The DOL Fiduciary Rule: Charting a Course, Avoiding Collisions & Potential Litigation Q&A #4

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Q&As on Annuity Sales Practices, 'Investment Advice' and Litigation

For the past several months, we have written about potential litigation issues under the "revised temporary" DOL Rule involving the offer and sale of annuities in the IRA market. This article continues that discussion. Recall that while the Rule's revised broad definition of "fiduciary" was adopted effective June 9, 2017, the Rule's exemptions were made available for a temporary transition period, by adherence only to the Rule's Impartial Conduct Standards. As in the past, the answers below are limited to the Rule's impact during this "temporary" period. In particular this Q&A addresses issues raised in the Department's recent release which provides for an 18-month Extension of Transition Period and Delay of Applicability Dates for the Best Interest Contract Exemption; the Class Exemption for Principal Transactions; and PTE 84-24 ("Release") (29 CFR Part 2550, 11/29/17) . In particular, we focus on the issues the Department (and consumer groups) raised regarding the status of "enforcement" procedures during the transition period, with an emphasis on the comments in the Release on potential implications for both regulatory enforcement and litigation during this period and beyond. In last month's Q&As we also suggested some measures to protect against exposure in connection with advising on or effecting a transaction involving advice on IRA purchases or distributions from an ERISA plan to an IRA. We now focus on recent comments from the Department that may be relevant to that analysis. The issues we have been discussing relate primarily to potential litigation involving the sale of annuities to IRAs or advice regarding such a sale. Such litigation, during this transition period can only be brought, if at all, as state law claims (presumably under a state law fiduciary standard) because ERISA does not provide a cause of action for breach of an alleged fiduciary duty unless the advice or sale is to an ERISA qualified plan. However, in this discussion, we will address the IRA only transactions as well as potential litigation in federal court when advice or sales are made to ERISA plans. **Q. Has the Department revised or provided additional direction in the Release regarding its "enforcement" position during this temporary transitional period?** **A.** Yes, in several respects; first, early in the Release, the Department notes that the primary reason for the comment letters opposing the proposed delay was that investors would be harmed because "*there would not be any meaningful enforcement mechanism in the PTE's without the contract, warranty, disclosure and other enforcement and accountability conditions.*"[i] The same commenters urged that the Department *"at a bare minimum, should add the specific disclosure and representation of fiduciary compliance conditions originally required for transition relief."****[ii]*** **Q. How did the Department respond to these criticisms of the delay?** **A.** First, the Department referenced the strong and substantial comments from the industry that *"investors are sufficiently protected by the imposition of the Impartial Conduct Standards along with many applicable non-ERISA consumer protections."* [iii] The extensive footnote references in the release which support these comments include a comment that, in addition to the existence of the Impartial Conduct Standards, "*there is an additional existing and overlapping robust infrastructure of regulations that are enforced by the SEC, FINRA, Treasury and the IRS, not to mention the Department"* to provide continuing protection to investors. **Q. What was the Department's ultimate rationale for not requiring the disclosures requested by those opposing the delay?** **A.** The Release provides the following reasons for not including these requirements:

1. Many financial institutions are already "using their compliance infrastructures" to meet the requirements of the Impartial Conduct Standards.

2. There are two enforcement mechanisms that remain in place: the imposition of excise taxes, and the existing cause of action under ERISA for improper fiduciary advice to ERISA plan assets, including advice concerning rollovers of plan assets into non plan investments.[iv]

Q. Why are these comments relevant to an analysis of litigation risk and the steps necessary to

reduce that risk? A. A response to that question involves a three-step evaluation.

1. To the extent the Department has provided guidance on the conduct expected of those parties deemed to be "fiduciaries," the failure to adhere to that conduct would logically result in consequences. For example when the Department says it "expects that advisers and financial institutions will adopt prudent supervisory mechanisms to prevent violations of the Impartial Conduct Standards,"[v] then the decision by financial institutions not to adopt such "supervisory procedures" might cause the Department to pursue enforcement.
2. The second step is mere conjecture: Would this failure to act also increase the likelihood of private litigation? Bearing in mind the obstacles to such litigation outlined in our prior Q&As, it is nonetheless certainly plausible that an individual or class action alleging improper sales practices would likely allege the failure to adopt such special "*prudent supervisory mechanisms*" aimed at preventing violations of the Impartial Conduct Standards as a crucial element to its cause of actions. Moreover, the Department's statement of its view that "*the impartial Conduct Standards require that fiduciaries, during the Transition Period, exercise care in their communications with investors, including a duty to fairly and accurately describe recommended transactions and compensation practices"**[vi]*** would suggest current obligations not contemplated by many of these financial institutions, as noted by the footnote references in the DOL release.[vii]
3. The third step requires even more conjecture: Would these allegations only be relevant in private litigation that involves an ERISA violation? For example assume there is an allegation of improper advice from a financial institution annuity representative to move assets from a 401k plan — in which case, the argument, hypothetically, would be that the failure to adhere to the Department's clear mandate in the Release involves a fiduciary breach under ERISA (whether it does or not is not the issue here, we are simply noting the potential argument).

   Another hypothetical: What about private litigation allegations that do not involve a violation of ERISA — such as a class action alleging widespread elder abuse or fraud and misrepresentation in the sale of "unsuitable" annuities? Given the history of the plaintiff's bar in connection with class actions against both life insurers and their life insurance sales agents, it obviously should not be surprising if such claims were to be made. Would the failure to meet the standards articulated by the Department advance such claims? I doubt it. Most state court judges attempting to analyze the merits of a garden variety fraud, misrepresentation or abuse claim will likely be constrained to rely on state law and state court precedents.

FINAL QUESTION: Does the Department's comment that it will not pursue claims against investment advice fiduciaries who are working diligently and in good faith to comply with their fiduciary duties and to meet the conditions of the Prohibited Transaction Exemptions impose an obligation on such fiduciaries to make good faith efforts to implement the delayed provisions of these PTEs? A. No. The DOL's release makes clear that there is no such specific obligation imposed on these fiduciaries during the transition period. Instead, the DOL stated it will "focus on the affirmative steps that firms have taken to comply with the Impartial Conduct Standards and to reduce the scope and severity of conflicts of interest that could lead to violations of those standards."[viii] Nonetheless, the Department goes on to note that for those institutions that choose to adhere to the "detailed standards" set forth in various portions of the delayed PTE's, such adherence "would certainly constitute good faith compliance."[ix]

[[i] Release at 14.
[ii] Release at 15.
[iii] Release at 16.
[iv] Release at 17. Of note, however is that the Department's release goes on to state that it will "reevaluate this issue as part of the reexamination of the Fiduciary rule and PTW's in the context of considering the development of additional and more streamlined approaches."
[v] Release at 18.
[vi] Release at 19.
[vii] See f.n. 29 to the Release and comments therein, including reference to Comment Letter 48 of the ACLI, to wit; "*we strongly oppose a delay approach, based on undefined and ambiguous factors, such as whether firm has taken 'concrete steps' to 'harness market developments', would require the Department to subjectively and inappropriately pick and choose among providers and products based on vague factors.*"
[viii] Release at 30.
[ix] *Id.*

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