For your information

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DOL Retreats on Brokerage Window "Safe Harbor"

The DOL issued an update to prior guidance on fiduciary responsibility for participant investments through brokerage windows. The guidance, in the form of a revised Field Assistance Bulletin, softens the DOL's stance on a fiduciary's responsibility to monitor and disclose information under the new ERISA Section 404(a) regulations about popular investments made through a brokerage window. The DOL announced its intention to continue the dialogue with fiduciaries and service providers about the duties fiduciaries may have under ERISA apart from those in the disclosure regulations, and indicates it may consider amendments to relevant regulatory provisions in the future.

Background

On May 7, 2012 the U.S. Department of Labor (DOL) issued Field Assistance Bulletin (FAB) 2012-02. The bulletin provided the DOL's response to 38 questions about the final regulations on participant-level retirement plan fee disclosure. [See our June 5, 2012 *For Your Information*.]

The response to question 30 of the FAB was quite surprising to plan sponsors and service providers. In the response to a question about plans that only provide investment options through a brokerage window, the DOL expressed concern that "a failure to designate a manageable number of investment alternatives raises questions as to whether the plan fiduciary has satisfied its obligations under section 404 of ERISA." The DOL went on to state that "unless participants and beneficiaries are financially sophisticated, many of them may need guidance when choosing their own investments from among a large number of alternatives."

Even if the plan fiduciary selected multiple designated investment alternatives (DIAs) as plan options, the response to question 30 stated that if "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 the regulation."

The "Safe Harbor"

For investment platforms, the FAB went on to state that when a platform holds more than 25 investment alternatives, "the Department, as a matter of enforcement policy, will not require that all of the

investment alternatives be treated, for purposes of this regulation, as designated investment alternatives if the plan administrator -

- makes the required disclosures for at least three of the investment alternatives on the platform that collectively meet the 'broad range' requirements in the ERISA 404(c) regulation, 29 CFR § 2550.404c-1(b)(3)(i)(B); and
- makes the required disclosures with respect to all other investment alternatives on the platform in which at least five participants and beneficiaries, or, in the case of a plan with more than 500 participants and beneficiaries, at least one percent of all participants and beneficiaries, are invested on a date that is not more than 90 days preceding each annual disclosure."

Although question 30 seemed to focus on sponsors that offer an investment platform in lieu of a line-up of DIAs, the DOL's response, and subsequent conversations with the DOL in several forums, made clear that it intends the rule to apply even when a brokerage window is offered alongside a line-up of DIAs.

Industry Response

After the release of the FAB, industry trade organizations met with the DOL to clarify what was intended. Once the DOL made clear that it considered question 30 applicable to all brokerage windows, those organizations endeavored to communicate the problems and concerns that would arise if popular brokerage window investments were subject to the same fiduciary obligations to report and monitor as those for designated investment alternatives chosen by the plan sponsor. The organizations also expressed concern that there is no system for identifying the popular investment options and that creating such a system would be a costly and time-consuming effort that could not feasibly be completed in time to produce the disclosure required for DIAs.

The trade organizations asserted that the DOL had introduced new rules without following established rulemaking procedures (that is, advancing the new requirement through a proposed regulation with an opportunity for comment from interested parties). The level of concern was such that a request was made to the Office of Management and Budget (OMB), asking that it address the DOL's failure to follow proper process.

Last week, the trade organizations found additional support on the Hill in the form of a letter to the DOL from Senator John Kerry (D-MA) asking that the DOL withdraw question 30 and instead pursue the issue in the traditional context of a formal rulemaking.

DOL Issues New Response to Question 30

On July 30, 2012, the DOL issued a replacement to the original FAB (Field Assistance Bulletin No. 2012-02R) "to further clarify its position and to give interested parties more time to engage in discussions with the Department on practical and cost effective ways to ensure participants and beneficiaries receive all the fiduciary protections afforded to them under ERISA when they use

brokerage windows and other similar arrangements, including, if appropriate, through amendment of relevant regulatory provisions."

In the new FAB, question 30 has been replaced with a new question 39. The replacement question eliminates the original "safe harbor" and references to "an affirmative obligation" to determine whether popular investments in a brokerage window should be treated as designated investment alternatives. The response to question 39 emphasizes that:

- A brokerage window, self-directed brokerage account or similar arrangement is not a DIA.
- Whether an investment alternative is a DIA will depend on whether it is specifically identified as available under the plan.
- The regulation does not require that a plan have a particular number of DIAs.
- Nothing in the FAB prohibits the use of a platform or a brokerage window, self-directed brokerage account, or similar plan arrangement in an individual account plan.
- Nothing in the FAB changes the 404(c) regulation or the requirements for relief from fiduciary liability under section 404(c) of ERISA or address the application of ERISA's general fiduciary requirements to SEPs or SIMPLE IRA plans.

In the response, however, the DOL reasserts its intention to engage in further discussion with "interested parties to help determine how best to assure compliance with these duties in a practical and cost effective manner" and, if appropriate, pursue regulatory amendments.

INSIGHT

The revised FAB addresses the points made by the trade organizations and restores the status quo unless and until an official change is implemented by the DOL through the regulatory process. Although it narrows the scope of the sweeping interpretation that the DOL had asserted in the FAB and defended in conversations and presentations, the new DOL question 39 seems to promise that the issue will be revisited.

The DOL reminds fiduciaries that their failure to designate DIAs in a plan covered by the investment choice regulations, for example, to avoid investment disclosures under the regulations, raises questions under ERISA Section 404(a)'s general statutory fiduciary duties of prudence and loyalty. In addition, fiduciaries of "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."

In Closing

This revised guidance from the DOL is good news for plan sponsors that offer brokerage windows through their 401(k) plans. Many had considered eliminating their windows specifically because of the earlier DOL guidance and the seemingly insurmountable data burdens that could result. The revised FAB is also good news for industry professionals who worked hard to communicate with the DOL the challenges of complying with the original "safe harbor" and the importance of following proper regulatory process. Although it is not possible to say when the DOL will revisit this, plan sponsors, fiduciaries, and service providers will be better prepared to respond to concerns the DOL may have when changes are explored through a regulatory process.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.
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