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November 19, 2014

Submitted electronically to e-ORI@dol.gov

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

Re: Request for Information on Brokerage Windows; RIN 1210-AB59

Ladies and Gentlemen:

The Investment Company Institute¹ is pleased to submit comments in response to the Department of Labor's (the Department) request for information (RFI) regarding standards for brokerage windows in participant-directed individual account retirement plans covered by the Employee Retirement Income Security Act of 1974 (ERISA). The Department is reviewing the use of brokerage windows (including self-directed brokerage accounts or similar arrangements) in these plans, to determine whether, and to what extent, regulatory standards or other guidance concerning the use of brokerage windows by plans are necessary to protect participants' retirement savings.² The Institute strongly supports efforts to promote retirement security for American workers and appreciates the Department's interest in examining the role of brokerage windows and similar arrangements in achieving retirement preparedness. Americans currently have \$24 trillion saved for retirement, with more than half of that amount in defined contribution (DC) plans and individual retirement accounts

¹ The Investment Company Institute (ICI) is the world's leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. ICI's U.S. fund members manage total assets of \$17.2 trillion and serve more than 90 million U.S. shareholders.

² See 79 Fed. Reg. 49469 (August 21, 2014).

(IRAs).³ About half of DC plan and IRA assets are invested in mutual funds, which makes the mutual fund community especially attuned to the needs of retirement savers.

As the Department noted, some plans offer participants the ability to invest through brokerage windows or self-directed brokerage accounts in addition to or in lieu of investments specifically designated by the plan's fiduciaries.⁴ In this respect, as the Department explained, brokerage windows allow participants access to a broader range of investments, including individual stocks, bonds and mutual funds, than otherwise would be available under a plan's menu of investment options. The Department also has made clear that plan fiduciaries do have obligations with respect to brokerage windows offered within plans, including prudently selecting and monitoring the brokerage window provider and providing participants with key information about the brokerage window option. While the Department has imposed fiduciary oversight responsibilities in connection with brokerage windows, it has repeatedly and expressly not extended the "designated investment alternative" (DIA) designation to investments that are available or acquired through brokerage windows.⁵ The Department's historical practice of excluding investments held in brokerage windows from the status as DIAs is both understandable and appropriate given the attendant obligations and exposure inherent in such a characterization. With potentially thousands of investments available through brokerage windows, compliance with the obligations (including the specific disclosure requirements) that apply to DIAs as applied to each individual investment available in a brokerage window would not only be virtually impossible, but would also serve to confuse and overwhelm plan participants by oversaturating them with information on potentially thousands of investments in which they are unlikely to invest.

We believe the Department's existing guidance pertaining to brokerage windows provides a clear road-map for plan fiduciaries who determine that a brokerage window option would be appropriate for their plans and participants. We are not aware of any gaps or areas where further guidance from the Department is desired. Nor are we aware of any problems associated with the inclusion of brokerage windows in plans that would necessitate additional guidance or rulemaking by the Department. Before proposing any changes to the existing framework surrounding brokerage windows, it is imperative that the Department first identify a problem in need of a solution. If such a problem is identified, the Department must undertake a proper cost-benefit analysis of any proposed changes. Because brokerage windows can serve beneficial purposes for plan participants, we caution the Department to carefully weigh the implications of any regulatory changes or guidance considered as a result of this RFI. The imposition of unrealistic or unreasonable new obligations with respect to

³ See Table 1 in Investment Company Institute, "The U.S. Retirement Market, Second Quarter 2014" (Sep. 2014); available at www.ici.org/info/ret_14_q2_data.xls.

⁴ See 79 Fed. Reg. 49469 (August 21, 2014).

⁵ See, e.g., 29 CFR § 2550.404a-5(h)(4); 29 CFR § 2550.404c-1(c)(4).

brokerage windows could effectively eliminate their use and potentially reduce retirement plan coverage for American workers, especially among very small plan sponsors for whom DIAs are often not practical or responsive to the needs of the participants.

I. Usage of Brokerage Windows

As the Department is aware, there are different types of arrangements within the term “brokerage window.” These include brokerage windows that offer virtually unlimited access to the full range of investments available in the marketplace, including stocks, bonds, and mutual funds. Other window arrangements may be more limited, for example, by only including mutual funds available on the brokerage platform made available. As data from some of our recordkeeper members show, a minority of plans (about 13 percent) at these recordkeepers offer brokerage windows. Because these plans tend to be larger, about 35 percent of the participants in plans at these recordkeepers are in plans offering brokerage windows. Yet only about 1 percent of the participants have self-directed brokerage accounts, and among those in plans with brokerage windows as an option, only about 2 percent of participants use them. Moreover, participants using brokerage windows tend to have higher account balances, suggesting that they are used primarily by higher-compensated employees.

