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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

**Re: Brokerage Windows in Participant-Directed Individual Account Plans
(RIN 1210-AB59)**

Ladies and Gentlemen:

The SPARK Institute appreciates the opportunity to comment on the Department of Labor's Request for Information ("RFI") regarding standards for brokerage windows in participant-directed individual account plans. The SPARK Institute's members have a strong interest in responding to the RFI because our members include a spectrum of leading recordkeepers, investment fund managers, and other service providers. We support efforts to expand effective retirement savings opportunities to more individuals.

At the outset, we commend the Department for taking the step of publishing the RFI to determine whether regulatory standards or guidance with respect to brokerage windows are necessary. We strongly believe that the exchange of information on this topic is critical and believe that our experiences with respect to brokerage windows can provide insight into how they are used in retirement plans. We also believe that a careful and measured approach will best serve plans and participants. Brokerage windows are a feature in many plans for a variety of reasons, and the Department should ensure that any new rules or guidance do not cause unnecessary harm or disruption to the plans and participants currently using brokerage windows.

Our responses to a selection of the Department's questions are below, but we highlight our key comments:

- For plans with designated investment alternatives ("DIAs"), offering a brokerage window is generally an *accommodation* made by SPARK members for those plan sponsors who determine that offering a brokerage window will serve their participants. Plan sponsors view brokerage windows as an important tool to supplement a plan's DIAs, allowing the plan to maintain a focused menu. Our members work diligently with plan sponsors to ensure participants' needs are met.
- Current guidance, including Q&A-39 of Field Assistance Bulletin 2012-02R, provides an adequate distinction between a plan's DIAs (or plan menu) and a brokerage window or similar arrangement.

- Based on published data, and data provided to us by our members, significantly less than half of all plans offer a brokerage window. When offered as an option, usage of brokerage windows by participants is quite low, generally no more than one to two percent of participants.
- Additional fiduciary rules with respect to brokerage windows are not necessary. ERISA’s flexible but uniform standard already requires plan fiduciaries to act prudently in selecting and monitoring the window service provider, and ensuring that the fees for the window are reasonable.
- The existing disclosure regulations – which provide information to the responsible plan fiduciary regarding the window provider’s services and direct and indirect compensation, and also provide information to plan participants as described in Q&A-13 of Field Assistance Bulletin 2012-02R – are adequate.
- If the Department determines that an additional disclosure may be helpful, we recommend the Department consider limiting the disclosure to plan participants who actually access the window. This disclosure might state that the investments in the brokerage window are neither selected nor monitored by the plan’s fiduciaries. The disclosure might also reiterate the information required by ERISA section 105, regarding the importance of a long-term diversified portfolio and the risks of holding more than 20 percent of a portfolio in a single undiversified security.

DEFINING “BROKERAGE WINDOWS” – SCOPE

Question 1

What are the various brokerage window, self-directed brokerage account, and similar arrangements that are made available in 401(k) plans, and which one (or more) is the most common? What are the benefits and drawbacks of these various arrangements?

The terms “brokerage window,” “self-directed brokerage account,” and similar terms, refer to a plan feature in which a large number of investments are made available to participants. In most cases, this plan feature supplements the plan’s DIAs, or the plan “menu,” which has been pre-selected by plan fiduciaries. In many cases, a brokerage window supplements a plan’s DIAs with additional mutual funds and exchange traded funds (“ETFs”). A brokerage window may include stocks, bonds, and other securities. Whatever investments it includes, a brokerage window is generally operated by a brokerage window service provider (“window provider”) on a platform that is separate from other plan investments. This is generally the case even if the brokerage window is offered by a broker-dealer that is an affiliate of the plan’s recordkeeper.

Whether serving small or large plans, a window provider will typically provide access to a large category of securities, but will also allow plan fiduciaries to limit securities individually or by type. Generally, the most common individual securities that fiduciaries restrict are securities of the plan sponsor itself. Similarly, participants are typically not allowed to trade on margin because of complications presented by ERISA’s prohibited transaction rules.¹ Common types of

¹ See DOL Reg. § 2550.404c-1(d)(2)-(3).

securities that are not available either because the window provider does not offer them, or because they have been limited by the plan fiduciaries, include:

- Private placements
- Tax exempt securities
- Derivatives, swaps, and futures
- Commodities
- Precious metals
- Options (calls and puts)
- Mortgage-backed and other asset-backed securities
- Publicly traded limited partnerships

Where a plan's brokerage window offers securities other than mutual funds and ETFs, generally the available securities include publicly traded equities, corporate bonds, U.S. Treasury securities, and municipal bonds. Plan sponsors often have significant flexibility to work with their window provider to tailor the available securities to meet the plan's needs. In addition to the ability to tailor the types of securities in the window, see our response to Question 12 for more information on the other kinds of restrictions plans may place on participants' use of a brokerage window.

