

**Testimony of Angela Capek**

**On behalf of Fidelity Investments**

**Before the U.S. Department of Labor Advisory Council on  
Employee Welfare and Pension Benefits Plans**

**Meeting on**

**“Understanding Brokerage Windows in Self-Directed  
Retirement Plans”**

**August 26, 2021**

## Introduction

Chairman Glenn Butash, Issue Chair Bill Johnsen and Members of the ERISA Advisory Council, thank you for the opportunity to speak with you today. My name is Angela Capek, and I am the Retirement Core Offerings Product Area Leader for Fidelity Investments. Fidelity appreciates the opportunity to share our insights and perspectives on self-directed brokerage accounts.

Fidelity is the nation's largest provider of workplace savings plans, including defined contribution (DC), defined benefit (DB), health and welfare and stock plan services to 22,000+ employers with 33.9 million workplace participant accounts. Fidelity provides recordkeeping, investment management, brokerage and custodial/trustee services to thousands of Code section 401(k), 403(b) and other retirement plans.

Fidelity's mission is to inspire better futures and deliver better outcomes for the customers and businesses we serve. We've spent over 40 years offering companies of all sizes—across all industries—the superior solutions and expertise they need to administer world-class retirement programs. We work with a broad spectrum of savers who have a diverse set of financial needs, challenges and goals.

Fidelity's self-directed brokerage offering, Fidelity BrokerageLink<sup>®</sup>, combines the convenience of a workplace retirement plan account with the additional flexibility of a brokerage account, giving participants expanded investment choices to manage their retirement savings. BrokerageLink<sup>®</sup> provides plans sponsors an alternative way to help participants manage their assets without putting more administrative burdens or fiduciary obligations on the sponsor.

Today, I will share insights with you on Fidelity's self-directed brokerage offering based on our experience with a diverse book of business, which represents 420,000+ participants across 5,300+ plans with \$107.5B in assets invested<sup>1</sup>. We'll share the extent to which plan sponsors are making BrokerageLink available and which participants are using it and to what extent. We'll share the educational and required disclosure collateral made available to participants to help them learn about self-directed brokerage accounts to ensure they understand it is their sole responsibility to evaluate the investments made available to them. Finally, in response to the Council's interest on whether additional guidance would be appropriate and necessary, Fidelity maintains that no further guidance or disclosure requirements are necessary. Participants are well informed and a plan sponsor's fiduciary responsibilities are sufficiently clear under the current regulations of the Department under section 404(c) of ERISA.

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<sup>1</sup> Data provided by Fidelity Workplace Solutions Analytics & Insights as of 6/30/2021

## **What is a Brokerage Window?**

A brokerage window within a participant-directed individual account plan provides participants access to a wide range of investments beyond the line-up of specific funds that may have been designated by a fiduciary for the plan. Typically, a brokerage account is established for the benefit of each participant who chooses to invest in one or more of these non-designated investments. Through the brokerage account, the participant often may invest in mutual funds, ETFs, stocks, bonds, CDs options and any other investments offered on the brokerage service provider's platform. In some cases, investments may be limited to a subset of investment types, such as mutual funds, either by plan fiduciary choice or because of the plan type (e.g., 403(b) plans are generally limited to offering annuities and mutual funds).

## **Plan Sponsor Adoption<sup>2</sup>**

Plan sponsors decide to adopt a self-direct brokerage option for a variety of reasons. For many, inclusion of BrokerageLink complements their strategy to maintain or move to a smaller designated plan investment lineup. Often the option is added in response to the wants and needs of a select number of their employees. Overall, people are becoming more aware of what self-directed brokerage accounts are, through word of mouth and awareness via social forums (e.g., Reddit). Many today are seeking to be to be more socially responsible with their investment choices in the form of Environmental, Social, and Governance (ESG) funds. Similarly, we've experienced an increase in inquiries around Shariah-compliant investing. Self-directed brokerage accounts can help make available investments that can meet these needs.

Fidelity currently administers BrokerageLink for 5,348 plans, which represents 23% of defined contribution plans on our platform. The plan adoption rate has been increasing (17.4% as of 1/1/2016). Sponsor adoption is highest among larger employers<sup>3</sup>, including tax-exempt organizations, at 50%, with 20% of smaller employers offering self-directed brokerage. Certain industries tend to have higher levels of interest and adoption in self-directed brokerage accounts. Professional services, including health care physicians, airlines, and legal services are most common (41.3% - 45.8%). Lower adoption is seen in the automotive, retail and construction industries (10.7% - 13.0%)

If a plan offers BrokerageLink, participants may invest in eligible securities according to rules defined by the plan. For example, participants may be allowed a full range of investment options or may be restricted to mutual funds only. Plan rules determine minimums for initial and subsequent investment, as well as total plan assets that can be invested.

