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THE 2016 ELECTION AND THE FUTURE OF THE DEPARTMENT OF LABOR FIDUCIARY RULE

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The election of Donald J. Trump to be the 45th president of the United States and Republican control of both congressional houses could have profound impacts on financial services regulation, including the fiduciary regulation and related prohibited transaction exemptions (PTEs and collectively with the regulation, the Rule) adopted by the US Department of Labor (DOL) earlier this year. The Rule became effective on June 7, 2016, and the House of Representatives sustained President Barack Obama's veto of the joint resolution of Congress disapproving the Rule on June 22, 2016.[1]

Many financial services firms are asking whether they still need to operate on the basis of the Rule's applicability date being April 10, 2017. At this time, there is no clear answer, and we do not know (and may not know until early next year) what the Trump Administration or new Congress intends in this area.

We have developed the questions and answers below to help in understanding the various possibilities and related issues.

- **What do we know about President-elect Trump's plans for the Rule?** While the Rule will likely be on the list of regulations to be reviewed as part of the transition, Mr. Trump has yet to take a formal position on the Rule.
  - His regulatory plans suggest he will seek to reduce regulation[2] and make significant changes to the Dodd-Frank Wall Street Reform and Consumer Protection Act.[3]
  - The only mention of the Rule came from an adviser to the Trump campaign, who was quoted as stating that a Trump Administration would repeal the Rule.[4]
  - President-elect Trump has not indicated whom he might appoint as Secretary of Labor, which might signal his intended direction in this area, although J. Steven Hart, a longtime Washington lobbyist, has been named as the leader of his labor transition team.[5]

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1 *See* US Senate, Vetoes by President Barack H. Obama, http://www.senate.gov/reference/Legislation/Vetoes/ObamaBH.htm; *see also* 5 U.S.C. § 801(a)(3) (providing that a major rule takes effect on the latest of (1) 60 calendar days after Congress receives a report on the rule or the rule is published in the Federal register; (2) 30 session days after Congress receives a veto from the president of a joint resolution of disapproval of the rule or, if earlier, the date on which either the House of Representatives or Senate votes and fails to override the veto; or (3) the date on which the rule would have otherwise taken effect).

2 *See* President-Elect Donald J. Trump, Policy, Regulatory Reform, https://www.greatagain.gov/policy/regulatory-reform.html ("Regulatory reform is cornerstone of the Trump Administration, and the effort will include a temporary moratorium on all new regulation, canceling overarching executive orders and a thorough review to identify and eliminate unnecessary regulations that kill jobs and bloat government.").

3 *See* President-Elect Donald J. Trump, Policy, Financial Services, https://www.greatagain.gov/policy/financial-services.html ("The Dodd-Frank economy does not work for working people. Bureaucratic red tape and Washington mandates are not the answer. The Financial Services Policy Implementation team will be working to dismantle the Dodd-Frank Act and replace it with new policies to encourage economic growth and job creation.").

4 Mark Schoeff Jr., *Trump Adviser Anthony Scaramucci Promises to 'Repeal' DOL Fiduciary Rule*, INVESTMENTNEWS, Oct. 18, 2016, *available at* http://www.investmentnews.com/article/20161018/FREE/161019925/trump-adviser-anthony-scaramucci-promises-to-repeal-dol-fiduciary ("Trump told Reuters in an interview that he would release a plan in about two weeks for overhauling the 2010 financial regulatory law known as Dodd-Frank.").

- It is possible President-elect Trump could indicate his intentions regarding his Secretary of Labor nominee (which could be telling), or even the Rule itself, in the coming weeks.

- **Could the DOL revoke the Rule?** Yes, the DOL has the authority to revoke the Rule, but cannot do so without going through a rulemaking process like the one that led to its adoption.[6]
  - DOL rulemaking is subject to Section 553 of the Administrative Procedures Act (APA), including public notice and comment requirements. There are two broad categories of exceptions to the requirements of Section 553 for rules dealing with military or foreign affairs and rules "relating to agency management or personnel or to public property, loans, grants, benefits, or contracts," but they do not appear to be applicable here.[7]
  - In addition, the DOL by its own regulations has established procedures for the revocation or modification of PTEs that require notice and comment.[8]
- **Could the DOL revise the Rule?** Yes, but as with revocation, the DOL would need to engage in notice and comment rulemaking to revise the Rule.
- **What could financial services firms do if the DOL does not act to revoke or revise the Rule?** Financial services firms could petition the DOL to reconsider the Rule or parts of the Rule.
  - Under Section 553(e) of the APA, each agency is required to "give an interested person the right to petition for the issuance, amendment, or repeal of a rule." This would provide a mechanism to compel a response to the DOL as to why the Rule should not be revoked or revised.[9]
  - If the DOL were so inclined, it could use the petition as a reason to grant a motion to reconsider the Rule, which possibly could be used to delay the applicability date or seek a stay of the court proceedings described below as first steps to eventually fully revoking or revising the Rule through the formal notice and comment rulemaking process.
- **What else could the DOL do short of formal rulemaking?** The DOL could also issue interpretive guidance to provide more flexible interpretations of ambiguous aspects of the Rule.

