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November 17, 2014

Attention: Brokerage Windows RFI
Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

RE: Request for information regarding standards for brokerage windows in participant-directed individual account plans (RIN 1210-AB59)

Dear Sir or Madam:

Russell Investments (Russell) welcomes the opportunity to respond to RIN 1210-AB59 regarding standards for brokerage windows in participant-directed individual account plans.

Background on Russell Investments

Russell Investments is a global asset manager and offers services that include advice, investments, and implementation. Russell stands with institutional investors, financial advisors, and individuals working with their advisors—using the firm's core capabilities that extend across capital market insights, manager research, portfolio construction, portfolio implementation, and indexes—to help each achieve their desired investment outcomes.

Russell has more than $279 billion in assets under management globally (as of 6/30/2014). As a consultant to some of the largest pools of capital in the world, Russell has $2.6 trillion in assets under advisement (as of 06/30/2014). Headquartered in Seattle, Washington, Russell operates globally.

Brokerage windows should be considered in the context of the wider plan structure

We begin with some introductory comments that are the foundation of our views on the topic of brokerage windows and, as such, are the foundation of our answers to the specific questions included in the RFI.

We believe that the brokerage window is best understood by setting it within the context of the wider plan structure (or "decision architecture") of the plan and, in particular, the application of the principle of libertarian paternalism (popularly referred to as "nudge"). Under this principle, the "paternalistic" side of the coin requires that the plan sponsor pay close attention to the design of a QDIA (sometimes referred to as the "Tier 1" option) to offer a strategy deemed appropriate for the typical plan participant and to the provision of an appropriate range of DIA options ("Tier 2") to allow some degree of customization of strategy to individual circumstances.

These two "paternalistic" tiers are made easier to operate by the existence of a "libertarian" brokerage window ("Tier 3"), which grants more direct control to those participants who regard the available choices as unsuitable or inadequate. The brokerage window allows the DIA options to focus on the majority of individual needs (i.e. to "limit the field," as described in the RFI) without having to worry about every conceivable individual circumstance that might exist, or to satisfy those individuals who prefer particular brand name funds or who take the view that "this is my money and I want to control how it is invested."

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Among the implications of this perspective – which we will expand upon in our answers to specific questions within the RFI – are the need for a clear definition of what falls into each category, and clear guidance regarding what is expected from fiduciaries with respect to each category.

Thank you for your consideration of our comments, which we would be happy to expand upon if required.

Faithfully,

Josh Cohen, CFA
Managing Director, Head of Institutional Defined Contribution
Russell Investments

Bob Collie, FIA
Chief Research Strategist - Americas Institutional
Russell Investments

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Russell Investments' response to selected RFI questions.

Question 3:

Should the fiduciary, disclosure, or other standards that apply to brokerage windows (and which are raised in more detail below) vary depending on the type of arrangement, or perhaps the ultimate number of investment options available to participants (e.g., a mutual fund window that offers access to fifty mutual funds vs. an open brokerage structure that offers access to many thousands of stocks, mutual funds, and other securities) and, if so, how?

The fiduciary standards, including disclosure standards, should differ between the DIA options and the brokerage window. This flows from the nature and purpose of the two types of option (we discuss that nature and purpose in our cover letter.)

However, we believe that further distinctions within the two types of option would only blur the lines, and would harm participants' interests. In other words, the same standards should apply to all arrangements that are deemed to fall into the brokerage window category.

Consistent with the principles set out in our cover letter, the essential distinction between the DIA (tier 1 and 2) options and the brokerage window (tier 3) is that in the DIA options the fiduciary has made deliberate decisions about what to include. As such, participants will rightly expect that certain minimum standards of review and diligence have been applied. In a brokerage window, the fiduciary does not make decisions to include certain investments: figuratively speaking, the window opens to the outside world. This is not to say that the window must necessarily make available every possible investment option (the fiduciary may reasonably judge certain investments to merit *ex*clusion without necessarily implying that everything else is consciously being *in*cluded) – the key distinction being that the DIA includes only options that have been "designated" or assessed, whereas the brokerage window consists primarily (perhaps even exclusively) investments of which no assessment has been made by the fiduciary.

It is therefore imperative that it be clear to a participant – without the need to read any particular small print or disclosure – that no endorsement from the fiduciary is implied by the inclusion of an investment option in the brokerage window. This would not be the case, for example, if the list of choices is too narrow; we believe that this creates a *de facto* DIA offering. In the example cited of a mutual fund window offering access to fifty funds, we would therefore argue that it is too easy for a participant to interpret such a structure as a DIA offering, rather than as a brokerage window. The DIA fiduciary standards should therefore be applied in this case.