Plan sponsors have a variety of reasons they choose to offer brokerage windows. One commonly cited advantage is that a brokerage window allows plan sponsors to maintain a smaller and simpler core line-up while providing flexibility to participants who are more comfortable selecting their own investments. In fact, to reflect research on participant behavior in the face of too many choices, plan consultants often recommend that fiduciaries keep the plan menu as simple as possible.² Another reason plan sponsors offer brokerage windows is to provide greater flexibility for participants with an advisor for financial planning.

For example, some plan sponsors of small plans select a product that makes available a large number of mutual funds, such as the provider's entire proprietary fund line-up. These products often include all of the key asset classes and are successful in enabling small plan sponsors to adopt plans. Further, these products allow participants access to diversified mutual funds while minimizing the time and resources the business owner must spend on the plan.

Question 2

If a more specific definition of a “brokerage window” is provided, as a regulatory or interpretive matter, how should it be defined?

We do not believe that defining the term “brokerage window” (beyond the current disclosure regulations) is necessary. The current disclosure regulations already contain a definition that

² See Squared Away, *401(k) Fund Choices: Less is More*, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE (Sept. 25, 2012), available at <http://squaredawayblog.bc.edu/squared-away/research/401k-fund-choices-less-is-more/>; Alina Tugend, *Too Many Choices: A Problem that can Paralyze*, N.Y. TIMES, (Feb. 26, 2010), available at <http://www.nytimes.com/2010/02/27/your-money/27shortcuts.html>.

tracks how the term is used and understood – a “brokerage window” is a plan feature or arrangement that allows participants to select investments beyond the plan’s designated investment alternatives.³

This definition works well because it distinguishes those investments that a plan fiduciary has “designated” – and thus the participant would understand are selected and monitored by a plan fiduciary – from those investments that the participant must independently investigate. To define the term further only risks leaving participants unsure of whether a plan fiduciary selected and monitors the investment option or if the participant must independently investigate the investment.

We believe that defining the term “brokerage window” beyond the current disclosure regulations is unnecessary. But if the Department defines the term, any definition should be broad. Brokerage windows currently provide participants with the ability to individualize and tailor their retirement savings to their particular needs. Therefore, the key to any definition is that it is broad enough to prevent definitional gaps and allows participants to continue to distinguish between investments that have been designated – or pre-selected – by the plan fiduciary, and investments in the window that the participant must independently investigate.

If the Department decides to propose a definition for brokerage windows, it is important that any change does not result in the remaining window investments being treated as designated investment alternatives. There is a stark contrast between designating specific investments for the plan menu and limiting a window to broad types or categories of investments. (In most cases restrictions imposed on windows by the sponsor are done at the asset class, rather than the fund, level.) For example, if a plan offers a mutual fund window with access to hundreds of mutual funds, such funds should not be treated as designated investment alternatives as a result of a plan sponsor’s decision to exclude from the window other individual securities, registered mutual funds, or employer stock. Such restrictions are reasonable and should not result in hundreds, and possibly thousands, of other investments available through the window being designated investment alternatives. In other words, simply because a plan sponsor excludes certain investments does not support the conclusion that the sponsor pre-selected or designated the hundreds or thousands of remaining investments.

Question 3

Should the fiduciary, disclosure, or other standards that apply to brokerage windows (and which are raised in more detail below) vary depending on the type of arrangement, or perhaps the ultimate number of investment options available to participants (e.g., a mutual fund window that offers access to fifty mutual funds vs. an open brokerage structure that offers access to many thousands of stocks, mutual funds, and other securities) and, if so, how?

³ See DOL Reg. §§ 2550.408b-2(c)(1)(viii)(C); 2550.404a-5(h)(4); DOL Field Assistance Bulletin 2012-02R, Q&A-39.

We strongly believe that uniform standards, including uniform fiduciary and disclosure standards, provide for the most efficient and cost-effective means of plan administration. ERISA sets forth heightened standards of care for fiduciaries, and Congress intended to “establish uniform fiduciary standards” under ERISA.⁴

With uniform standards, a fiduciary’s duty with respect to a brokerage window is the same as for any other plan feature or service provider: The fiduciary must evaluate the overall structure of a window and the window provider “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”⁵ Before selecting a window provider, the fiduciary should assess the quality of the services to be provided and the reasonableness of the compensation to be paid for such services.⁶ ERISA’s uniform rules are also flexible – meaning that the fiduciary’s process is based on the “circumstances then prevailing” – and thus whether a brokerage window is right for one plan depends on the facts and circumstances of that plan. Plan sponsors are best situated to determine whether a brokerage window is right for their plan, and if it is, to also determine what features the window should have and what role the window will play.

Uniform disclosure standards also provide – and are necessary – for efficient plan administration. The current disclosure standards under the Department’s 408(b)(2) regulations are flexible and already provide for a significant amount of disclosures related to brokerage windows that benefit plan fiduciaries.⁷ In promulgating the current disclosure regulations, the Department acknowledged that plan fiduciaries “benefit from increased uniformity in the way that information is presented to them.”⁸ Requiring more stringent disclosure standards for brokerage windows under the 408(b)(2) regulations would subtract from the increased uniformity that the current regulations provide to plan fiduciaries.