Individual account plans use brokerage windows in a variety of situations and for different purposes. Brokerage windows may be offered at the request of participants or because some participants simply want additional investments beyond the plan’s DIAs. Participants who desire investments beyond those designated by the plan sponsor may want to achieve greater diversification, access to additional market segments, or access to socially responsible or religion-compliant funds. Brokerage windows provide access to these broader investment opportunities to participants who want and believe they could benefit from them, without the plan sponsor having to take on fiduciary responsibility for selecting additional investments it may not believe are appropriate for all participants.⁶ Other participants may want access to a brokerage window to engage the services of an investment adviser who will manage the account for the participant.

We believe that most large plans with brokerage windows have a menu of DIAs in addition to the window. In contrast, we believe brokerage-window-only plans are more common in the small plan world (such as Simplified Employee Pension (SEP) plans in which typically only a few employees participate, but also small 401(k) plans), although we do not know how common. This suggests that in the small plan context, the ability to have a plan with a brokerage window and without a menu of DIAs may enable a small business owner to offer a plan when he otherwise may not be inclined to do so. It is possible that many small plans would not have been established if the brokerage-window-only design was not possible. These types of plans typically are low-cost and viewed as “starter” arrangements, in

⁶The Department noted some of the benefits of having a brokerage window on page 7 of the RFI.

that the plan sponsor may eventually step up to offering a plan with DIAs as the number of employees grows.

The Department indicated in the RFI that it understands that some plan fiduciaries view brokerage windows as a way to avoid having to provide the investment-level information required under the participant disclosure rule. We are not aware of any evidence that such a view or practice exists among plan fiduciaries or to support a suggestion that any incidence is widespread or prevalent. In any case, we note that various options are available to employers who are interested in avoiding the obligations associated with DIAs, including the use of other types of plans or arrangements such as payroll-deduction IRAs, SEPs or SIMPLE IRAs. Plan design choices such as these are of course considered “settlor” decisions,⁷ even if the desire to avoid the obligations associated with designating investments were a factor in the decision.

II. Additional Guidance Relating to Brokerage Windows is Unnecessary

The Department has articulated the fiduciary standards associated with including brokerage window options in participant-directed individual account plans, including disclosure obligations, and we believe no additional guidance is needed at this time. For example, in FAB 2012-02R (Q&A 39), the Department explained that “fiduciaries of such plans with platforms or brokerage windows, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan are still bound by ERISA section 404(a)'s statutory duties of prudence and loyalty to participants and beneficiaries who use the platform or the brokerage window, self-directed brokerage account, or similar plan arrangement, including taking into account the nature and quality of services provided in connection with the platform or the brokerage window, self-directed brokerage account, or similar plan arrangement.” These sentiments are consistent with past guidance by the Department indicating that “[w]ith regard to the prudent selection of service providers generally . . . a fiduciary should engage in an objective process that is designed to elicit information necessary to assess the provider’s qualifications, quality of services offered and reasonableness of fees charged for the service. The process also must avoid self dealing, conflicts of interest or other improper influence.”⁸ We do not believe it is necessary for the Department to

⁷ See Advisory Opinion 2001-01A (Jan. 18, 2001); Advisory Opinion 97-03A (Jan. 23, 1997) (explaining that the Department has long taken the position that there is a class of discretionary activities which relate to the formation, rather than the management, of plans, and that these so-called settlor functions include decisions relating to the establishment, design and termination of plans and, except in the context of multi-employer plans, generally are not fiduciary activities governed by ERISA). See also letter to John N. Erlenborn from Dennis M. Kass (March 13, 1986).

⁸ FAB 2007-01, Q&A 2 (selection of investment advice providers). See also 72 Fed. Reg. 60451, 60453 (Default Investment Alternatives under Participant Directed Individual Account Plans) (“The selection of a particular qualified default investment alternative (*i.e.* a specific product, portfolio or service) is a fiduciary act and, therefore, ERISA obligates fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries. A fiduciary must engage in an objective, thorough, and analytical process that involves consideration of the quality of competing providers and

prescribe specific standards for selecting and monitoring each of the different types of service providers. The existing guidance on selecting plan service providers both generally and in specific cases provides a thorough foundation for plan fiduciaries considering brokerage window providers.

