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Brokerage Window Fiduciary Duties in Light of DOL Cryptocurrency Guidance

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The DOL's (DOL) recent warning that it is launching a new investigative program aimed at plans that offer investments in cryptocurrency and related products, including through brokerage windows, sent shockwaves through the 401(k) plan community.[1] (See our Legal Alert.) Apart from much-debated questions about the prudence of investing in cryptocurrency assets, the DOL's statement was alarming because it could be read to suggest that plan fiduciaries may be responsible for particular investments offered through a brokerage window.

In this post, we address considerations for fiduciaries of plans that offer brokerage windows in light of this guidance.

Brokerage Windows Overview

A brokerage window is a feature under which participants in a 401(k) plan or other participant-directed retirement plan can elect to invest in a wider array of investments than those that have been chosen as investment options by the plan fiduciaries (known as "designated investment alternatives"). A brokerage window may be desirable for participants who are, or who believe themselves to be, particularly sophisticated investors. For example, some participants may work with an investment adviser that recommends specific investments (other than the designated investment alternatives) that may be appropriate for their overall portfolio. Other participants may want to structure an investment portfolio that meets certain religious or ethical standards. Brokerage windows offer a way of accommodating participants by making investment options available to them that fiduciaries have not determined are appropriate for participants as a whole.

Brokerage windows are not a required feature for a 401(k) plan. ERISA itself does not address brokerage windows, but they have been recognized in DOL regulations and other guidance. Under DOL regulations, investment options available under a brokerage window are not subject to the same fiduciary standards or disclosure obligations as apply to a plan's designated investment alternatives.[2] In 2012, the DOL issued guidance stating that if a sufficient number of participants invest in a particular investment in a brokerage window, an affirmative obligation arises on plan fiduciaries to determine whether they should treat the investment as a designated investment alternative.[3] However, the DOL quickly withdrew that part of its guidance.[4]

While plan fiduciaries do not have the same responsibility for selecting and monitoring particular investments available under a brokerage window as they do for designated investment alternatives, fiduciaries may be responsible for the decision to offer a brokerage window, including how it is structured and communicated to participants. The DOL has taken the position that brokerage windows are subject to the general fiduciary duties of prudence and loyalty, including "taking into account the nature and quality of services provided" under the brokerage window.[5] The DOL's participant disclosure regulations also require a description of any brokerage windows under the Plan,[6] so there could potentially be a breach of fiduciary duty if the brokerage window's terms are not appropriately disclosed to participants. In 2014, the DOL issued a request for information about brokerage windows to help assess how ERISA's fiduciary standards may apply to them.[7] However, the DOL has not followed up with formal guidance clarifying fiduciary standards applicable to brokerage windows.

Brokerage Windows under DOL's Cryptocurrency Guidance

Compliance Assistance Release 2022-01 ("Cryptocurrency Guidance") warned fiduciaries that if they allow investments in cryptocurrencies or related products, including through a brokerage window, they "should expect to be questioned about how they can square their actions with their duties of prudence and loyalty." The reference to "related products" could potentially be interpreted very broadly because the DOL stated that it was concerned not only with direct investments in cryptocurrencies, but also with "other products whose value is tied to cryptocurrencies." This suggests that fiduciaries may be subject to questioning, for example, if they offer a brokerage window that permits investment in mutual funds with cryptocurrency strategies.

This raises questions as to whether the DOL has fundamentally changed its view of the responsibilities of plan fiduciaries for determining whether particular options in a brokerage window are prudent. Does this imply that plan fiduciaries have the obligation to review and screen the thousands of available investments through a brokerage window for cryptocurrency strategies? If plan fiduciaries do screen for cryptocurrency strategies, does that imply that fiduciaries have determined that unscreened mutual funds are appropriate for participants?

Moreover, there are practical questions as to how plan fiduciaries could screen for cryptocurrency strategies. The terms of brokerage windows generally allow fiduciaries to impose limits on available investments based on the structure of the investment. For example, a brokerage window may be restricted to mutual funds only. Fiduciaries may also be able to exclude certain types of investments that may not be appropriate for a tax-qualified retirement plan, such as tax-exempt mutual funds. However, it may be impractical, at least at this point, for fiduciaries to exclude all mutual funds "whose value is tied to cryptocurrencies" from a brokerage window.