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<sup>2</sup> Data provided by Fidelity Workplace Solutions Analytics & Insights as of 6/30/2021

<sup>3</sup> Refers to Strategic, Select, Large and Tax-Exempt markets

Fidelity makes available three standard investment package options. Expanded options (79%), offering the widest array of choice, is most often selected. Mutual funds only (17%) and mutual fund and ETFs (4%) options are also available. Fidelity institutes various product level restrictions on securities that are otherwise made available through our retail services (e.g., master limited partnerships (MLPs)). Plan sponsors can further limit what is made available by blocking specific CUSIPs or security types. We also require all employer securities, of all equity types, to be restricted.

Plan sponsors have some additional configuration choices, availability of which may provide them with greater comfort in making the offering available. Outside these choices, there are no additional administrative responsibilities for plan sponsors who make self-directed brokerage available to their participants.

- 94% of plans allow participants to invest 95%+ of their account balance in BrokerageLink.
- As a general rule, plans have adopted minimums of \$500 for both initial account openings and subsequent transfers, with only about 5% not instituting any minimums.
- 97% allow for future direct payroll contributions with no minimums.
- Source level restrictions on assets allowed can be established, including Roth source handling.

Fidelity does not record keep any plans where the only investments made available in the plan are made available solely through BrokerageLink (i.e., no designated fund lineup).

A brokerage window feature must also be made widely available to participants in a plan in order to conform with non-discrimination rules under section 401(a)(4) of the Internal Revenue Code (so-called “benefit, right or feature” testing requirements).<sup>4</sup>

### **Participant Adoption and Investment Behaviors<sup>5</sup>**

Self-directed brokerage accounts address the needs of participants who are comfortable researching a broad universe of investments. The ability to diversify across thousands of mutual funds and securities can help meet their specific investment objectives.

According to a recently conducted Fidelity participant loyalty and satisfaction survey, BrokerageLink participants have a high degree of financial confidence, prefer to manage their finances alone and have broader financial plans in place.<sup>6</sup>

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<sup>4</sup> See *Treas. Reg. § 1.401(a)(4)-4*

<sup>5</sup> *Data provided by Fidelity Workplace Solutions Analytics & Insights as of 6/30/2021*

<sup>6</sup> *Fidelity Q3'20 Participant Loyalty & Satisfaction Study*

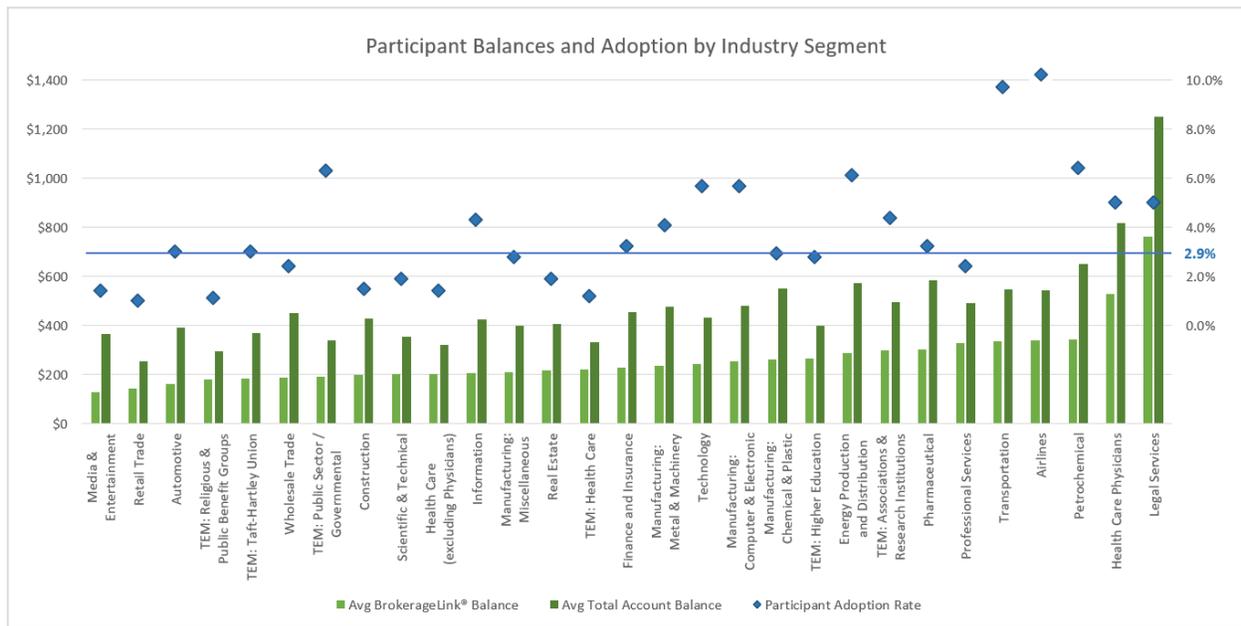
The typical investor in BrokerageLink tends to be older (80% over age 40), with higher salaries (\$203k average income vs. \$105k for non-BrokerageLink participants) and higher account balances (\$456k average balance vs. \$112k for non-BrokerageLink participants). They have healthy savings habits (13.9% average deferral rate vs. 8.5% for non-BrokerageLink participants) and overall are more engaged in their retirement plan. Compared to non-BrokerageLink participants, they process six times more exchanges, login to their accounts three times more often and contact a phone representative twice as often.

