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Fiduciary Rule Status in Doubt Following Conflicting Courts of Appeals Decisions

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The status of the Department of Labor's (DOL) final regulation expanding the scope of fiduciary status due to "render[ing] investment advice for a fee" and its accompanying prohibited transaction exemptions (the "Fiduciary Rule") is in doubt following conflicting decisions handed down this week from two U.S. Courts of Appeals. Earlier this week, the Tenth Circuit upheld the Fiduciary Rule following a procedural challenge regarding its application to fixed indexed annuity sales. However, the Fifth Circuit quickly followed with a decision rejecting the premise of the Fiduciary Rule and vacating it entirely.

Fiduciary Rule Controversy

The Fiduciary Rule has been widely seen as an overreach by the DOL, which has jurisdiction over employer plans under ERISA. In particular, the Fiduciary Rule leveraged the DOL's authority to interpret prohibited transaction rules and issue related exemptions applicable to both employer plans and IRAs to provide for more sweeping regulations of the financial services industry, such as broker-dealers, which are already subject to regulation by the SEC. The SEC has not welcomed this encroachment (see our blog post: here) and has announced that it is working on its own fiduciary rule.

The DOL has been reviewing the Fiduciary Rule, but has allowed parts of the Fiduciary Rule to become effective in June 2017, including the rule's expansive interpretation of the circumstances in which one becomes a fiduciary by providing investment advice for a fee. While the Fiduciary Rule is under review, the DOL has retreated from many of the rule's most controversial aspects, including issuing an extended transition period through June 2019, in which the conditions for complying with exemptions under the Fiduciary Rule are limited to meeting "impartial conduct" standards and issuing a temporary enforcement policy to suspended enforcement of the regulation against entities taking good faith steps to comply these standards. (See our blog post: here.)

However, the Fifth Circuit's decision calls into question whether we will see revisions narrowing the scope of the Fiduciary Rule, for example, by making the limited transition period rules permanent, or whether the Fiduciary Rule will be withdrawn entirely.

Tenth Circuit Upholds Rulemaking on Narrow Grounds

A three-judge panel of the Tenth Circuit (based in Denver) issued a unanimous decision on March 13, 2018, finding that the DOL acted within its regulatory authority in issuing certain aspects the Fiduciary Rule. The case was focused on the DOL's decision to exclude the sales of fixed indexed annuities from the scope of Prohibited Transaction Exemption 84-24, which was revised as part of the Fiduciary Rule, and

requiring instead that the sale of these products meet the more rigorous BIC Exemption requirements. In upholding the regulation under the relatively narrow facts presented, the Tenth Circuit found that the DOL had met its procedural obligations under administrative rule making requirements, including providing adequate notice of the scope of its rule, and had not acted arbitrarily in treating fixed index annuities differently from fixed rate annuities.

Fifth Circuit Vacates Fiduciary Rule

In a more sweeping decision issued March 15, 2018, a panel majority of the Fifth Circuit (based in New Orleans) vacated the Fiduciary Rule "*in toto*" after ruling that the DOL had exceeded its rulemaking authority. This ruling echoed much of the criticism of the Fiduciary Rule that it improperly bootstrapped its authority over prohibited transaction interpretations and exemptions to provide substantive regulations over broker-dealers and other entities outside of DOL regulatory purview. But the ruling is particularly noteworthy for attacking the foundation of the Fiduciary Rule—the expansive concept of what it means to provide investment advice for a fee that renders one a fiduciary.

The majority opinion found that the Fiduciary Rule's interpretation of the statutory provisions underlying "investment advice fiduciary" relies too narrowly on a purely literal construction that disregards the common law notion of a "fiduciary" as requiring "a relationship of trust and confidence between the fiduciary and client." The majority noted a historical distinction between "investment advisors, who were considered fiduciaries, and stockbrokers and insurance agents, who generally assumed no such status in selling products to their clients." The investment advisor relationship was one of trust and confidence, whereas the selling of investment products for a commission was not. The DOL's prior regulation, which the Fiduciary Rule replaces, employed a five part conjunctive test, which the majority noted recognized this distinction. Further, the majority doubted that "investment advice for a fee" was intended to encompass stockbrokers and insurance agents who receive commissions only for completed sales rather than for delivering pitches.

By ignoring these distinctions, the court found the Fiduciary Rule "fatally conflicts with the statutory text and contemporary understandings" as well as the statutory context created by Congress in which the interpreted provisions reside. In view of these considerations (and many others detailed in the lengthy opinion), the majority found the Fiduciary Rule must be vacated entirely.

In a dissenting option, the court's Chief Judge found the Fiduciary Rule to be a permissible reinterpretation of the statutory text and was supported by a reasoned explanation warranting judicial deference. Accordingly, the dissent would have upheld the Fiduciary Rule entirely.

Future of the Fiduciary Rule

As a result of these conflicting decisions, the future of the Fiduciary Rule is uncertain. While the Tenth and Fifth Circuit opinions create a potential circuit split inviting resolution by the Supreme Court, either decision could be reviewed *en banc* by their respective full courts. Contrary decisions in either case could cause the split to resolve itself before ever reaching the high court.

Moreover, as the DOL continues its review of the Fiduciary Rule during the transition period, it may

decide to revise certain aspects of the Fiduciary Rule or retreat from the rule altogether. DOL officials have already responded to the Fifth Circuit's decision by saying that the DOL will not be enforcing the Fiduciary Rule pending further review.

So while the Fifth Circuit's decision is a significant development in the Fiduciary Rule saga, it undoubtedly will not be the final battle of this controversy.