



## Statement of the U.S. Chamber of Commerce

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

**TO:**        **2021 Advisory Council on Employee Welfare and Pension Benefit Plans**

**DATE:**    **June 24, 2021**

**BY:**        **Chantel Sheaks, Vice President, Retirement Policy, U.S. Chamber of Commerce**

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1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic, political, and social system based on individual freedom, incentive, initiative, opportunity, and responsibility.

**Written Statement of**  
**Chantel Sheaks, Vice President, Retirement Policy, U.S. Chamber of Commerce**  
**Before the**  
**2021 Advisory Council on Employee Welfare and Pension Benefit Plans**  
**Meeting on**  
**“Understanding Brokerage Windows in Self-Directed Retirement Plans”**  
**June 24, 2021**  
**Don’t Break Brokerage Windows**

**Summary**

Although participant uptake in brokerage windows is relatively low, it is an important tool for plan sponsors to use to respond to unique participant investing needs. Based on member input, such requests include wanting more varied investment options beyond the core lineup or requesting a specific type of investment, such as Shariah investing, funds that do not include specific investments, or overall ESG investing. Including such investment as a core investment option may not make sense for the plan if few individuals are using it. Because of the work it takes to properly implement these, plan sponsors do not enter into these lightly.

So that plan sponsors can continue to respond to unique participant needs through brokerage windows, we believe that DOL should make it easier for these to be offered by clarifying the application of ERISA Section 404(c) protection, by issuing tip sheets to help plan sponsors understand what is involved from selecting, to monitoring to terminating a brokerage window option and by providing model language and a checklist of suggested participant disclosures.

**Background**

*What Is It?*

The Employee Retirement Income Security Act of 1974 (ERISA) and the underlying regulations do not define a “brokerage window” or a “self-directed brokerage window”. However, a basic definition is an investment option in a participant-directed 401(k) plan that gives participants and beneficiaries the capabilities to buy and sell investment securities through a brokerage platform.<sup>1</sup> It is unclear if limiting the options available on the platform would impact whether the option is a brokerage window. For purposes of this testimony, I will use the generally accepted definition.

*Who Offers and Uses It?*

The most recent and widely available statistic on the availability of brokerage windows in self-directed 401(k) plans is a 2015 Aon study finding that about 40 percent of plans offered a brokerage window.<sup>2</sup>

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<sup>1</sup> See “What is a Brokerage Window”, James Chen available at [https://www.investopedia.com/terms/b/brokerage\\_window.asp](https://www.investopedia.com/terms/b/brokerage_window.asp), last updated November 20, 2019.

<sup>2</sup> Aon Hewitt. “2016 Hot Topics in Retirement and Financial Well-Being,” Page 14.

According to the same study, about 3 to 4 percent of participants use them. Vanguard reports that 19% of its 401(k) accounts offer a brokerage window, but only 1% of participants take advantage of it.<sup>3</sup>

Those who use the brokerage window tend to have higher account balances. According to Charles Schwab data, a leading brokerage account provider, the average advised balance for self-directed brokerage accounts as of March 31, 2019 was \$436,593.<sup>4</sup>

The question remains that if there are few participants using this type of investment, why do plan sponsors offer it? Based on member input, plan sponsors offer brokerage windows not because they are trying to shirk their fiduciary duty, but because participants request them. These requests can be because the participant wants more varied investment option than available in the core lineup or the participant wants a specific type of investment, such as Shariah investing, funds that do not include certain investments, or overall ESG investing. It may not make sense to include such options in the core lineup if few individuals are using it. By making a brokerage window available, plan sponsors can respond to such specific requests. Finally, based on input from our members, most individuals who use brokerage windows are highly educated individuals who often work in finance, investing, law or engineering.

Plan sponsors do not make the decision to offer a brokerage window lightly because it takes a substantial amount of work to include this as an option<sup>5</sup>. As with any investment option, plan sponsors must do their due diligence in selecting a vendor, including a rigorous RFP process. Not only does this take time, but it also takes money. In addition, although not required to monitor each underlying investment (which would be virtually impossible), plan sponsors must monitor the brokerage window vendor, the same as any other service provider. Finally, depending on performance and/or participant and plan needs, a plan sponsor may need to change vendors. This also can be very time-consuming because not all vendors will offer the same options and plans may need to make very complex decisions on making a change and transitioning to a new vendor. For example, some vendors allow Roth contributions to be in a brokerage window, but others do not.

### What Are the Current Rules?

Nothing in ERISA prohibits a plan sponsor from including a brokerage window as part of an ERISA Section 404(c) plan. However, the DOL has stated that

fiduciaries of . . . plans with . . . brokerage windows . . . are still bound by ERISA section 404(a)'s statutory duties of prudence and loyalty . . ., including taking into account the nature and quality of services provided in connection with" the brokerage window.<sup>6</sup>

The duty in selecting and monitoring a brokerage window service provider is no different than the fiduciary obligation in selecting and monitoring other service providers.

