Federal Judge Upholds Obama Fiduciary Rule

By Kerry Pechter *Thu, Feb 9, 2017*

Ignoring a Trump administration request to delay her ruling, Chief Judge Barbara Lynn of the Northern District of Texas, Dallas Division, rejected industry arguments that the Obama Department of Labor had exceeded its authority.

Despite the Trump administration's request for her to delay its publication, a federal judge in Dallas yesterday released an 81-page **ruling** that upheld the legal basis of the Obama "fiduciary rule" in the face of challenges from life insurance and annuity industry groups.

In *Chamber of Commerce of the U.S.A. et al v. Edward Hugler, Acting Labor Secretary, and the Department of Labor*, Judge Barbara M. G. Lynn affirmed that the Obama DOL acted within its authority when it required financial advisors to put the interests of retirement investors ahead of their own and allowed investors to sue advisors who violate that requirement.

Among other things, the Obama fiduciary rule makes it difficult for broker-dealer reps and insurance agents to accept commissions from insurance companies when selling annuities to rollover IRA clients and 401(k) plans—thus interfering with a long-standing and lucrative business model. The rule went into effect in June 2016 but the industry was given until April 2017 to fully comply with it.

On Tuesday, the Trump DOL, in an extraordinary direct appeal by the executive branch to the judicial branch, asked Lynn for a delay. In an equally extraordinary show of defiance of the executive branch, Lynn apparently ignored the request and released her ruling.

President Bill Clinton appointed Lynn, 64, to the federal bench in 1999. In 2016, she became the first woman to hold the position of chief judge of the Northern District of Texas, Dallas Division.

The suit filed by the Chamber, the Annuity Leadership Council, and the American Council of Life Insurers, claimed that, "financial professionals are improperly being treated as fiduciaries and should not be required to comply with heightened fiduciary standards for one-time transactions."

They also claimed that "the conditions to qualify for an exemption under BICE [the Best Interest Contract Exemption, which, if met, allowed commission-paying sales of indexed and variable annuities] are so burdensome that financial professionals will be unable to advise the IRA market and sell most annuities to ERISA plans and IRAs."

Specifically, the plaintiffs' suit said that:

- The Fiduciary Rule exceeds the DOL's statutory authority under ERISA.
- The BICE exceeds the DOL's exemptive authority, because it requires fiduciaries who advise Title II plans, such as IRAs, to be bound by duties of loyalty and prudence, although that is not expressly provided for in the statute.
- The written contract requirements in BICE and PTE 84-24 impermissibly create a private right of action.
- The rulemaking process violates the Administrative Procedure Act ("APA") for several reasons, including that the notice and comment period was inadequate, the DOL was arbitrary and capricious when it moved exemptive relief provisions for FIAs from PTE 84-24 to BICE, the DOL failed to account for existing annuity regulations, BICE is unworkable, and the DOL's cost-benefit analysis was arbitrary and capricious.
- The BICE does not meet statutory requirements for granting exemptions from the prohibited transaction rules.
- The new rules violate the First Amendment, as applied to the truthful commercial speech of their members.
- The contractual provisions required by BICE violate the Federal Arbitration Act.

In her ruling, Judge Lynn rejected all of these claims and refuted the arguments behind them. The Trump administration is expected to try to repeal or rescind the rule—especially the part that allows clients to sue brokers in court rather than having complaints heard in industry-dominated arbitration hearings.

The fiduciary rule has plugged what the Obama administration saw as a much-abused loophole in pension and securities laws. For many years, commission-paid brokers and agents could sell annuities and mutual funds that weren't necessarily in the client's best interest. They could justify such sales by claiming that they weren't acting as ongoing, trusted advisors to their customers but merely as salespeople in a classic buyer-beware situation.

The Obama DOL acted in part because the stakes were becoming higher. At the time the rule was issued, some $7 trillion had migrated from the institutional realm of 401(k) plans into the retail world of individual IRAs through the mechanism of so-called "direct rollovers," where it was easier for brokers and agents to take advantage of the loophole.

One legal complication: Rollover IRAs fell into a grey zone between the institutional and retail worlds. The DOL saw them as under its jurisdiction, while the financial industry saw rollover IRAs as part of its turf.

Fees were also typically higher in the retail rollover world and regulations less strict. That made rollover assets a potential boon to the retail financial services industry but a source of concern for the DOL. It saw high fees eating up a significant portion of American’s tax-deferred savings and potentially consuming much of the benefits to savers of the right to defer income taxes on the money in their 401(k) and traditional IRA accounts until age 70½.