Participant interest in BrokerageLink has remained relatively flat as a percentage of total participants since 2015 at an adoption rate of 2.9% (in terms of absolute numbers, 420,408 participants are currently invested vs. 219,907 on 1/1/2016). Adoption rates do vary some by client market segment, with 4.1% of participants associated with our largest clients engaged and only 1.8% of participants in the tax-exempt space engaged. As noted previously, certain industries have notably higher involvement. For example, our airline industry clients have a 10.3% participation rate.

On average, participants are investing 56% of their retirement plan assets in BrokerageLink, a rate that has remained steady since 2015. BrokerageLink assets are at an all-time high of \$107.48B (vs. \$36.91B on 1/1/2016), with these assets representing 6% of total plan assets, up from 5.4% at year-end 2015. Participants in certain industries have a tendency to invest a greater portion of their retirement plan assets in BrokerageLink (e.g., 67% for tax exempt higher education) and in others industries a smaller percentage (e.g. 41% for automotive).

It's important to emphasize that the portion of assets invested at an individual level remains steady at 56%. The continued growth in overall BrokerageLink assets is primarily being driven off market activity, not as a result of participants allocating a greater proportion of their plan accounts to BrokerageLink. Market activity was accountable for 59% of overall growth in 2020 from \$68.26B to \$94.23B. While 2020 transactions included \$20B in money moved in (includes contribution, loan repayments, and money exchanges in), \$9.35B also moved back out.

The average BrokerageLink account holds \$256k. The average total account balance is notably higher for BrokerageLink participants (\$456k) vs. non-BrokerageLink participants (\$112k). While BrokerageLink balances when viewed by client segments do not range greatly (\$239k to \$361k), a deeper look by industry shows significant variability, with legal services (\$760k) on the upper end and media and entertainment (\$127k) on the lower end.



Balances and Adoption Rate by Industry

### Generational Trends<sup>7</sup>

A notable shift has started to take place over the last 18 months with the younger generation becoming more interested in expanding outside their plan’s investment lineup. The average age for those invested in BrokerageLink at the end of 2015 was 50.8 and had increased to 51.5 in 2019. Since then, the trend has reversed, with the average age now at 50.1. Millennials are making a move. Millennials and Generation X individuals have been opening accounts at about the same rate, with about 48% of new accounts attributed to each. Back in 2015, Millennials only accounted for 18% of new account openings. Trending indicates Millennials will surpass all other generations in new account openings very quickly and Generation Z has opened nearly 2,500 accounts since the beginning of 2020. Recent market volatility around “meme stocks” has also awakened many to the possibility of investing. In general, 58% of Gen Z are more motivated to start educating themselves on trading and investing due to recent market volatility – they are more excited to learn about the stock market because of the impact it could have on their finances.<sup>8</sup> 5 years ago, Millennials represented 8% of all BrokerageLink accounts and now account for 23%, with a drop off by Boomers from 52% down to 32%. Gen X remains engaged at a relatively flat rate (45% vs. 40%).

