

## DOL's Fiduciary Rule: Death By A Thousand Cuts?

By **Andrew Oringer**

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Every now and then one wakes up with a thought along the lines of, "How the heck did we get to where we are?" Such a thought may easily be brought to mind by the present state of play regarding the new fiduciary regulation (the regulation) promulgated by the U.S. Department of Labor and the related amended and new "prohibited transaction" class exemptions (together with the regulation, the rule) under the Employee Retirement Income Security Act of 1974 and the corresponding provisions of the Internal Revenue Code of 1986 (the code).



Andrew Oringer

Let's review. Almost seven (!) years ago, the DOL proposed a fundamental rewrite of the "investment advice" definition under ERISA (and the code). The resulting firestorm of controversy eventually caused the DOL to announce in September 2011 that it would be withdrawing the proposal. It appeared to many as though the DOL's initiative would remain dormant, until, years later, then-President Barack Obama himself publicly got behind the DOL's efforts in a 2015 speech to the AARP. Shortly thereafter, the DOL repropose the rule, again to a great deal of controversy.

Once the process had been reinvigorated, it soon became fairly evident that the timetable for finalization was being driven by the then-upcoming election. Clearly, it seemed, there was an attempt to get the regulation finalized before the election, in the event that a new administration would not support the DOL's efforts and would eventually try to scale back or completely eliminate the regulation.

An additional process point loomed, however. What if the regulation were finalized before the election, but was not yet effective at the time of a changeover in administrations? Would the regulation still be jeopardy? This issue was surely a difficult one for the DOL from a practical perspective, as there was no feasible way to require actual implementation in the market before Inauguration Day.

The rule was eventually finalized in 2016. Ultimately, the regulation's implementation was cleverly couched in terms of pre-election effectiveness, but with delayed applicability. This approach seemed designed at least in part to have the effect of entrenching the new rule, in the event that a new administration would later seek to waylay any not-yet-effective regulations of the outgoing administration.

Such a concern was not a frivolous one. The animosity within the Trump circle for the rule started to

become obvious before the 2016 election was held. In October 2016, in one of the first in a procession of anti-rule comments to emanate from the Trump campaign and administration, Anthony Scaramucci, then a senior adviser to the Trump campaign (and later quite the colorful and ever-so-temporary official member of the Trump administration) hyperbolically commented: "We're going to repeal it. It could be the dumbest decision to come out of the U.S. government in the last 50 to 60 years ... It's about like the Dred Scott decision."

Much of the controversy surrounding the rule circled around the fact that, while it has a consumer-protection bent rather than a traditionally retirement-centric bent, it was promulgated not by the U.S. Securities and Exchange Commission, the presumed watchdog for investors' interests, but rather by the DOL. Indeed, the DOL shoehorned its market-shaking efforts into a regulatory scheme extending to non-ERISA individual retirement accounts (IRAs), on the slender reed of a 1978 administrative reorganization plan that had basically been intended merely to bring tax and labor interpretations of duplicative tax and ERISA provisions into mutual accord.

So then Donald Trump was elected president, and, sure enough, Reince Priebus, then White House chief of staff, issued a Jan. 20, 2017 memorandum (not unlike a similar memorandum issued by the incoming Obama administration in 2008) essentially freezing all regulatory action that was not yet effective. As alluded to above, however, the regulation was effective — it simply wasn't yet applicable. It thus escaped the reach of the Priebus memorandum, making the "effective-but-not-yet-applicable" device start to look pretty smart, after all.

Still, indications were that the rule could well be in trouble. Shortly after the election, in December 2016, the regulation made its way onto the radar of the influential House Freedom Caucus, showing up on its hit list of undesirable regulatory activity. And, as February approached, there started to be noise that the Trump administration not only would deal with the rule, but might do so in tandem with efforts related to dealing with the more high-profile Dodd-Frank legislation, thus making it less likely that the rule would escape high-level attention. Eventually, on Feb. 2, 2017, White House Economic Counsel Director Gary Cohn, signaling that significant action relating to the rule could be imminent, said to *The Wall Street Journal*: "We think it is a bad rule. It is a bad rule for consumers."

The events of the next day unfolded interestingly and, in retrospect, set the table for some surprises yet to come. On Feb. 3, 2017, the executive order on Dodd-Frank was released, and there were reports that there would be action delaying the applicability of the rule. What we wound up with was a presidential memorandum directing a reexamination of the rule, and outlining concepts that could form the basis for "revising" and maybe even "rescinding" the rule. However, in a surprise twist, the executive order did not provide for a delay, but later that same day was followed by a press release from the acting secretary of labor indicating that a delay in applicability would at some point be proposed. It appeared that the Trump administration had become attuned to the need to attend to a process regarding a delay, rollback or elimination of the rule. What was not evident at the time is that the administration was quite possibly about to become a captive victim to that process.