With respect to disclosures to participants, please see our response to Question 29.

PLAN INVESTMENT OFFERINGS – BROKERAGE WINDOWS AND DESIGNATED INVESTMENT ALTERNATIVES

Question 4

What are the characteristics of plans that offer brokerage windows?

Based on input from our members, the vast majority of plans with which SPARK member companies work that offer a brokerage window also provide a menu of DIAs. Among plans with DIAs, many data sources reflect that plans of many sizes offer brokerage windows. For

⁴ H.R. REP. NO. 93-1280, at 5186 (1974) (Conf. Rep.).

⁵ ERISA § 404(a)(1)(B).

⁶ See ERISA § 408(b)(2).

⁷ See DOL Reg. § 2550.408b-2(c).

⁸ 75 Fed. Reg. 41600-01; see also 72 Fed. Reg. 70988-01.

example, according to 2013 data released by Vanguard, 11 percent of Vanguard plans with fewer than 1,000 participants, and 28 percent of Vanguard plans with greater than 5,000 participants, offer a self-directed brokerage feature.⁹ Similarly, data from the Plan Sponsor Council of America (“PSCA”) shows that while larger plans are slightly more likely to offer a brokerage window, smaller plans also offer them. PSCA reports that 26.2 percent of plans with 5,000 or more participants offer a brokerage window (and 13.5 percent offer a mutual fund window), while 16.1 percent of plans with fewer than 50 participants offer a brokerage window (and 8.5 percent offer a mutual fund window).¹⁰ Based on consistent input from our members, the vast majority of plans that offer a brokerage window also offer a menu of designated investment alternatives.

Whether big or small, plans’ reasoning for offering a window in addition to their DIAs differ. For example, a sponsor of a large plan may decide that a brokerage window is the best way for the plan to accommodate participant requests for supplemental investment options outside a plan’s designated investment alternatives. Meanwhile, the sponsor of a small plan may decide that a brokerage window is the best means of offering additional mutual funds outside of those designated by the fiduciary, and at the same time allow the plan fiduciary to focus his or her oversight on a manageable number of designated investment alternatives.

In our members’ experience, plan sponsors that offer brokerage windows do not do so in order to avoid the Department’s disclosure rules. Several SPARK members that work with brokerage windows reported not having *any* plans that offer a brokerage window in place of designated investment alternatives.

Distinct from generally larger plans that establish and maintain DIAs, some SPARK Institute members do have plan clients that use a “brokerage-only” arrangement. Such arrangements generally occur in the very small plan space¹¹ and can be effective, for example, where an investment advisor such as a registered investment advisor has been retained to assist participants with investing their accounts, or where the plan or participant has the assistance of a broker-dealer or other financial advisor. In such a case, a “menu” of DIAs from which participants will make investment allocation decisions is not practical. Those members that offer such an arrangement report that this is used where it makes sense for that plan’s unique needs, and decidedly not to avoid any disclosure rules or to obfuscate fees. Rather, by working with either a brokerage account provider or insurance company, such arrangements offer a way for very small firms to facilitate retirement savings for their employees without the need to engage and pay for a recordkeeper, trust provider, or both.

Question 5

No Response.

⁹ See Vanguard, *How America Saves* at 49 (2014).

¹⁰ Plan Sponsor Council of America, *56th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2012 Plan Experience*, at 35 (2013) (reporting that plans had an average of 19 investment options available for participant contributions in 2012).

¹¹ Often, these plans are owner-only and owner-spouse plans and thus not subject to ERISA. When additional employees are added to the plan, the plan would be subject to ERISA.

Question 6

What is a typical number of “designated investment alternatives” offered by a 401(k) plan? Are plans increasing, decreasing, or holding constant the number of designated investment alternatives that they offer? If the number is changing, why?

There are a number of data sources that attempt to track the “average” number of plan investments. One survey states that plans offer 19 funds on average.¹² Other data sources conclude that the average number of funds is between 20 and 27, with some of these figures distinguishing each distinct target date fund in a target date “suite” as a separate investment.¹³ Of note, a relatively recent plan design trend has been to restructure plan investment menus. Rather than targeting an optimal number of funds, plan sponsors have been changing the nature of investments by adding tiers or types of investments based on the level of comfort a participant has with investments (*e.g.*, Tier 1 might be all target date funds, Tier 2 might be selected funds grouped by asset class, and Tier 3 might be a brokerage window) and to simplify the selection process for participants.

Question 7

No Response.

Question 8

At what point might the number of investment options available to plan participants warrant treating the options as a “brokerage window” of some variety, rather than as a menu of “designated investment alternatives?” Does the detailed investment-related information required by the Department’s participant-level disclosure regulation for designated investment alternatives (vs. brokerage windows) affect the answer to this question and, if so, how?

The number of funds designated as investment alternatives in the plan menu should not affect whether or not the DIAs are part of a “window” because the key is that these investments have been *designated* for the menu. Conversely, the number of investment options available to plan participants through a window should not determine how the options are categorized or labeled.