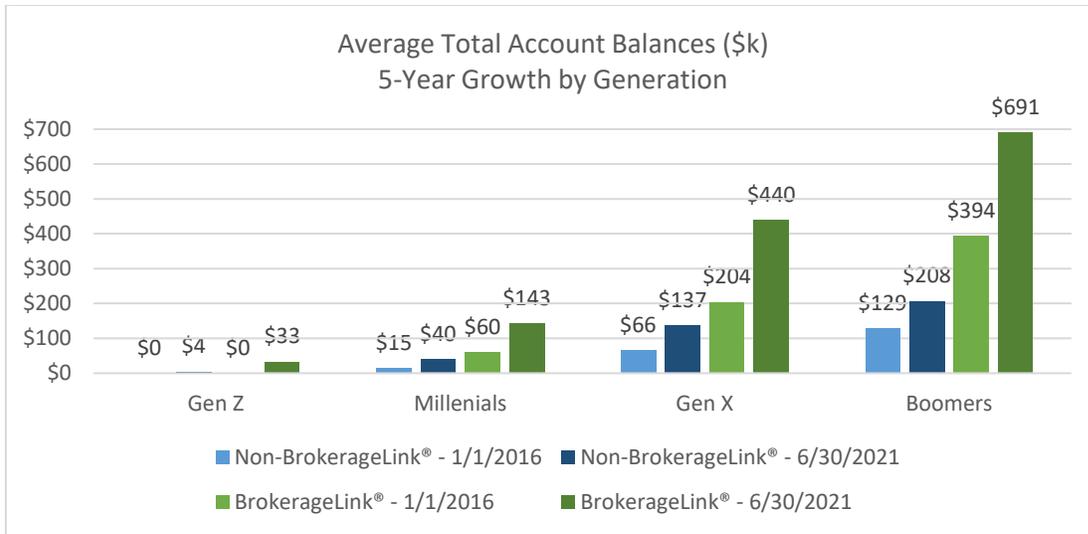
<sup>7</sup> Baby Boomers are those people born between 1946 and 1964

Gen X are those people born between 1964 and 1980

Millennials are those people born between 1981 and 1997

Gen Z are those people born 1997 and later

<sup>8</sup> April 2021 Fidelity Gen Z Investor Survey, Online CARAVAN omnibus survey conducted by ENGINE INSIGHTS among a U.S. sample of 2,004 adults who are Gen Z (18-24), millennials (25-40), and Gen X (41-56)



**Total Account Balance Growth by Generation**

*Investment Trends*

How our BrokerageLink participants invest their assets is quite diverse, both in terms of security types and the individual securities. The following percentages of total BrokerageLink assets are invested in each of the following security types:

- 57.8% (\$60.8B) – mutual funds (includes Fidelity and non-Fidelity funds)
- 27.4% (\$28.8B) – stock
- 13.4% (\$14.0B) – ETFs
- 1.4% (\$2.5B) – real estate investment trusts, CDs and other securities

The typical investor is diversifying within their BrokerageLink account, each with an average of 9 holdings. Investments chosen by our 400,000+ participants vary widely, with 3.8M positions held across 55,000+ individual securities. 46% of held securities carry just a single position with nearly 70% holding 5 or fewer positions. Conversely, investments with 500 or more positions account for just over 2% of all BrokerageLink investments. Only 31 securities have a concentration of 10,000 or more positions.

*Stay in Plan*

It's too premature to say definitively, but early indications observed in the data point to participants in plans with BrokerageLink possibly being more inclined to stay in plan upon separation from service given the expanded universe of investment choices that remain available to them. Terminated participants currently hold 25% of BrokerageLink accounts vs. 5 years ago they represented 18% of accounts.

## **Brokerage Windows and Nonqualified Plans<sup>9</sup>**

Individuals eligible for nonqualified retirement plans often have an expectation that self-directed brokerage accounts will be available in their nonqualified plan when it's an option under their qualified plans. Fidelity offers brokerage windows within assetized nonqualified plans. This allows participants to invest their deferred compensation as if the money was held in a brokerage account. Notional earnings are calculated, adjusted to gains, losses and fees, as if the participant was investing money in an actual brokerage account. Any nonqualified plan account remains unfunded for ERISA purposes and is a bookkeeping entry on the plan sponsor's financial statements. We require these plans to establish a Rabbi Trust with Fidelity as the trustee.