Question 6:

What is a typical number of "designated investment alternatives" offered by a 401(k) plan? Are plans increasing, decreasing, or holding constant the number of designated investment alternatives that they offer? If the number is changing, why?

Even though (as described in our cover letter) each tier of the structure plays a specific role in the overall plan architecture under the general principle of libertarian paternalism (or "nudge"), this perspective is relatively new. The various options have, in many cases, evolved to play these roles rather than having been designed to do so from the start.

One aspect of this evolution has been a general trend toward a reduction in the number of DIAs being offered. This reflects a move toward the streamlining of menus, consistent with the "paternalistic" view of DIA offerings.

Question 8:

At what point might the number of investment options available to plan participants warrant treating the options as a "brokerage window" of some variety, rather than as a menu of "designated investment alternatives?" Does the detailed investment-related information required by the Department's participant-level disclosure regulation for designated investment alternatives (vs. brokerage windows) affect the answer to this question and, if so, how?

The distinction between the DIA options and the brokerage window is critical, since different fiduciary standards are to be applied. As we have described in our response to question 3, we believe that the key distinction lies in the fact that the fiduciary has not assessed the suitability of the investments that are available through the brokerage window.

What is more, it is essential that this distinction is intrinsically clear to the participant. By this we mean that participants would face undue risk if it is necessary to read disclosure statements in order to understand the nature of the window.

One factor in whether the distinction is intrinsically clear is the number of investment options. As mentioned above, a too-narrow list of choices creates a *de facto* DIA offering. This is not the only factor however. See also our response to question 29.

Question 13:

Is there evidence of good or poor decision-making and outcomes by those participants using brokerage windows? What types of evidence are available?

The outcome of a brokerage window investment is difficult to judge. That is because the objective of the decision is not known: the individual participant has consciously taken over control of the investment process and the fiduciary has no way of knowing the reasoning or objectives behind decisions that have been made after that point. A simple measurement of the net return earned offers a first-order test of the success of the decision, but not necessarily definitive proof of good/bad decision-making or even of a good/bad outcome. For example, an individual might use the brokerage window to create a low risk or defensive investment portfolio. If this underperforms the DIA options in a strong market, it should not be deemed to be an unsuccessful outcome, since the return has been earned with less risk and the outcome was exactly what should be expected from a defensively-positioned portfolio.

It is important to note, however, that – if it were possible to measure on a like-for-like risk-adjusted basis – brokerage windows should in general be expected to deliver worse outcomes on average than DIAs. The point of the brokerage window is to allow individuals control over their own investments, rather than necessarily to enhance the outcome.

This does, of course, raise the obvious question of whether individuals need protection from themselves, and whether a pure paternalistic approach should be preferred. This is addressed in questions 14 and 17.

Question 14:

What benefits accrue to participants that invest through brokerage windows? Do participants who do not invest through the brokerage window benefit from having a brokerage window option in their plan, and if so, how?

As we stated in our cover letter, the DIA offerings are made easier to operate by the existence of a "libertarian" brokerage window, which allows participants who regard the available choices as unsuitable or inadequate to take more direct control themselves ("this is my money and I want to control how it is invested.") The benefit to the participant investing in the brokerage window should therefore be seen in terms of freedom to control their own outcomes.

Participants who do not participate in the brokerage window benefit to the extent that the purpose served by the brokerage window would otherwise need to be served by the DIA options. The brokerage window allows the plan fiduciary to implement DIA options with a focus on the majority of individual needs without having to worry about meeting the needs of those participants who want greater individual control.

Question 17:

What factors do plan fiduciaries consider and what challenges, if any, do they face when deciding whether to include a brokerage window and who should provide the window?

The inclusion of a brokerage window might be seen as a judgment that it is preferable to allow participants freedom to control their own investments – if they choose to do so – than to protect them from themselves. While there may be objective criteria that can from part of such a judgment (for example, the nature of the participant population), it seems to us that this is primarily a subjective judgment by the plan sponsor.

One notable challenge is the need to ensure that fiduciary obligations are being met. This challenge arises in part because the environment has changed in the past few years; the emphasis on decision architecture is a relatively new perspective, and most brokerage windows predate that perspective. Clarification of the role of the brokerage window and the expectations of fiduciaries with regard to it would therefore be helpful.