In addition to guidance on selecting and monitoring service providers, the Department has provided detailed guidance on the disclosure obligations associated with brokerage windows under the participant disclosure regulation.⁹ First, as part of the general plan-related information required to be provided to participants initially and annually, plan administrators must include 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.¹⁰ Second, along with the individual expenses disclosed initially and annually, the plan administrator must provide an explanation of any fees and expenses that may be charged against the individual account of a participant or beneficiary on an individual (rather than plan-wide) basis, including fees for brokerage windows.¹¹ Third, on a quarterly basis, the dollar amounts actually charged for those individual expenses during the preceding quarter must be provided (plus a description of the services to which the charges relate).¹²

In Field Assistance Bulletin 2012-02R, Q&A 13 and 14, the Department expanded on the kind of information that should be provided to participants under the aforementioned three parts of the disclosure rule that specifically apply in the case of a brokerage window. In this respect, the FAB guidance explains that the general description of the window “must provide sufficient information to enable participants and beneficiaries to understand how the window, account, or arrangement works (*e.g.*, how and to whom to give investment instructions; account balance requirements, if any; restrictions or limitations on trading, if any; how the window, account, or arrangement differs from the plan's designated investment alternatives) and whom to contact with questions.” In terms of the individual fees and expenses associated with a brokerage window, the FAB guidance explains that the

investment products, as appropriate.”); 73 Fed. Reg. 58447, 58448 (Selection of Annuity Providers—Safe Harbor for Individual Account Plans) (“As with the proposal, the first condition for safe harbor relief is that the plan fiduciary engage in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. . . . Consistent with other guidance from the Department, this process must avoid self dealing, conflicts of interest or other improper influence, and should, to the extent feasible, involve consideration of competing annuity providers.”); Understanding Retirement Plans Fees and Expenses, available at <http://www.dol.gov/ebsa/publications/undrstndgrtrmnt.html>; Meeting Your Fiduciary Responsibilities, available at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>; Tips For Selecting And Monitoring Service Providers For Your Employee Benefit Plan, available at <http://www.dol.gov/ebsa/newsroom/fs052505.html>.

⁹ 29 CFR § 2550.404a-5.

¹⁰ 29 CFR § 2550.404a-5(c)(1)(i).

¹¹ 29 CFR § 2550.404a-5(c)(3)(i)(A).

¹² 29 CFR § 2550.404a-5(c)(3)(ii).

information “would include: (1) any fee or expense necessary for the participant or beneficiary to start, open, or initially access such a window, account, or arrangement (such as enrollment, initiation, or start up fees), or to stop, close or terminate access; (2) any ongoing fee or expense (annual, monthly, or any other similarly charged fee or expense) necessary for the participant to maintain access to the window, account, or arrangement, including inactivity fees and minimum balance fees; and (3) any commissions or fees (*e.g.*, per trade fee) charged in connection with the purchase or sale of a security, including front or back end sales loads if known; but would not include any fees or expenses of the investment selected by the participant or beneficiary (*e.g.*, Rule 12b-1 or similar fees reflected in the investment's total annual operating expenses).” In regard to the statement of fees actually charged during the preceding quarter, Q&A 13 of the FAB states that the “description of the services must clearly explain the charges (*e.g.*, \$19.99 brokerage trades, \$25.00 brokerage account minimum balance fee, \$13.00 brokerage account wire transfer fee, \$44.00 front end sales load).” The Department also explains, in Q&A 14, that the individual expense information regarding brokerage windows required under the regulation must be provided to all participants and beneficiaries, not just to those participants who have elected to use the window. Collectively, these explanations provide a comprehensive framework for disclosing the key information participants need to make informed decisions about whether to direct the investment of their account balances into a brokerage window option.

The Department has recognized that while participants who have access to a brokerage window need certain information to decide whether to make use of the window, it would be impractical to apply the investment-level disclosure requirements of the participant disclosure rule¹³ to investments within the brokerage window. As mentioned earlier, the participant disclosure regulation defines a DIA as “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” and excludes from the definition of DIA “brokerage windows,’ ‘self-directed brokerage accounts,’ or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.”¹⁴ In effect, the Department wisely determined that plan administrators are not required to include on the comparative chart of investment options investments that are available within a brokerage window and that are not DIAs.¹⁵ As discussed above, doing so would result in a chart

¹³ 29 CFR § 2550.404a-5(d).

