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THE FIDUCIARY RULE MAY HAVE BEEN A DISTRACTION

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A History Lesson

The Birth and Death of a Rule…

In 2010, the Obama Administration proposed a rule through the Department of Labor that would govern how investment advice is given to retirement plan participants and entities that sponsor those plans, generally employers. In April 2016, the "fiduciary rule" was published in the Federal Register and was given a target effective date of June 7, 2016. That rule included a default delay of April 7, 2017 should it require further review. It did, and in March 2017, the fiduciary rule was revised by the Trump Administration's DOL regulators with a new partial effective date of June 9, 2017.[1] The full rule was set to go into effect in early 2018, but was delayed by the DOL until June 30, 2019 at the eleventh hour.[2] In March 2018, the federal Fifth Circuit Court of Appeals vacated the existing DOL fiduciary rule, rendering the rule as written virtually ineffective.[3] The DOL did not challenge this ruling.[4]

"To see what is right and not to do it is want of courage, or of principle."

CONFUCIUS

…But The Standard Seems to Have a Life of Its Own

Amid the upheaval surrounding the DOL Fiduciary Rule, the Securities and Exchange Commission has been not-so-quietly taking up the mantle of a wide-reaching standard of care. It appears this standard of care will apply to all types of registered investments and the various financial professionals who sell them or provide advice regarding them. The SEC now seems willing to embrace and run with something which has eluded it for – even if unintentionally – for so long.

Walter "Jay" Clayton, an alumnus of the University of Pennsylvania, is a career attorney and a former partner of law firm Sullivan & Cromwell. He was appointed to chair the SEC by President Trump in January 2017 and confirmed by the senate May 2, 2017 in a 61-37 vote.[5]

Prior to Mr. Clayton taking the reins of the SEC, other chairs had tried and failed to develop a consensus among the agency's commissioners regarding a uniform standard of care for brokers and investment advisors and the clients they serve. In June 2017, Mr. Clayton released a request for comment on a fiduciary standard to US lawmakers and SEC staff.[6] In early

2018, Mr. Clayton and other commissioners, including former acting chair, Michael Piwowar – formerly a critic of a broad fiduciary standard – indicated there is developing consensus among the current SEC commissioners around a fiduciary or best interest standard.[7]

In May 2018, Mr. Piwowar announced plans to step down from his commissioner role in July 2018.[8] His replacement has not been announced as of the writing of this piece.

Mr. Clayton has since expressed direct support for a best interest standard, very similar to the DOL's fiduciary rule, going so far as to say recently that…

"By raising the conduct standard applicable to broker-dealers, we are applying consistent, fiduciary principles across the spectrum of investment advice. In a word: harmonization. Broker-dealers will be, and investment advisers already are, required to act in the investor's best interests."[9]

One may conclude, then, that the SEC is not going to look the other way when it comes to the fiduciary responsibilities of the professionals it over-sees.

So What?

Trying to predict what the SEC will do and when is not a very constructive exercise. Having said that, it appears the SEC has the motivation and muscle to effect widespread change in the securities industry when it comes to how financial advisors interact with their clients…and who can even operate under the professional title of "financial advisor."

In the October 2017 Thought Leadership piece, titled "*If the DOL Delays, Why You Should Not*," we saw how postponing alignment with the standards embodied in the fiduciary rule could potentially put your practice in a precarious position. The DOL fiduciary rule would have only applied to qualified retirement accounts. The SEC has the capacity to act on a much larger stage.

Indeed, it has already signaled stricter enforcement of advisors and firms which fail to disclose conflicts of interest in relation to fund share classes. SEC Division of Enforcement co-chair Steven Peikin, a Clayton appointee, said in early 2018 that the agency "will continue to pursue securities violations associated with mutual fund share class selection disclosure failures."[10]

One may conclude, then, that the SEC is not going to look the other way when it comes to the fiduciary responsibilities of the professionals it oversees. One may also be wise to take Mr. Clayton and the other commissioners at their word on this matter.

The SEC has very clearly stated on its own web site on the page entitled "Information for Newly-Registered Investment Advisers," that "investment advisers are fiduciaries." And, further, that investment advisors "have a fundamental obligation to act in the best interests of [their] clients and to provide investment advice in [their] clients' best interests."[11]

How Did We Get Here?

