ERISA Advisory Council Meeting

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Compass Financial Partners, a Marsh & McLennan Agency Company, recognizes that brokerage windows can play an important role in enhancing retirement outcomes and commends the ERISA Advisory Council on its efforts to seek more information on this relevant topic prior to making any recommendations on the need for additional rulemaking. I am here with you today based on my involvement with the Government Affairs Committee of the National Association of Plan Advisors (NAPA), and am honored to have an opportunity to speak on this important topic. NAPA and its sister organizations of the American Retirement Association support all efforts to improve and strengthen our retirement system. While the industry uses a variety of labels for these type of accounts - brokerage windows, mutual fund windows, brokerage accounts, self-directed brokerage accounts (SDBAs) – in my remarks today I will use the term SDBA to apply to all of them. In general, we are supportive of plans making available a SDBA option as a compliment to a thoughtfully designed core menu of Designated Investment Alternatives (DIAs), particularly for those plans that have core menus that do not fully address the investment needs of all their participants. We also are very supportive of efforts to ensure that retirement plan participants are provided meaningful and effective disclosures about the investment options offered by their plans. Clarification of the role of the SDBA and the expectations of fiduciaries with regard to it would be helpful as I will outline in my testimony, which is based on our experience in working with challenges and opportunities of SDBA's.

Before sharing some specific observations about SDBA, I should step back and let you know how I view my role as a co-fiduciary to plan sponsor committees, as it shapes my perspective on all aspects of plan design, including whether or not to use a SDBA option. First and foremost, my role is to work with the plan sponsor to design a plan to maximize the likelihood that participants accumulate sufficient assets over the course of their working years to be able to retire with dignity on their own terms, with particular care given to the interests of the least sophisticated participants. In doing so, we work to ensure that the plan is managed in full accordance with all regulations and laws. Department of Labor guidance, such as the 2013 "Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries", is particularly helpful towards that end.

At a somewhat more granular level, we work with plan sponsors to design menus that offer an appropriate array of investment options for their participants, with specific options that have been thoroughly vetted from an investment due diligence perspective, and where the specific vehicles chosen (share classes, collective investment trusts, separate accounts) are the lowest cost means of accessing that particular strategy. These three activities are each relevant in the discussion on SDBA – in fact, they represent the biggest benefit to SDBA inclusion in a plan and at the same time two biggest potential challenges, in my opinion.

- In terms of the **appropriate array of investment choices** within a plan, we tend to encourage a somewhat paternalistic approach in building out the core menu of designated investment alternatives, avoiding risky, complex, or non-traditional investments that less sophisticated participants could misuse. We promote a long-term perspective to wealth creation, and the menus we help build typically consist of broadly diversified options across a number of different asset categories and styles, including both actively-managed and low-cost index strategies to meet different participant needs. The core menu is where the bulk of participants will be invested, and it is the most cost-effective solution for 401(k) plans, so care should be taken to build a sufficiently robust solution in which the vast majority of plan participants will choose to invest.

  With that said, we understand that there are participant circumstances that might warrant a broader array of investment choices. Examples that I have seen across our clients include participants working with an external

financial adviser, participants subject to specific investment constraints (such as investing by those who follow the principles of Islamic finance), or participants who feel that they are sufficiently sophisticated to warrant more targeted strategies to tailor their portfolios. For these situations, a SDBA can be a valuable benefit in that it allows those with a specific need to access a broader array of investment options. However, because of the procedural hurdles involved in establishing and funding the SDBA, the risk that less sophisticated participants will inadvertently select investment products that are inconsistent with long-term retirement savings is minimized. This is a significant benefit of including an SDBA.

- However, there are challenges with including the SDBA as well. One is ensuring participants understand the difference in the fiduciary's role with respect to **investment due diligence**. The designated investment alternatives within the core menu benefit from constant oversight by our internal investment team -- a blend of quantitative and qualitative analysis designed to form a judgment as to the merits of including and/or maintaining an investment option in the plan. The results of this analysis are discussed regularly with our plan sponsor clients at their review meetings, with the investment committee ultimately exercising fiduciary judgment in determining what options should be available to plan participants.

  By contrast, and by design, the SDBA consists exclusively of investments in which *no assessment has been made by the fiduciary*. It is therefore imperative that it be clear to a participant that no endorsement from the fiduciary is implied by the inclusion of an investment option in the SDBA. The disclosure that SDBA investments have not undergone the rigorous fiduciary review that the DIAs have endured should not be buried in fine print. This perhaps, presents an opportunity for further guidance from regulators on what is expected of plan fiduciaries when participants take over full control of investment decisions.

- Another challenge with including the SDBA is cost. We also go to great lengths to **reduce costs** of prudently selected DIAs for plan participants through a variety of means. Sometimes this means utilizing collective investment trusts or separate accounts, vehicles that are typically not available outside of a qualified plan. Sometimes it means using retail share classes and rebating any embedded revenue sharing within the fund back to the participant. In every case, whenever we propose including a new investment within a plan menu, we have worked to determined that the strategy is reasonably priced relative to other available alternatives, and we have worked to ensure that we are using the lowest cost way of accessing the strategy.