¹⁴ 29 CFR § 2550.404a-5(h)(4).

¹⁵ In view of the impracticality of imposing ERISA-based disclosure requirements on all of the investments available within a brokerage window, it may be more appropriate to treat a participant investing within a brokerage window similar to a retail or IRA brokerage account customer. This typically is what happens in practice. For example, when investing in a mutual fund through a brokerage window, the participant will receive a prospectus and all disclosures provided to shareholders generally. In addition, we note that quarterly benefit statements will reflect the individual investments made through a brokerage window (as under section 105 of ERISA, individual account plans must provide the value of each investment to

identifying investment information on potentially thousands of investments for which the vast majority of participants in the plan have no interest. Such an oversaturation of information would not only cause confusion, but would divert the focus of participants from information on the investment options that have been selected by the plan fiduciaries. It is no surprise then that the Department has provided for similar treatment of brokerage windows in other contexts, including the regulations under ERISA sections 408(b)(2) (service provider disclosure to plan fiduciaries),¹⁶ 408(g) (eligible investment advice arrangements),¹⁷ and 404(c) (liability relief for participant direction),¹⁸ and the reporting requirements of Form 5500.¹⁹ The Department has been unwavering in its position that brokerage windows are not DIAs—a label that imposes specific obligations that follow from a plan fiduciary’s express decision to select a particular investment option—and there does not appear to be any logical reason to change this treatment going forward.

To change the current framework would require review and amendment of the numerous existing regulations referenced above, including those where the term “designated investment alternative” is defined to exclude brokerage windows, self-directed brokerage accounts, and similar arrangements.

III. Implications of Imposing New Obligations Regarding Investments within Brokerage Windows

If the Department decides to propose new obligations for plan fiduciaries with respect to brokerage windows, the Department should ensure that the obligations are both fundamentally sound and workable. Imposing an obligation to treat investments within a brokerage window as DIAs, similar

which assets of the individual account have been allocated). This serves as an additional layer of disclosure to participants using brokerage windows.

¹⁶ 29 CFR § 2550.408b-2(c)(1)(viii)(C) (A “designated investment alternative” is any investment alternative designated by the covered 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-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the covered plan.)

¹⁷ 29 CFR § 2550.408g-1(c)(1) (The term “designated investment option” means any investment option 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 option” 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. The term “designated investment option” has the same meaning as the term “designated investment alternative” as defined in 29 CFR 2550.404a-5(h).)

¹⁸ 29 CFR § 2550.404c-1(e)(4) (A “designated investment alternative” is a specific investment identified by a plan fiduciary as an available investment alternative under the plan.)

¹⁹ The Form 5500 generally allows plans with participant-directed brokerage accounts to report the aggregate value of the assets on line 1c(15) (“Other” category).

to the approach taken in the withdrawn Q&A 30 of FAB 2012-02, would not only be unworkable from a practical standpoint, but would conflict with the basic principles underlying ERISA section 404(c) and the regulations thereunder. Under section 404(c), if a plan provides for individual accounts and permits a participant to exercise control over the assets in his or her account, then the plan fiduciaries may not be liable “for any loss, or by reason of any breach, which results from such participant’s, or beneficiary’s exercise of control.” The regulations under section 404(c) issued by the Department, require that at least three “core” investment alternatives be offered through the plan and that certain investment rights and information be provided regarding investments that are designated.²⁰ The preamble to the regulation explains that the act of limiting or designating investment options in a 404(c) plan is a fiduciary function which is not a direct or necessary result of any participant direction. In designating investment options, the plan fiduciary must prudently select the option and periodically evaluate the option to determine whether it should continue to be available as a designated investment option.²¹ The Department clearly has drawn a distinction between affirmative actions of plan fiduciaries in designating investment options and situations which result from a participant’s or beneficiary’s exercise of control. Imposing an obligation to treat as DIAs certain investments selected by participants in brokerage windows, solely as a result of a participant’s actions, would turn this distinction on its face and runs counter to decades of precedent.

