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Are Brokerage Windows Broken? Cryptocurrency Release Creates Concern for Plan Fiduciaries

By Mark E. Bokert and Alan Hahn

In recent months, the U.S. Department of Labor ("DOL") has become aware of firms marketing investments in cryptocurrencies to 401(k) plans as potential investment options for plan participants. In response to these concerns, the DOL issued Compliance Assistance Release 2022-01 (the "Release").

The Release warns 401(k) plan fiduciaries to "exercise extreme care" before considering cryptocurrency investments. The Release also states that the DOL will investigate plan fiduciaries who make cryptocurrency available to plan participants, either as a core investment option or through a brokerage window. This threat has sent shutters through the benefits community as numerous brokerage windows permit such investments.

As a result of the Release, plan fiduciaries will need to work with their ERISA counsel to evaluate their brokerage windows.

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THE DOL COMPLIANCE ASSISTANCE RELEASE

The Release confirms the well-established principles that fiduciaries must act solely in the financial interests of plan participants and adhere to the strict standards of professional care most commonly known as the duty of prudence and the duty of loyalty.[1] Courts have commonly referred to these duties of prudence and loyalty as the "highest known to the law."[2] Inherent within these is the duty to monitor plan investments. A fiduciary's analysis of whether to offer a cryptocurrency investment option to plan participants is subject to these duties.

The Release observes that cryptocurrency investments are at their early stage of development. As such, the DOL has serious concerns about the prudence of a fiduciary's decision to allow plan participants to direct investments in cryptocurrencies, including products whose value is tied to cryptocurrencies. Cryptocurrency investments present significant risks and challenges to participants' retirement accounts, including, among other things, volatility, the ability of plan participants to make informed investments, custodial and recordkeeping concerns, valuation issues and evolving regulatory requirements.

Based on these concerns, the Release states that "plan fiduciaries responsible for overseeing such investment options *or allowing such investments through brokerage windows* should expect to be questioned [by the DOL] about how they can square their actions with their duties of prudence and loyalty in light of the risks."[3]

EARLIER DOL ACTION ON BROKERAGE WINDOWS

Although there is no precise legal definition, a brokerage window, which is sometimes referred to as a "self-directed brokerage account" or "self-directed account," commonly allows participants to invest their 401(k) account balances in a variety of investments beyond the menu of core investment options offered by the plan. A brokerage window provides participants with the ability to choose from among additional investment alternatives, which can include individual publicly-traded securities, mutual funds, bonds, exchange traded funds, and stock options. Brokerage windows can vary in the number of investment options that may be available. Plan sponsors may restrict the types of investments available through a brokerage window or even exclude specific investments, such as employer stock or individual stocks and bonds.

Brokerage windows started to gain popularity in the 1980s and many plans offer brokerage windows. In 2010, the DOL issued participant disclosure regulations pursuant to ERISA Section 404(a) which included the DOL's first guidance on brokerage windows.[4] In general, these regulations describe what information plan fiduciaries must disclose to plan

participants about their plan's core investment options (referred to in the regulations as "designated investment alternatives"). The regulations define a brokerage window by excluding it from the definition of a designated investment alternative, and stating that a brokerage window "enables participants and beneficiaries to select investments beyond those designated by the plan."[5]

In response to questions from the benefits community about the regulation, the DOL issued Field Assistance Bulletin 2012-02 (the "Bulletin").[6] In the Bulletin, the DOL explained how the disclosure requirements apply to investments that are made available through brokerage windows. The DOL stated that if a certain number of participants (five for plans with 500 or fewer participants and one percent for those plans with more than 500 participants) select an investment through a brokerage window, plan fiduciaries could have an obligation to determine whether that investment should be treated as a designated investment alternative.[7]

This portion of the Bulletin was met with widespread consternation from the benefits community, but provided a glimpse into the thoughts of the DOL regarding brokerage windows. The Bulletin suggests that plan fiduciaries have some fiduciary responsibility regarding brokerage window investments. At the very least, it appears that the DOL wants plan fiduciaries to understand what investments are made by participants through their brokerage window.

