March 20, 2018

Fifth Circuit Vacates DOL's ERISA "Fiduciary Rule"; DOL Announces Non-Enforcement Policy, Pending Further Review

On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit set aside the Department of Labor's so-called "fiduciary rule" in *Chamber of Commerce of the United States of America, et al.* v. *United States Department of Labor, et al.*[1] The 2-to-1 decision held that the rule exceeded the regulatory authority granted to the Department of Labor ("DOL") by the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

The future of the rule remains uncertain; on March 16, 2018, a DOL spokesman announced that, pending further review, DOL will not be enforcing the rule. DOL has not yet indicated whether it will seek further review of the decision, which it could do by filing a petition for rehearing with the Fifth Circuit or a petition for certiorari with the U.S. Supreme Court. While the Fifth Circuit decision says that the rule is "vacated" without geographic limitation, it remains uncertain whether, in fact, private plaintiffs may still attempt to enforce the rule in courts outside of the Fifth Circuit, which hears appeals from federal courts in Texas, Louisiana, and Mississippi.

Background

The fiduciary rule was adopted largely as a consumer protection measure aimed at thwarting conflicted investment advice by commission-paid brokers and salesmen for retail financial retirement products. Many brokers and salesmen, who were not treated as ERISA fiduciaries under the old 1975 rule, would have been treated as ERISA fiduciaries under the new rule if their communications to clients or potential clients were in the nature of **advice** or **recommendations** about the advisability of acquiring, holding, or disposing of specific investments in their retirement accounts. The rule became partially effective in June 2017 and was scheduled to become fully effective on July 1, 2019.

Given its consumer protection focus, the new rule was mostly irrelevant to private equity and hedge fund managers. Nonetheless, because the new regulation could have made someone an ERISA fiduciary who did not expect to be one (and who would not have been one under the 42-year-old regulation that it replaced), even private investment fund managers with mostly an institutional clientele have been supplementing their funds' offering and subscription materials to ensure that their investors are not expecting an ERISA fiduciary relationship.

[1] The opinion can be found at http://www.ca5.uscourts.gov/opinions/pub/17/17-10238-CV0.pdf.

Further, because a regulatory safe harbor exemption from the application of the new rule was unavailable with respect to individual retirement accounts ("IRAs") that are not managed by professional investment advisers, many private fund managers have already taken actions to limit the ability of IRA investors to subscribe for interests in new funds or to subscribe for additional interests in existing funds. Funds that have continued to accept investments from non-expertly managed IRAs have generally exercised special care to fairly inform the investor that no advice is being given to make or maintain the investment.

What's Next?

In anticipation of the new rule, many large financial institutions and insurance companies restructured their product offerings and fee structures for retail retirement investors to avoid claims of conflicted fiduciary advice; we would not expect many service providers to the retirement industry to reverse course.

In the wake of the Fifth Circuit ruling, private fund managers may choose to revisit earlier decisions to reject new subscriptions from ERISA and IRA investors that are not professionally managed per the fiduciary rule's safe harbor. However, for private investment funds that have enhanced their offering and subscription materials to emphasize that the fund manager is not giving fiduciary investment advice to IRAs or any other ERISA investors, we expect that managers will continue to emphasize that they are not assuming any fiduciary duties under ERISA in connection with marketing their funds and that investor communications do not constitute ERISA fiduciary investment advice.

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