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Individual Brokerage Accounts: What Plan Sponsors Must Disclose to Participants

Client Bulletin

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Plan sponsors have a fiduciary duty to make disclosures to participants about brokerage accounts. We are concerned that this duty has not been well-publicized and that some plan sponsors may not be making the disclosures. This Bulletin discusses:

What plan sponsors must disclose for brokerage accounts, including:

- Who is responsible for drafting these disclosures?
- Who distributes the disclosures?

When and to whom plan sponsors must provide such information, including:

- What are the procedures for the initial and annual distributions?
- Issues to consider when a plan offers only brokerage accounts.
- What are the DOL concerns?

Conclusion

The participant disclosure requirements for brokerage accounts should not be overlooked by plan sponsors and committees. Though the requirements are less for designated investment alternatives, there are specific items that must be disclosed — initially and annually. It may be easy to assume that a plan's providers will automatically make the disclosures. However, the Participant Disclosure Regulation places the legal burden squarely on the shoulders of the fiduciaries — the plan sponsor and the committee members, and we are aware of some instances in which broker-dealers providing brokerage accounts say they are unable to provide the information. While fiduciaries can rely —to a degree —on qualified providers, they should at least take the steps to form a reasonable belief that the requirements are being satisfied. That could involve, for example, some combination of: a contractual provision obligating the service provider to make the disclosures, comparing the provider's disclosures to the DOL guidance (*e.g.*, a checklist), and similar steps.

Background

A growing number of participant-directed plans offer brokerage accounts to participating employees, in addition to the designated investment alternatives ("DIAs") that make up the plan's core lineup. As with any plan service, the plan sponsor, as the primary plan fiduciary—or the plan committee serving in that role, has the fiduciary responsibility to prudently select and monitor the broker-dealer who maintains the individual brokerage accounts. (See, *e.g.*, DOL Field Assistance Bulletin (FAB) 2012-02R, Q&A 39.) While that responsibility is well-known, there is another, less known, fiduciary responsibility for these accounts. It is the fiduciary duty to provide eligible employees and participants with specified information about the brokerage accounts and their costs.

ERISA Regulation Section 2550.404a-5 (the Participant Disclosure Regulation or the Regulation) requires that plan administrators of participant-directed plans make certain fee and investment disclosures to participants. (The "plan administrator" is the fiduciary responsible for administering the plan. In almost all cases, it is either the plan sponsor or the committee.)

The disclosures must be provided to newly eligible employees before they can first direct the investment of their accounts. The disclosures must also be made to all participants annually. (Note that "participant" is broadly defined and includes all eligible employees even if they do not enroll in the plan.)

The Participant Disclosure Regulation requires that investment-related disclosures be made for DIAs, but is less clear about the disclosures for self-directed brokerage accounts. To remedy this, the DOL provided detailed guidance in FAB 2012-02R. First, in Q&A 29, the DOL notes that the investment-related information required for DIAs is not required for either the brokerage account itself, since it is not a DIA, nor for the investments in the brokerage account. Nevertheless, there are disclosure requirements for brokerage accounts, as explained in Q&A 13 of the FAB. The Q&A divides those requirements into three categories:

Required Disclosures

General Description of Arrangement

First, the plan administrator is required to provide a general description of the brokerage account arrangement. In the FAB, the DOL says that "at a minimum," the description must explain "how and to whom to give investment instructions; what account balance requirements, if any, apply; any restrictions or limitations on trading; how the brokerage account differs from the plan's DIAs; and whom to contact with questions." This information must be included in written materials and given to newly eligible employees initially and to all participants annually.

Written Explanation of Expenses

Second, the Regulation requires that the plan administrator provide an explanation of any fees and expenses that may be charged against the account of a participant on an individual, rather than on a plan-wide, basis. With respect to a brokerage account, this would include:

- any fee or expense necessary for the participant to open an account (such as enrollment, initiation, or start up fees), or to close the account;
- any ongoing fee or expense necessary for a participant to maintain the brokerage account, including inactivity fees and minimum balance fees; and
- 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 this would not include any fees or expenses of the investments selected by the participant (*e.g.*, Rule 12b-1 or similar fees reflected in the investment's total annual operating expenses).