¹² Plan Sponsor Council of America, *56th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2012 Plan Experience*, at 35 (2013) (reporting that plans had an average of 19 investment options available for participant contributions in 2012); *see also* Plan Sponsor Council of America, *55th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2011 Plan Experience*, at 35 (2012) (reporting that plans had an average of 19 investment options available for participant contributions in 2011).

¹³ *See* Vanguard, *How America Saves* at 46 (2014) (reporting that in the over 3,000 plan sponsors Vanguard serves, the average number of investment options in a plan – counting each distinct target-date fund as a single option – is 27); Aon Hewitt, *2013 Universe Benchmarks* (2013) (reporting that surveyed defined contribution plans had an average of 20 investment options if each distinct target-date fund was counted as a single option); Deloitte Consulting, the International Foundation of Employee Benefit Plans, & International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey*, at 44 (2012) (reporting that the nearly 400 401(k) plan sponsors surveyed had an average of 25 investment options in 2011).

In most cases, plan sponsors offer brokerage windows to supplement plan investments. Since plan investments vary, the number and type of investment options in brokerage windows will also vary. As a result, the number of investment options available to participants through a plan's window should not determine how the window, or the funds that can be accessed through it, are categorized or labeled. Rather, the question should be whether a plan fiduciary has "designated" an investment as available on the plan's official menu. Once again, the key is that participants understand that investments in the window have not been designated as investments by the plan fiduciary.

Informally, Department officials have expressed concern that plan sponsors may use a brokerage window to avoid the participant disclosure requirements. This is decidedly not the experience of our members. Our members have already invested significant resources in programming their systems to assist plan sponsors in complying with the new disclosure requirements. They would not benefit now by offering brokerage windows in order to "avoid" the disclosures that their systems have already been programmed to distribute. (Plan sponsors intent on avoiding the Department's disclosure requirements could do so more easily by adopting a payroll deduction IRA. Plans sponsors that offer brokerage windows as part of their plan design do not do so in order to avoid or minimize their disclosure responsibilities.) Moreover, most members report that offering a brokerage window is an *accommodation* that service providers make to plan sponsors. In fact, some of our members report that they do not actively market brokerage windows and that the feature is only offered at the request of plan sponsors.

When the brokerage account provides the basic structure for a plan that does not have DIAs, the arrangement is selected because it provides a low-cost way for a sponsor to facilitate retirement savings that can, at the same time, provide for the investment allocations to fit the very specific needs of a small business's employees.

PARTICIPATION IN BROKERAGE WINDOWS

Question 9

How many participants, or what proportion of participants, typically use their plan's brokerage window? What proportion of a plan's total assets typically is invested through the brokerage window?

In general, the percentage of participants using a brokerage window represents a very small subset of individuals within the already small set of plans that offer brokerage windows. According to 2013 data from Vanguard, of the more than 3,000 plans that Vanguard serves, 13 percent offer self-directed brokerage accounts.¹⁴ While a recent study based on survey data by Deloitte suggests that number is closer to 30 percent in the broader market,¹⁵ some SPARK

¹⁴ See VANGUARD, *How America Saves* at 49 (2014).

¹⁵ Deloitte Consulting, the International Foundation of Employee Benefit Plans, & International Society of Certified Employee Benefit Specialists, *Annual Defined Contribution Benchmarking Survey*, at 65 (2013-14) (reporting that 28 percent of the 265 401(k) and 403(b) plan sponsors surveyed – 55 percent of which had more than 5,000

members report that a much smaller percentage of their plan sponsor clients – as low as 6 percent of plans – offer a window feature. A SPARK member that is one of the largest and well-known 401(k) providers reports that about 8 percent of its plan sponsor clients offer a brokerage window.

Within those plans that offer a brokerage window as an additional option, reports demonstrate that an extremely small percentage of participants use the window. For example, Vanguard reports that only one percent of participants utilize available brokerage windows,¹⁶ and another well-known provider reported that about 1.5 percent of participants with access to a brokerage window use it. Several SPARK members reported to us that *less than one percent of participants* use brokerage windows.

The percentage of plan assets invested through such brokerage windows mirror the extremely low participation rates. For example, some SPARK members report that among large subsets of their clients, less than 2 percent of all plan assets are invested in self-directed brokerage accounts. A member reported that while 6 percent of their full-service defined contribution clients offered a brokerage window, only 0.33 percent of participant assets were invested in the brokerage window.

Thus, while brokerage windows are not unusual, the data suggest a minority of plans offer them and that *a very small number of participants use them*. At the same time, data suggest that the use of target date funds, managed accounts, and asset allocation portfolios is increasing.¹⁷ This indicates that while a minority of participants chooses to participate in brokerage windows, significantly larger numbers of participants remain “do it for me” investors.