Special rules apply with respect to individual account plans that allow a participant or beneficiary to exercises control over the assets in the participant's account. Specifically, if the participant or beneficiary exercises control over the assets in the account,

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<sup>3</sup> Vanguard. "How America Saves 2019," page 68.

<sup>4</sup> Charles Schwab. "The Schwab Self-Directed Brokerage Account Indicators," page 3.

<sup>5</sup> Because most plans allow participants to direct their own investments, they also follow the requirements of ERISA Section 404(c) and the applicable regulation. Merely offering a brokerage window would not meet the regulatory requirements under ERISA Section 404(c), which means offering a brokerage window is additional work on top of meeting the ERISA Section 404(c) requirements.

<sup>6</sup> DOL Field Assistance Bulletin 2012-02R, Q&A 39, July 30, 2012.

- The participant or beneficiary is not deemed a fiduciary because of exercising such control; and
- No person who is otherwise a fiduciary is liable for any loss resulting from the participant or beneficiary exercising such control.<sup>7</sup>

To obtain relief under ERISA 404(c), the regulation provides specific requirements with respect to designated investment alternatives offered under the plan. The regulation defines a designated investment alternative as “a specific investment identified by a plan fiduciary as an available investment alternative under the plan.”<sup>8</sup> However, the regulation does not specify whether a brokerage window or other similar investment is a designated investment alternative for ERISA Section 404(c) purposes.

The 2010 disclosures regulation under 29 CFR § 2550.404a-5 contains specific rules and exceptions for brokerage windows. First, 29 CFR § 2550.404a-5(c)(1)(i)(F) requires that a plan administrator (or a person designated by the plan administrator to act on its behalf) must provide each participant or beneficiary:

A description of any “brokerage windows,” “self-directed brokerage accounts,” or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

A plan administrator or delegate also is required to provide information relating to any fees that can be charged against an individual account, including fees for brokerage windows.<sup>9</sup>

Unlike the ERISA Section 404(c) regulations, the disclosure rule under 29 CFR § 2550.404a-5 provides that the term “‘designated investment alternative’ shall not include ‘brokerage windows,’ ‘self-directed brokerage accounts,’ or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.”<sup>10</sup>

## **Recommendations**

### *What Should Be the Underlying Consideration?*

In looking at the issue, the DOL should keep in mind the maxim of “First do no harm” with respect to both participants and plan sponsors. A gut reaction may be that more disclosures are better. However, as discussed below, more disclosure is not needed, rather better disclosures are needed. In addition, DOL must remember that the underlying investments in the brokerage window are regulated by a myriad of other laws that are aimed at protecting and informing individuals of the consequences of investing in a particular investment.<sup>11</sup>

Requiring plans sponsors to provide additional disclosures related to the underlying investments in brokerage windows not only would be duplicative of current laws governing these investments but would be cost-prohibitive, because, as a practical matter, it would be impossible given the sheer number of options.

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<sup>7</sup> ERISA § 404(c); 29 USC § 1104(c).

<sup>8</sup> 29 CFR § 2550.404c-1(e)(4).

<sup>9</sup> 29 CFR § 2550.404a-5(c)(3).

<sup>10</sup> 29 CFR § 2550.404a-5(h)(4).

<sup>11</sup> See “The Laws that Govern the Securities Industry” available at <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry>.

### What Formal Guidance Should Be Issued?

Plan sponsors recognize that the selection and monitoring of the service provider for a brokerage account is a fiduciary obligation. Plan sponsors are willing to take on this obligation at the request of participants to ensure that these participants have the ability to exercise control over their accounts to invest in options in brokerage windows that best suit them. The DOL should clarify that if a fiduciary otherwise meets the requirements under ERISA Section 404(c) and the applicable regulation, including the required disclosures under 29 CFR § 2550.404a-5, the fiduciary is not liable for any losses that a participant or beneficiary may incur from investing in a brokerage account.<sup>12</sup> Furthermore, the DOL should clarify that the duty to monitor applies to monitoring the brokerage account service provider, but not to each underlying investment.<sup>13</sup>

### What Else Could DOL Do?

#### Model Disclosures

A key to participants understanding investment risks is not more disclosure but rather targeted disclosure. Investing through a brokerage window is not suitable for everyone, and each participant needs to decide whether it is the right choice for the participant. DOL could assist plan sponsors by issuing model disclosures for plans sponsors to use to inform participants of this. This could be done by researching and soliciting current disclosures that plans sponsors use to come up with the model. In addition to or alternatively, the DOL could compile a checklist of other useful information to consider disclosing. Sample language and a list of other useful information are in Appendix A.