At this juncture, the consistent flow pretty much up and down the line continued to be that the rule was an anathema to the new administration. Sean Spicer, then the White House press secretary, called the rule a "regulatory overreach" by the DOL, and said:

The rule's intent may be to have provided retirees and others with better financial advice, but in reality, its effect has been to limit the financial services that are available to them. President Trump does not intend to put unnecessary limits on economic opportunity.

Similarly, in connection with the issuance of the Feb. 3 presidential memorandum, a senior White House official told Time:

We want them to cease the implementation of this and completely review the fiduciary rule. We think that this was a complete miss on what they were trying to do. It has taken away a huge variety of investment options for individual investors.

SEC Commissioner Michael Piwowar, echoing these sentiments, stated on March 2, 2017: "I think it is a terrible, horrible, no good, very bad rule. For me, that rule was never about investor protection. It was about enabling trial lawyers to increase profits." (Later, on July 25, 2017, he more officially wrote to the DOL that he "has many concerns with" the rule.)

On March 2, 2017, the DOL proposed the promised 60-day extension to June 9, as presaged by the DOL's Feb. 3 press release, and then proceeded to finalize it on April 7, 2017. However, the finalization was effective in a way that plotted a course to actual applicability on June 9, rather than to a continuing procession of extensions, as had been widely expected. Soon thereafter, it was reported that, on or around May 10, 2017, DOL Secretary Alexander Acosta in a meeting with Sen. Tim Scott, R-S.C., said (and emailed to the effect) that the "rule is his number one priority, and that he is actively seeking a way to freeze the rule that will 'stick.'"

It is submitted here that a record this broad, fully developed and fractured, with both support and harsh criticism from both sides of the aisle, would have supported a wide range of potential action in connection with the regulation — from going back to that status quo ante of 1976, to leaving the regulation in place as finalized, to extending the applicability date further in order to allow for additional consideration, to virtually anything in between. Arguably, if there were ever a record that would leave an extremely broad array of administrative action within the range of reason, this is it. Ultimately, though, as he explained in his May 22, 2017, op-ed in *The Wall Street Journal*, Acosta tepidly and begrudgingly conceded not to forestall further the general June 9 applicability of the rule. And so the regulation is still here with us, having become generally applicable on June 9, 2017.

The DOL's final April 7 action also suspended until Jan. 1, 2018 (this period of suspension being referred to below as the "transition period") a wide range of detailed requirements in the critical "best interest contract" exemption (the BIC exemption). By doing so, the DOL established a period extending through the end of 2017 during which the only real surviving requirement of the BIC exemption involves adherence to a general and high-level formulation of the BIC exemption's "impartial conduct standards" (the impartial conduct standard). (More on that later.) But, at the end of the day (at least so far), the basics of the rule itself, including the regulation itself essentially in its entirety, did somehow manage to become applicable on June 9.

How (with apologies to Dr. Seuss) can this be? Well, maybe during the keyest of key periods in this little passion play, the DOL had no leadership at the top. Andrew (Andy) Puzder had been nominated as secretary of labor, but, well ... suffice it to say that the Puzder nomination didn't quite work out. Then, the Neil Gorsuch U.S. Supreme Court confirmation process took center stage in the Senate and muscled away a number of things, including consideration of Acosta as Puzder's replacement nominee. So, days turned into weeks, in which there still was no labor secretary.

Why did this matter? One theory for the survival of the rule thus far is that zealously driven DOL personnel who believed ardently in the rule and its propriety were able to steer a then-rudderless ship

away from the palpable tide of animosity for the rule within the Trump administration. Former Speaker of the House Newt Gingrich described the situation this way:

The [presidential memorandum]'s intention was clear-as-day. It aimed to indefinitely delay or outright kill this bad rule before it could hurt middle class American investors. Instead, [continuing personnel] at the Department of Labor effectively expedited the rule with minimal changes. This was exactly the opposite of President Trump's instructions.

This explanation is one way of explaining how we have a rule that is in fact applicable as of June 9, in the face of a tide of indications and pronouncements throughout the Trump administration that were (and continue to be) consistently pitched heavily against the rule.

