign by the Department, the consensus view of the Council was that an educational campaign is not necessary at this time.

VI. RECOMMENDATION

The Council recommends that the Department should consider further fact-finding related to “brokerage window only” (“BWO”) plans—*i.e.*, plans that have no designated investment alternatives and brokerage accounts are the sole investment option.

The Council's sole recommendation focuses on further fact finding on the BWO type plans that were identified from the testimony offered by several witnesses. The Council members agreed that those types of plans may not incorporate the spirit of ERISA's intent and protections for financially inexperienced employees and may need the Department's attention in the form of further fact finding.

As noted in this report, the Council heard testimony regarding the use of BWO plans that suggests there may be areas of potential concern regarding their use. Financially inexperienced employees may be disadvantaged with a sub-optimal experience as these types of plans may have limited features available to them as contrasted to the features available to participants in plans serviced through institutional recordkeepers and other plan service providers.

Another area of concern that the Council observed is when a BWO plan does not have a default brokerage window provider. A lack of a default brokerage provider can be a barrier for financially inexperienced employees when deciding whether to participate in the plan. Employees may not have the ability or comfort to select a brokerage provider to begin participating.

The Council heard testimony about the importance of brokerage windows and the role that they play in allowing employers to sponsor retirement plans that appeal to participants because they can customize their portfolios in ways that otherwise would not be possible under the standard investment lineup. For example, if a participant wants to invest in options that support specific policy goals, such as environmental, social and governance ("ESG"), religious, or other investing preferences. Because the Council was unable to obtain evidence directly evidencing a problem with BWO plans, the Council was reluctant to make a recommendation that could adversely affect this business segment. The majority of the Council did not want to recommend guidance that potentially could dissuade small employers from sponsoring retirement plans as retirement security is an important public policy goal.

For the reason as noted above, the Council recommends that the Department should consider further fact finding related to BWO plans. Such fact finding could take the form of issuing a Request for Information that asks interested stakeholders in the BWO market for data to determine whether any material problems exist and the impact of any potential regulatory approaches. The Council believes

that by focusing its fact finding in the BWO market the Department could obtain the necessary data to determine whether any further action is necessary.