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Individual brokerage accounts: Good riddance!

There are still many small business plans that use separate brokerage accounts for keeping track of each participant's account. One wonders why a plan sponsor would do so when technology offers less troublesome and friendlier ways of participant recordkeeping. Sponsors likely do so because they believe this is a better way to diversity their available plan investments (*e.g.*, stocks and bonds, rather than mutual funds) or that it is somehow a less costly way to do things. We are not convinced that either of these reasons is correct.

We expect that in many cases it is the investment advisor—typically a broker at one of the wire houses—who encourages the plan sponsor to maintain their plan recordkeeping in this way. We are quite sure these employers—and maybe their advisors—are not fully aware of the potential compliance problems in using brokerage accounts, including discriminatory benefits, rights, and features (BFR). This violation occurs if plan features are offered to highly compensated employees that are not offered to others. We note that if the feature is set by the plan sponsor, but rather is established because of a requirement of the brokerage company (*e.g.*, the company requires that managed accounts must have a minimum balance of, say, $100,000), that's not discriminatory because it is a requirement of the broker and not the plan. Plans with multiple brokerage accounts also will have substantial accounting costs to keep track of the monies within the accounts. Recently we were told by a compliance officer at a national brokerage firm that the advisor may use an individual account for a participant to stay below the radar of the firm's compliance department. Apparently, the compliance arm of this firm set different criteria for plan accounts than for other trust or personal brokerage accounts. When a separate brokerage account is set up for each participant, it is frequently opened as a non-retirement plan account, although that would be a problem if it is opened in the individual's rather than the plan's name.

But all of this is likely to come to a screeching halt due to the DOL's soon-to-be-released final guidance on reasonable service provider agreements and fee disclosure, and could also be affected by the recent Supreme Court decision in the *LaRue* case.

The immediate impact from this DOL guidance regarding reasonable service provider agreements and fee disclosure will not only require full disclosure of fees and revenue sharing between service providers (*e.g.*, broker and advisor) and plans, but will require these service providers to have a formal agreement with the plan. Drafting an agreement to address the typical plan and advisor relationship while satisfying the compliance department of a wire house will be a complex process under the proposed regulations. This will be especially true with individual brokerage accounts for each plan account, which may not permit easy compliance with the final DOL regulations. In speaking with compliance people at a brokerage firm, we find they do not seem willing to take on the possibility of a potential for a violation that would result in a prohibited transaction.

The impact from the Supreme Court decision in *LaRue v. DeWolff* on separate brokerage accounts may take longer to emerge. This case involved a lawsuit brought by a participant of a plan because of an alleged failure by the trustee to follow an investment instruction given by the participant. The informal communication of investment direction by a participant when an individual brokerage account is used opens the door for similar alleged failure to follow investment instructions. The participant generally calls the broker to give the instruction. There is oftentimes no written correspondence or confirmation of the trade that was made.

Bottom line: We suspect that the day of using individual brokerage accounts for plan participants is about to end! ❖

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