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Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter Archive Message #690

Date:05-Apr-18

Subject: Mary E. Vandenack and the Fifth Circuit's Vacating the Fiduciary Rule

"The Fifth Circuit Court of Appeals recently issued a ruling vacating the Fiduciary Rule. In making the ruling, the Court cited multiple grounds. The Court concluded, among other things, that the promulgation of the Fiduciary Rule was an arbitrary and capricious action in excess of the DOL's statutory authority to promulgate regulations. The Court made a distinction between investment advice fiduciaries to employer and union sponsored retirement plans who are compensated on a fee basis and brokers and insurance salespersons who earn a commission. The Court concluded that brokers and insurance salespersons will typically not be investment advice fiduciaries under ERISA absent a showing of an ongoing relationship involving trust and confidence in the adviser. The Court also concluded that DOL has no authority to regulate IRA fiduciaries.

Despite the ruling by the 5th Circuit vacating the Fiduciary Rule, finality does not yet exist. The DOL could challenge the ruling by requesting a rehearing en banc or appealing to the US Supreme Court. The Fiduciary Rule remains technically in effect until any period for appeal has closed. To the extent that the Fiduciary Rule remains in effect, a private litigant could potentially pursue a cause of action based on the Fiduciary Rule.

Financial professionals, even those in the Fifth Circuit, should avoid assuming that the rule does not apply until the DOL position is clear. Financial professionals should also continue to be aware of any actions by the SEC and the various states that may create a variation of the obligations of the Fiduciary Rule."

We close the week with **Mary Vandenack**'s commentary on *Chamber of Commerce of the United States v. United States Dep't of Labor*.

Mary E. Vandenack is founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, benefits, private wealth planning, asset protection planning, executive compensation, equity fund development, business and business succession planning, tax dispute resolution, international tax, state and local tax, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as Co-Chair of the Futures Task Force, Co-Chair of the Technology and Economics of Law Practice Committee and Vice Chair of the Asset Protection Planning Committee. Mary is a member of the American Bar Association Techshow Board and incoming co-Chair of Law Practice Magazine. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law, building sustainable law firms, and alternative fees for process-oriented law firms.

Here is her commentary:

EXECUTIVE SUMMARY:

The Fifth Circuit Court of Appeals recently issued a ruling vacating the Fiduciary Rule. In making the ruling, the Court cited multiple grounds. The Court concluded, among other things, that the promulgation of the Fiduciary Rule was an arbitrary and capricious action in excess of the DOL's statutory authority to promulgate regulations. The Court made a distinction between investment advice fiduciaries to employer and union sponsored retirement plans who are compensated on a fee basis and brokers and insurance salespersons who earn a commission. The Court concluded that brokers and insurance salespersons will typically not be investment advice fiduciaries under ERISA absent a showing of an ongoing relationship involving trust and confidence in the adviser. The Court also concluded that DOL has no authority to regulate IRA fiduciaries.

FACTS:

On March 15, 2018, the Fifth Circuit Court of Appeals, in *Chamber of Commerce of the United States v. United States Dep't of Labor,*[i] vacated the Fiduciary Rule stating that the Department of Labor's ("DOL") promulgation of the rule was "an arbitrary and capricious exercise of administrative power."

The DOL issued the Fiduciary Rule on April 6, 2016.[ii] The rule expanded the definition of "investment advice fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA)[iii] to include advice with respect to IRA accounts. The Fiduciary Rule provides that a person is an investment advice fiduciary if he or she receives direct or indirect compensation for a "recommendation" as to the advisability of holding or disposing of certain securities, how assets should be invested after a rollover or the management of securities with respect to rollovers, distributions or transfers from a plan to an IRA.

Under the Fiduciary Rule, to be considered an "investment advice fiduciary," the adviser would first need to make a "recommendation." A recommendation is a "communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage or refrain from taking a particular course of action."

Title II of ERISA contains prohibited transactions, which include rules prohibiting certain conduct or transactions involving fiduciaries related to retirement plans. The DOL has authority to create exemptions to prohibited transactions. In promulgating the Fiduciary Rule, in addition to amending several existing exemptions, the DOL added a Best Interest Contract Exemption ("BICE") to the prohibited transaction exemptions of ERISA. The BICE exemption requires financial advisers working on commission to provide clients with a disclosure agreement where a conflict of interest could exist. An example of a conflict of interest would be when an adviser would receive an additional commission if a client picked a particular product.

