Cash Holdings in Self-Directed Brokerage Accounts – A Suggestion for Plan Sponsors

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A self-directed brokerage account (SDBA) is a popular investment option for plan sponsors to provide to its participants. The SDBA provides participants who want more investment options with flexibility to invest retirement contributions in different products, including various mutual funds and exchange traded funds. Plan sponsors are able to provide participants with access to thousands of investment options normally too untenable (and otherwise unwieldy) to be offered as core investment options.

The US Department of Labor (DOL) has provided little guidance for monitoring SDBAs. Provided that the SDBA is populated with various investment options, nothing requires plan sponsors to "look under the hood" of the SDBA for the practicality of those investment options to its participants. Despite the lack of federal guidance, I believe circumstances and general fiduciary responsibilities prompt plan sponsors to consider action regarding those accounts.

A recent article in USA Today by author Erin Lowry entitled "Millennials, you've got this all wrong. You need to stop 'saving' for retirement," highlights a concern for participants. (https://www.usatoday.com/story/money/columnist/2019/06/20/millennials-need-stop-saving-retirement-broke-millennial/1360048001/). Lowry's research concluded the study subjects mistakenly believed that "saving" for retirement is equivalent to "investing" for retirement. This mistaken belief led study subjects to make contributions to their 401(k) plan without choosing investment options for the contributions.

Congress passed the Pension Protection Act of 2006 which recommended a safe harbor for plans in the form of a Qualified Default Investment Alternative (QDIA) for ERISA plans and a default investment option for non-ERISA plans.[i] The QDIA identifies a particular investment direction for retirement savings when no direction is provided by the participants themselves. If a sponsor does not provide a QDIA, they may face fiduciary liability when a participant fails to direct contributions into an investment. Establishing and monitoring the QDIA allows plan sponsors safe harbor relief from fiduciary and legal responsibilities.

Since the QDIA does not apply to voluntary elections, participants who elect to use the SDBA may encounter situations as described by Lowry. No allocation is ever made to a SDBA except for participant transfers of assets from core investment options to those accounts, meaning it is assumed participants are actively managing their account. SDBA cash accounts can contain thousands of dollars, or even 100% of a participant's invested amounts. These dollars are not invested in a CD fund or a money market fund, but instead sit in a temporary transitory account waiting to be invested. With the availability of safe money market funds or CD funds to the participant, having money in the SDBA cash account earning a minimal return is the virtual equivalent to hiding cash under a mattress instead of placing that cash in a bank to earn interest.

Legitimate reasons do exist why participants may leave some money in this cash account, as it is the primary staging area within the SDBA window for participants to make investment choices. For example, money transferred from the plan sponsor to the SDBAs and vice versa first moves

into this cash account. Participants could still be researching the most appropriate investment option for themselves within the SDBAs before making a final choice. Any investment option dividends not directed for reinvestment also reside in the cash account.

Although these reasons are valid, there may be other reasons money is in an SDBA cash account. Could it be an example of the phenomenon Lowry discussed where participants believe simply moving money into the SDBA is an actual investment selection? Did the participants transfer retirement money from another plan but failed to direct it for investment? Did the participants select an investment and fail to take the necessary steps to finalize the transaction? No matter what the reasons why participant money remains uninvested in a cash account for so long, the problem exists and should be addressed.

While the above discussed rules governing QDIAs would not apply to SDBAs, as the SDBA is a free election by participants, it seems plan sponsors may want to take an active role in these situations. As fiduciaries, plan sponsors are tasked to ensure that participants have adequate investment options for retirement funds and to monitor these funds for their continued suitability. This, however, is not to suggest that plan sponsors must establish the equivalent of a QDIA within the brokerage window. Although doing so addresses the general issue, it may go beyond the responsibilities as plan administrators (so long as the participants voluntarily moved money into the SDBA). However, plan administrators can implement prudent steps to protect participants from unintended mistakes.

To accomplish this goal, and consistent with their fiduciary responsibility, plan sponsors' monitoring should also include a periodic review of the cash accounts of the SDBAs to note individuals with high (more than 50% of their money), static balances (no changes to the balance, other than minimal interest increases, for more than six months) in their SDBA cash accounts. An annual notice to these participants in plan programs to alert individuals that their retirement funds are not currently invested is a good first step. The annual notice should be a targeted mailing to those participants advising them that: 1) the cash account is not intended as an investment option and cash-like investment options are available within the SDBA platform, and 2) the investment options within the primary plan's investment window and the myriad investment options within the SDBA are still available for selection by the participant. If the participant still chooses to have a high, static balance in their account, that becomes an informed choice of the participant as opposed to a possible mistaken belief.

Beyond directly informing participants of high, static balances, the SDBA literature plans provide to participants should clarify that simply transferring money into the SDBA does not invest the money in any investment fund, and participants should make a further selection in the SDBA platform in order to do so. Additionally, the SDBA literature that plans provide to participants should note that putting money in the cash account is not a viable long-term investment option. These two additional actions also serve to put participants on notice that simply choosing an SDBA is not enough of an investment decision and that a further step must be taken.

As long as plan sponsors provide participants with investment options pursuant to regulations and monitor those options, the fiduciary responsibility to participants is fulfilled. Although plan

sponsors are not responsible for the suitability of any individual investment choice a participant eventually makes, plan sponsors should embrace an inherent responsibility to address participants' potential errors when obvious. Plan sponsors should be reviewing the SDBAs, notifying participants of any failure to actually invest those assets and encouraging them to take whatever action they feel is appropriate for their particular retirement needs and goals.

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[i] For ease of discussion on this article, QDIA will refer to both an official QDIA under ERISA and a default investment option for non-ERISA plans. Different specific regulations apply to each, but the same fiduciary principles apply to both.