Our experience is that participants choose to participate in brokerage windows for a variety of reasons. Some participate to invest in name brand or well-known mutual fund options with which they are familiar, but that are not offered by their employer’s plan. Another common reason to invest in a brokerage window is to access “socially responsible” investment funds that may not be available on a plan menu because of the Department’s guidance with regard to such funds.¹⁸ Others participate to gain further sub-asset class diversification beyond the plan’s designated investment alternatives. In our experience, the small percentage of participants who choose to participate in brokerage windows do not day trade within the window; rather, they use

employees, 10 percent of which had between 1,000 and 5,000 employees, and 32 percent of which had between 100 and 1,000 employees – offered a brokerage window in 2012); *see also* Deloitte Consulting, the International Foundation of Employee Benefit Plans, & International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey*, at 45 (2012) (reporting that 22 percent of the nearly 400 401(k) plan sponsors surveyed – 39 percent of which had more than 5,000 employees, 30 percent of which had between 1,000 and 5,000 employees, and 20 percent of which had between 100 and 1,000 employees – offered a brokerage window in 2011).

¹⁶ *See* VANGUARD, *How America Saves* at 55 (2014).

¹⁷ *See* EBRI Issue Brief, *What Does Consistent Participation in 401(k) Plans Generate? Changes in 401(k) Account Balances, 2007-2012*, Brief No. 402 (July 2014).

¹⁸ *See* DOL Advisory Opinion 98-04A (May 28, 2008). This opinion allows the use of socially-responsible funds in plans based on benefits collateral to the economic interests of the plan, but only if the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.

the window to invest their retirement savings in diversified and long-term investments they trust or with which they are familiar.

Questions 10-11

No Response.

Question 12

What types of restrictions, if any, are typically made on brokerage window participation (e.g., minimum account balances, minimum dollar amounts that may be transferred to a brokerage window, maximum percentage of account balance that may be invested through a brokerage window, etc.)?

Plans place various types of restrictions on participants within a brokerage window, including restricting the percentage of assets that a participant may invest in the window. While it is important to highlight these restrictions, we feel it is equally important to highlight the protections in place for participants who choose to invest through a brokerage window. While some of the protections are built into the window provider's service, others are put in place by the plan sponsor or by existing rules.

First, window providers generally have a documentation requirement. Often, a participant who invests through a brokerage window must sign a form or agreement with the window service provider. A signed documentation requirement ensures that participants take a proactive step prior to entering the brokerage window. The requirement also provides participants an opportunity to contemplate and make an informed decision to invest in the window.

Existing rules also protect participants within a brokerage window. For example, the recent disclosure requirements ensure that all plan participants are well informed of the fees and risks associated with a brokerage window. In addition, participants will not be automatically enrolled in brokerage window investments such as mutual funds, stocks, or bonds. Rather, a participant must make an affirmative election to participate in a brokerage window.

It is important to note, however, that plans do not restrict the use of brokerage windows to participants that are "sophisticated," executive, or management employees. Doing so would almost certainly violate the nondiscrimination rules in the Internal Revenue Code. Code section 401(a)(4) prohibits a qualified plan from discriminating in favor of "highly compensated employees." The implementing regulations state that this prohibition includes a prohibition on discrimination in the plan's "benefits, rights or features."¹⁹ The right to a "particular form of investment" is a "right or feature" for this purpose.²⁰

A plan might violate the nondiscrimination rules if it imposed a restriction on the use of a brokerage window that, while on its face did not restrict use based on a participant's

¹⁹ Treas. Reg. § 1.401(a)(4)-4.

²⁰ Treas. Reg. § 1.401(a)(4)-4(e)(3)(iii)(C).

compensation, resulted in the brokerage window being “effectively available” to a group of employees that substantially favors highly compensated employees.²¹ Accordingly, qualified plans subject to the nondiscrimination rules generally do not impose conditions on rights or features of a plan that are significantly correlated with being a highly compensated employee. Even if they could, our members’ experience suggests that both highly compensated and non-highly compensated employees can benefit from brokerage windows due to their ability to select investments tailored to their personal preferences (*e.g.*, name brand mutual funds).²² The existing protections ensure that each participant must make an affirmative and informed decision to participate in a brokerage window.

Question 13

No Response.

Question 14

What benefits accrue to participants that invest through brokerage windows? Do participants who do not invest through the brokerage window benefit from having a brokerage window option in their plan, and if so, how?

Please see our response to Question 12 for a discussion of the benefits to participants who invest through a brokerage window.

Participants who do not invest in a brokerage window also benefit because the window allows the fiduciary to maintain a smaller, more targeted menu of investments. The smaller menu aids investment decision-making, encourages plan participation, and helps to reduce inertia.²³

SELECTING AND MONITORING BROKERAGE WINDOWS AND SERVICE PROVIDERS

Question 15

No Response.

Questions 16-17

Do plan recordkeepers typically require the use of their own or affiliated brokerage services, or are plan fiduciaries able to shop for brokerage windows provided by multiple vendors? Are there ways in which brokerage window providers favor or encourage

²¹ Treas. Reg. § 1.401(a)(4)-4(c)(1).

²² It would also be difficult to argue that a plan participant should be barred from investing in a fund through a brokerage window to which they would have access as a retail investor.