  Within a SDBA option, this level of rigor around cost is not present, and the range of available vehicles is more limited. Here is an example we recently shared with a client that has plan assets in excess of $2 billion. One of their current core menu options is a large cap growth fund. Due to the size of this position in the plan, we have been able to utilize an institutionally priced collective investment trust version of the strategy that is priced at 34 basis points. If a participant were to access this same strategy through a SDBA, they would have to invest in the retail share class of the mutual fund version of the strategy, at a cost of 86 basis points. Same strategy, managed by the same PM team, just more than twice as expensive. Taking this example a step further, let's assume we were considering the same fund for a small plan or even a start-up, but operated under a fee-leveling arrangement where revenue sharing is credited back to participants. If the plan held the same retail mutual fund in its core line-up, participants would be receiving back 35 basis points in revenue sharing, thus paying only 51 basis points on a net basis—less than 2/3 the cost of the same strategy in the SDBA. Ensuring participants understand this potential cost differential is a significant challenge of including a SDBA.

  As stated earlier, we believe a healthy balance of offerings in the core menu that has the greatest potential likelihood of meeting all participants investment needs, even with the existence of an SDBA, is most prudent. While not necessarily a common practice, some fiduciaries may see a brokerage window as a way to minimize their fiduciary liability by creating a very streamlined core menu, where the participant has few choices of designated investment alternatives but do have access to an SDBA. This risks creating a sub-optimal experience for plan participants by discouraging investment in thoroughly vetted DIA's, and due to higher fees in some cases. Although I do not believe there is a need for formal regulations on this topic, plan sponsors should be aware of the potentially unforeseen consequences of a limited core menu coupled with an SDBA. To that end, publication

of tips or best practices by the Department could promote understanding that a design of this type may curtail the purchasing power of institutional, lower-cost investment options, and fee leveling.

The potential concerns around the lack of due diligence and the issue of cost can be addressed with clear disclosures to participants about the ways in which SDBA investments differ from core menu offerings. Our experience reviewing the disclosures from various recordkeepers suggests there might be an opportunity for clearer guidance about what should be included and how best to present the information.

On the broader topic of SDBA regulation and guidance, I would note that ERISA plan investments through SDBA remains largely uncharted territory. SDBAs are defined by what they are not rather than what they are. Fiduciaries operate under the broad understanding that ERISA Section 404(a) fiduciary duties of prudence and loyalty apply, but with little guidance on how to translate those concepts into the SDBA context. Some areas for consideration along these lines are the following:

- The extent to which plan sponsors can select limitations on what can be offered through SDBA (e.g., mutual funds only or commission-free only) without implicating ERISA fiduciary duties. For example, does the duty to act for the exclusive purpose of providing benefits and defraying plan expenses require fiduciaries to evaluate the nature of costs that may be incurred in connection with individual investment choices? And further, what is required as a best-practice, for determining such limitations? Could fiduciaries limit SDBA to no-commission platforms without reviewing whether and how such brokerage platforms generate indirect compensation to the recordkeeper?
- There is also an opportunity to clarify both the disclosure, as well as determination of suitability, of fees. As with any fiduciary-related decision, prudently selecting a service provider requires a validation process. This would incorporate vetting procedures of service providers considered, fee structure comparatives, and services being offered. How does a fiduciary then, achieve a sufficient vetting process if only one brokerage option is available on a particular recordkeeping platform? To what extent should SDBA fees influence the choice of recordkeeper platform, realizing that only a small percentage of participant assets will likely end up there?
- What about the risk of over-trading? Employees may end up trading so often inside their accounts that commissions take a large percentage of their returns, or they might buy high and sell low, which may further erode their investment returns. How has the most recent Gamestop, AMC and the like trading frenzy impacted plan participants? Does a fiduciary have a duty to monitor the impact of trading fees, and outcomes, on participant accounts?
- Finally, we believe that it would be beneficial for there to be guidance to fiduciaries regarding what, if any, data should be gathered for monitoring purposes. Although a fiduciary should not be expected to make an assessment of the quality of any decision made by an individual participant within the brokerage window, should a plan sponsor assess the data that is available regarding participant choices in the SDBA? It is arguably better for fiduciaries to be aware of the decisions being made and the outcomes experienced by participants, but does having this information create a de-facto requirement to then to act upon it? Additional guidance on the monitoring standards required of plan fiduciaries would be valuable.

In closing, while I have raised various areas where further regulatory guidance could be beneficial, any new guidelines or regulations should be carefully considered so as to avoid the unintended consequence of causing plan sponsors to cease offering SDBAs. A SDBA can be beneficial for plan participants, and a perceived increase in fiduciary risk around offering one will likely result in plan sponsors choosing not to do so. Providing clarification around the challenges that I noted will help plan sponsors be comfortable that they are addressing those appropriately, thereby allowing more participants have access to investments that are appropriate for their objectives as well as the information necessary to make informed choices about utilizing a SDBA.

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