Beware the Ides of March: The Fifth Circuit Vacates the Fiduciary Rule "In Toto," While the Tenth Circuit Upholds DOL's Treatment of Fixed Indexed Annuities

Employee Benefits Alert
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Following a period of relative silence from the trio of federal appellate courts tasked with ruling on challenges to the Department of Labor's (DOL's) new fiduciary definition and final conflict of interest regulation (the Fiduciary Rule), a pair of decisions, one from the Fifth Circuit and another from the Tenth, recently arrived within days of each other. On March 15, 2018, heralding the Ides of March, the Fifth Circuit issued a harsh rebuke of DOL's actions and vacated the Fiduciary Rule "*in toto*."[1] The 2-1 split decision paid no heed to a decision by the Tenth Circuit, filed just two days earlier, upholding a portion of the same rule regulating fixed indexed annuities (FIAs).[2] Still pending is the National Association for Fixed Annuities' appeal to the D.C. Circuit, which has been briefed, but oral argument stayed pending the Fifth Circuit's decision.[3]

The Fifth Circuit Speaks

In *Chamber of Commerce v. U.S. Department of Labor* , Circuit Judge Edith H. Jones, writing for the majority in a 2-1 decision joined by Circuit Judge Edith Brown Clement, missed no opportunity to critique DOL and its Fiduciary Rule. Observing that the Rule "fundamentally transforms over fifty years" of industry practices, affecting a "large swatch" of the financial services and insurance industries, her opinion could just as well have been written by the Chamber.[4] In turn, the dissent, authored by Chief Judge Carl E. Stewart, quoted liberally from the district court opinion and sided with DOL. Neither the majority nor dissent took notice of, cited, or even acknowledged the Tenth Circuit opinion.

Definition of "Investment Advice Fiduciary" Conflicts with Unambiguous Statutory Text

Circuit Judge Jones began by applying the "common law presumption," under which Congress incorporated the common law meaning of the term "fiduciary" when it included that term in ERISA.[5] Like much of ERISA, she explained, the meaning of "fiduciary" arises out of trust common law, meaning that fiduciary status "turns on the existence of a relationship of trust and confidence."[6] The court rejected DOL's argument that the common law presumption should be displaced on the grounds that it would be inconsistent with the statute, explaining that DOL read the inconsistency exception to the presumption too broadly, and in any event, the "trust-and-confidence standard" ***is*** consistent with the statute.[7]

Even setting aside the common law presumption, Circuit Judge Jones went on to explain that the Fiduciary Rule conflicts with the statute and Congress's "contemporary understanding of its language."[8] Relying on several textual arguments, she explained that Congress knew of the distinction between investment advisers and salespeople when it crafted its definition of an investment advice fiduciary in 1974.[9] DOL's decision to go "straight to the dictionary" to define "investment" and "advice" as a means of "rewrit[ing] the law that is the sole source of its authority" and doing away with the historical distinction between sales and advice was unsupportable.[10] The statute's subsections immediately preceding and following the investment advice fiduciary definition provided further support for the court's conclusion that Congress intended to predicate fiduciary status on a special relationship of trust and confidence. In the context of investment advice, such a relationship did not extend to broker-dealers, insurance agents, or others who sell financial products.[11]

Finally, Circuit Judge Jones rejected DOL's policy argument that its new definition was needed to protect plan participants, a fundamental purpose of ERISA.[12] Instead, she opined that a statute's purpose cannot supersede its plain text: "vague notions of a statute's 'basic purpose' are nonetheless inadequate to overcome the words of its text regarding the specific issue under consideration."[13] While the policy reasons cited by DOL may indeed warrant reconsideration of the definition, any such action was for the legislature to take.[14] Quoting the late Justice Antonin Scalia, Congress enacted "ERISA, an enormously complex and detailed statute that resolved innumerable disputes between powerful competing interests—not all in favor of potential plaintiffs."[15]

The Fiduciary Rule is Unreasonable, Arbitrary, and Capricious

In a decision clearly anticipating Supreme Court review, Circuit Judge Jones went on to address the reasonableness of the Fiduciary Rule, even assuming *arguendo* that the definition of investment advice fiduciary were ambiguous. Not surprisingly, she gave no quarter, concluding that the Rule was not "salvage[able]" and that DOL had acted "brazenly" in promulgating it.[16]

First, ERISA Titles I and II grant DOL only limited authority to regulate individual retirment accounts (IRAs), and the Fiduciary Rule overreaches by subjecting IRA fiduciaries to the ERISA duties of prudence and loyalty through the Best Interest Contract (BIC) Exemption.[17] Noting that Congress had already created in 2006 a "nuanced" prohibited transaction exemption for "eligible investment advice arrangements," the majority found the Fiduciary Rule unreasonable and overbroad, admonishing DOL that "[w]hen Congress has acted with a scalpel, it is not for the agency to wield a cudgel."[18]

Next, the majority sided with the Chamber in concluding that the BIC Exemption violates the separation of powers. By creating a private right of action enabling IRA owners to bring quasi-ERISA suits, DOL overstepped, since "[o]nly Congress may create privately enforceable rights."[19] Further, the prohibition in best interest contracts of clauses that permit arbitration of class actions violates the Federal Arbitration Act.[20]