What did happen when the regulation became applicable? As noted above, the DOL had suspended much of the detailed and difficult provisions of the BIC exemption, and that step was helpful, to be sure. But the effort to allow the market time to breathe fell short on its own terms. While the aspects of the rule involving needed documentation generally were mercifully put off, the focus was on the exemptions. Unfortunately, one of the key exceptions under the regulation — the exception for dealings with independent fiduciaries — has a significant potentially documentary component. Because that component of the rule was not within the provisions deferred by the DOL, the June 9 applicability date triggered a disjointed fire drill that has resulted (and continues to result) in a proliferation of added provisions and new stand-alone documentation that arguably do little if any good to anyone, save possibly for the lawyers who become responsible for drafting the documentation and responses thereto.

The palpable animosity towards the rule within the DOL and elsewhere within the administration is not without clear manifestations that have real impact. Thus, while we do presently have an applicable rule, the administration's negativity regarding the rule seems to be coalescing such that the rule is progressively being pared down. Here is a sampling of some recent activity:

- Following the final action that locked in the June 9 applicability date, the DOL, on May 22, 2017, issued a temporary enforcement policy under which during the transition period the DOL will not pursue claims against those "working diligently and in good faith to comply," or treat them as being "in violation." The DOL expressly noted that its "general approach to the June 9 implementation will be marked by an emphasis on compliance assistance (rather than citing violations and imposing penalties)." The policy also effectively applies with respect to the code's excise-tax provisions.
- On July 6, 2017, the DOL issued a request for information, asking, among other things, whether the rule "appropriately balance[s] the interests of consumers in receiving broad-based investment advice while protecting them from conflicts of interest."
- Later in July 2017, in the pending Chamber of Commerce case regarding the regulation, the DOL acknowledged and admitted that the BIC exemption's requirement that a "best interest" contract not contain a bar on class actions (which requirement is contained in the private-right-of-action provisions of the BIC exemption that are currently suspended) is inconsistent with certain other federal law, at least in the context of arbitrations. In August 2017, the DOL sent a letter to the judge in the pending Thrivent case, stating that the claim there revolving around the requirement in the BIC exemption relating to class actions "will likely be mooted in the near future," thus reinforcing the notion that the DOL may be about to abandon the BIC exemption's class action waiver provision, as applied to arbitration agreements. The DOL subsequently issued

an enforcement policy confirming that it would not pursue a claim based solely on the failure to comply with the BIC exemption's requirements regarding class actions (as applied to arbitration agreements).

- Also in August 2017, the DOL issued FAQs regarding the rules that provide relief under the "408b-2" disclosure rules for certain issues that may arise as a result of the regulation, and provide certain other regulation-related relief. In those FAQs, the DOL mentioned "the unique circumstances of the Department's ongoing review" of the rule.
- On Aug. 9, 2017, the DOL filed a notice in the Thrivent case that it intended to propose that the portions of the BIC exemption (and other exemptions) that are presently suspended through 2017 would be suspended for an additional 18 months, until July 1, 2019 — which, in these circumstances, would seem like a veritable eternity. That proposal was eventually published in the Federal Register on Aug. 31, 2017.

All of that, then, is a part of how we got to where we are. But, now, where are we? It is not surprising, in light of the above-described hostility to the rule, that during the transition period, which now may apparently be extended at least through June 2019, the rule has in some ways effectively been significantly declawed.

Much of this declawing centers around the current state of play surrounding the BIC exemption. In many situations, even where there is a recommendation being made and no exception from fiduciary status is available, the BIC exemption may well be applicable. When the BIC exemption was initially finalized, attempts to satisfy it looked to be potentially daunting, in light of its specific substantive and procedural requirements, many revolving around confirmation that the impartial conduct standards have been satisfied. However, during the transition period, which may now be in place until at least mid-2019, all that's presently left of the impartial conduct standards is the generic and broadly stated standard itself, and there may be any number of providers that will find their way to an acceptable comfort level (possibly, in some cases, with additional attention to somewhat bulked-up internal policies and controls) that the standard will be met.

And that's not all. In the case of non-ERISA IRAs, there is yet another aspect of the rule as it has developed that would seem to be a key part of the risk calculus. In particular, while much fanfare was focused on the expanded reach of the rule to non-ERISA IRA's, it turns out that, at present and for the foreseeable future, owners of (non-ERISA) IRAs have no claim whatsoever under the rule. Thus, the customer on the other end of a transaction from a financial institution or financial professional will have no claim under the rule that the institution or professional is a fiduciary, engaged in prohibited self-dealing or otherwise has violated the law by virtue of running afoul of the rule.

