



## ADVISORY

A GFOA *advisory* identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is *not* to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

### **Brokerage Window Options for Defined Contribution Retirement Plans (2001) (CORBA)**

**Background:** In recent years, a number of public retirement plans have implemented or considered offering brokerage window options for participants in defined contribution plans. The purpose of this recommendation is to provide guidance to state and local government plan sponsors as to the basic issues to be addressed in providing such an option. Further, this recommendation seeks to assist plan sponsors in protecting themselves from fiduciary liability while offering investment options to their participants over which the plan sponsor has no oversight.

Brokerage windows can be defined as a type of defined contribution plan which allows plan participants to select a much larger number of investments through a broker. They enjoy the same tax advantages as a regular defined contribution plan. Depending on the plan, brokerage windows can allow a participant to invest in only mutual funds or invest in both mutual funds and individual securities.

**Recommendation:** The Government Finance Officers Association (GFOA) recommends that state and local governments exercise extreme caution when considering whether to offer a brokerage window option in conjunction with a defined contribution retirement plan. Such options should be offered only after:

- (a) careful review by the governing board;
- (b) only if clearly outlined in the investment guidelines established for the plan; and
- (c) a program has been established for providing investment education and asset allocation information.

Careful consideration should be given as to whether to offer, through the brokerage window, mutual funds only or a full range of investment instruments. Further consideration should be given to requiring a minimum balance and limiting the amount of participant assets that can be placed through the brokerage window.

If a brokerage window option is offered, it is recommended that the plan sponsor require a written acknowledgement from the participant that the participant:

- understands and accepts any and all risks associated with this selection;
- understands an undiversified portfolio consisting of a small number of individual securities has an unusual risk profile and increases the likelihood of a failure to meet retirement goals, relative to a comparable benchmark;
- understands and accepts that none of the investments available in the self-directed brokerage option have been reviewed for suitability by the plan sponsor;
- is solely responsible for determining the suitability or appropriateness of any selected investment; and
- agrees to hold the plan sponsor harmless against any claims, damages or other causes of actions which may arise as a result of any negative consequences resulting from use of the brokerage window option.

In addition, it recommended that the plan sponsor disclose to participants the basic fees for participating in the brokerage window and the potential for additional fees and transaction costs.

### **References**

- GFOA Best Practice, “Encouraging Financial and Retirement Planning.”
- Public Employee Retirement Series: Guides for Trustees and Administrators, Planning and Establishing Preretirement Education Programs.
- GFOA Best Practice, “Asset Allocation Guidance for Defined Contribution Plans.”

Approved by the GFOA’s Executive Board, 2001