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A new curve in the fiduciary road: What the Fifth Circuit Court of Appeals' decision may mean for advisors



Last week, I had an update on the status of the DOL Fiduciary Rule all ready to publish... and then the Fifth Circuit Court of Appeals introduced another curve in the fiduciary road on Thursday, March 15. So, here's a new update.

What does the Fifth Circuit Court of Appeals' decision mean right now?

After several failed attempts to derail the Fiduciary Rule through litigation, on Thursday March 15, opponents of the Fiduciary Rule succeeded in a 2-1 vote by the Fifth Circuit Court of Appeals. **The court's decision essentially wipes the Fiduciary Rule off the books entirely.** This decision will take effect on May 7, 2018. As of that date, we theoretically return to the rules, exemptions, and guidance that pre-dated the Fiduciary Rule.

I say "theoretically" because, while the court's decision vacates the Fiduciary Rule entirely, **that doesn't mean everything returns to the way it was before the Fiduciary Rule.** From a regulatory perspective, yes, it will be like the rule never existed. But, from a practical perspective, a lot has happened in the time since the Fiduciary Rule went into effect that is hard to unwind. For example:

1. **Changes in product models:** In the wake of the Fiduciary Rule, many firms began reducing their product inventory to better align sales/advisory practices to fiduciary standards of prudence, diligence, and care and reduce the cost structure of many products in order to remain competitive and profitable;
2. **Changes in sales and service models:** Many firms modified commission grids, front-end loads, and revenue sharing arrangements and moved to advisory-only models to better align sales/advisory practices to clients' best

interests (duty of loyalty);

3. **Continued streamlining of advice:** The Fiduciary Rule increased the need for firms to streamline the delivery of advice to reduce risk, increase through-put, and improve consistency of quality advice through robo solutions, model portfolios, and similar solutions; and
4. **Heightened consumer awareness and expectations:** The Fiduciary Rule and protracted debates have increased many consumers' awareness of conflicts, differences in business models, and other features that likely have changed consumer preferences and expectations.

These changes are likely to have a lasting effect on the market—well beyond May 7. Moreover, to the extent there is proposed new rulemaking, these changes are likely to heavily influence the shape of new regulations.

Will the DOL or SEC promulgate new regulations?

The short answer is Yes. There are two primary reasons for this:

1. Many recognize that greater clarity and uniformity when it comes to how financial services are rendered to investors, particularly individual investors, would help the entire industry—investors, advisors, asset managers and home offices;
2. There are others waiting in line to fill the void that will be created in the absence of the Fiduciary Rule.

On that first point, many in financial services have wanted the SEC (under Section 913 of the 2010 Dodd-Frank Act) to take the lead in proposing a fiduciary standard. When the SEC tried and failed to do it, the DOL took the torch. The experience of the past few years has impressed on everyone, including the SEC, the need to take leadership in this space and advance a *uniform* rule.

The added reason for the SEC to do this is the second point I mentioned: If the SEC does not address this quickly and confidently, others will try and that trying will cause significant confusion and ambiguity. Various federal and state agencies and organizations have already been busy working on their own fiduciary standards, all of which are, or are likely to be, stricter than current SEC advisory-fiduciary rules and more like the DOL's Fiduciary Rule. Examples include:

1. The Certified Financial Planner Board has developed its own fiduciary standards and is likely to release additional (DOL-like) standards in the coming months.
2. Various states such as Nevada, New York, Maryland, New Jersey, and Illinois have introduced new fiduciary standard proposals or soon may.
3. Some state regulators, such as the Secretary of the Commonwealth of Massachusetts, are seeking to advance consumer protections through enforcement efforts.

So, what's next? Here are a few thoughts:

1. **Various groups will try to appeal the Fifth Circuit's decision. It is not an impossible hurdle, but it is a challenging one to overcome.** The main reason is the White House and Congress have long-looked upon this Obama-era rule with disfavor. In addition, the current administration wants to curtail agency rulemaking and defer to Congress. The Fifth Circuit's decision was largely premised on that argument; namely, that a federal agency (DOL) over-stepped its authority by supplanting Congress' judgment (codified in the statutory language of ERISA) with its own (the Fiduciary Rule). There are various ways that the court's decision could be challenged, so stay tuned.
2. **The SEC will release its proposed fiduciary rules for advisors and broker-dealers within the next two months.** As is common in such rulemaking processes, the SEC will give the public 2-3 months to review the rules and make comments. Then the SEC will either re-propose its rules or finalize them. I expect that could happen before year-end, in which case the SEC's fiduciary rules could go into effect somewhere between late 2019 to mid-2020.
3. **The DOL will hold off on further rule-making until the SEC has acted.** The DOL is not likely to have the support of the current Administration to advance new rules or fight the Fifth Circuit's decision. The DOL has been consulting with the SEC on their proposed rulemaking, so I expect that to be the main way in which the DOL gets to influence a uniform fiduciary standard. In addition, to the extent that the SEC's rules leave gaps or inconsistencies, I expect the DOL to work to close those gaps and resolve those inconsistencies.
4. **There will be a short-term flurry of activity from other organizations/states during this period of ambiguity.** It is equally possible that the Fifth Circuit Court's decision may deter states from creating new rules. The court's decision may also embolden them to act more swiftly and aggressively.

The bottom line

- We urge advisors to contact their home office for guidance, where applicable.
- We believe that regardless of the Fiduciary Rule, every indication is that there is a sustained shift to more fiduciary-like standards for broker-dealers and possibly some enhancements ahead to existing SEC fiduciary

standards. Advisors who anticipate these changes and continue to evolve towards that paradigm will be at a competitive advantage in the face of major industry-wide challenges like demographic change, technology development and margin compression.

- We believe that advisors should continue to find ways to create capacity and manage risk. The Fiduciary Rule was gasoline on that fire, but the fire is still burning. Our view is that whatever further changes the DOL, the SEC or others plan to make, the features of prudence, loyalty, fees, and disclosure will persist—and you will have to demonstrate that you met those standards.
- Russell Investments has been a partner in meeting the fiduciary challenge for over 40 years and has nearly 20 years of experience in helping advisors implement fiduciary solutions. Regardless of the fate of the DOL fiduciary rule, we are committed to assisting advisors in addressing not only the threat of regulatory risk, but also the opportunity for competitive differentiation.

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