In response to the concerns raised by the benefits community, including concerns over fiduciary liability, the DOL issued Field Assistance Bulletin 2012-02R, which deleted the provisions under which investments selected through a brokerage window could be characterized as a designated investment alternative.[8]

The next time the DOL focused on brokerage windows was in 2014. In that year, the DOL issued a public request for information ("RFI") on the usage of brokerage windows.[9] The purpose of the RFI was to increase the DOL's understanding of the prevalence of brokerage windows and their role in participant-directed individual account plans. The RFI focused on why and how often brokerage windows were offered under ERISA-covered plans, and included numerous questions that covered such things as fiduciary duties, reporting, participation, costs and definitional issues. Ultimately, the DOL did not issue any additional guidance as a result of the RFI.

In 2021, the ERISA Advisory Council examined brokerage windows.[10] The stated purpose of the examination was to gain a better understanding of the prevalence, usage, and implementation of brokerage windows. The examination focused on the prevalence of brokerage windows (how many plans offer them and the extent to which assets are invested in them), the types of plans that offer brokerage windows, and the types of plan participants who use brokerage windows and the manner in which they are used. In the course of the examination, the Council considered numerous issues, including:

- Whether the DOL should promulgate guidance regarding the definition of "brokerage window";
- Whether the DOL should examine "brokerage window only" ("BWO") plans, i.e., plans that have no core investment options;
- Whether the DOL should require plan fiduciaries to disclose to participants the risks associated with investing through a brokerage window; and
- Whether the DOL should undertake an educational campaign to apprise plan participants of the risks associated with investing through brokerage windows.

Notably, the Council determined that it only had one recommendation for the DOL – that the DOL consider further study of BWO plans.

CASE LAW

Case law has not provided much clarity regarding the definition of "brokerage window" or the extent to which ERISA's fiduciary responsibilities, including the duties of prudence and loyalty, apply to brokerage windows.

In *Moitoso v. FMR LLC*,[11] plaintiffs sued plan fiduciaries on the theory that they failed to monitor the investments offered through a "mutual fund only" window. The plan at issue was maintained by Fidelity and offered three categories of investments: two core investment alternatives, a platform of Fidelity mutual funds, and another platform of non-Fidelity funds.

In declining to determine whether ERISA fiduciary duties (in particular, the duty to monitor plan investments) applied to the investments underlying the Fidelity platform, the court noted that it had "not found a judicial opinion actually analyzing" whether there is a duty to monitor funds available through a brokerage window and observed that the DOL has treated the term very broadly.[12] The court then stated that "in the absence of other regulations explicitly imposing such a duty, it is hesitant to state unequivocally that there either is, or is not, a fiduciary responsibility to monitor self-directed brokerage accounts."[13] The court decided that the platform of Fidelity mutual funds was not a brokerage window because the options were limited to the sponsor's proprietary mutual funds which were available through the sponsor's regular recordkeeping system, not the brokerage platform. The court then held that because "Fidelity was not offering its funds in the equivalent of a brokerage window, it can face fiduciary liability" for its failure to monitor such funds.[14]

In *Ramos v. Banner Health*,[15] plaintiffs also sued on the theory that defendants failed to monitor the investments offered through a "mutual fund only" window. The "mutual fund only" window at the center of this case allowed participants to invest in several hundred mutual funds. The court did not expressly conclude that the "mutual fund only" window was a brokerage window. Instead, the court concluded that it did not need to determine whether the defendants were required to monitor the underlying investments because the plaintiffs had failed to show loss causation.[16]

PRACTICAL ADVICE

Prior to the DOL issuing Compliance Assistance Release 2022-01, most plan sponsors and their advisors believed that in order to add a brokerage window to a plan, they should:

- Evaluate the need and desirability of offering a brokerage window;
- Evaluate the window provider in terms of its experience and expertise;
- Evaluate the costs associated with the brokerage window to ensure they are reasonable; and
- Be prepared to monitor the window provider and the costs.