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[5] *See* Rebekah Mintzer, *Veteran DC Lobbyist Leads Trump's Labor Transition Team*, NAT'L LAW J., Nov. 10, 2016, *available at* http://www.nationallawjournal.com/id=1202772095562/Veteran-DC-Lobbyist-Leads-Trumps-Labor-Transition-Team?slreturn=20161011100440.

[6] *See* Section 551(5) of the Administrative Procedure Act (defining "rulemaking" as the "agency process for formulating, amending, or repealing a rule").

[7] *See* Section 553(a) of the Administrative Procedure Act.

[8] *See* 29 C.F.R. § 2570.50(b) ("Before revoking or modifying an exemption, the Department will publish a notice of its proposed action in the FEDERAL REGISTER and provide interested persons with an opportunity to comment on the proposed revocation or modification. Prior to the publication of such notice, the applicant will be notified of the Department's proposed action and the reasons therefore. Subsequent to the publication of the notice, the applicant will have the opportunity to comment on the proposed revocation or modification."). To the extent that the DOL were to propose to revoke the Rule, the applicant notice portion of this regulation may not apply, given that the DOL adopted the new exemptions and amended the existing exemptions on its own motion.

[9] *See* Section 555(e) of the Administrative Procedure Act ("Prompt notice shall be given of the denial in whole or in part of a written application, petition, or other request of an interested person made in connection with any agency proceeding. Except in affirming a prior denial or when the denial is self-explanatory, the notice shall be accompanied by a brief statement of the grounds for denial."); *Auer v. Robbins*, 519 U.S. 452, 459 (1997) ("The proper procedure for pursuit of respondents' grievance is set forth explicitly in the APA: a petition to the agency for rulemaking, § 553(e), denial of which must be justified by a statement of reasons, § 555(e), and can be appealed to the courts, §§ 702, 706.").

- This might involve replacing only those published FAQs regarding the Rule that are viewed as overly restrictive or impractical and publishing new FAQs to provide greater flexibility.[10]
- Typically, guidance and interpretive documents, such as FAQs, can avoid the formal notice and comment rulemaking process, although there are occasional exceptions. Moreover, even if not required to go through the notice and comment rulemaking process, such changes in interpretations can often then be challenged in court.
- While an interpretive rule does not have the same "force of law" as a formally adopted regulation, courts will often consider such interpretations in reaching their conclusions.[11] In this regard, more flexible FAQs might be most impactful where they are issued prior to private litigation and in the event courts defer to the DOL's interpretations in reaching conclusions about the provisions of the Rule.

- **Could the DOL delay the compliance date of the Rule?** While the Rule has already gone into effect, the DOL might decide to delay the April 10, 2017, "applicability date" of the Rule (which, for all practical purposes, is understood to be the "compliance date") by issuing an interim final rule.
  - The DOL could seek to delay the compliance date, announcing the delay through a public notice that is not subject to advance notice and comment rulemaking. Action to postpone the compliance date indefinitely or even for a shorter period of time without notice and comment rulemaking might be subject to challenge absent good cause.[12] In addition, it would seem to stretch prior precedent, which has typically focused on delaying the effective dates of rules that were not already effective.[13] Prior incoming administrations have sought to suspend "midnight rulemaking" by outgoing administrations to reconsider or withdraw the rules. For example, at the start of the Obama Administration, the DOL delayed the effective and applicability dates of the regulations interpreting the statutory investment advice exemption under Sections 408(b)(14) and 408(g) of the Employee Retirement Income Security Act of 1974 (ERISA), which had not yet become effective. The DOL, under then-President George W. Bush's Administration, adopted the rule on January 9, 2009, and it was published in the Federal Register on January 21, 2009.[14] The rule had not yet become effective, though, and the DOL, following a memorandum dated January 20, 2009, from the president's chief of staff directing agency heads to consider extending for 60 days the effective dates of

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[10] *See* Conflict of Interest Exemptions FAQs, https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf.

[11] *See Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) ("We consider that the ruling, interpretations, and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance.").

[12] *See Natural Resources Defense Council, Inc. v. EPA*, 683 F.2d 752, 761 (3d Cir. 1982) (concluding that the indefinite postponement of a final rule is tantamount to a repeal of the rule, which would require notice and comment rulemaking); *Council of the S. Mountains v. Donovan*, 653 F.2d 573, 582 (DC Cir. 1981) (finding that a six-month suspension of a rule would otherwise be subject to notice and comment rulemaking had the agency not found good cause to dispense with such rulemaking).