Additionally, DOL's actions attempted to "outflank" Congress's intent to regulate broker-dealers involved in IRAs and FIAs through the 2010 Dodd Frank Act, which permitted the U.S. Securities and Exchange Commission (SEC) to issue standards further regulating broker-dealers and investment advisors, and allowed states to regulate FIAs.[21] Finally, according to the majority, it was well to heed the Supreme Court's instruction that courts should question any agency regulation issued under a "long-extant" statute, when that regulation exerts "novel and extensive power over the American economy."[22] Skepticism is appropriate here, because DOL issued the Fiduciary Rule under such a statute, and because DOL readily acknowledged the significant economic effect the Rule will have on the "trillion-dollar" investment industry.[23]

The Fifth Circuit panel majority accordingly reversed and vacated "the Fiduciary Rule *in toto*."[24] Chief Judge Carl E. Stewart's dissenting opinion would uphold the Fiduciary Rule as a "statutorily permissible and reasonable exercise of [DOL's] regulatory authority."[25]

The Tenth Circuit Weighs In

Two days before the Fifth Circuit's decision, the Tenth Circuit, in *Market Synergy Group, Inc. v. United States Department of Labor*, upheld a part of the Fiduciary Rule involving FIAs.[26] Affirming the decision of the district court, a unanimous panel, led by Judge Paul J. Kelly and joined by Judges Carlos F. Lucero and Scott Matheson Jr., rejected Market Synergy's three pronged attack on DOL's treatment of FIAs as "arbitrary and capricious" agency action.

The panel first determined that DOL provided sufficient notice of the treatment of FIAs under the Fiduciary Rule. DOL's proposed Rule "clearly asks for comment on whether removing variable annuities from PTE 84-24 but leaving FIAs and fixed rate annuities struck the appropriate balance."[27] Further, DOL was not arbitrary or capricious in distinguishing fixed rate annuities from FIAs. DOL adequately explained that FIAs are more complex than fixed rate annuities, riskier, and heighten the conflicts of interest experienced by investment advisors recommending them.[28] The court also found that DOL had considered state regulations of FIAs and found the lack of uniform state regulations "'particularly concerning' for complex and risky products such as FIAs."[29]

With respect to the impact on the insurance industry, according to the panel, DOL reasonably considered the fact that "the FIA market relies 'heavily' on independent insurance agents." DOL's ultimate decision that the fear of adjusting to the BIC Exemption was "overstated and counteracted by the benefit to investors" to the tune of "millions of dollars by reducing or curtailing conflicted advice from fiduciaries" was a reasonable one.[30]

What's Next

In the wake of the Fifth Circuit decision, DOL appears to have put the entire Fiduciary Rule into suspense on a nationwide basis, at least for the time being. Whether it accepts the defeat or chooses to press ahead with the litigation is open to question. If it decides to do the latter, its options are to request *en banc* review or petition to the Supreme Court. Even if it accepts defeat, reinstating the 1975 investment fiduciary definition and vanquishing the BIC Exemption and the rest of the Fiduciary Rule or continuing to reevaluate the Rule, that decision itself may trigger additional litigation, thus ensuring that the impact of the Rule continues to have profound and lasting consequences for the financial services industry. In addition, another wild card is the SEC's proposed fiduciary rulemaking, tentatively scheduled to be unveiled in the fall of 2018. In any event, awaiting DOL's next steps, as well as Market Synergy's strategy and the action in D.C. Circuit, will surely be developments to watch.

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1 *Chamber of Commerce v. United States Dep't of Labor* , No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018).

2 *Mkt. Synergy Grp., Inc. v. United States Dep't of Labor* , No. 17-3038, 2018 WL 1279743 (10th Cir. Mar. 13, 2018).

3 *Nat'l Ass'n for Fixed Annuities v. United States Dep't of Labor* , No. 16-5345, Order (Nov. 14, 2017), Doc. 37.

4 *Chamber of Commerce*, 2018 WL 1325019, at *1.

5 *Id.* at *7. Under the "common law presumption," courts must presume that Congress intended to incorporate the common law meaning of terms it uses, absent indication to the contrary. *Id.*

6 *Id.* at *7–8.

7 *Id.* at *8.

8 *Id.* at *9.

[9] *Id.* at *9–11.
[10] *Id.*
[11] *Id.* at *12–13.
[12] *Id.* at *14.
[13] *Id.* (quoting *Mertens v. Hewitt Associates, Inc*., 508 U.S. 248, 261 (1993)).
[14] *Id.* at *14.
[15] *Id.* (quoting *Mertens*, 508 U.S. at 262).
[16] *Id.* at *17–18.
[17] *Id.* at *16–18.
[18] *Id.* at *17–18.
[19] *Id.* at *18–19
[20] *Id.* at *19
[21] *Id.* at *19–20
[22] *Id.* at *20–21
[23] *Id.* at *21
[24] *Id.*
[25] *Id.* at *23
[26] *Mkt. Synergy Grp., Inc. v. United States Dep't of Labor* , No. 17-3038, 2018 WL 1279743, at *1 (10th Cir. Mar. 13, 2018).
[27] *Id.* at *4.
[28] *Id.*
[29] *Id.* at *6.
[30] *Id.*