Fidelity currently administers self-directed brokerage accounts for 10% of the assetized nonqualified plans (6.9% of all nonqualified plans) we record keep. 1,077 nonqualified plan participant accounts are funded with average balances of \$303k.

## **Fees and Costs**

No fees are charged to open a BrokerageLink account and in most cases transaction fees do not apply. Transactional fees that may apply, for certain security types like Options, are fully outlined in the Commission Schedule.

Fidelity does not universally impose a maintenance fee for BrokerageLink. However, where recordkeeping fees are based on a bundled pricing arrangement, which is most prevalent with smaller employers, it's very typical for the fee structure to also include a BrokerageLink maintenance fee. In a bundled pricing arrangement, recordkeepers collect all of the revenue sharing from the plan's investment options. This additional maintenance fee ensures participants who invest in BrokerageLink pay a share of the recordkeeping cost, even if they invest 100% of their account assets in BrokerageLink. 40% of BrokerageLink plans charge a fee, with nearly 99% of these plans charging \$100.00 or less annually (99.6% at \$100). Charging a separate maintenance fee for plan sponsors with a fixed price arrangement is not necessary as these fees can be taken from all participants, including those who invest 100% of their account balance in BrokerageLink.

BrokerageLink provides access to a vast array of investments and share classes widely available to retail investors, including over 4,500 mutual funds. These share classes may include retail and institutional. Retirement share classes (i.e., Class K funds) are not available. However, other security options can be obtained with similar underlying investment objectives to an otherwise desired Class K fund with similar, or potentially even lower, expense ratios. Fidelity also has four zero expense ratio index mutual funds available through BrokerageLink which are not available for inclusion in any designated plan lineup.

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<sup>9</sup> Data provided by Fidelity Workplace Solutions Analytics & Insights as of 6/9/2021

## Disclosures, Notices and Account Opening Transparency

Investment-related information requirements do not apply to investments held through brokerage windows since the 2010 404(c) Regulation specifically excludes brokerage windows from the definition of designated investment alternative. Rather the regulation requires that a description of the brokerage window must be provided in initial and annual notices. FAB 2012-02R provides that the description should include information about what the brokerage window is, how it works (i.e., how to provide instructions, applicable account balance requirements and/or restrictions), how it differs from the plan's designated investment alternatives and a contact for questions. In addition, any fees related to maintaining brokerage accounts as well as any transaction fees, such as commissions, must be disclosed.<sup>10</sup> In addition, plan fiduciaries should ensure that the plan meets all other disclosure requirements applicable under the 2010 404(c) Regulation. These include a statement that the plan is intended to be an ERISA section 404(c) plan and that the fiduciaries may be relieved of liability for the losses resulting from participant's investment instructions.

Fidelity provides a substantial amount of educational information and required disclosures on behalf of the plan sponsor to participants who may be considering and to those who do make the choice to use this expanded investment option. Participants exploring whether a self-directed brokerage account may be right for them have access to a variety of resources:

- Frequency Asked Questions
- Overview Brochure
- Commissions Schedule
- Plan Fact Sheet

When a participant is ready to open an account, they do so online where the following information is presented for review on the *Agree to Terms* page. The participant acknowledges by opening the BrokerageLink account that they have "Read, agree to be bound and shall exercise the limited trading authority conferred to you by the Trustee of your employer's retirement benefit plan in accordance with the BrokerageLink Participant Agreement and Account Terms and Conditions provided ..."

- BrokerageLink Participant Agreement
- Important Notice
- Trusted Contact (retail requirement)
- Commission Schedule
- Householding of Shareholder Documents (retail requirement)
- Electronic Delivery and Beneficiary Elections
- Fidelity® Government Cash Reserves Prospectus (cash position core fund)

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<sup>10</sup> FAB 2012-02R, Q&A-13 (July 30, 2012)

In addition, the following “Important Notice” is contained and emphasized upfront within the Participant Agreement and is also presented as a standalone notice.