Conferring DIA status on some or all investments made through brokerage windows by participants also would be administratively unworkable for many reasons. As we described in a letter to Phyllis Borzi dated July 3, 2012 (a copy of which is attached), such a requirement raises several issues, including:

- Whether plans could feasibly monitor and track the investment selections made by participants in brokerage windows in order to determine whether a particular investment should be treated as a DIA (or whether a threshold number of participants have invested in a particular investment thereby triggering DIA status);²²
- Whether it would be possible (or practicable from a plan cost perspective)²³ for plan fiduciaries to determine whether the potentially thousands of individual investments available through a brokerage window would be prudent investment options for participants (and continue to monitor each investment for prudence after such an initial determination);

²⁰ See 29 CFR § 2550.404c-1.

²¹ 57 Fed. Reg. 46906 (October 13, 1992).

²² This raises the related question of how many participants must independently select a particular investment within a brokerage window in order to trigger DIA status and for how long the investment must be held by each participant.

²³ In this respect, where plan fiduciaries with no particular expertise to evaluate individual stocks held by participants through brokerage accounts conclude that they are required to retain financial advisors and experts to advise them, the costs associated with the engagement of the advisors may properly be charged against the plan as a whole.

- The practicality of notifying other participants when a particular investment acquired through a brokerage window (such as stock in a particular public company) is considered to be a DIA under the plan and then again when the such stock is no longer held or the number of participants investing in that stock falls below a designated threshold for triggering DIA status (*e.g.*, should participants then be notified that the investment is no longer a DIA?); and
- What happens when a plan fiduciary concludes that a particular investment option within the brokerage window is not prudent, *e.g.*, would the plan need to restrict access to or force participants out of that particular investment? Could it make the investment available for only a select group of participants?

The issues raised by the obligations set forth in the now-withdrawn Q&A 30 were complex and would have resulted in plans eliminating brokerage window options altogether, due to the virtual impossibility of compliance. If the Department considers proposing other new obligations with respect to brokerage windows, it is important to ensure that these types of issues can be dealt with in a practical, workable manner and that the new obligations would not effectively preclude plans from including brokerage window options. Given the important role of brokerage windows in many small business plans, we are concerned that the inability to offer a brokerage window could result in many employers simply not offering a plan at all.

* * *

The Department's existing guidance concerning the inclusion of brokerage windows is clear. Historically, the Department has held that the plan fiduciaries must prudently select and monitor a brokerage window provider and furnish participants with key information about the brokerage window option. The investments available within a brokerage window, for good reason, are excluded from the definition of DIA and thus are not subject to ERISA's prudent selection and monitoring standards and the Department's investment-level disclosure requirements. This treatment is embedded throughout the Department's regulatory framework and any changes to the treatment of brokerage windows would require wholesale changes to numerous existing regulations and other guidance.

We understand that the purpose of the RFI is to gather information about how brokerage windows are used in participant-directed individual account plans and to determine whether any new standards or guidance are necessary to protect participants. We commend the Department for proceeding in this manner. As part of the proper rulemaking process, the Department should identify a problem in need of a solution. In addition to identifying a problem, any proposal should include an appropriate regulatory impact analysis examining the costs and benefits associated with the changes. We urge the Department to take into account the legitimate purposes served by brokerage windows

and the benefits to not only those participants who elect to use windows, but also other participants choosing from a reasonable menu of DIAs. In addition, it is important to recognize that brokerage windows are integral to the decision to offer a plan, especially in the case of many very small plans. Imposing unrealistic or unreasonable new obligations on plan sponsors with respect to brokerage windows could effectively eliminate their use and potentially reduce retirement plan coverage for American workers.

We appreciate the opportunity to help inform the Department as it determines whether additional protections are needed for participants and beneficiaries with access to brokerage windows. Please do not hesitate to contact the undersigned at (202) 326-5800 if you have any questions.

Sincerely,

/s/ David M. Abbey

/s/ Elena B. Chism

David M. Abbey
Senior Counsel – Pension Regulation

Elena B. Chism
Senior Associate Counsel – Pension Regulation

Attachment

July 3, 2012

The Honorable Phyllis C. Borzi
Assistant Secretary
Employee Benefits Security Administration
U. S. Department of Labor
200 Constitution Avenue, N.W. – Suite S-2524
Washington, DC 20210

Re: FAQ-30 of Field Assistance Bulletin 2012-02

Dear Ms. Borzi:

The Investment Company Institute¹ is writing to encourage the Department of Labor (“Department”) to rescind FAQ-30 of Field Assistance Bulletin 2012-02, which has the effect of creating new law, rights, or obligations without proper notice and comment in violation of Administrative Procedures Act (“APA”) and Office of Management and Budget (“OMB”) requirements.² We believe that FAQ-30 – (a) serves to work substantive changes or major legal additions to existing rules or regulations without satisfying APA’s and OMB’s notice and comment requirements, (b) will have enormous costs and adverse effects with respect to the retirement plan system, and (c) should be withdrawn to allow for proper rulemaking consistent with the APA and OMB requirements.

