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Fifth Circuit Vacates DOL Fiduciary Rule

On March 15, 2018, the United States Court of Appeals for the Fifth Circuit released an opinion concluding that the U.S. Department of Labor's ("DOL") Fiduciary Rule, including the Best Interest Contract ("BIC") Exemption and other related exemptions, should be vacated *in toto*. The decision in *U.S. Chamber of Commerce v. DOL*, a consolidated case including actions filed by the Indexed Annuity Leadership Council and the American Council of Life Insurers, is an unequivocal rejection of both the Fiduciary Rule itself and the basis on which DOL asserted its regulatory authority. Although the ultimate fate of Fiduciary Rule is not entirely certain, the Fifth Circuit's decision provides the Trump Administration a clear pathway to undoing the Fiduciary Rule and reinstating the prior definition of "investment advice."

I. Overview of the Decision

The Fifth Circuit's decision is sweeping in scope and a resounding defeat for DOL. The Court determined that the Fiduciary Rule conflicts with the statutory text of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 ("ERISA"), which assigns fiduciary status to persons who render investment advice for a fee or other compensation or have any authority or responsibility to do so, and with the counterpart provision in section 4975(e)(3)(B) of the Internal Revenue Code of 1986 ("Code"). The decision includes an examination of the common law meaning of the word "fiduciary," which requires a relationship of trust and confidence, and determines that Congress codified that common law meaning in the statutory text. The Court ruled that by attempting to broadly expand the universe of persons to whom fiduciary status is assigned to include ordinary salespersons, such as stockbrokers and insurance agents, the Fiduciary Rule "fatally conflicts with the statutory text."

The Court also reasoned that, even if one were to assume for the sake of argument that the Fiduciary Rule did not conflict with the statutory text of ERISA and the Code, the Fiduciary Rule nonetheless fails to meet the "reasonableness" requirements of the U.S. Administrative Procedures Act and under the U.S. Supreme Court's *Chevron* doctrine. The Court found that the Fiduciary Rule was unreasonable for numerous reasons, including for being illogical and inconsistent, and for infringing on "SEC turf" (the regulation of broker-dealer sales practices and compensation) in a manner that undercuts Congress' Dodd-Frank instruction to the SEC not to prohibit commission-based compensation. In this regard, the Court expressed the view that "[r]ather than infringing on SEC turf, DOL ought to have deferred to Congress' very specific Dodd-Frank delegations and conferred with and supported SEC practices to assist IRA and all other individual investors." The Court concluded that the Fiduciary Rule bears all of the hallmarks of an unreasonable regulation and an arbitrary and capricious exercise of administrative power.

II. Implications of the Decision and Next Steps

For the moment, the Fiduciary Rule remains technically in effect, and DOL has 45 days to petition the Fifth Circuit for a rehearing. DOL has not publicly discussed its intentions, but given the Trump Administration's misgivings over the Fiduciary Rule, as expressed in the President's February, 2017 memorandum instructing DOL to reconsider the Fiduciary Rule, it appears unlikely that DOL will seek a rehearing. Moreover, even if DOL were to seek a rehearing, it appears unlikely that the Court would reconsider its conclusions, and successful petitions for *en banc* rehearings are rare. Assuming DOL does not seek a rehearing, the Fifth Circuit is expected to enter a mandate vacating the Fiduciary Rule on May 7, 2018. That mandate would vacate the Fiduciary Rule on a nationwide basis, restoring the *status quo* before the rule took effect.