Question 18:

What are the most common reasons for adding a brokerage window feature (e.g., flexibility and increased investment options for participants, to facilitate the ability of participants to work with an adviser or a managed account provider, etc.)? What role, if any, do concerns about fiduciary responsibility or disclosure obligations play in deciding whether to add a brokerage window?

Brokerage windows allow participants freedom to control their own investments if they choose to do so. The most common reason for offering this freedom is a demand for it. Fiduciary responsibilities are a consideration at present in the sense that fiduciaries do not want to be held accountable for decisions made by participants who choose to exercise the freedom offered by the brokerage window; to the extent that they feel they will be held accountable, they are less likely to offer the window.

Fiduciaries would be more comfortable in offering (or in some cases deciding not to offer) a brokerage window if they were sure of what exactly is expected of them when they allow participants to take over control of the investment decision. At a minimum, it is essential that participants understand that fiduciary responsibilities are different in the brokerage window than in the DIA options.

There is also another angle on the question of fiduciary responsibility. This is that some fiduciaries may see the brokerage window as a way to minimize – perhaps even to sidestep – their own obligations. While we do not believe that this attitude is widespread, it is clearly an undesirable view. This is another reason that it would be good to update and clarify the obligations of fiduciaries with regards to brokerage windows, and also that it is clear what is (and what is not) a true brokerage window.

In particular, the RFI describes a brokerage-window-only plan model. In our experience (working primarily with large plans), we have seen little evidence that this model is widespread. However, we feel that this model falls short of the standards that should be asked of a 401(k) plan structure. The clarification of the obligations of fiduciaries should include a statement either that the brokerage-window-only model is deemed acceptable or (our recommendation) that it is not.

Question 22:

How do plan fiduciaries monitor investments made through their plan's brokerage window, if at all? For example, do plan fiduciaries have access to information about specific investments that are selected or asset class or allocation information?

The question of what information fiduciaries should gather is an important area for this review, and one where there is scope to improve the functioning of the system.

Historically, such information would have been difficult to gather. Today, most record keepers could provide it, so that is no longer the primary barrier.

Rather, there is a conundrum for fiduciaries: does having this information create an obligation to act upon it? And, if nothing is to be done with the information, why bother to gather it? This has, we believe, made fiduciaries slow to seek information even though it would now be possible to do so.

We believe that the existence of a “libertarian” (tier 3) level within a plan structure (see our cover letter for a description of the 3-tier plan structure) – a level which carries different fiduciary obligations than the “paternalistic” DIA options – does not mean that the fiduciary has no obligation at all. It is surely better for fiduciaries to be aware of the decisions being made and the outcomes experienced by participants; this gives a better understanding of what the window is being used for and supports periodic re-assessment of whether the “freedom to choose” objective continues to outweigh the “protection from themselves” objective.

Therefore, we believe that it would be beneficial for there to be guidance to fiduciaries regarding the gathering of data for monitoring purposes. Specifically, since the brokerage window inevitably creates the possibility that an individual will make an inappropriate investment decision, it should be made clear that the fiduciary is not expected to be able to prevent poor decisions from being made. Indeed, the fiduciary should not be expected to make an assessment of the quality of any decision made by an individual participant within the brokerage window.

However, the fiduciary should be expected to periodically assess that there is no pattern of systematic poor decision-making within the window, which could be an indicator of a flaw in the decision architecture. For example, if a number of participants are using the brokerage window to access an investment which could be purchased more cheaply through the DIA options.

Question 28:

How significant of a factor to plan fiduciaries are these costs when deciding to add a brokerage window to their plan? How do plan fiduciaries monitor or oversee the fees and costs of a brokerage window, available investments, and related services? How much discretion does a plan fiduciary have in negotiating brokerage commissions and other costs that presumably cannot be controlled by participants?

Fees are clearly a significant and easily measurable element of an investment program. We discuss in our response to question 22 the monitoring of brokerage windows, and fees and other costs are an important (albeit not the only) element of that monitoring.

While the nature of a brokerage window means a plan sponsor can’t monitor every investment option offered in the brokerage window, our experience is that plan sponsors can and should monitor other aspects of the brokerage window. This includes account fees, transaction fees, breadth of offerings and participant support services. Plan sponsors, with the support of consultants and advisors, can compare these features to ensure they are appropriate and market competitive. Some record keepers require the use of a particular brokerage window provider, and fees may not be negotiable. That being said, there is always the choice not to offer a window: no brokerage window is better than a bad brokerage window.