Fortunately, Ali Khawar, acting secretary of the DOL's Employee Benefits Security Administration (EBSA), has stated that the intent of the Cryptocurrency Guidance was not a "backdoor way to regulate brokerage windows in a whole new way."[8] He also clarified that the guidance does not say that fiduciaries are responsible for reviewing and approving each individual investment option available under a brokerage window. However, further guidance is needed to clarify the DOL's position on the scope of fiduciary responsibility for investment

options under a brokerage window.

Brokerage Windows under Section 404(c) of ERISA

Plan fiduciaries have a duty to ensure that any brokerage window offered is prudent, but they should not have a responsibility to vet specific investment options available under a brokerage window. Section 404(c) of ERISA generally relieves fiduciaries of responsibility for participants' investment decisions provided that certain conditions are met. However, DOL regulations provide that Section 404(c) does not "relieve a fiduciary from its liability to prudently select and monitor any service provider or designated investment alternative offered under the plan."[9]

The implication is that fiduciaries may be held responsible for a brokerage window as a plan feature (including its design, expenses, and how its terms are communicated with participants) but not for particular funds in which participants choose to invest under a brokerage window. A plan's holdings of specific investments under a brokerage window are necessarily the product of participants' decisions to invest in investment options that are not designated by the plan fiduciaries, so they should qualify for relief under Section 404(c). In *Hughes v. Northwestern University*, the Supreme Court recently reaffirmed that fiduciaries have a duty to "monitor all plan investments and remove imprudent ones."[10] Although *Hughes* does not distinguish between designated investment alternatives and investment options available through a brokerage window, Secretary Khawar's comments noted above confirm that he does not view *Hughes* as fundamentally changing plan fiduciaries' responsibilities for brokerage window investments.

While fiduciaries should not have responsibility under Section 404(c) for screening particular brokerage window investments, they may still have some responsibility for investments available under the brokerage window, but the extent of this responsibility is not clear. For example, should fiduciaries have responsibility for screening categories of investments that they cannot determine would be appropriate for participants? This is one possible reading of the DOL's position in the Cryptocurrency Guidance. Such a position would undercut some of the benefits of a brokerage window. For example, under this reading, participants would still be able to invest in a large cap fund other than the large cap fund that fiduciaries designated. However, sophisticated investors could be prevented from investing in certain types of investments that may be appropriate for their particular circumstances, but which may not be appropriate for participants as a whole. Further guidance from the DOL would be needed to clarify its position.

Considerations for Plan Fiduciaries

Although the scope of fiduciary responsibilities in the context of a brokerage window has not been clearly established, plan fiduciaries may consider taking the following steps:

- Review commissions and other fees charged to a plan or to participant accounts with respect to a brokerage window for overall reasonableness and to determine whether they are reasonably allocated

among participants.

- Review restricted categories of investments under the brokerage window with an investment adviser and/or consult with the brokerage window provider as to whether restricted categories of investments are consistent with those of similar clients and appropriate for plan participants.
- Review the potential for any conflicts of interest under the brokerage window feature.
- Review fee disclosures, summary plan descriptions, brokerage window enrollment materials and any other plan disclosures to ensure that they accurately describe the material terms of a brokerage window.
- Review utilization of the brokerage window, including the portion of participants enrolled in the brokerage window, and the proportion of plan accounts of participants invested in a brokerage window, to assess whether any limitations are appropriate to encourage diversification.

As with any review, plan fiduciaries should ensure that their review of their brokerage windows is appropriately documented in their meeting minutes or other official records.

Footnotes

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[1] See DOL Compliance Assistance Release 2022-01 (March 10, 2022).

[2] 29 C.F.R. §§ 2550.404a-1(f)(5); 2550.404a-5(h)(4).

[3] Field Assistance Bulletin (FAB) 2012-02 (May 7, 2012), Q&A-30.

[4] FAB No. 2012-02R (July 30, 2012).

[5] FAB 2012-02R, Q&A-39.

[6] 29 C.F.R. § 2550.404a-5(c)(1)(i)(F).

[7] EBSA Notice, “Request for Information Regarding Standards for Brokerage Windows in Participant-Directed Individual Account Plans” (August 21, 2014).

[8] Austin Ramsey, *Crypto 401(k) Warning Casts Shadow over T. Rowe Price Settlement,* Bloomberg Law, April 27, 2022).

[9] 29 C.F.R. § 2550.404c-1(d)(2)(iv).

[10] 142 S.Ct. 737, 741 (Jan. 24, 2022).