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.9 trillion and serve over 90 million shareholders.

² It is well settled that agency positions that work substantive changes or major legal additions to existing rules or regulations are subject to the APA’s notice and comment procedures as legislative rules. *See U.S. Telecom Association v. FCC*, 400 F.3d 29, 34 – 35, 365 U.S. App. D.C. 149 (D.C. Cir. 2005). More specifically, “if an agency adopts ‘a new position inconsistent with’ an existing regulation, or effects ‘a substantive change in the regulation,’ notice and comment are required.” *Id. at 35* (quoting *Shalala v. Guernsey Memorial Hospital*, 514 U.S. 87, 100, 115 S. Ct. 1232, 131 L. Ed. 2d 106 (1995)). *See also* OMB’s Final Bulletin for Agency Good Guidance Practices (the “OMB Bulletin”).

1. FAQ-30 Creates New Law, Rights, or Obligations Without Proper Notice and Comment

The Institute has been a vocal proponent of fee disclosure and has repeatedly praised the Department for its efforts to issue regulations on the disclosure of fee and other information to participants. We have also been supportive of Department efforts to add clarification of the regulation's requirements through the issuance of interpretive guidance in the form of Field Assistance Bulletin 2012-02 (the "FAB"). While the FAB generally provides helpful interpretive guidance clarifying language used in the regulations, FAQ-30 of the FAB, on the other hand, serves to work substantive changes and legal additions to existing rules. In this respect, FAQ-30 would require plan fiduciaries to continually examine the open brokerage windows³ of participants and beneficiaries to determine if a "significant" number of participants and beneficiaries has independently invested in a particular investment and treat such investment as a "designated" investment option subject to fiduciary review. Such a position is inconsistent with existing regulations and serves to effect a substantive change in the regulations. The fact that the Department intends this new position to have the force of law is obvious from its introduction of a safe harbor provision introduced in conjunction with the rule.⁴

The relevant regulations describing the Department's position on a plan fiduciary's obligation to review "designated" investment options were issued in 1992 under section 404(c) of ERISA. Under section 404(c) of ERISA, if a plan provides for individual accounts and permits a participant to exercise control of the assets in his or her account, then the plan's fiduciaries may not be liable "for any loss, or by reason of any breach, which results from such participant's, or beneficiary's exercise of control." To satisfy section 404(c), a plan must comply with regulations issued by the Department, which require that at least three "core" investment alternatives be offered through the plan and that certain investment rights and information be provided regarding investments that are designated.⁵

In the Preamble to the section 404(c) regulations, the Department "points out that the act of limiting or designating investment options which are intended to constitute all or part of the

³ "Open brokerage windows" have been described by the Department as brokerage accounts available through a plan that allows "plan participants to invest in a wide range of funds, stocks, bonds and other investments offered through a designated broker for the brokerage window." See DOL FAQs About the 2009 Form 5500 Schedule C, Question 5, available at http://www.dol.gov/cbsa/faqs/faq_scheduleC.html.

⁴ In this respect, the Department indicates that it would not assert an enforcement action against a plan fiduciary if, "[p]ending further guidance in this area," the plan fiduciary treats as a "designated" investment alternative, any investment in which at least five participants, in the case of a plan with 500 or fewer participants (or 1 percent of all participants, in the case of a larger plan), are invested through a brokerage window on a date that is not more than 90 days preceding each annual disclosure.

⁵ See 29 CFR § 2550.404c-1.

investment universe of an ERISA 404(c) plan is a fiduciary function which, whether achieved through fiduciary designation or express plan language, is not a direct or necessary result of any participant direction of such plan.” Therefore, according to the Department, to the extent the plan fiduciary designates an investment option, “the plan fiduciary has a fiduciary obligation to prudently select such vehicles, as well as a residual fiduciary obligation to periodically evaluate the performance of such vehicles to determine, based on that evaluation, whether the vehicles should continue to be available as participant investment options.”⁶

While the Preamble language makes it clear that any choices the plan sponsor makes in designating investment options must be prudent, by its express language it distinguishes an affirmative action on the part of a fiduciary from an event “which results from [a] participant’s, or beneficiary’s exercise of control.” The Department’s FAQ-30 would turn this distinction on its face by providing that the investment actions of “significant” numbers of participants and beneficiaries, *i.e.*, acts within the “participant’s or beneficiary’s exercise of control,” can result in a plan fiduciary being required to treat the investment as being “designated” by the fiduciary for purposes of the rule. Specifically, Q&A-30 provides:

If through a brokerage window or similar arrangement, non-designated investment alternatives available under a plan are selected by significant numbers of participants and beneficiaries, an affirmative obligation arises on the part of the plan fiduciary to examine these alternatives and determine whether one or more such alternatives should be treated as designated for purposes of this regulation. (Emphasis added).

