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DOL Less Likely to Appeal Fifth Circuit Ruling Vacating Expansion of Fiduciary Rule in Light of Recent SEC Guidance

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Summary

In a recent 2-1 decision, the Fifth Court vacated the US Department of Labor's controversial expansion of the ERISA fiduciary regulations (the New Fiduciary Rule). If the DOL does not seek a rehearing, the Fifth Circuit will enter a mandate revoking the New Fiduciary Rule nationwide. However, given recent fiduciary regulations proposed by the Securities and Exchange Commission, the DOL may be less likely to appeal the ruling and no longer seek to enforce the New Fiduciary Rule.

In Depth

The Fifth Circuit released its ruling last month in *US Chamber of Commerce v. Department of Labor*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018). In a 2-1 decision, the court vacated the US Department of Labor's (the DOL) controversial expansion of the fiduciary rules under the Employee Retirement Income Security Act of 1974, as amended (ERISA) pursuant to regulations finalized in April 2016 (the New Fiduciary Rule). Chief Justice Carl E. Stewart served as the lone dissenter. Although the effective date of some provisions of the New Fiduciary Rule was extended to July 1, 2019, the court's decision renders the rule's fate beyond that date to be uncertain. In response to the decision, a DOL spokesperson stated that "[p]ending further review," the DOL will not be enforcing the New Fiduciary Rule.

The DOL may be unlikely to appeal the Fifth Circuit ruling given the Securities and Exchange (the SEC) issued its own proposed fiduciary regulations on April 18, 2018, which contain many provisions similar to the DOL's New Fiduciary Rule.

Background of the DOL's New Fiduciary Rule

In April 2016, the DOL released regulations targeted at revamping the definition of "fiduciary" under the applicable ERISA provisions. The regulations also included amendments to six existing exemptions and two new exemptions to the prohibited transaction provisions of ERISA and the Internal Revenue Code. By promulgating the New Fiduciary Rule, the DOL moved away from the previous five-factor test used to ascertain fiduciary status. Under the previous test, an individual or entity is a fiduciary if (1) it renders advice or makes recommendations as to the value of securities or other property, (2) on a regular basis, (3) pursuant to a mutual agreement between the person or entity and the plan, (4) the advice serves as the primary basis for investment decisions with respect to plan assets and (5) the advice is individualized. In addition to changing the fiduciary definition, the New Fiduciary Rule also introduced the Best Interest Contract (BIC) exemption, which provides a method that allows fiduciaries to avoid prohibited transaction penalties.

When the New Fiduciary Rule was first enacted, the DOL estimated that it would cost between $10 and $31.5 billion to comply with the final rule and the exemptions over the next 10 years. In early 2017, President Trump instructed the DOL to review the New Fiduciary Rule and update its analysis as to the economic and legal consequences of the rule.

The Fifth Circuit's Ruling

After providing an extensive overview of the New Fiduciary Rule, the Fifth Circuit first explained that the common-law definition of "fiduciary," which evokes meanings of trust and confidence, is presumed to apply. The court relied on Congress's decision not to place the term fiduciary in quotes as evidence that Congress felt the meaning under the common law was self-explanatory. The court dismissed any notion advanced by the DOL that this presumption could be displaced due to inconsistency with the language, structure, or purposes of the statute.

Next, the court concluded that the New Fiduciary Rule contradicted the text of the "fiduciary" provision of the statute irrespective of the meaning under common law. In particular, the court identified the distinction between investment advisors, who were considered fiduciaries when Congress enacted ERISA, and stockbrokers and insurance agents, who are not generally known as fiduciaries. The court relied on the fact that investment advisors are paid to render advice upon which investment decisions are made, and stockbrokers and insurance agents, conversely, are paid only for completed sales. The court stated that:

DOL's 1975 regulation flowed directly from contemporary understanding of "investment advice for a fee," which contemplated an intimate relationship between adviser and client beyond ordinary buyer-seller interactions. The Fiduciary Rule is at odds with that understanding.

The court further noted the New Fiduciary Rule's lack of indicia of a "special relationship." Whereas the statute uses terms such as "authority" and "responsibility," which ordinary salespeople would not possess, the New Fiduciary Rule does not include these concepts.

After dispatching with the New Fiduciary Rule on the grounds that it contradicted the statute, the court went on to explain that the rule failed the reasonableness test of *Chevron* and the Administrative Procedures Act. The Court outlined multiple reasons that the regulation was unreasonable:

- First, the New Fiduciary Rule ignores the distinction drawn by Congress in enacting ERISA Titles I and II, which exposes ERISA employer-sponsored plans and IRA accounts to separate regimes. Specifically, use of the BIC exemption by brokers and insurance representatives, as would be required to preserve commissions, would result in exposure for potential liabilities outside of the tax penalties provided in ERISA Title II. This type of exposure was not previously applicable under federal law.
- Second, the New Fiduciary Rule's definition of "fiduciary" would be applicable to almost any broker or insurance salesperson interacting with IRA clients. The DOL even conceded that the New Fiduciary Rule "could sweep in some relationships that are not appropriately regarded as fiduciary in nature." The court stated that "[w]hen Congress has acted with a scalpel, it is not for the agency to wield a cudgel."
- Third, the BIC exemption was problematic in a variety of ways. Initially, the court noted that it could not serve as a "cure" to the overbreadth of the New Fiduciary Rule. The New Fiduciary Rule and the BIC exemption also seemed to be an attempt to side-step Congress's decision to withhold regulatory authority of IRA plans from the DOL. Further, the BIC exemption violated the separation of powers provision by indirectly creating a vehicle for private lawsuits, where that power is reserved to Congress alone.
- Finally, the court noted the US Supreme Court's skepticism of federal regulations "crafted from long-extent statutes that exert novel and extensive power over the American economy." The court looked to the DOL's desire to "transform the trillion-dollar market for IRA investments, annuities and insurance products, and to regulate in a new way the thousands of people and organizations working in that market."

Where Do We Go from Here?

The most immediate consequence of the Fifth Circuit's ruling is that New Fiduciary Rule is no longer enforceable in Texas, Louisiana and Mississippi, which make up the Fifth Circuit. The DOL can petition the court for a rehearing or seek Supreme Court review. If the DOL does not seek a rehearing, the Fifth Circuit will enter a mandate revoking the New Fiduciary Rule nationwide. Litigants across the country are also taking notice. On March 27, 2018, the National Association for Fixed Annuities dropped its challenge of the New Fiduciary Rule in the US Court of Appeals for the DC Circuit due to the Fifth Circuit's ruling.

Instead of appealing the Fifth Circuit ruling, the DOL may instead rely on the SEC's proposed fiduciary regulations to offer protections to plan participants and beneficiaries that were intended to be added by the New Fiduciary Rule. The SEC is accepting comments on its proposed fiduciary regulations for 90 days.

Plan sponsors should continue to follow developments related to the enforceability of the New Fiduciary Rule and the SEC’s proposed fiduciary regulations, particularly as these rules relate to their appointment and monitoring of service providers that provide fiduciary investment advice to plan participants.