FACT SHEET: A DISTRICT COURT UPHOLDS THE DOL'S HISTORIC RULE ESTABLISHING THE BEST INTEREST STANDARD FOR FINANCIAL ADVISERS WHO SERVE RETIREMENT SAVERS

The Decision in *NAFA V. Perez, No. 16-1035 (D.D.C.)*

Background. On April 8, 2016, the Department of Labor ("DOL") issued a rule requiring all financial advisers to put the best interests of their clients ahead of their own financial interests when they provide advice for retirement accounts. The new rule will save Americans billions of dollars annually that brokers, insurance companies, and other financial firms have been receiving from investment recommendations that pay handsome fees and commissions but yield poor returns for clients. The final rule was issued after an extraordinarily thorough and thoughtful rulemaking process at the DOL, and it fulfills the letter and spirit of the federal law that Congress passed in 1974 (known as "ERISA") to ensure that retirement savings are protected by the highest standards of loyalty and care.

The attacks on the rule. The financial adviser industry, including insurance companies and agents, launched an all-out war on the rule, attempting to derail it at every step: during the rulemaking process, through numerous bills in Congress, in media campaigns, and most recently, in a series of six lawsuits. On June 2, 2016, the National Association for Fixed Annuities filed a six-count complaint in the U.S. District Court for the District of Columbia attacking the rule on multiple grounds and seeking an injunction against application of the rule. Better Markets and other members of the "Save Our Retirement" coalition filed amicus briefs in defense of the rule. The Court heard oral argument on August 25, 2016.

The Court's decision. On Friday, November 4, 2016, in the first case to resolve any of the pending legal challenges to the rule, Judge Randolph D. Moss issued a 92-page memorandum opinion firmly rejecting each and every one of NAFA's claims. The Court carefully examined NAFA's claims in turn, applied well-established principles of statutory construction and judicial review of agency rules, and held against NAFA on every count, finding as follows.

1. *Scope of Authority.* The DOL acted well within its statutory authority to define terms, and its definition of rendering "investment advice" in the rule is fully consistent with the provisions in ERISA. The Court observed that "Indeed, if anything, it is the [old DOL rule]—and not the current rule—that is difficult to reconcile with the statutory text." The DOL rule not only fits within the statutory text, it also "fits comfortably" within the broad, protective purposes of ERISA, especially since the retirement landscape has changed so much over the last several decades and individuals are more dependent than ever on sound advice.

2. *Authority over IRAs.* The DOL had the authority to impose duties of loyalty and prudence on advisers to IRA accounts under its broad power to impose conditions when it grants exemptions from EIRSA's prohibitions. Here, the DOL reasonably concluded that allowing IRA advisers and others to continue receiving commission-based compensation (something prohibited by ERISA) would necessitate the imposition of additional protective conditions, including the duties of loyalty and prudence. In fact, under ERISA, without imposing those conditions, the DOL could not have allowed insurance agents selling FIAs to continue receiving sales commissions.

3. *The private right of action.* While the rule requires IRA advisers to enter enforceable contracts with clients if they wish to continue receiving commission-based compensation, the DOL did not

thereby create a private right of action—something only Congress can do. By requiring a contract between the adviser and the client, the DOL was simply conditioning the right to continue receiving commission compensation, not creating a right of action. Under the rule, state law—and nothing in the rule or federal law—would determine the enforceability of the contract terms. Moreover, courts have long permitted IRA participants and beneficiaries to bring state law claims for breach of annuity contracts.

4. *“Reasonable compensation.”* The requirement in the Best Interest Contract exemption (“BIC”) that an adviser may not receive more than “reasonable compensation” for its recommendations is not void for vagueness under the Due Process clause. That phrase satisfies the core test, which is less exacting in the area of economic regulation than other areas: whether a reasonably prudent person, familiar with the objectives of the regulation, would have fair warning of what is required. In fact, the term “reasonable” is ubiquitous in the law, including many federal statutes, ERISA itself, other DOL rules and exemptions (where it is also the subject of guidance), and the case law.

5. *Placing fixed indexed annuities (“FIAs”) under the BIC exemption, not PTE 84-24.* It was not arbitrary and capricious for the DOL to apply the more protective conditions of the BIC, rather than PTE 84-24, to FIAs, given their risks and complexities. The scope of judicial review on an “arbitrary and capricious” claim is narrow, and here the DOL considered the appropriate factors, drew rational or plausible conclusions, and offered reasoned explanations for its choices.
   - The DOL’s decision does not conflict with the Harkin amendment in Dodd-Frank, which deals with securities law, not ERISA.
   - The DOL provided notice and an opportunity to comment on the possibility that FIAs would be placed under the BIC in the final rule—the final rule was a logical outgrowth of the proposed rule.
   - The treatment is workable, as it is possible for insurance companies to reasonably ensure that its advisers—including independent agents—will adhere to the BIC; they need not vouch for the conduct of agents selling *other* companies’ insurance products.
   - The DOL did consider the marginal costs and benefits of placing FIAs under the BIC. *Michigan v. EPA* does not require a formal, monetized cost-benefit analysis. Further, executive orders addressing cost-benefit analysis by agencies do not create *any* substantive or procedural rights enforceable against the United States.
   - A common theme in NAFA’s brief is the disruption and the need to restructure operations that the rule will entail. But DOL considered the greater harm from losses suffered by investors due to conflicted investment advice. DOL struck a balance and it is not the role of the court to substitute its judgment for that of the agency.

6. *The Regulatory Flexibility Act (“RFA”).* DOL did assess the impact of the rule on small businesses, and this satisfied the RFA’s purely procedural requirements. A reasonable, good-faith effort is all that is required. Here, the DOL specifically (1) addressed issues raised by public comments; (2) described the projected reporting, recordkeeping, and compliance requirements; and (3) described the steps the agency took to minimize any significant impact on small entities, along with a statement of the reasons for the alternatives adopted.