²³ See Squared Away, *supra* note 2; see also Plan Sponsor Magazine, *Choice Overload* (Sept. 2003), available at <http://www.plansponsor.com/MagazineArticle.aspx?Id=6442455959> (citing research that “on average, every additional 10 investment choices cuts participation rates by 2%.”).

investment in proprietary funds or products through brokerage windows? What factors do plan fiduciaries consider and what challenges, if any, do they face when deciding whether to include a brokerage window and who should provide the window?

In our experience, market competition gives plan fiduciaries the opportunity to shop for the brokerage window provider that best fits the plan's needs. That said, some plan recordkeepers partner with just one brokerage window provider. This is not unusual; in fact, the practice reflects basic cost saving techniques that any service provider may use. All service providers put together a package of services using subcontractors and partners. (Similarly, one would not expect a car dealer to offer tires from different manufacturers on a new car.) Fiduciaries are free to select a different provider if the package of services – including the brokerage window – does not meet the plan's needs.

Where the recordkeeper has its own window provider, the recordkeeper often requires fiduciaries to use its proprietary window feature. In many cases, this requirement is due to the technological difficulties and cost of incorporating a third-party brokerage window system with the recordkeeper's existing platform or service model.

Furthermore, like any subcontractor, the performance and fees of a window provider reflect on the recordkeeper or service provider with whom it partners. Recordkeepers want to ensure that the window provider is offering the best possible services. In this sense, market forces serve as additional protection for participants and plan fiduciaries. Further, we note that when a brokerage window provider is selected by the recordkeeper, the sponsor is not making a separate fiduciary decision to retain a brokerage window provider; it is including that factor as one aspect of its decision about its recordkeeper.

Question 18

What are the most common reasons for adding a brokerage window feature (e.g., flexibility and increased investment options for participants, to facilitate the ability of participants to work with an advisor or managed account provider, etc.)? What role, if any, do concerns about fiduciary responsibility or disclosure obligations play in deciding whether to add a brokerage window?

Please see our response to Question 4.

Question 19

When a plan fiduciary selects a brokerage window feature for a plan, does the plan fiduciary typically enter into a contract for this service, on behalf of the plan? If so, who are the parties to the contract? If not, why not?

We are aware of instances where a plan fiduciary or plan sponsor contracts directly with a brokerage window provider on behalf of a plan, but we are also familiar with instances where a service provider contracts with a window provider on behalf of a plan. In both instances, the contractual arrangements meet ERISA's requirement that plan assets be held in trust. The

preferred contractual arrangement varies depending on numerous factors, including the size of the plan and the relationship between the recordkeeper and the window provider.

Question 20

Do plan participants themselves commonly contract with the vendor when they choose to participate in the brokerage window (either in lieu of, or in addition to, a contract with a plan official) and, if so, what role, if any, does a plan fiduciary play in this process?

In our experience, plan participants do not generally sign a formal “contract” with a window provider as part of the brokerage window process. But participants almost always complete a form, account opening agreement, or some other type of documentation prior to entering the window. We feel this documentation is an important step in helping the participant engage and become more familiar with the brokerage window process prior to making the decision to invest through the window. In a very small plan that does not have an investment menu, there are instances where the business owner sponsoring the plan will pre-select a small number of broker firms from which the individual employee can choose to set up an account. Considerations in such situations include willingness to work with the payroll provider or specific account minimum provisions.

Question 21

No Response.

FIDUCIARY ACCESS TO INFORMATION ABOUT BROKERAGE WINDOW INVESTMENTS

Question 22

How do plan fiduciaries monitor investments made through their plan’s brokerage window, if at all? For example, do plan fiduciaries have access to information about specific investments that are selected or asset class or allocation information?

Plan fiduciaries receive reports and information from brokerage window providers regarding participant investments in the window. Like all service provider reporting to plan fiduciaries, the amount of reporting will vary from provider to provider. Typically, plan fiduciaries have access to statements that are sent to individual participants, including brokerage window statements that are sent quarterly or, in some cases, monthly. Many providers also make available (on the plan sponsor section of their website about participant account information) data on a real-time basis. Fiduciaries do not generally receive confirmations of trades made by participants, as this information is of little use and would quickly overwhelm the fiduciaries.²⁴

²⁴ At least one member reported to us that fiduciaries can elect to receive copies of trade confirmations.

Aggregate data²⁵ on the usage of brokerage windows is, in our members' experience, the key information to help fiduciaries evaluate the brokerage window feature in the context of the overall plan. This data allows plan fiduciaries to monitor brokerage window providers and evaluate whether the provider is meeting the plan's needs. Although we are not aware of plan sponsors monitoring participants' individual portfolios, the monitoring of the brokerage window provider ensures that participants receive a cost-effective and efficient brokerage window.

We strongly object to any additional monitoring requirements of the type contemplated by Q&A-30 of Field Assistance Bulletin 2012-02, and feel additional requirements would effectively be a solution in search of a problem. Requiring plan fiduciaries to monitor participants' investments in hundreds, or possibly thousands, of investment options is unnecessary and cost prohibitive. Plan fiduciaries spend significant resources educating participants and disclosing the necessary fees and information regarding brokerage windows. Additional monitoring requirements will only impose additional costs on plans while providing little benefit. As stated repeatedly in this letter, the key is that the participant understands that brokerage window investments have not been selected and are not being monitored by plan fiduciaries, so that the participant knows he or she must make an independent investigation before investing.