The implementation of the Fiduciary Rule has been one of starts and stops. The impartial conduct portion of the fiduciary rule went into effect on June 9, 2017. The impartial conduct portion of the rule requires financial advisers who manage retirement accounts, including IRAs, or provide retirement advice to act in the best interest of customers over the interests of the adviser. The implementation of other aspects of the Fiduciary Rule was delayed until July 1, 2019.

The Chamber of Commerce case was filed in April, 2017 by the US Chamber of Commerce, Financial Services Institute, and various other organizations in the financial industry requesting a stay of implementation of the Fiduciary Rule.[iv] The motion to stay was denied at the District Court and an appeal was filed to the Fifth Circuit Court of Appeals.

In July 2017, the DOL announced that it would "not pursue claims against fiduciaries who were working diligently and in good faith to comply with the new fiduciary rule or treat those fiduciaries as being in violation of the fiduciary rule." Following the Fifth Circuit decision, the DOL indicated that the Fiduciary Rule will not be enforced pending further review.

Title I of ERISA covers employer and union sponsored retirement plans (as well as health plans). Creation of IRAs is covered in Title II of ERISA (along with other provisions that apply to employer sponsored retirement plans, individual retirement annuities, and tax favored trusts and plans).

The term "fiduciary" is defined in Title I, 29 U.S.C. §1002(21)(A), and Title II, 26 U.S.C. §4975(e)(3) as follows:

> …a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

The Fifth Circuit Court focused on the second prong of the definition of fiduciary in its analysis. The Court discussed a 1975 DOL regulation that contained a five part test to determine when an adviser would be considered a fiduciary and noted that such five part test required a relationship of trust and confidence between an adviser and the client for such status to result.[v] Throughout its opinion, the Court repeatedly concluded that a fiduciary relationship involved a relationship where an adviser's services were furnished regularly and were the primary basis for client investment decisions. The Court also concluded that Congress intended to incorporate common law concepts of fiduciary into ERISA and that the common law concept of fiduciary also required that a special relationship involving trust and confidence between the adviser and the recipient of advice.

The Court drew a distinction between an “investment adviser” rendering advice for a fee, who is a fiduciary, and a stockbroker or insurance salesperson paid on commission. The basis for such distinction was that a stockbroker or insurance salesperson will typically engage in a one time transaction for a commission and will not meet the requirement of providing advice on a regular basis. The Court also concluded that giving advice on a rollover, also likely to be a one-time transaction, would not result in an adviser being a fiduciary absent the regular relationship involving trust and confidence.

In addition, the Court acknowledged that the Fiduciary Rule withdrew from fiduciary status, communications that do not rise to the level of “recommendations” but continued to focus on the “regular and primary” basis aspect of the fiduciary relationship.

The opinion noted that “Stockbrokers and insurance agents are compensated only for completed sales (“directly or indirectly”), not on the basis of their pitch to the client. Investment advisers on the other hand, are paid fees because they render investment advice.” In making the distinction, the Court noted that an investment adviser being paid a fee would typically involve regular work with a client resulting in trust, confidence and reliance on recommendations of the advisor as distinguished from a one-time transaction with a broker or insurance salesperson. The Court indicated that the Fiduciary Rule improperly eliminated the distinction between investment advisers and stockbrokers and insurance salespersons. A stockbroker can be a fiduciary under ERISA, but only if the stockbroker provides regular advice on an individualized basis.

The dissent noted that the intent of the Fiduciary Rule was to include in the definition of recommendation “a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.” The dissent stated “As a matter of ordinary usage, there can be no “’serious dispute’ that someone who provides ‘a recommendation’ … is rendering investment advice.” The dissent noted that the application of the

Fiduciary Rule would result in fiduciary treatment when an adviser makes a recommendation upon which the investor might reasonably rely.

The Fifth Circuit cited seven different bases for its conclusion that the Fiduciary Rule was an unreasonable action by the DOL. The first reason recited was that the DOL failed to distinguish its authority under Title I and Title II of ERISA. The Court concluded that the DOL has no authority to regulate IRA fiduciaries. A second reason for the Court's conclusion was that under ERISA, fiduciaries are already generally prohibited from selling financial products to plans. Trying to impose fiduciary status based on something a fiduciary is prohibited from doing is unreasonable.