In a 2014 Forbes article titled "The Brokerage World Is Changing, Who Will Survive?" author Andre Cappon recited a brief history of the brokerage industry.[12] In the section entitled "Retail Brokerage Business Models," Cappon states that "brokers became primarily 'asset gatherers…' The broker's value proposition thus became: customer relationship management, asset allocation (based on customer age, income and risk profile), selection of mutual funds/asset managers." Brokers used to sell investments. Today, the term "broker" and "investment advisor" are often used interchangeably. If the SEC has its way, that may change shortly.[13]

On a broader scale, the average financial advisor has gone from being a mutual fund or insurance salesperson in the 1980s and 1990s to more of generalist consultant to his or her clients today. Retail clients now seek advice from their advisor, not a pitch on a product. This evolution has happened faster and more thoroughly in some quarters than others. It is not the purpose of this piece to explore that subject fully. However, the evolution is clear.

Unless you've been living under a rock or operating your practice in a silo – or you simply lack the perspective of time – the reality is that the financial advisor is no longer primarily a salesperson for an insurance company or a brokerage firm. Today's financial advisor is equipped with multiple tools, products, and skill sets for solving a retail client's financial puzzle. Risk mitigation. College funding. Starting a business. Growing an investment or real estate portfolio. Saving for retirement. Efficient tax planning. Debt reduction. Prudent estate distribution methods. Planning for longevity. Healthcare needs later in life. Special needs planning for family members with disabilities. Caring for an aging parent. Divorce. Business succession. The list is seemingly endless.

Today's financial advisor is advising more on solutions and strategies than mere product selection. Regulatory guidelines require investment advisor representatives to help their clients select the most appropriate investment solution at the most reasonable cost without respect to how much they or their firm earns as a result. Certified Financial Planner® professionals are required to behave in a similar manner according to their professional code of conduct.

If you are an IAR and are not already operating in this manner, you may soon be required to do so. If not, your mode of doing business may become outmoded.

"Sensible people will see trouble coming and avoid it, but an unthinking person will walk right into it and regret it later."

Jewish Proverb

A prudent planner might be well advised to consider a higher standard today and not wait for the rule of law to force change…

What's Next?

As mentioned earlier, trying to predict what the SEC will do and when is not constructive. What may be far more constructive is embracing the change that is already here.

1) Are you a fiduciary?

   You might already know how to answer this question. But, if you are not sure what you are, then it would be advisable to consult your firm's compliance department or outside legal counsel immediately. You are required by law and by codes of professional conduct to act in the manner you hold yourself out to the public. Failure to do so could cost you your career…and more.

2) If you are a fiduciary, be a fiduciary.

   The SEC outlines several requirements for fiduciary advisors in its "Information for Newly-Registered Investment Advisers" page.11 Here are a few:

   a) "You must employ reasonable care to avoid misleading clients…"
   b) "You must provide full and fair disclosure of all material facts to your clients and prospective clients…"
   c) "You must eliminate, or at least disclose, all conflicts of interest that might incline you — consciously or unconsciously — to render advice that is not disinterested."

   Similarly, the CFP Board outlines the following in its Code of Ethics and Professional Responsibility:[14]

   > "Principle 4 – Fairness: Be fair and reasonable in all professional relationships. Disclose conflicts of interest. Fairness requires impartiality, intellectual honesty and disclosure of material conflicts of interest. It involves a subordination of one's own feelings, prejudices and desires so as to achieve a proper balance of conflicting interests. Fairness is treating others in the same fashion that you would want to be treated."

   The new CFP Board Code of Ethics and Standards of Professional Conduct which will become effective October 2019 is even more granular and specific.[15]

3) Suitability is probably not suitable anymore.

   With the SEC about to embark on an effort to align the fiduciary or best interest conduct requirements for IARs and Registered Reps, the idea that suitability of an investment or financial product will continue to be an acceptable standard may be heading the way of the legendary cowboy chasing the proverbial sunset. A prudent planner might be well advised to consider a higher standard today and not wait for the rule of law to force change when it may be too late to catch the last train out of Dodge.

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About Ashton Thomas Private Wealth

Ashton Thomas Private Wealth is a diversified, boutique financial advisory firm headquartered in Scottsdale, Arizona. We're committed to excellence, integrity, and respect in every aspect of our business. We also strive to stay at the forefront of technological innovation and thought leadership within our industry. We encourage our advisors and staff to use independent thought and collaborate collegially.