Questions 23-24

No Response.

BROKERAGE WINDOW COSTS

Question 25

What are the most common costs associated with participation in a brokerage window (e.g., account fees, brokerage commissions, etc.), and what dollar amounts are typically charged? Are there costs to including a brokerage window that usually are borne by the plan sponsor or by the plan, rather than by individual participants who use the brokerage window?

The costs associated with a brokerage window generally fall into four categories:

- Maintenance fees charged by the recordkeeper (typically paid by the plan and/or participants) to facilitate the interface with the window provider,
- Account maintenance fees charged by the window provider (typically paid by participants),
- Trading and commission costs associated with trading in the window (paid by participants), and
- Expense ratios of mutual funds and ETFs (paid by participants).

²⁵ By "aggregate data" we simply mean plan-level data such as the number of participants using the window and the total plan assets held within the window, not data on individual investments held by individual participants.

Question 26

To what extent are brokerage windows effectively subsidized by plan participants other than those participating in the brokerage window?

Although each window provider varies in how they structure their fees, the fees of the window are generally designed to cover the entire cost of the window feature. Like any optional plan feature, generally the plan sponsor charges a fee to each participant that uses the feature; the fee is designed to reflect the marginal cost to the plan. But like other optional features – including loan charges, managed account fees, and similar structures – this may not always perfectly reflect the cost.²⁶

The Department’s 408(b)(2) disclosure regulation provides transparency in how the fees of investments in the plan provide indirect compensation to the service provider. Any indirect compensation to a covered service provider received through a plan’s use of a brokerage window would also be disclosed. This provides plan fiduciaries the information they need to evaluate the compensation that the service provider will receive to determine if that compensation is reasonable in light of the services provided.

Questions 27-28

No Response.

DISCLOSURE CONCERNING BROKERAGE WINDOWS AND UNDERLYING INVESTMENTS

Question 29

Is the information required to be disclosed about brokerage windows by the Department’s participant-level disclosure regulation sufficient to protect plan participants? Is this required information more or less than plans disclosed prior to the effective date of the regulation? Does this information usually come from plan administrators or from a third party, such as plan service or investment providers? What additional information, if any, is or should be disclosed to participants?

As discussed in our response to Question 12, we strongly believe that the disclosure information currently required by the Department’s disclosure regulations is sufficient to protect plan participants. As the Department is aware, all participants currently receive a detailed description of the fees and expenses to open, maintain, and terminate a brokerage window account and that fees or commissions may be charged with respect to each investment option.²⁷ In addition, participants receive a statement of the actual fees and expenses that were charged to their

²⁶ See Field Assistance Bulletin 2003-3 (“[P]lan sponsors and fiduciaries have considerable discretion in determining, as a matter of plan design or a matter of plan administration, how plan expenses will be allocated among participants and beneficiaries.”).

²⁷ See DOL Reg. § 2550.404a-5(c)(3).

account during the preceding period, although due to the nature of how a brokerage account works, the commission costs are generally presented to the employee prior to executing a given trade. Finally, participants receive a quarterly statement reflecting the investments held in the brokerage window.²⁸

In Q&A-13 of Field Assistance Bulletin 2012-02R, the Department summarized and amplified the information that participants should receive regarding brokerage windows under the participant disclosure regulation. We believe the Department got the balance between informing and overwhelming a participant exactly right in Q&A-13, and recommend that the specific guidance in that question remain in place.

While participants are not receiving information in the same way as they would for designated investment alternatives under 29 CFR § 2550.404a-5(d), this information is readily available. For example, like for any investor, a mutual fund's fees and historical performance are readily available online in the prospectus or summary prospectus. We believe different disclosure for DIAs is appropriate, and properly reinforces that investments selected by the participant are distinct from those the participant selects from a plan's DIAs.

If the Department were to consider additional guidance for sponsors with brokerage windows in their plans, we believe that participants could benefit from a statement of how the investments in brokerage windows differ from the plan's designated investment alternatives. For example, this could include a disclosure that the investments in the brokerage window are not selected or monitored by the plan's fiduciaries. In the event the window permits investments in non-diversified securities, the Department could recommend that a plan sponsor provide a disclosure communicating that the participant takes on additional risks by holding non-diversified securities. Such a disclosure could also inform participants that they may want to consider seeking the assistance of a financial advisor, unless the brokerage window is provided in conjunction with such advisory services as in some very small plans.

A disclosure or notice such as the one suggested above is similar to disclosures already provided in analogous situations. For example, ERISA requires participant statements to include an explanation regarding the importance of a long-term diversified portfolio and a statement of the risk that holding more than 20 percent of a portfolio in the security of one entity may not be adequately diversified.²⁹ In addition, participants in 404(c) plans must be told that fiduciaries may be relieved of liability in certain instances.³⁰ Providing similar disclosures for brokerage windows would distinguish brokerage windows from designated investment alternatives, and better educate participants prior to them electing to direct their assets to a particular investment option in the window.