Question 29:

Is the information required to be disclosed about brokerage windows by the Department's participant-level disclosure regulation sufficient to protect plan participants? Is this required information more or less than plans disclosed prior to the effective date of the regulation? Does this information usually come from plan administrators or from a third party, such as plan service or investment providers? What additional information, if any, is or should be disclosed to participants?

The single most important condition that must be met in order to protect participants and avoid undue risk is that nobody should use the brokerage window without being aware that, in doing so, they are moving into a different environment, in which the plan sponsor bears less fiduciary responsibility for selecting and monitoring the investment funds (and that costs are potentially higher than in the DIA options.) That condition cannot be met by standard disclosures alone: many participants will not read the disclosures. As we stated in our response to question 3, it should be clear to a participant that no endorsement from the fiduciary is implied by the inclusion of an investment option in the brokerage window *without the need to read any particular small print or disclosure*. This might be achieved through a combination of the presentation of the brokerage window option (ensuring it is kept clearly distinct from the DIA options) and the design of the window, with disclosures used to support the message.

Once a participant has elected to use the brokerage window, other disclosures become necessary. At this point, the purpose of the disclosures is to provide support for their decision-making.

Question 31:

The Department has said that disclosures regarding brokerage windows or similar arrangements under the participant-level fee disclosure regulation must, at a minimum, provide sufficient information to enable participants and beneficiaries to understand how the brokerage window works (e.g., how and to whom to give investment instructions; account balance requirements, if any; restrictions or limitations on trading, if any; how the brokerage window differs from the plan's designated investment alternatives) and who to contact with questions. See FAB 2012-02R at Q&A 13. Do these disclosures regarding how the brokerage window differs from the plan's designated investment alternatives typically include a description of the different risks and costs of investing through a brokerage window compared to investing in a designated investment alternative? Also, do the disclosures typically include a description of differences in fiduciary duties owed to participants investing through a brokerage window compared to investing in a designated investment alternative?

As described in our response to question 29, the foremost message to be communicated to participants using the brokerage window is that they are electing to move into a different environment in which they will receive less support from the plan sponsor, and in which they are, in effect, on their own.

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Question 37:

Do these questions indicate a need for guidance, regulatory or otherwise, on brokerage windows under ERISA's fiduciary provisions? For instance, is there a need to clarify the extent of a fiduciary's duties of prudence, loyalty, and diversification under section 404(a) of ERISA, both with respect to brokerage window itself, as a plan feature, and with respect to the investments through the window? If guidance is needed, please try to identify the precise circumstances in need of guidance. If no guidance is needed, please explain why not.

Yes, there is a need for guidance.

As we have argued in our responses to various questions above, the role of brokerage windows today is different than when they were first introduced, and fiduciaries are not always sure exactly what is expected of them.

Specific areas of guidance would include:

- What should be considered a brokerage window and what should be considered a DIA (see our response to question 3 for further comment on this point).
- The circumstances in which it is prudent to offer a brokerage window, and the circumstances in which it is not (see our response to questions 13 and 17 for further comment on this point).
- Conditions that must be met within a brokerage window, including disclosure requirements (see our response to question 18 for further comment on this point).
- Necessary steps to ensure that those who use a brokerage window are aware that there is a different level of fiduciary responsibility for the plan sponsor with regard to those investments (see our response to questions 8 and 29 for further comment on this point).
- What data ought to be gathered to monitor the brokerage window, and the purpose for which that data should be applied (see our response to question 22 for further comment on this point).

Question 38:

The annual reporting requirements contain a special provision for plans with brokerage windows. Specifically, subject to certain exceptions, the Schedule H allows plans to report certain classes of investments made through a brokerage window as an aggregate amount under a catch-all “other” category rather than by type of asset on the appropriate line item from the asset category, e.g., common stocks, mutual funds, employer securities, etc. Should this special provision be changed to require more detail and transparency regarding these investments? If so, what level of transparency is appropriate, taking into account current technology and the administrative burdens and costs of increased transparency?

As referenced in our response to question 22, we believe that fiduciaries should be encouraged to gather more information concerning decisions made within the brokerage window. Since this would provide data that may be helpful for regulatory bodies or researchers, it would be beneficial to make it more widely available to the extent it is practical to do so.