#### Tips for Plan Sponsors

As noted above, the plan sponsors that offer brokerage windows as an investment alternative do not make this decision lightly. Many are larger employers that have more knowledgeable staff and more resources to be able to determine whether to offer this. To assist plan sponsors in determining whether to offer a brokerage window, the DOL could compile a tip sheet that includes items that plan sponsors could consider in determining whether to offer a brokerage window, such as which participants are asking for it and which will use it, what other options are available, the cost to implement it, and the cost to monitor it. In addition, informal guidance could be issued relating to considerations when selecting a brokerage window provider, changing a brokerage window provider, and how to terminate offering a brokerage window.

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<sup>12</sup> Recently, there has been a glut of ERISA excess fee litigation, most of which is copycat litigation aimed at settlement. See “401(k) Fee Suits Flood Courts, Set for Fivefold Jump in 2020”, Jacklyn Wille, Bloomberg, Aug. 31, 2020 available at <https://news.bloomberglaw.com/employee-benefits/401k-fee-suits-flood-courts-on-pace-for-fivefold-jump-in-2020>. This litigation has forced plans to look at much more conservative designated investment alternatives. Brokerage windows could be the next wave of class action cases against plan sponsors, and this guidance from the DOL would be helpful for plan sponsors to continue to offer brokerage windows even with this new litigation threat.

<sup>13</sup> Any obligation to monitor each and every investment in a brokerage account would effectively prohibit plan fiduciaries from offering brokerage accounts in ERISA plans because it is not possible for a fiduciary to actively monitor the hundreds of thousands of options offered in brokerage windows. See *Moitoso v. FMR LLC*, 451 F. Supp. 3d 189 (D. Mass. 2020) (“Brokerage windows can provide plan participants significant freedom by allowing them to select from a menu of hundreds thousands of investments, making it perhaps unrealistic for a fiduciary to monitor them all.”)

## **Conclusion**

Although there is a relatively small uptake when brokerage windows are offered, those who do take advantage of this option are generally more sophisticated investors, and they are very satisfied with it. Brokerage windows also allow plan sponsors to meet the unique investing needs of certain participants. DOL should make it easier, not more difficult, for plan sponsors to offer this option if a plan sponsor feels it appropriate. This could be done by issuing formal guidance that a plan fiduciary is not liable for monitoring each underlying investment, tips on if and how to offer a brokerage window, and sample language that describes what is involved with investing through a brokerage window.

## Appendix A

### Sample Brokerage Window Language and Other Appropriate Disclosures

- The self-directed brokerage window investment option is designed for the plan participant who wants to independently and actively manage a portion of his or her savings plan assets and accepts responsibility for researching, selecting, monitoring, and managing the investments. Before deciding to invest through the brokerage window, you need to make sure you have the time and knowledge to do so, and that you are aware of any fees, such as the initial fee, any trading fees and commissions.
  
- Carefully consider the investment objectives, risks, charges, and expenses of any mutual fund or ETF before investing. To learn about specific mutual funds or ETFs, call [Insert Vendor Name] to obtain prospectuses or summary prospectuses. Prospectuses or summary prospectuses provide details on a mutual fund or ETF's objectives, investment strategies, risks, performance, distribution policy, fees and expenses, fund management, and other important information. It is recommended that you read a mutual fund's or ETF's prospectus or summary prospectus carefully before investing.
  
- The advisory services associated with the plan's recordkeeper will **not** advise you about the suitability of any security or investment strategy outside the core funds. If you decide to invest through the brokerage window, you, or an investment adviser that you select, must determine which investments are right for you. Neither the advisory services nor the plan sponsor is liable for any losses or expenses that you incur from investing in the brokerage window. It also cannot provide financial, legal, or tax advice on these securities or investment strategies.
  
- Each time you place a trade, [Insert Vendor Name] provides you with an official trade confirmation via your choice of email or mail. Additionally, you will receive a brokerage statement for any month in which there is trading activity. You will also receive fund prospectuses and semi-annual and annual reports for the investments in your brokerage window account from the issuer. The market value of your brokerage window account will be reflected on your plan statement, but the individual investments will not.
  
- Other appropriate disclosures related to brokerage windows:
  - Enrollment, account access, and trading instructions;
  - Any fees or minimum transfer amounts for account opening/maintenance, individual trades/liquidations, commissions, individual research requests, etc.;
  - Identification of banks holding funds, FDIC coverage, dividend reinvestment options;
  - Instructions and requirements for distributions: liquidation and transfer to core funds or availability of distribution in-kind.