Fifth Circuit Decision Results in Surprising Win for Providers of Financial Services

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Just as we are tuning in for March Madness, it seems that the Department of Labor (Department) has been dealt the latest upset in the fight to implement its final rule, which regulates certain activities of financial service providers, including investment advisers, broker-dealers, insurance brokers, and banks. The rule effectively broadens the scope of fiduciary status under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986, as amended (Code), for financial service providers who make recommendations to employer-sponsored plans or individual retirement accounts (IRAs) with respect to the investment of plan assets. As a result, recommendations by this group can result in conflicts of interest and, thereby, implicate certain prohibited transaction rules under ERISA and the Code. The Department attempted to address this issue with a new prohibited transaction exemption known as the Best Interest Contract Exemption (BICE), including a more streamlined version for certain providers who receive only a level fee in connection with their recommendations.

Although the rule was finalized on April 8, 2016 and became effective on June 7, 2016, the applicability date of the final rule was delayed until April 10, 2017. Note, however, that material provisions of the BICE were ultimately delayed until July 1, 2019. That being said, any advisor who otherwise desires to rely on the BICE to avoid a prohibited transaction must act in good faith during this transition period. Meaning, the advisor must act in the best interests of the participant, must avoid making any misleading statements, and must not charge more than reasonable compensation.

From the time of its initial proposal and even following its final promulgation, the rule has been under attack by the financial services industry and other interested groups. Several cases were filed in the Fifth, Tenth and D.C. Circuits. The Department has been the victor in the lower courts, but appeals were filed.

The Department has consistently rallied behind the rule as necessary to protect the interests of participants, beneficiaries, IRA owners and small plan sponsors, especially in light of the increased use of defined contribution plans and IRA rollovers. Despite arguments to the contrary, the Department has steadfastly defended its ability to issue the rule based on its delegated authority to issue regulations, rulings, opinions, and exemptions under ERISA and the Code.

On March 13, 2018, the Tenth Circuit Court of Appeals concluded in *Market Synergy Group, Inc. v. U.S. Dep't of Labor* (D.C. No. 5:16-CV-04083-DDC-KGS) that the issuance of the final rule by the Department was not an abuse of power in violation of the Administrative Procedure Act. Specifically at issue in *Market Synergy* was the treatment of fixed index annuities under the new and revised prohibited transaction exemptions. Issuers of these products would need to satisfy the requirements of the new Best Interest Contract Exemption in order to avoid a prohibited transaction. However, the Tenth Circuit disagreed that this change in treatment was arbitrary or capricious. Noteworthy, Market Synergy did not challenge the Department's authority to issue the final rule or the broadened definition of fiduciary prescribed under the rule. The *Market Synergy* decision seemed to be a slam dunk for the Department of Labor.

But days later, the Fifth Circuit Court of Appeals answered with an opposing opinion in *Chamber of Commerce of the United States of America, et. al. v. U.S. Dep't of Labor*, et. al., No. 17-10238 (5th Cir. Mar. 15, 2018). In a 2-1 vote, the Fifth Circuit held that the Department exceeded its authority under ERISA in issuing the broadened definition of fiduciary and vacated the rule altogether. While this latest court opinion puts opponents of the final rule on the scoreboard, it results in greater uncertainty for the financial services industry.

It's not clear what the Department's next move will be. It could request an *en banc* hearing of the Fifth Circuit, which could ultimately result in an appeal to the United States Supreme Court. At this time, however, the Department has announced that it will not enforce the rule. For many financial service providers who have already amended their service agreements to reflect their reliance on the Best Interest Contract Exemption— including the streamlined compliance for level fee fiduciaries—this provides little comfort. For these advisors, we recommend that they continue to operate in accordance with the good faith standard of the exemption that is currently in effect. For those advisors who have not taken such affirmative steps toward compliance with the good faith standard, it may be tempting to sit on the bench, but they should also consider reviewing their business practices to address perceived conflicts of interest as we expect that there will be some changes in the law in the near future—whether such changes are promulgated by the Department of Labor or the Securities Exchange Commission. As any good coach will tell you, the best defense is a good offense.

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