Fifth Circuit Vacates DOL Fiduciary Rule

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In a 2-1 decision, the U.S. Court of Appeals for the Fifth Circuit vacated the Department of Labor's fiduciary rule, including the expanded definition of "investment advice fiduciary" and the associated exemptions. The decision nullifies the Department's 2016 regulation—at least in the Fifth Circuit, which includes Texas, Louisiana, and Mississippi—but is not likely to be the last word on this topic. The case is *U.S. Chamber of Commerce v. DOL*, No. 17-10238, 2018 WL 1325019 (5th Cir Mar. 15, 2018).

Over the course of more than forty pages, the majority decision recounted the history of ERISA's definition of fiduciary and concluded that the Department's expansion of the definition reflected a policy decision that was beyond the Department's authority. In so holding, the Court explained that expansion of service providers' obligations under the law and individuals' ability to enforce the law in court requires an act of Congress rather than an unelected agency of the Executive branch.

The Court first determined that the statute's definition of fiduciary was not ambiguous and must be interpreted consistently with the common law. In particular, the Court highlighted a distinction in the common law between an "investment adviser," who regularly gives advice that is the primary basis for investment decisions, and a broker-dealer, whose principal role is sales. The Court concluded that the Department's 1975 definition of "investment advice fiduciary"—the five-part test that the Department said was outdated and too narrow—properly reflected that distinction. Although the Court left the door open for the Department to make changes to the definition, the Court rejected the Department's justification for a complete rewrite:

That times have changed, the financial market has become more complex, and IRA accounts have assumed enormous importance are arguments for Congress to make adjustments in the law, or for other appropriate federal or state regulators to act within their authority.

Second, even assuming that the statute's definition of fiduciary was ambiguous, the majority concluded that the Department's expanded definition was not a "reasonable" interpretation of the statute. The Court detailed a number of reasons for this conclusion, including the following:

- The fiduciary rule ignores Congress's decision in ERISA to subject employer-sponsored plans to a different regime than IRAs. In particular, the Court observed that the statute does not subject IRA fiduciaries to ERISA's duties of prudence and loyalty or to ERISA's private right of action. The new Best Interest Contract Exemption would wipe away this distinction, because its conditions include a contractual commitment to the duties of prudence and loyalty that can be enforced by a private right of action.
- By the Department's own admission, the new definition of "investment advice fiduciary" could "sweep in some relationships that are not appropriately regarded as fiduciary in nature." The Court rejected the Best Interest Contract Exemption as a solution to this defect because the exemption is conditioned on taking on the very fiduciary status, responsibility, and risk that the Department acknowledged may not have been intended.
- The Best Interest Contract Exemption violates Constitutional separation of powers: only Congress may create privately enforceable rights of action. In addition, the exemption's restriction of arbitration provisions (subsequently abandoned by the Department) violates the Federal Arbitration Act.
- The fiduciary rule essentially outflanks Congressional initiatives under the Dodd-Frank Act to bestow oversight of broker/dealers upon the SEC. "Rather than infringing on SEC turf, DOL ought to have deferred to Congress's very specific Dodd-Frank delegations and conferred with and supported SEC practices to assist IRA and all other individual investors."

What does this all mean? The direct consequence of the Court's decision is that the expanded definition of "investment advice fiduciary" is no longer enforceable within the Fifth Circuit. We do not expect this to be the final word, however. The Department can still seek rehearing by the Fifth Circuit (either by the same panel or by the full Court) and/or review by the U.S. Supreme Court.

More indirectly, the decision articulates principles that could embolden the Trump administration's general deregulatory agenda and might affect the Department's review of the fiduciary rule. Even if other courts continue to disagree with the Fifth Circuit's conclusion (as the Tenth Circuit did most recently, discussed here), the decision further clears a path for withdrawing the fiduciary rule or a regulatory compromise that softens its impact—for example, by expanding the "seller's" exception and eliminating the most onerous requirements for the Best Interest Contract Exemption.

In the coming months and years, we expect to see continued focus on the fiduciary standard in all three branches of government:

- Challenges related to the Department's authority (both to create the new rule and to scale it back) are likely to continue in the courts.
- So far, the Department is continuing its review of the rule; and even if the Department puts it aside, a future administration could reopen the project.
- Members of Congress are likely to continue proposing legislation going both ways—with one side of the aisle seeking to expand the definition of fiduciary legislatively and the other side seeking consistency between DOL and the SEC.

It is too soon to guess where things will end up, and probably premature to change compliance strategies dramatically. Stay tuned.

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