The Fifth Circuit Court also took issue with the DOL's addition of the BICE exemption to the prohibited transaction exemptions of ERISA. The Court noted that the Fiduciary Rule would subject brokers and insurance salespersons selling investments to IRA owners to the same obligations of loyalty as ERISA plan fiduciaries and that such result was independently indefensible and thus not administratively feasible. The Court noted that BICE was an attempt to salvage the overbreadth of the Fiduciary Rule and then referred to BICE as an exploitation of the DOL's narrow exemptive power. The Court also concluded that BICE extended beyond the DOL's power to create exemptions and was a violation of separation of powers.

The Fifth Circuit also indicated that the Fiduciary Rule was an effort by the DOL to outflank Congressional initiatives for oversight of brokers handling IRA investments. The Court noted the Dodd-Frank Act and stated that the SEC was empowered to promulgate standards for broker dealers.

COMMENT:

Despite the ruling by the 5th Circuit vacating the Fiduciary Rule, finality does not yet exist. The DOL could challenge the ruling by requesting a rehearing en banc or appealing to the US Supreme Court. The Fiduciary Rule remains technically in effect until any period for appeal has closed. To the extent that the Fiduciary Rule remains in effect, a private litigant could potentially pursue a cause of action based on the Fiduciary Rule.

There also exist differences between Circuits. In *Market Synergy Group, Inc. v. United States Department of Labor*, [vi] the Tenth Circuit Court issued a ruling in support of the Fiduciary Rule by ruling that no irreparable harm resulted by requiring a BICE concerning fixed indexed annuity sales. The Tenth Circuit concluded that DOL's treatment of fixed indexed annuities differently from fixed rate annuities was not arbitrary given the difference in the character of the risk.

In addition to the possibility that the DOL could challenge the Fifth Circuit ruling, the SEC has requested comments from the public with respect to standards of conduct for investment advisers and broker-dealers. It is possible that the SEC could step in and issue regulations that impact the fiduciary obligations of financial professionals.

Several states are considering adopting statutes that impose standards similar to those promulgated in the Fiduciary Rule. States are also finding other ways to apply the Fiduciary Rule to financial service providers. The Commonwealth of Massachusetts recently filed a complaint against Scottrade, Inc. alleging that failing to comply with the Fiduciary Rule resulted in violation of state securities laws.[vii]

Financial professionals, even those in the Fifth Circuit, should avoid assuming that the rule does not apply until the DOL position is clear. Financial professionals should also continue to be aware of any actions by the SEC and the various states that may create a variation of the obligations of the Fiduciary Rule. For the financial industry as a whole, the Fiduciary rule complicated the nature of compensation for representatives as well as products and services that would be offered. Given much of the financial industry has made changes based on the Fiduciary Rule, a return to functioning in the same manner as prior to the Fiduciary Rule is not a simple task and whether or not a financial firm can do so is not yet clear.

If the Fifth Circuit ruling ultimately results in the death of the Fiduciary Rule, sponsors of employer retirement plans will want to be sure that those providing advice to the plan will be fiduciaries with respect to the plan. Given the Fifth Circuit distinction between investment advisers who are paid a fee for advice and stockbrokers and life insurance salespersons who are paid a commission for selling a product, plan sponsors may want to choose investment advisers to whom they pay a fee to be sure of fiduciary status or otherwise require any advisers to agree to become a plan fiduciary.

Investors with IRA assets or contemplating a rollover from a retirement plan to an IRA should be advised that advisers with respect to rollover transactions and IRAs may not be required to have the best interests of the investor in mind and can engage in transactions, without disclosure, despite a conflict of interest.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mary Vandenack

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[i] *Chamber of Commerce of the United States v. United States Dept't of Labor*, 2018 U.S. App. LEXIS 6472 (5th Cir. March 15, 2018).

[ii] 29 CFR 2510.

[iii] 29 US Code Chapter 18.

[iv] *Chamber of Commerce of the United States of America, et al. v. Hugler, et al*., 231 F. Supp. 3d 152 (N.D. Tex. Feb. 8, 2017).

[v] 29 C.F.R. §2510.3-21(c)(1)(2015.).

[vi] *Mkt. Synergy Grp., Inc. v. United States Dep't of Labor*, 2018 U.S. App. LEXIS 6209 (10th Cir. March 13, 2018).

[vii] LISI Employee Benefits and Retirement Planning Newsletter #689 (March 20, 2018) at http://www.leimbergservices.com.