[13] See Memorandum for the Heads of Executive Departments and Agencies from Rahm Emanuel, Assistant to the President and Chief of Staff (Jan. 20, 2009), 74 Fed. Reg. 4435 (Jan. 26, 2009) (directing agency heads to (1) withdraw all proposed or final regulations that had not yet been published in the Federal Register; (2) consider 60-day delays, but with a public comment period, for all rules that had been issued but had not gone into effect; and (3) refrain from sending any additional rules, except for emergency ones or ones subject to legislative or judicial deadlines, to the Federal Register until reviewed by an agency head appointed by President Obama); Memorandum for the Heads and Acting Heads of Executive Departments and Agencies from Andrew Card, Jr., Assistant to the President and Chief of Staff (Jan. 20, 2001), 66 Fed. Reg. 7702 (Jan. 24, 2001) (directing agencies to (1) implement 60-day delays to any regulation that had been issued but had not gone into effect, and (2) refrain from sending any additional regulations, except for emergency ones, to the Federal Register until reviewed by an agency head appointed by then-President Bush).

[14] *See* Investment Advice—Participants and Beneficiaries, 74 Fed. Reg. 3822 (Jan. 21, 2009).

regulations that had been published in the Federal Register but had not gone effective, proposed to extend the effective date and applicability date of the rule, and requested public comments on legal and policy questions relating to the final rule.[15]

  - Another option would be for the DOL to delay the compliance date of the Rule by issuing an interim final rule subject to notice and comment that would occur **after** announcing the delay. The idea here is that the notice and comment period is offered in the event that comments might cause the agency to "change its mind" based on the comments. But, in effect, because the comment period itself takes time to conclude, such an approach would likely result in the delayed compliance date becoming the final new date (unless further extended). In sum, delaying the compliance date would initially give the financial services industry more time to prepare for compliance with the Rule and also potentially provide the DOL time to start a rulemaking to revoke or revise the Rule or get congressional action. It would not, however, permanently undo the Rule absent further action to revoke or revise the Rule so that the risk of private litigation, discussed below, would remain.

- **What might happen to existing cases challenging the Rule?** The pending litigation will likely continue into the Trump Administration.
  - There are currently six pending lawsuits challenging the DOL's authority to issue the Rule.[16] But on November 4, 2016, the US District Court for the District of Columbia found in favor of the DOL in one of these cases,[17] although the decision is expected to be appealed to the US Court of Appeals for the District of Columbia Circuit.
  - President Trump could instruct the US Department of Justice (DOJ) to stop defending the Rule in court. This would not be unprecedented, as President Obama took a similar step in instructing the DOJ to stop defending the Defense of Marriage Act (DOMA).[18] Instructing the DOJ to stop defending the Rule could present an effective way to have the courts strike down the Rule unless a third-party intervened and continued a successful defense, without DOJ's participation,[19] as happened when the House Bipartisan Legal Advisory Group voted to intervene in defense of DOMA.[20]
- **Could Congress take action in the event the Trump Administration does not?** Given that the Trump Administration is likely to be revisiting a number of initiatives of the Obama Administration, and that the new Congress will remain under Republican control, there are several steps that could occur in January 2017 or shortly thereafter that would affect whether the Rule survives.

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[15] *See* Investment Advice—Participants and Beneficiaries, 74 Fed. Reg. 6007 (Feb. 4, 2009). The regulation was ultimately withdrawn and later reproposed.

[16] *Chamber of Commerce v. Perez*, No. 16-1476 (N.D. Tex., filed June 1, 2016); *Am. Council of Life Insurers v. Perez*, No. 16-1530 (N.D. Tex., filed June 8, 2016); *Indexed Annuity Leadership Council v. Perez*, No. 16-1537 (N.D. Tex., filed June 8, 2016); *Nat'l Ass'n for Fixed Annuities v. Perez*, No. 16-1035 (D.D.C., filed June 2, 2016); *Mkt. Synergy Grp., Inc. v. Perez*, No. 16-04083 (D. Kan., filed June 8, 2016); *Thrivent Financial for Lutherans v. Perez*, No. 16-03289 (D. Minn., filed Sept. 29, 2016). The Northern District of Texas cases have been consolidated, and a hearing is scheduled for November 17, 2016.

[17] *See Nat'l Ass'n of Fixed Annuities v. Perez*, No. 16-1035 (RDM), mem. op. (D.C. Cir. Nov. 4, 2016).