The litany that inexorably leads to this result is as follows:

- It would have been the case under even a fully effective rule that, for those providers taking the position that they are not making recommendations or are otherwise not fiduciaries under the regulation, the rule did not provide for a private right of action for the (non-ERISA) IRA owner. Thus, in the case of services to a (non-ERISA) IRA regarding the investment of IRA assets, the IRA owner had (and has) no claim against the provider under the rule.

- Why? The answer is that (1) there is no claim under ERISA because ERISA doesn't apply, and (2) there is no claim under a "best interest" contract in that no such contract would be offered by the provider where the protection of the BIC exemption is not being sought. That's two strikes — and there is no need for a third strike, as there is no other possible source of a claim under the rule.
- During the transition period, this result applies with striking breadth in all cases, whether or not the provider is a fiduciary and whether or not the provider is seeking or would benefit from coverage by the BIC exemption. While the present transitional relief remains in place (presently an open-ended prospect), there simply is no written-contract requirement in place under the BIC exemption.
- Thus, there is no private right of action, even where the provider seeks to come under the protection of the BIC exemption. In short, during the transition period, (non-ERISA) IRA owners will have no claim under the rule against providers that those providers have engaged in prohibited fiduciary self-dealing under the rule regarding the management of assets held in the IRA — whether or not the provider turns out to have been a fiduciary, and whether or not the provider turns out to have engaged in prohibited self-dealing.

For those affected providers with credible positions regarding any of the relevant issues, it would seem to be relevant to the risk analysis that the customer has no potential claim. Indeed, as a corollary to there being no claim, there is no violation of substantive law. There simply is a potential tax issue under the code's excise-tax rules.

So just what is the remaining risk under the excise-tax rules? The remaining risk is that the Internal Revenue Service of today would be sufficiently motivated to pursue an excise-tax claim, notwithstanding the possible arguments from the provider that (1) (A) it has not made a recommendation, and (B) an exception from fiduciary status might be available; (2) if a recommendation has been made and the provider turns out to be a fiduciary, maybe there has been no prohibited self-dealing; and (3) if the provider is a fiduciary and did engage in prohibited self-dealing, the sliced-and-diced BIC exemption might be available so as to exempt the otherwise taxable conduct. And even then, should all of that fail, there may still be the additional argument that, if the fees charged are not in excess of reasonable fees, the applicable "amount involved" on the excise-tax side of the ledger is zero. This is not the proverbial "audit lottery" approach, where a taxpayer with no position just hopes that no one comes knocking for taxes; rather, this situation involves the possibility of any number of pro-taxpayer positions, combined with an uncertain likelihood that the IRS would ever pursue a controversial, complex, multi-faceted and generally difficult claim. Providers with a credible counterargument regarding one or more of the elements of a possible claim by the IRS can consider for themselves how likely it is that an excise-tax claim will be made and successfully pursued.

Before the risk-calculus point is left, it should be noted that there is another fiduciary-type risk that could theoretically surface. The risk is that the customer might bring the provider into state court with a claim that the provider is a fiduciary under applicable state law, has breached applicable fiduciary duties, and therefore has some kind of liability. But is this really a real-world risk? In this regard, it should be understood that such a claim has always been out there (absent some change in state law newly giving rise to such a claim). In addition, if one truly is worried about the state-law risk, then the provider's concern should be generically as to all accounts, not just retirement accounts — by hypothesis, the issues are under state law of general applicability (assuming that the state law in

question is not somehow directed at IRAs). Maybe concern on the state-law front is heightened in that maybe the DOL's issuance of the rule has raised the profile of a potential fiduciary claim; and maybe a state court judge would look to the regulation by analogy. But, again, if that is the concern then (again, assuming that there is no relevant state law that is IRA-focused) the concern is not really limited to activity regarding retirement accounts.

What is the end game here for this so far never-ending story? One possibility is that a unified standard across all accounts, not just retirement accounts, will be developed and implemented, either developing out of a joint SEC/DOL effort of some sort, or emerging out of Congress, or some combination of the two. It is submitted here that any final standard, whether emanating only from the DOL or coming from a more coordinated effort, should be workable and not overbroad, and that any protection for the investor community should not needlessly distort the flow of investment opportunities away from retirement savings.

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*Andrew L. Oringer is co-chair of the ERISA and executive compensation group, and leads the national fiduciary practice at Dechert LLP in New York.*

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