Fidelity's 'New Best Interest Paradigm' Does Not Serve the Best Interests of America's Working Families and Retirees

In its comment on the Department of Labor's conflict of interest rule proposal, Fidelity Investments has offered an "alternative" approach that it describes as a simpler means of achieving the same ends. In reality, the Fidelity alternative fails to deliver meaningful new protections for workers and retirees who turn to financial professionals for retirement investment advice. As such, it is unacceptable as an alternative to the DOL rule proposal and unworkable for retirement savers.

Fidelity's "new best interest paradigm" suffers from three fatal flaws:

- It fails to apply a best interest standard to the full range of services perceived and relied on as fiduciary investment advice by retirement savers.
- It allows certain rollover and pension benefit withdrawal recommendations to be made without regard to the best interests of the retirement saver.
- It fails to take meaningful steps to curb industry practices that encourage advice that is not in the best interest of the retirement saver.

Fidelity's Alternative Fails to Subject All Investment Advice to a Fiduciary Standard

One of the key strengths of the DOL rule proposal is that it closes loopholes in the definition of investment advice that have for too long enabled financial firms to provide services that are perceived and relied on by retirement savers as objective advice without having to act in the best interests of those customers. Those loopholes have left working families and retirees without the protections of a fiduciary standard precisely when the conflicts of interest associated with the advice are most intense and the risks to the investor are greatest.

Fidelity's proposed approach would reopen those loopholes through the combined effect of two seemingly innocuous provisions. First, Fidelity proposes to limit fiduciary protections to situations in which the advice recipient has "a reasonable expectation" that he or she can rely on the advice as "unbiased and in the recipient's best interests." Second, firms would be permitted to dictate the scope and terms of the relationship through a pre-engagement contract negotiated outside the fiduciary standard. If this approach were adopted, firms could simply dictate as part of the contract that the advice is not unbiased to evade their fiduciary duty, just as they use fine print legal disclaimers today to achieve the same result. Consider this example of such a disclaimer, which is ubiquitous in Fidelity's retirement materials and is typical of those firms currently use to evade their fiduciary duty: "Guidance provided by Fidelity is educational in nature, is not individualized and is not intended to serve as the primary or sole basis for your investment or tax-planning decisions."

Fidelity's Alternative Would Create a New Loophole for Rollover Recommendations

One of the chief ways that financial firms take advantage of retirement savers is by encouraging them to roll money out of their 401(k) or pension and into higher cost or riskier investments in an IRA. But higher costs can over the years seriously erode workers' retirement savings. The DOL rule would address this problem by requiring that recommendations with regard to rollovers from defined contribution plans and withdrawals from defined benefit pension plans be based on the customer's best interest. In contrast, Fidelity's proposed approach would continue to allow financial firms to make rollover and benefit withdrawal recommendations without regard to the best interests of the customer as long as they do not include specific investment recommendations.

Under Fidelity's proposed approach, all firms would have to do to evade their fiduciary duty to put the customer first would be to separate the recommendation regarding *whether* to take a benefit withdrawal or rollover from specific recommendations regarding *how* to invest the proceeds. So, for example, a firm could recommend that a federal employee roll money out of the Thrift Savings Plan without having to consider whether that move was in the individual's best interests. If the employee decided to follow that non-fiduciary advice, any best interest obligation would apply only to recommendations of how to invest the proceeds based on the available investment options. The adviser would not be required to recommend investments that are better for the investor than those in the TSP they convinced them to leave. This would leave retirement savers vulnerable to self-interested and costly advice when making one of the most important financial decisions of their lives.

If this approach were adopted, financial firms would benefit, as their ability to syphon funds out of workplace retirement plans could continue virtually unimpeded. Meanwhile, retirement savers who turn to financial professionals for help navigating these decisions would have no assurance that the recommendation they receive to leave the relatively protected environment of the 401(k) plan or to forego the guaranteed monthly payments for life of a traditional pension plan is designed to serve their financial interests rather than those of the advice provider.

Fidelity's Alternative Fails to Rein in Practices that Conflict with Customer Interests

In developing its rule, the DOL rightly concluded that, to be effective, a best interest standard must be backed by meaningful constraints on common industry practices that work against that goal. As such, the DOL rule proposal would require financial firms to abandon current industry practices that compensate and reward advisers for recommendations that are not consistent with customers' best interests. Such practices include setting quotas for the sale of proprietary products and basing bonuses or payouts on the adviser's success in meeting those quotas, rewarding advisers with vacation trips for high volume of sales, or paying advisers significantly more to sell higher risk investments or investments that make revenue sharing payments.

Fidelity's new best interest paradigm includes no restrictions on such practices. Instead, Fidelity's alternative relies exclusively on disclosure to address conflicts of interest. But extensive academic research has shown that conflict disclosures are ineffective in protecting investors from the harmful consequences of conflicts and may, in some cases, actually do more harm than good. For retirement savers to reap the full benefits of a best interest standard, firms must be required to dismantle the complex web of toxic incentives that work against that goal.

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More than ever before, working families and retirees bear the full brunt of responsibility and risk associated with saving for an independent and secure retirement. When they turn to financial professionals for advice to help them navigate those complex issues, they deserve objective advice, and not just a sales pitch dressed up as advice. Because it would make it too easy for firms to evade their fiduciary obligations and would do too little to rein in harmful practices that exacerbate sales-related conflicts, Fidelity's "new best interest paradigm" fails to provide that assurance.