[18] *See* Letter from Eric H. Holder, Jr., Attorney Gen., to The Honorable John A. Boehner, Speaker, U.S. House of Representatives (Feb. 23, 2011), *available at* https://www.justice.gov/opa/pr/letter-attorney-general-congress-litigation-involving-defense-marriage-act.

[19] *See* FED. R. CIV. P. 24 (dealing with intervention).

[20] *See* Holly K. Hooper, *House Leaders Vote to Intervene in DOMA Defense*, THE HILL (Mar. 9, 2011), a*vailable at* http://thehill.com/blogs/blog-briefing-room/news/148521-house-leaders-vote-to-intervene-in-doma-defense.

- Congress could attempt to amend ERISA and Section 4975 of the Internal Revenue Code of 1986 (the Code) to limit the impact of potential fiduciary regulation on broker-dealers, insurance companies, banks, and other financial services firms, such as by (1) amending the definition of an "investment advice" fiduciary to exclude broker-dealers and other types financial services firms; (2) providing explicit prohibited transaction relief (similar in concept to the Section 408(g) statutory exemption for "investment advice" to plan participants and individual retirement accounts (IRAs) that was enacted in 2006); (3) providing that the receipt of differential compensation is not a violation of fiduciary duty or other federal or state law; or (4) limiting the DOL's ability to interpret the prohibited transaction provisions and PTEs under Section 4975 of the Code with respect to IRAs (e.g., by transferring the authority to the US Securities and Exchange Commission).[21]
- Congress could also defund the Rule through an appropriations bill, which would effectively prevent the DOL from using any resources to enforce the Rule. This might not provide much relief absent DOL action to suspend the applicability date, as financial services firms might still be deemed fiduciaries and need to rely on the Best Interest Contract exemption, which in turn would raise the potential of litigation brought by customers and the plaintiffs' bar to enforce private rights of action (see next section).

- **How do these options impact potential private litigation?** Absent revocation or repeal, it remains possible that the Rule could be used as the basis for private litigation.
  - Because the requirements of the Rule do not need to be met until the applicability date (currently April 10, 2017), it is unlikely that a court would apply the Rule before that date – which, as indicated, could be postponed. While private litigants could conceivably make arguments based on treating the principles described in the Rule as more faithful and DOL-endorsed interpretations of existing law rather than changes to a long-standing regulation, even if the Rule is not yet applicable, one court has already rejected such an argument based on the DOL's 2010 proposal.[22]
  - Preventing DOL action on the Rule, such as by Executive Order or congressional resolution, without delaying the applicability date, also might not prevent private litigants from bringing actions based on the Rule.
- **Should firms continue working toward compliance with the Rule by the applicability date?** Yes, it makes sense at this time for financial services firms to continue working toward being in compliance with the Rule by the applicability date (currently April 10, 2017) given the uncertainty, but firms might also start analyzing whether they can delay implementing certain compliance steps until they know more about whether changes are likely. Some are already considering a delayed timetable for implementation.
  - At this time, there is no assurance that either the Trump Administration or Congress will act by the applicability date. It will take time to put in place the new leadership at the DOL, without which it may be difficult to initiate a rulemaking process, and it may also take more than three months to enact final legislation.
  - Until more information is gleaned from the Trump Administration or Congress, we expect that many financial services firms will continue to work toward compliance with the Rule by the

[21] It seems unlikely that the Retail Investor Protection Act, introduced by Rep. Ann Wagner (R-MO), would resurface as it focused on delaying DOL rulemaking until after the SEC adopts rules under Section 913 of the Dodd-Frank Act, although it might be modified to delay the applicability date of the DOL rule until after the SEC adopts a final rule.

[22] *Santomenno v. John Hancock Life Ins. Co.*, 768 F.3d 284 (3d Cir. 2014), *cert. denied,* No. 14-1054, 2015 U.S. LEXIS 2766 (Apr. 20, 2015).

applicability date, rather than take the risk of being unprepared and vulnerable to enforcement action or private litigation in the event that the Rule takes effect without change. In particular, we are aware that securities and banking regulators are already asking firms about how they intend to comply with the Rule, so that firms will need to have a response to those inquiries so long as there is no indication that the Rule will be revoked or delayed.

- Financial services firms might nonetheless reconsider whether they need to implement their compliance programs and client documentation on the same schedule, or whether certain aspects might be held back until closer to the applicability date, in case the Trump Administration or Congress takes action to delay the applicability date or otherwise revoke or revise the Rule. In particular, there may be steps firms intended to take in the November through January timeframe, such as issuing new compensation plans or sending out BIC Exemption transition notices, that they could consider postponing at least until after the Trump Administration takes office on January 20th, at which point the future prospects of the Rule may have become much clearer.

If you have any questions or would like more information on the issues discussed in this report, please contact any of the following Morgan Lewis lawyers:

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