ERISA Fiduciary Rule

Fifth Circuit Vacates New ERISA Fiduciary Rule

SUMMARY
On March 15, 2018, the Court of Appeals for the Fifth Circuit vacated, in its entirety, a 2016 Department of Labor (the “DOL”) package of regulations providing an expansive new definition of “investment advice fiduciary” and related exemptions (the “2016 Fiduciary Rule”). The fate of the 2016 Fiduciary Rule is uncertain; the Fifth Circuit ruling will not go into effect for several weeks, and then only if the DOL does not appeal the decision. Further complicating the issue is the fact that the Fifth Circuit’s decision comes just days after a Tenth Circuit decision that upheld a provision of the 2016 Fiduciary Rule, which may invite Supreme Court review, although the two opinions are not starkly in conflict. In any case, the matter may be resolved much sooner if the DOL simply gives up the fight; a DOL spokesman has been reported as saying that, in light of the Fifth Circuit decision, the DOL will not be enforcing the rule.¹ The Trump Administration has been reconsidering the Obama era rule, and may revise it or attempt to repeal it altogether.

BACKGROUND
In April 2016, the DOL overhauled its regulations regarding the definition of “investment advice fiduciary”² by issuing the 2016 Fiduciary Rule, which consists of a new regulation, amendments to six existing exemptions, and two new exemptions to the prohibited transaction provisions in both ERISA and the Internal Revenue Code (the “Code”). In general, the 2016 Fiduciary Rule provides that a person “renders investment advice for a fee,” and therefore, is an “investment advice fiduciary,” whenever such person is compensated in connection with a “recommendation as to the advisability of” buying, selling or managing “investment property” and such advice is directed “to a specific advice recipient … regarding the advisability of a particular investment or management decision with respect to” the advice recipient’s investment property.³ As a consequence, many financial service providers who provide such
recommendations that formerly were not ERISA fiduciaries became fiduciaries as a result of the 2016 Fiduciary Rule and are, therefore, subject to ERISA fiduciary standards of care and/or the prohibited transaction rules. This caused widely used compensation arrangements in the retail financial services industry—such as sales commissions, revenue-sharing arrangements and other types of indirect compensation—to be prohibited to these fiduciaries unless the fiduciaries satisfied the requirements of one of the exemptions to the 2016 Fiduciary Rule.

The 2016 Fiduciary Rule includes an exemption that allows certain financial service providers treated as investment advice fiduciaries to avoid prohibited transaction penalties if such service providers enter into contracts with clients that, among other things, affirm such service providers’ fiduciary status and incorporate certain required “impartial conduct standards” (the “Best Interest Contract Exemption” or “BIC Exemption”). Contracts that comply with the BIC Exemption provide owners of IRAs and other retirement accounts with a means to sue financial service providers for violations of fiduciary duties similar to the right of action afforded to pension plans and 401(k) plans under Title I of ERISA.

FIFTH CIRCUIT DECISION

The Fifth Circuit addressed an appeal by a number of industry groups that challenged the 2016 Fiduciary Rule on multiple grounds, which were all rejected by the district court. The Fifth Circuit held, in a 2-to-1 decision, that (i) the 2016 Fiduciary Rule is inconsistent with the statutory and common law definition of “investment advice fiduciary,” (ii) the DOL generally overreached its regulatory authority, (iii) the DOL’s imposition of contract terms in the BIC Exemption is unauthorized, and (iv) the 2016 Fiduciary Rule’s distinction between variable and fixed indexed annuities is unreasonable. More specifically, the Fifth Circuit majority opinion (the “Majority Opinion”) held that:

- The 2016 Fiduciary Rule is inconsistent with the statutory and common law definition of “investment advice fiduciary” because it failed to maintain the distinction between mere sales conduct in which there is no special relationship of trust and confidence and the provision of investment advice for a fee, inappropriately causing the former to be included in the scope of actions that create a fiduciary relationship;

- The BIC Exemption represents an attempt by the DOL to circumvent the limits of its regulatory authority with respect to IRAs, with the Majority Opinion holding that the 2016 Fiduciary Rule “impermissibly conflates the basic division drawn by ERISA” between IRAs, which are only subject to the prohibited transaction rules under the Code, and retirement plans protected by both ERISA and the Code, and that the DOL “may not create vehicles for private lawsuits indirectly through the BIC Exemption contract provisions where it could not do so directly”; and

- The revision of Prohibited Transaction Exemption 84-24, which exempts certain fixed rate annuities but not fixed indexed annuities, “places a disproportionate burden on the market for fixed indexed annuities, as opposed to competing annuity products,” and represents an attempt by the DOL to “outflank” congressional initiatives to secure further oversight of the sale of fixed-indexed annuities.
The fate of the 2016 Fiduciary Rule has long been uncertain. Just two weeks after taking office, President Trump directed the DOL to reexamine the rule and prepare an updated economic and legal analysis. The DOL has nonetheless defended the rule in the courts over the last year.

The Tenth Circuit decision on March 13, Market Synergy Group, Inc. v. United States Department of Labor, upheld the provision in the 2016 Fiduciary Rule that distinguishes between fixed rate annuities and fixed indexed annuities, but it is unclear whether the two decisions present a clear split that will attract the Supreme Court's attention. The Tenth Circuit specifically did not address the validity of the 2016 Fiduciary Rule as a whole; rather, it only considered a claim that this distinction did not comply with certain requirements of the Administrative Procedures Act. While the Fifth Circuit held that the distinction between fixed rate annuities and fixed indexed annuities under the 2016 Fiduciary Rule was unreasonable, it did not specifically address the particular claims that were addressed by the Tenth Circuit.

For now, the regulatory environment has not formally changed, so there is not yet a firm legal basis for providers of financial services to abandon the policies and procedures that have been adopted in response to the rule. Even if the DOL does not appeal, the Fifth Circuit ruling would not come into force for several weeks, and the DOL has not indicated with certainty that the 2016 Fiduciary Rule will be taken off the books.

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Under this definition, a person is a “fiduciary” with respect to a plan to the extent that, among other things, he or she “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.” 29 U.S.C. § 1002(21)(A)(ii).

29 C.F.R. § 2510.3-21(a) (2017).


Id. at *16, *18.

Id. at *5, *19.


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