‘Circuit Split’ over DOL Fiduciary Rule?

By Kerry Pechter *Fri, Mar 16, 2018*

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The New Orleans-based U.S. Court of Appeals, Fifth District, has reversed the ruling of a federal district court and “vacated” the Obama Department of Labor’s controversial Fiduciary Rule “*in toto*.” In her March 15 ruling, Circuit Judge Edith H. Jones called the rule “an arbitrary and capricious exercise of administrative power.”

The ruling was a victory for the plaintiffs, who included the American Council of Life Insurers, the National Association of Insurance and Financial Advisors, the Financial Services Institute, the U.S. Chamber of Commerce and several other lobbyists or trade groups representing various manufacturers or distributors of indexed annuities.

But hold the celebration (or funeral, as the case may be). Earlier this week, on March 13, the Denver-based U.S. Court of Appeals, Tenth Circuit, affirmed a lower court ruling in favor of the fiduciary rule. In Judge Paul J. Kelly’s 16-page opinion, the Obama DOL “examined the relevant data and articulated a rational connection between the facts found and the decision made” and therefore did not act in an arbitrary or capricious manner, as charged by Market Synergy Group, a Topeka-based insurance marketing organization.

Though two circuit courts disagreed, the disagreement may not have been direct enough to constitute a “circuit split” that would impel the case to the Supreme Court. [For an expert opinion, see attorney Marcia Wagner’s comments in *RIJ* today.]

But the two judges took clearly opposing views of the business issue in the case. Judge Jones, a Reagan appointee, accepted the industry’s argument that the costs of compliance with the fiduciary rule outweigh any consumer benefits it might produce. Judge Kelly, a George W.H. Bush appointee, specifically accepted the Obama DOL’s argument that “the benefits to investors outweighed the costs of compliance.”

Here’s *RIJ’s* take on the news:

The evolution over the past 43 years of defined benefit plans into 401(k) plans and 401(k) plans into rollover IRAs, with rollover IRAs emerging as the de facto final vessel for trillions of dollars of tax-deferred savings for tens of millions of Americans, has resulted in a regulatory, legal and political train wreck.

Over those four decades, changes in the delivery of financial services have outpaced changes in the regulatory framework around retirement savings. During that time, the boundary between regulations for individual savings vehicles (IRAs) and institutional or group savings vehicles (mainly 401ks) has become blurred. The difference between a mere broker or agent and a “trusted advisor” has also become blurred.

With the unanticipated rise of the rollover IRA, the line between the Department of Labor’s jurisdiction and the Securities & Exchange Commission’s jurisdiction has turned grey and blurry. The conflict between individual choice and the type of consensual group behavior necessary for the achievement of public policy goals—which is relevant in this case—has always been and always will be present in situations like this.

So a highly politicized fog has descended on the question of whether the DOL fiduciary rule should be upheld or ditched. The law, as ever, is open to endless interpretation, a good deal of it driven by politics or ideology. But the fundamental issue in the fiduciary rule debate, I think, can be reduced to fairly clear questions:

When people roll over their 401(k) group plan assets to an individual IRA, should they keep or lose the Department of Labor-enforced protections and restrictions that they had in the group plan? Should they instead be entirely free (within the tax laws) to take their money into the financial marketplace and enjoy the risks and benefits of a caveat emptor relationship with any type of service provider?

Naturally, different interest groups have different answers. The Obama Department of Labor, believing that the loss of ERISA protections is hurting the public’s retirement readiness and thwarting the intent of the pension laws to encourage and protect long-term savings, was determined to extend the 401(k) protections/restrictions into the rollover IRA realm by creating the fiduciary rule. It says that if you advise an IRA, you’ll be held to the same standards as an advisor to a 401(k).

The financial services industry, mindful that the fiduciary rule would limit or at least complicate its members’ ability to sell mutual funds and equity-linked annuities into the multi-trillion dollar rollover IRA market, believes that people should be free to do what they want with their rollover money. In court, it claimed that its interests align with the public’s interests. Judge Jones appears to have agreed.

The lack of consensus on these issues isn’t surprising, if only because of certain inherent ambiguities. Defined contribution plans aren’t really pension plans; they’re profit-sharing plans with no specific retirement income provisions that would characterize them as pensions. Rollover IRAs are even less pension-like: they’re simply tax-deferred personal savings vehicles.

The Obama DOL’s effort to extend its jurisdiction to IRAs was arguably a stretch. (The Obama administration exercised its will through regulations because the legislation route was blocked by the Republican Congress.) But without it, defined contribution plans will continue to become mere incubators of future brokerage accounts, and not incubators of personal pensions.

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