Of course, DOL could also appeal the Fifth Circuit's decision to the U.S. Supreme Court, but for the reasons noted above, it appears unlikely to us that the Administration would take this route. Some commentators have cited the recent 10th Circuit *Market Synergy* decision in favor of DOL to support claims of a circuit court "split" that requires Supreme Court resolution. We believe that view is mistaken. The *Market Synergy* decision is narrowly focused on a single exemption (PTE 84-24), and a single element of DOL's PTE 84-24 amendment (the exclusion of fixed indexed products) and does not reach the much broader issue decided by the Fifth Circuit in *Chamber of Commerce* – namely, the validity of the rule itself. While a similarly broad-based judicial challenge is currently pending in the D.C. Circuit *National Association for Fixed Annuities* case, it appears likely that the appellants in that litigation will withdraw their appeal, thus foreclosing any potential for a split.

In the event DOL decides to let the *Chamber of Commerce* decision stand, it is possible that a third party (*e.g.,* a consumer group) could attempt to intervene in the case. However, the third party would face an uphill battle to convince the Fifth Circuit to allow the intervention. Even if intervention were granted, the intervenor would face the same challenges as DOL with respect to a rehearing request or an appeal.

III. Considerations

- *When should one consider making changes in response to the Fifth Circuit's decision?*

The Fifth Circuit is not expected to officially vacate the Fiduciary Rule until May 7, and until that time, the Fiduciary Rule is technically in place. Therefore, it may not be advisable to make large scale immediate changes but rather use this period to inventory the activities that could be affected and consider potential strategies. We do think it would make sense, even at this early stage, for firms to consider limiting the circumstances under which acknowledgements of fiduciary status may be being provided.

- *If the Fiduciary Rule is vacated, what activities will be considered investment advice?*

The DOL's prior rule (*i.e*., the five-part test) will be restored. Under that rule, a person is a fiduciary if he or she (i) renders advice to the plan as to the value of or advisability of buying, selling, or investing in securities or other property (ii) on a regular basis (iii) pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between the plan or plan fiduciary (iv) that the services will serve as a primary basis for investment decisions, and (v) the advice will be individualized to the plan based on the particular needs of the plan regarding such matters as investment policies or strategy, overall portfolio composition and diversification.

- *Going forward, is rollover advice fiduciary advice?*

Assuming the Fiduciary Rule is vacated, one-time rollover advice generally should not be fiduciary advice if the service provider is not otherwise a fiduciary. However, there is an open question as to whether such rollover recommendations are investment advice if they are made by a person serving as a fiduciary for other purposes.

- *What should be done regarding representations of fiduciary status made because of the Fiduciary Rule?*

Service providers first will want to reevaluate whether their sales and other communications are fiduciary investment advice under the five-part test. If not, it is advisable to considering withdrawing or correcting prior statements. For example, service providers should consider updating their ERISA section 408(b)(2) disclosures.

- *Can service providers continue investment advice programs?*

Generally, service providers can continue to operate fiduciary investment advice programs even after the Fiduciary Rule is vacated. However, many investment advice programs were designed to rely on the BIC Exemption, which will be vacated along with the Fiduciary Rule. Therefore, service providers should consider whether there are strategies available to avoid prohibited transactions (*e.g.,* Sun America programs) or existing avenues for exemptive relief.

IV. Final Thoughts

The Fifth Circuit's decision creates a clear pathway for DOL to completely undo the Fiduciary Rule. Although not entirely certain, the most likely scenario is that DOL will decline to seek a rehearing or to appeal the ruling. In this circumstance, the Fiduciary Rule will be vacated, and the DOL's prior five-part test will be reinstated. The transition from the Fiduciary Rule to the five-part test will have its own challenges. Service providers will need to consider whether investment advice and participant communications strategies put into place to comply with the Fiduciary Rule are still workable. Additionally, there are a number of open legal questions related to the effect of the Fifth Circuit's decision that will need to be evaluated.

Finally, the Fifth Circuit's decision is unlikely to be the end of the debate over investment advice. The Chairman of the SEC expects to release a new securities law based fiduciary rule this year, and several of the states are pursuing their own expanded fiduciary standards. Moreover, progressive Democrats in Congress are very likely to advocate for legislation to make more financial professionals fiduciaries. It is almost certain that the debate over investment advice will continue.