INDUSTRY ORGANIZATIONS SUE TO PREVENT ENFORCEMENT OF THE FIDUCIARY RULE

Date: 23 June 2016

Investment Management Alert

The Department of Labor's ("Department") Fiduciary Rule[1] and related Best Interest Contract Exemption[2] and Prohibited Transaction Exemption amendments[3] (collectively, the "Regulatory Package") have faced significant resistance since their release in early April. Most recently, Congressional Republicans passed a joint resolution seeking to nullify the Regulatory Package, which was subsequently vetoed by President Obama on June 8.[4]

Industry response has been equally sharp. Since June 1, five lawsuits (the "Lawsuits") have been filed against the Department, by plaintiffs that represent a cross section of stakeholders affected by the new Regulatory Package (the "Plaintiffs"). The Lawsuits[5] allege the Regulatory Package is an unlawful regulatory regime that, in effect, uses prohibited transaction exemptions and class-action lawsuits to regulate market participants and commercial activities that are beyond the scope that the Department is authorized to regulate under ERISA. The Plaintiffs claim that the Regulatory Package forces market participants into "fiduciary" status (and associated duties and liabilities) with customers, by threatening the loss of traditional revenue streams unless market participants comply with the requirements of the Best Interest Contract Exemption ("BIC Exemption"). The Plaintiffs allege that this exemption imposes onerous compliance requirements, unlawfully creates a private right of action and imposes duties on individual retirement accounts ("IRAs") and other non-ERISA plans where no statutory right exists.

Plaintiffs share a common narrative that under the Fiduciary Rule, the Department has improperly expanded the definition of "fiduciary" for purposes of ERISA-prohibited transaction rules, having the effect of blocking market participants from collecting transaction-based fees, such as commissions. Plaintiffs allege that the Department leaves industry professionals no way to continue to offer their services and products except to acknowledge fiduciary status and comply with the BIC Exemption. According to the Plaintiffs, this regime will have far-reaching economic repercussions both to the industry and to consumers of retirement advice by simultaneously restricting the availability, and raising the cost, of retirement consultation services.

Plaintiffs also specifically focus on the Regulatory Package's impact on fixed indexed annuities. While the proposal allowed fixed indexed annuities to use the traditional exemption for insurance products, Prohibited Transaction Exemption 84-24, the final Regulatory Package disallowed that use, requiring advice regarding these products to be given under the BIC Exemption. Plaintiffs claim that this unexpected change was not subject to proper notice and comment and thus violated the Administrative Procedure Act ("APA"). The Plaintiffs also allege that, in many cases, it is impossible for independent insurance agents selling fixed indexed annuities to satisfy the BIC Exemption, forcing them to leave the business.

The Plaintiffs' other arguments under the APA include that the Regulatory Package, and the regulatory regime contemplated by it, violates the APA and exceeds the authority of the Department by (i) issuing regulations with respect to IRAs that are regulated pursuant to the Internal Revenue Code, administered by the Department of

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Treasury; (ii) failing to give adequate notice of the regulatory extent of the final rule; (iii) failing to offer a reasoned basis for the final regulations, and (iv) failing to properly consider the economic impact of the final regulations on their respective industries. Some Plaintiffs also challenged the propriety of the creation of the class action claim as a violation of the Federal Arbitration Act.

Several of the Plaintiffs allege constitutional violations, including under the First Amendment to the Constitution of the United States, on the premise that the Regulatory Package places an undue burden on the recommendations by sellers of retirement products, which the Plaintiffs claim is non-misleading commercial speech. One Lawsuit challenges the Regulatory Package on Fifth Amendment grounds, claiming it is unduly vague.

Each of the Plaintiffs requests declaratory judgment against the Regulatory Package. Several Plaintiffs request injunctive relief, preventing implementation of the Regulatory Package. The U.S. District Court for the District of Columbia has set a hearing date for August 25 on the National Association for Fixed Annuities' request for a preliminary injunction.

We are monitoring the Lawsuits closely; however, we recommend that our clients continue their plans to come into compliance with the Regulatory Package before the April 10, 2017, compliance date.

Notes:

[1] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,945-21,002 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2510.3-21).

[2] Best Interest Contract Exemption, 81 Fed. Reg. 21,002-21,089.

[3] Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters, 81 Fed. Reg. 21,147-21,181 (Apr. 8, 2016).

[4] Presidential Statement on Vetoing H.J. Res. 88 (Jun. 8, 2016).

[5] *Chamber of Commerce of the United States of America v. U.S. Department of Labor* (3:16-cv-01476), District Court for the Northern District of Texas, June 1, 2016; *The National Association for Fixed Annuities v. Thomas E. Perez* (1:16-cv-01035), District Court Of Columbia, June 2, 2016; *Market Synergy Group, Inc. v. U.S. Department of Labor* (5:16-cv-04083), District Court for the District of Kansas, June 8, 2016; *Indexed Annuity Leadership Council Life Insurance Company of the Southwest v. Thomas E. Perez* (3:16-cv-01537-N), District Court for the Northern District of Texas, June 8, 2016; *American Counsel of Life Insurers v. Thomas E. Perez* (1:16-cv-1530), District Court for the Northern District of Texas, June 8, 2016. The Department has filed an unopposed motion to consolidate the three cases filed in the Northern District of Texas.

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