Flashpoint: Did the 5th Circuit Kill the DOL Fiduciary Rules?

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Ferenczy FlashPoint: Did the 5th Circuit Kill the DOL Fiduciary Rules?

As most following this saga had expected, the 5th Circuit Court of Appeals (covering Louisiana, Mississippi, and Texas) issued its decision on March 15, 2018, ruling that the Department of Labor (DOL) Fiduciary Rules (including the Conflict of Interest regulation [Labor Reg. §2510.3-21], as well as the Best Interest Contract Exemption (BICE) and other exemptions) are legally impermissible. As a result, the Court vacated the regulations. [Chamber of Commerce, et al. v. U.S. Dept. of Labor]

What does this mean legally?

Commentators are disputing whether the effect of the decision is to void the Fiduciary Rules across the country or just in the 5th Circuit. At the very least, the decision means that neither the DOL nor private individuals can enforce these regulations in the courts located in the 5th Circuit. However, keep in mind that other courts, most particularly the 10th Circuit Court of Appeals (covering Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming)—which acted two days before the 5th Circuit—have upheld the Fiduciary Rules.

When some appellate courts decide issues of law one way and others make the opposite decision, it is a called a “split in the Circuits.” This means that federal law applies one way in one part of the country, and differently in another part. This is one of the circumstances that commonly cause the Supreme Court to consent to hear an appeal. Of course, a Supreme Court decision is binding throughout the country. So, the 5th Circuit decision sets up the likelihood of a Supreme Court appeal, with the potential of getting the “final word” legally on the Fiduciary Rules.

What does this mean practically in the meantime?

On a practical basis, this decision may not cause any significant action by anyone in the short run. The enforcement of the Fiduciary Rules is in limbo at this point, and in large measure has been since they became effective. The DOL reportedly already stated it will suspend enforcement of the Fiduciary Rules in the meantime.

The Trump Administration has been decidedly lukewarm on the Fiduciary Rules since it took office, ordering the DOL to review the Fiduciary Rules to determine whether they are effective or detrimental to the ability of plans and their participants to obtain quality advice and investment access. The DOL, in turn, stated that it is working with advisors and fiduciaries who have made a good faith effort to comply with the Fiduciary Rules to assist in that compliance rather than penalizing them. And, most entities—particularly larger financial institutions and brokerages—made significant compliance efforts in anticipation of the applicability date of the Fiduciary Rules in June of 2017. In addition, the DOL delayed the applicability of BICE and the other exemptions until the second quarter of 2019, requiring only that financial institutions and advisors act in the meantime in the best interests of their clients (i.e., follow the prudence and loyalty requirements of ERISA), charge reasonable fees, and not make any misrepresentations.

It is unlikely that anyone will take a huge U-turn at this juncture to return entirely to the pre-Rules practices, at least until the legal effect of the 5th Circuit decision is more settled.

What happens next?

The DOL has four possible responses to this decision. It may (1) ask for all the 5th Circuit judges to hear the case (called an "en banc" hearing), which could result in a different ruling; (2) choose to appeal the 5th Circuit decision to the Supreme Court; (3) wait to see if the plaintiffs in the 10th Circuit decision appeal their case to the Supreme Court; or (4) begin the process of modifying or revoking the Fiduciary Rules. It is also possible that the split in the Circuits will give Congress the impetus it needs to pass legislation to revoke the Fiduciary Rules (or, while unexpected, to modify ERISA to enhance the enforceability of the Fiduciary Rules).

What should you do in the meantime?

If you are in the process of expending significant effort or money to comply with the Fiduciary Rules, you likely should put any new actions on hold pending further developments.

On the other hand, if you have modified your procedures to conform to the Fiduciary Rules, continuing to do so will not put you in any jeopardy. These Fiduciary Rules enhance the rules for fiduciary compliance, so continuing to comply is going above and beyond what was necessary before they were effective.

Special consideration: rollover advice

The one exception to the above statement is in the area relating to rollover advice. You may recall that, before the Fiduciary Rules, a fiduciary to a plan was prohibited from providing advice to participants regarding rollovers that would affect the fiduciary's compensation. This advice constituted a self-dealing prohibited transaction, for which there was no exemption. The Fiduciary Rules did two things. First, they made everyone who gave rollover advice a fiduciary, even if there was no preexisting relationship with the plan. Second, they granted an exemption from the self-dealing rules for "level fee" advice—that is, advice by a fiduciary who receives level fees (i.e., a flat dollar amount or a set percentage of plan assets) from the plan to a participant to roll over funds to an IRA from which the fiduciary would also receive level compensation. If the Fiduciary Rules are overturned, “strangers” to the plan who give rollover advice will go back to being non-fiduciaries. However, the exemption that protected plan fiduciaries will be the proverbial baby out with the bath water.

If you are located within the 5th Circuit, you may want to refrain from relying on the level compensation exemption for rollover advice if you are a fiduciary to the plan. Advisors in other parts of the U.S., whether plan fiduciaries or other advisors, should be able to rely safely on the level fee exemption until further legal action is taken.

<u>One More Current Development to Mention</u>

While vaguely defending the increase to VCP fees in its response to a comment letter to ASPPA (stating, much to the wry amusement of those of us who do these filings, that the time needed to review a VCP application is the same for small as for large plans), the IRS has walked back the increase in user fees for determination letters on plan termination. These fees had been increased from $2,300 to $3,000 in Rev. Proc. 2018-6. In Rev. Proc. 2018-19, issued by the IRS on March 14, the IRS agreed to return to the $2,300 fee level for these applications. Of course, this may be a pyrrhic victory for practitioners, as these applications are filed relatively rarely (certainly when compared to VCP filings).

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FERENCZY
BENEFITS LAW CENTER
We are your ERISA solution™

Ilene Ferenczy • ilene@ferenczylaw.com | Alison Cohen • acohen@ferenczylaw.com
Adrienne Moore • amoore@ferenczylaw.com | Adriana Starr • astarr@ferenczylaw.com
Tia Thornton • tthornton@ferenczylaw.com | Leah Dean • ldean@ferenczylaw.com

2635 Century Parkway Suite 200, Atlanta, GA 30345
T 404.320.1100 | F 404.320.1105 | www.ferenczylaw.com