If the Department adopts a disclosure similar to the one we describe above, we recommend that the Department issue model language that can be used by plans. The Department issued well-

²⁸ See ERISA § 105(a).

²⁹ See ERISA § 105(a)(2)(B)(ii)(II).

³⁰ See DOL Reg. § 2550.404c-1(b)(2)(i)(B).

received model language in Field Assistance Bulletin No. 2006-03 and similar model language in this case would be very helpful.

Questions 30-32

No Response.

THE ROLE OF ADVISERS

Questions 33-36

No Response.

FIDUCIARY DUTIES

Question 37

Do these questions indicate a need for guidance, regulatory or otherwise, on brokerage windows under ERISA’s fiduciary provisions? For instance, is there a need to clarify the extent of a fiduciary’s duties of prudence, loyalty, and diversification under section 404(a) of ERISA, both with respect to brokerage window itself, as a plan feature, and with respect to the investments through the window? If guidance is needed, please try to identify the precise circumstances in need of guidance. If no guidance is needed, please explain why not.

As we have explained in our response to Question 3, we do not believe that additional guidance under ERISA’s fiduciary provisions is needed. ERISA’s standards are flexible and fact specific.

If the Department, nonetheless, issues regulatory or other guidance on ERISA’s fiduciary provisions, such guidance could create a complication that the Department would need to resolve – the guidance might strongly suggest plan sponsors should discontinue brokerage windows. In that case, the Department may need to clarify how ERISA’s fiduciary provisions would apply with respect to *unwinding* a brokerage window. The plan may not offer another investment with similar risk and return characteristics to an investment held in the brokerage window. In addition, participants in the brokerage window will tend to be the most engaged and active participants, and thus fiduciaries will want to proceed keeping in mind their particular needs.

In the event the Department decides to issue guidance – although we do not believe it is necessary – the guidance would need to be carefully considered and should not undercut existing rules, including guidance on qualified default investment alternatives pursuant to ERISA section 404(c)(5).

ANNUAL REPORTING AND PERIODIC PENSION BENEFIT STATEMENTS

Question 38

No Response.

Question 39

ERISA section 105 requires plans to furnish benefit statements at least quarterly in the case of participant-directed individual account plans. How do these benefit statements typically reflect investments made through brokerage windows?

Brokerage window benefit statements are generally provided separately from other plan benefit statements, and we strongly believe that the Department should continue to permit providers to provide separate statements for brokerage windows.

The Pension Protection Act of 2006 amended ERISA section 105 to change the frequency and delivery method for participant benefit statements. To clarify the 2006 amendments, the Department issued Field Assistance Bulletin 2006-03 which acknowledged that “in many instances,” information required for benefit statements will involve “multiple service providers.” In the 2006 Bulletin, the Department stated that “good faith compliance with the pension benefit statement provisions [did] not preclude the use of multiple documents or sources for benefit statement information,” as long as certain notification requirements were met, including notifying participants in advance how information will be made available to them.

Some providers rely on the 2006 Bulletin and follow its guidance in providing separate detailed brokerage window and DIA statements.³¹ In many instances, even though a plan statement may not contain detailed information about a participant’s investments within the brokerage window, the plan statement often shows the participant’s overall balance invested through the window as one “fund.” The various investments selected through the brokerage window are generally detailed on a separate statement from the brokerage provider.

The Department should continue to permit separate brokerage window statements because they provide the necessary information to participants at a more reasonable cost. As explained in our earlier responses, brokerage window providers may not be affiliated with a plan’s recordkeeper and windows often operate on a separate platform from other plan investments. To integrate the separate platforms to provide one combined and detailed statement would require a significant amount of resources, and in some instances it is possible that the necessary resources may outweigh the benefits of a combined statement, in part because of the extremely small percentage of participants who choose to participate in brokerage windows.

We are also not aware of any concern that participants are somehow harmed by receiving a separate quarterly statement reflecting their brokerage window investments. Participants who

³¹ The helpful guidance in Field Assistance Bulletin 2006-03 is also of critical importance in 403(b) plans, which often reflect multiple vendors.

elect to use a brokerage window understand that this is a separate feature of the plan and will not be confused by receiving a separate statement reflecting their window investments. We see no reason to require expensive programming to create a single statement that, in our members' experience, is not needed.

* * * *

We thank you for the opportunity to comment on this very important effort and for your consideration of our views. The SPARK Institute looks forward to working with the Department to ensure that any further regulation or guidance serves our shared goal of encouraging participants to save adequately and invest those savings in a well-informed, long-term, and diversified manner. If you have additional questions, please do not hesitate to contact me or the Institute's outside counsel Michael Hadley of Davis & Harman LLP, at 202-347-2230.

Sincerely,

Robert G. Wuelfing

Robert G. Wuelfing
Executive Director
The SPARK Institute, Inc.