*“Neither the Plan Sponsor nor any Plan fiduciaries (including but not limited to the Plan Administrator, the Plan’s Administrative Committee and Investment Committee) (together, “Plan Officials”) have evaluated the investments available through this BrokerageLink account option. The Plan does not and will not monitor the investments available through BrokerageLink. You understand that BrokerageLink is being offered solely to provide participants with additional flexibility in making retirement plan investments. You further understand and acknowledge that: 1) the Plan does not make any representations or warranties as to the soundness of any investments available through BrokerageLink; 2) the Plan is not responsible for and will not review or monitor the investments available through BrokerageLink; 3) the Plan is not responsible for and will not evaluate your investment choices; 4) it is your sole responsibility to determine if the investments available through BrokerageLink are suitable for your personal retirement savings plan; 5) the Plan is not liable for any loss that may result from your investment choice(s) through BrokerageLink; and 6) you assume all liability for losses/consequences attributable to any investment decision made in connection with BrokerageLink. You understand that there may be additional fees and charges for your participation in BrokerageLink, including but not limited to annual account maintenance fees, fees associated with each trade made via BrokerageLink, and other fees as set and authorized by the Plan. You agree that these fees may be charged directly against the account balance.”*

On occasion a plan sponsor may approach Fidelity asking for customizations to our notices and disclosures. We’ve met the needs for these high-volume self-directed brokerage clients by incorporating an additional client-specific disclosure directly within the account opening process. For example, one transportation and warehousing corporation (\$4.6B in total assets, 12.3% held in BrokerageLink) drafted a “Hold Harmless and Indemnification Agreement” for inclusion. Another information industry client (\$45B in total assets, 6.4% held in BrokerageLink) requested an additional company specific “important notice” to reiterate “...you are solely responsible for the selection and monitoring of investments you make through BrokerageLink. Neither the Plan nor its sponsor, fiduciaries or service providers, have made any determinations with regard to the appropriateness of the investment alternatives available.”

Most BrokerageLink materials also include the following risk disclosure:

*“BrokerageLink includes investments beyond those in your plan's lineup. You should compare investments and share classes that are available in your plan's lineup with those available through BrokerageLink, and determine the available investment and share class that is appropriate for your situation. The plan fiduciary neither evaluates nor monitors the investments available through BrokerageLink. It is your responsibility to ensure that the investments*

*you select are suitable for your situation, including your goals, time horizon, and risk tolerance.”*

Finally, participants receive initial and annual participant fee disclosure notices as required per DOL Reg. §404a-5. These notices include transparency on any self-directed brokerage fees that may apply (e.g., administrative fees, certain trades). A summary of certain trade-specific fees that may apply are presented and refers back to the fully comprehensive cost information available in the Commission Schedule and how to obtain it.

### **Perspective on Additional Guidance and Disclosures**

Fidelity’s view is the current legal framework sufficiently supports that brokerage windows may be an effective way for plan sponsors to make investment options available to participants without assuming fiduciary risk with respect to those investment options. This support is derived from the language of ERISA section 404(c) itself and the structure of DOL regulations which impose obligations on fiduciaries only with respect to “designated investment alternatives” chosen by the employer for a plan’s fund lineup. Since a brokerage window is simply a means of making available a wide range of investments that are not themselves designated for a plan’s fund lineup, these fiduciary obligations do not extend to investments held through a brokerage window. However, as with any service provider used by a plan, fiduciaries do have an obligation to prudently select and monitor the brokerage services provider.

Fidelity contends self-directed brokerage accounts are already highly regulated and the regulations are clear and sufficient. In addition, to ERISA and DOL regulations, plan investments in brokerage windows are further governed by SEC brokerage rules. In particular, Fidelity urges the Department not to issue informal guidance resources (i.e., “tips”). While often presented as informal, our experience is that such guidance is often construed as formal instruction by field office personnel and used as the basis for audit inquiries.

Our plan sponsors carefully consider whether a self-directed brokerage account option is right for their plans and participants and they understand their role as a plan fiduciary. In the event plan sponsors have questions, we point them to several resources based on current regulations. This information is intended to assist plan fiduciaries in understanding their fiduciary responsibilities associated with investment alternatives made available through a brokerage window and to highlight the risk mitigation benefits such arrangements may provide.

Finally, as has been extensively outlined, a considerable amount of required participant disclosures are already in place to protect all parties. Additional disclosures are not required and would be burdensome from an administrative perspective. In addition, more disclosure would further compound an already legalese heavy participant experience.

## Closing

I would like to express Fidelity's appreciation for being asked to speak with the Council today. On behalf of Fidelity, our clients and the millions of Americans we serve, especially the over 400,000 workplace plan participants currently taking an especially vested interest in managing their financial futures with the help of BrokerageLink accounts, we appreciate the opportunity to share our insights and thoughts with you today.