What we believe sets us apart:

- A family-oriented, warm, professional culture where you and your clients can thrive
- A seamless, cutting-edge technology solution to manage your practice and serve your clients
- Smart, interactive tools for communicating with clients and tracking their progress
- Single-platform access to SMA and institutional fund managers with a choice of custodian
- A fully-integrated 401(k) platform with comprehensive fiduciary capabilities
- Over 40 years of combined in-house portfolio strategy experience and guidance

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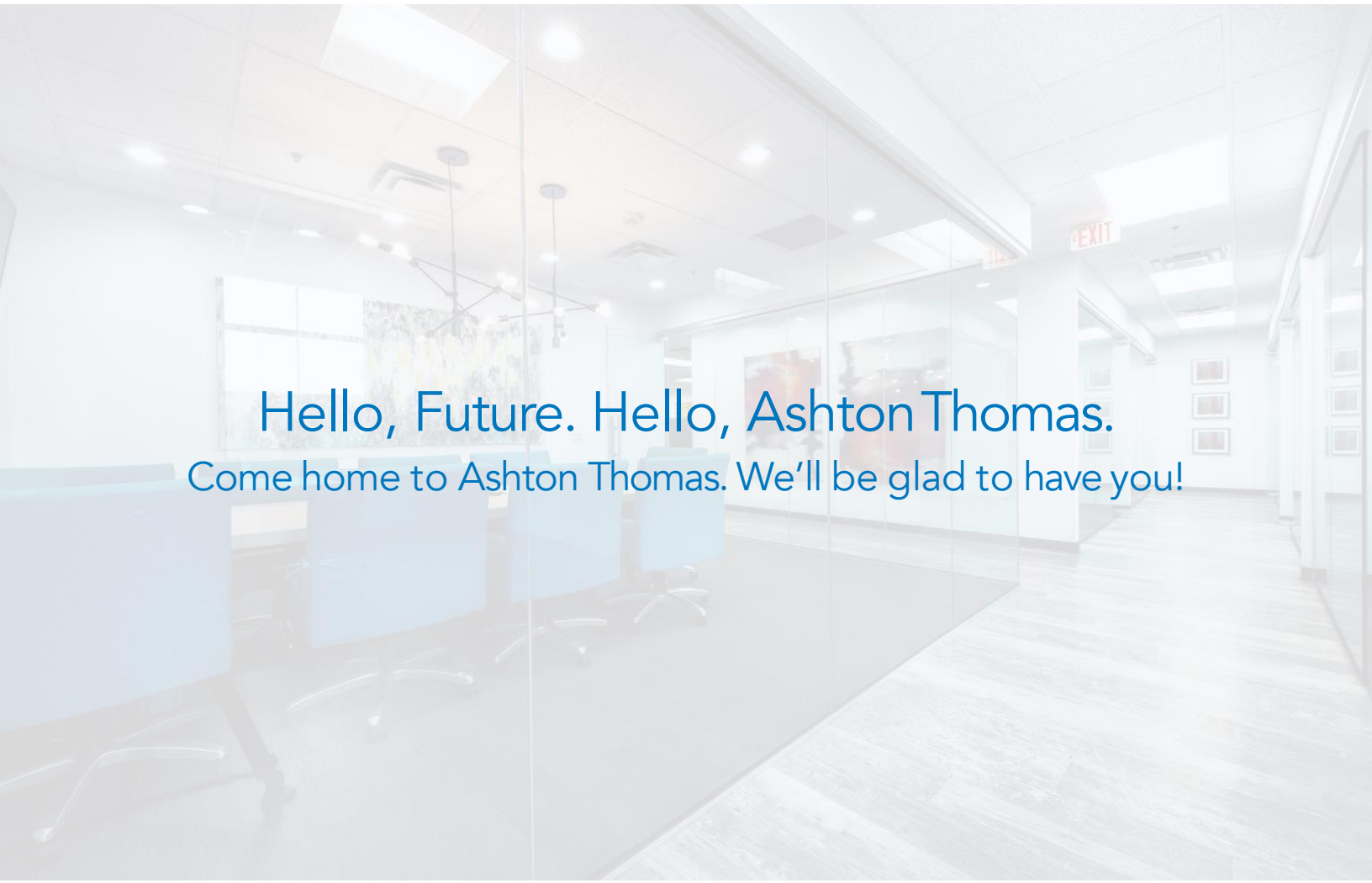

Hello, Future. Hello, Ashton Thomas.

Come home to Ashton Thomas. We'll be glad to have you!