Significantly, subsequent to the issuance of the 404(c) regulations and prior to the FAB, the Department never expressed or implied that plan fiduciaries may be required to treat investments selected by participants through brokerage accounts as investments “designated” by the plan fiduciary and subject to review for prudence. Indeed, the regulation which FAQ-30 is intended to clarify (*i.e.*, 29 CFR § 2550.404a-5) expressly excludes “brokerage windows” from the definition of “designated investment alternatives.” Similar to Section 404(c), “designated investment alternatives,” are defined as:

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-directed brokerage accounts,’ or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by plan.⁷

⁶ 57 Fed. Reg. 46906 (October 13, 1992) (Emphasis added).

⁷ 29 CFR § 2550.404a-5(h)(4).

Furthermore, at no time following adoption of the ERISA Section 404(c) regulation or during the rulemaking process associated with the ERISA Section 404a-5 or 408(b)(2) regulations did the Department suggest the position taken in FAQ-30 – despite having had four years since the proposal of the regulation and 18 months since the publication of the regulation.⁸

We want to be clear. The concerns expressed by plan sponsors and others regarding the impact of FAQ-30 is not based on a misunderstanding regarding the obligation of plan fiduciaries to prudently assess the fees and service providers associated with the brokerage window. What apparently is not appreciated by the Department is that there is a huge leap from prudently selecting and monitoring service providers to now being mandated to treat investments independently selected by participants through a brokerage window as “designated” investments with all the attendant obligations and exposure inherent in such a characterization. Such a mandate clearly serves to work substantive changes and major legal additions to existing rules and regulations.

2. The Application of FAQ-30 Will Have Enormous Costs on the Retirement System

The referenced positions set forth in FAQ-30 will have enormous costs and adverse effects on the retirement plan system that we believe should have been further developed and considered as part of a public notice and comment process. Many of these adverse costs and effects have been described in detail in separate letters sent to you by the American Benefits Council (“ABC”) dated June 14, 2012, and on behalf of multiple trade organizations representing various aspects of the retirement industry, including the Institute, dated June 25, 2012. We will not repeat those identified costs and effects here. Instead, we think it would be helpful to illustrate some of the practical difficulties associated with the application of FAQ-30, which we believe could have been alleviated through the type of public notice and comment process required by applicable law.

First, as noted by ABC, despite the significance of FAQ-30 on plan sponsors and their ability to administer their plans, no guidance was provided regarding how many participants must be invested in a brokerage window investment before the number is treated as “significant” and thereby triggering inclusion of the investment as a “designated” investment alternative. Similarly, no guidance was provided regarding how long an investment must be held before it is required to be considered in the analysis of what investments are deemed to be held by a “significant” number of participants, and thereby required to be treated as a “designated” investment alternative. The failure to provide any such guidance raises numerous questions. For example—

- If, over the course of a week, five participants in a plan with 100 participants independently buy Facebook, Inc. stock (NASDAQ: FB) through their respective brokerage accounts, but

⁸ The participant-level fee disclosure regulation (located at 29 CFR § 2550.404a-5) was proposed on July 23, 2008, and finalized on October 20, 2010.

three of the five sell the stock after holding it for three weeks, is Facebook stock considered to be held by a “significant” number of participants? What if no other participants buy the stock and the three participants held the stock for two months and then sold it?

- At what point would the plan sponsor be required to treat the Facebook stock as a “designated” investment alternative and make the other 95 participants aware of the availability of the investment? Immediately upon determining that Facebook stock was held by five participants? Within one week of the acquisition?
- What happens if the remaining two participants sell their Facebook shares? Does the plan sponsor no longer treat the investment as a “designated” investment alternative? Would the plan sponsor be required to inform the plan participants that Facebook stock is no longer a “designated” investment alternative? What if a week later, two additional participants acquire Facebook stock?