The requirement to disclose commissions and fees would be problematic for brokerage accounts, in the absence of the relief provided by the DOL in Q&A 13:

"The Department understands that in some circumstances the specific amount of certain fees associated with the purchase or sale of a security through a window, account, or arrangement, such as front end sales loads for open-end management investment companies registered under the Investment Company Act of 1940, may vary across investments available through the window or may not be known by the plan administrator or provider of the window, account, or arrangement in advance of the purchase or sale of the security by a participant or beneficiary. In recognition of the foregoing, a *general statement that such fees exist and that they may be charged against the individual account* of a purchasing or selling participant or beneficiary, and *directions as to how the participant can obtain information about such fees* in connection with any particular investment, ordinarily will satisfy the requirements of paragraph (c)(3)(i)(A) of the regulation." (Emphasis added.)

Thus, the requirement for advance disclosure of trading fees can be satisfied if the plan administrator provides a general description of the types of fees that might be charged and an indication of how the participant can obtain the details. This means that if the administrator knows that there is a $100 annual fee for using the brokerage account, but other charges for transactions may vary, the $100 should be disclosed along with a statement that there may be additional fees and how to obtain information about them.

The disclosures would also need to include other known fees that participants may reasonably expect to incur, such as, the brokerage commissions charged for purchasing securities. In addition, the DOL guidance states that the plan administrator should instruct participants to ask the brokerage account provider about "any fees, including any undisclosed fees, associated with the purchase or sale of a particular security through a window, account, or arrangement, before purchasing or selling such security."

In explaining why it opted to permit limited disclosures, the DOL explained that "otherwise, plan administrators might inundate participants and beneficiaries with information about the cost of buying or selling all the various securities available through a window, account, or arrangement, despite the fact that participants and beneficiaries may not have the interest or expertise to purchase or sell each or any such security."

Disclosure of Dollar Amount of Charges

The third part of Q&A 13 is the requirement that the plan administrator provide participants, on a quarterly basis, with a statement of the dollar amount of fees and expenses actually charged during the preceding quarter against their individual accounts, along with a description of the services to which the charges relate. (Note that the preamble to the regulation explains that these disclosures may occur more frequently than quarterly, for example, on confirmation statements or monthly reports.) In the FAB, the DOL gave the following examples: "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)."

As a result, plan committees should confirm that their brokerage account providers can capture and disclose this information to participants. That may be more difficult than it appears, since we have heard that some broker-dealers cannot provide all of this information. (Note that, while the Regulation imposes the fiduciary duty on the plan sponsor to provide the disclosures, the actual delivery of the disclosures can be done by service providers, so long as the plan administrator (*e.g.*, plan committee) has engaged in a prudent process to evaluate the service provider for this purpose.)

Additional Issues

Who Should Get the Disclosures

In addition to the substantive requirements for brokerage accounts, the FAB also discussed whether the disclosures could be given to only those participants who had elected brokerage windows. The DOL concluded that the plan administrator must furnish the required annual information to all participants (*including eligible employees who do not have account balances*) so that they have sufficient information to make informed decisions about whether to invest through a brokerage account. Thus, the brokerage account information needs to be included in the initial/annual disclosures provided to all eligible individuals — and not just to those who have elected a brokerage account.

DOL Concerns Regarding Plan with Only Brokerage Accounts

Finally, in Q&A 39, the DOL discussed whether a brokerage account is considered a designated investment alternative when the plan does not designate any investment alternatives. The DOL first provides the expected answer that the platform and brokerage account are not DIAs: The DOL then points out that there is nothing in the Participant Disclosure Regulation that requires a plan to have a specific number of DIAs or prevents an arrangement in which no investments are designated. However, the DOL expressed reservations about such an arrangement, saying:

"Nonetheless, in the case of a 401(k) or other individual account plan covered under the regulation, a plan fiduciary's failure to designate investment alternatives, for example, to avoid investment disclosures under the regulation, raises questions under ERISA section 404(a)'s general statutory fiduciary duties of prudence and loyalty."

This language signals the DOL's concern about arrangements in which fiduciaries do not designate investment alternatives, if their intent is to evade disclosure requirements in ERISA. The DOL indicated that it will visit this issue in the future, stating that "the Department intends to engage in discussions with interested parties to help determine how best to assure compliance with these duties in a practical and cost effective manner, including, if appropriate, through amendments of relevant regulatory provisions."

In the same Q&A, the DOL explained its opinion that fiduciaries must prudently select and monitor the providers of brokerage accounts:

"Also, 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."

Plan committees should engage in a documented process to prudently determine whether the costs and services of their plan's broker-dealer and brokerage accounts are reasonable and appropriate. As a part of that process, the committees should review the 408(b)(2) disclosures by the broker-dealers and, to be cautious, should compare the services and costs to those of competing broker-dealers.