Depending on the sophistication of the participant population, or for other reasons, plan fiduciaries also could decide to place limits on the brokerage window. For example, fiduciaries could limit investments through a brokerage window to a certain percentage of a participant's account balance (e.g., 10 percent), or limit investments to mutual funds and/or ETFs (i.e., prohibit investments in employer stock, individual stocks and stock options). Notably, most plan sponsors and advisors did not believe that they had any responsibility with respect to the investments underlying the brokerage window, i.e., there was no obligation to seek information about such investments nor to monitor them.

Does the Release change of any of this? For the most part, the answer is no, but the Release does suggest that the DOL thinks that there is some ERISA fiduciary responsibility with respect to the underlying investments in a brokerage window. The mere suggestion of this may cause plan sponsors to avoid adding a brokerage window to their plan, as it would be very difficult and burdensome to monitor the window's investments if that what the DOL is aiming toward.

For the time being, it would likely be wise for plan sponsors to wait for the DOL to clarify their statements within the Release before adding a brokerage window to their plan.

With respect to plans that already offer a brokerage window, we would not expect the Release to compel most plan sponsors to terminate their windows which in itself would raise fiduciary issues. Rather, we would expect most plan sponsors to focus on the primary purpose of the Release which is to warn against cryptocurrency investments and to threaten an investigation of plans that allow such investments. In response to the Release, we would expect many plan sponsors to consider prohibiting plan participants from investing in cryptocurrency through their brokerage window.

A recommended first step in that process would be for plan sponsors to evaluate the extent to which their brokerage window allows crypto-investments. They should understand that numerous ETFs have exposure to crypto-investments. Further, plan sponsors may be surprised to learn that Fidelity, despite the cautions of the Release, will soon offer bitcoin as an investment option for the 401(k) plans it administers.

A second step would be for plan fiduciaries to consider limiting or prohibiting plan participants from investing in cryptocurrency through their brokerage window.

Plan sponsors should be wary of the DOL's threat to investigate those who allow crypto-investments, as any investigation is likely to pose difficult questions for plan sponsors and is unlikely to be singularly limited to their decision to offer cryptocurrency investments. If past practice is any indicator, the DOL will, instead, cast a wide investigative net and evaluate the plan's entire fiduciary process and policies.

CONCLUSION

The DOL's Compliance Assistance Release struck a strong cautionary tone about allowing cryptocurrency investments in 401(k) plans. In the Release, the DOL threatened to investigate any plan that allows cryptocurrency investments, either as part of their core investment options or through a brokerage window. By including brokerage windows in the Release, the DOL created uncertainty with respect to the fiduciary requirements relating to such windows.

In response to the Release, it would be wise for plan fiduciaries to consider limited or restricting their brokerage windows so that plan participants are not allowed to invest in cryptocurrency.

Notes

1. Compliance Assistance Release 2022-01, U.S. Department of Labor, Employee Benefits Security Administration (March 10, 2022).

2. *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

3. Compliance Assistance Release 2022-01 (emphasis added).

4. 29 C.F.R. § 2550.404a-5.

5. 29 C.F.R. § 2550.404a-5(h)(4).

6. U.S. Department of Labor Field Assistance Bulletin No. 2012-02 (May 7, 2012).

7. *Id*. at Q&A 30.

8. U.S. Department of Labor Field Assistance Bulletin No. 2012-02R, Q&A 39 (July 30, 2012).

9. Request for Information Regarding Standards for Brokerage Windows in Participant-Directed Individual Account Plans, 79 Fed. Reg. 49469 (Aug. 21, 2014).

10. Advisory Council on Employee Welfare and Pension Benefit Plans, Report to the Honorable Martin Walsh, United States Secretary of Labor, Understanding Brokerage Windows in Self-Directed Retirement Plans (December 2021).

11. 451 F. Supp. 3d 189 (D. Mass. 2020).

12. *Id*. at 208.

13. *Id*. at 207.

14. *Id*. at 210.

15. 461 F. Supp. 3d 1067 (D. Colo. 2020).

16. *Id*. at 1127.

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