The potential scenarios are infinite and the questions above, which focus solely on one stock, do not begin to illustrate the complexity of this new compliance task given that hundreds of different funds and stocks are likely to be held within the aggregate brokerage accounts of plan participants at any given time. We are aware of no way of systematically determining the number of plan participants who are invested in a particular investment through a brokerage window and how these holdings change over time. And without clarifying how the Department’s new “significant participation” test is intended to work,⁹ there is no way to develop systems for assisting plan fiduciaries with this critical responsibility. Thus, plan fiduciaries will be required to review print outs of brokerage window holdings on a daily basis and attempt to compare and contrast the holdings from participant to participant and from day to day to determine how those holdings change over time.

It also seems apparent that the Department did not fully consider the implications for plan fiduciaries who, faced with the specter of potential of litigation and the absence of clear guidance regarding the application of the provision, do decide to treat a particular investment acquired by several participants through a brokerage window as a “designated” investment alternative. In this respect, while plan fiduciaries may find it manageable to review investment options they do designate before making the investment available, very few fiduciaries are equipped to engage in ongoing reviews of thousands of potential funds and stocks that could be selected by several participants investing through their respective brokerage windows.

⁹ The Department has stated that the safe harbor (*see* note 4, *supra*.) is not meant to be used to clarify application of the word “significant” used in the general rule. Moreover, the safe harbor provides relief solely with respect to enforcement actions brought by the Department; it provides no relief from participant lawsuits based on claims that a particular investment acquired through a brokerage window was in fact a “designated” investment alteration subject to review and oversight.

- Thus, for example, where plan fiduciaries with no particular expertise to evaluate individual stocks held by several participants through brokerage accounts conclude that they are required to retain financial advisors and experts to advise them,¹⁰ are the costs associated with the engagement of the advisors properly charged against the plan as a whole, or would the costs be more properly allocated to the few individual participants who hold the stock?
- How do the plan fiduciaries explain to participants who have never acquired individual stocks that Facebook is now a designated investment option? Does doing so imply that holding a non-diversified investment like Facebook stock is appropriate for all participants?
- If plan fiduciaries conclude that the deemed designated investment option (*e.g.*, Facebook) is not appropriate, would they be required to restrict access to that investment through the brokerage window (potentially resulting in increased costs and administrative burdens)?
- If plan fiduciaries conclude that the costs of ongoing monitoring and review of brokerage account investments makes it infeasible to allow brokerage windows, as most will surely do, would they be required to force the sale of investments currently held by participants through the brokerage window? What if such a forced liquidation placed the participants at a significant market risk?

The uncertainties and difficulties inherent in complying with FAQ-30 can only be touched upon here, but even the obvious questions raised above show that this new rule will have enormous costs and adverse effects on the retirement system. Simply put, this new rule subjects plan sponsors to substantial exposure and litigation risk for which there is no reasonable way to mitigate or protect against.

3. FAQ-30 Should Be Withdrawn To Allow For Proper Rulemaking

The Institute has enormous respect for the Department's staff and has no doubt that the new position instituted through FAQ-30 was well intended. While the Department has indicated a willingness to consider clarifications of FAQ-30, the implications of this new position – which clearly were not appreciated prior to issuance – are too complex and far reaching to be left to the limitations of the FAB process. Moreover, FAQ-30 has immediate application and there are simply too many issues that need to be identified and resolved now. Because FAQ-30 serves to work substantive changes and major legal additions to existing rules or regulations without satisfying APA's notice and comment procedures, the Institute believes that the only way to move forward is for the Department to withdraw the FAQ to allow for proper rulemaking in compliance with APA and OMB requirements. Such a process presents the only reasonable (and required) way to ensure that the much needed analysis of the

¹⁰ See, *e.g.*, *Marshall v. Glass/Metal Ass'n. and Glaziers and Glassworkers Pension Plan*, 507 F. Supp. 378 (D. Hawaii, 1980).

The Honorable Phyllis C. Borzi

July 3, 2012

Page 7 of 7

policy, compliance costs and other issues inherent in a legal change of this nature are vetted, understood and introduced in a manner that allows for manageable implementation by plan sponsors.

Sincerely,

David M. Abbey

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Senior Counsel – Pension Regulation

cc: The Honorable Cass R. Sunstein, Office of Management and Budget

Michael L. Davis, Deputy Assistant Secretary, Employee Benefits Security Administration