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October 22, 2019

By E-mail: eric@decisionengines.tech
and U.S. Mail

Mr. Eric S. Smith
Chairman & Chief Executive Officer
Decision Technologies Corporation
755 W. Big Beaver Road, Suite 150
Troy, MI 48084

Re: Opinion for Decision Technologies Corporation

Dear Mr. Smith:

Decision Technologies Corporation ("DTC") has developed a patented decision-assistance technology ("Decision Assistance Technology" or "DAT") for use in the financial services industry. DTC's DAT may be used by registered broker-dealers and their registered representatives ("Reps"), registered investment advisors ("RIAs") and their individual advisor representatives ("IARs") (collectively, "Firms" at the institutional level or "Advisors" at the individual representative level) to comparatively evaluate investment products. DAT may be used by Firms offering investment-related services through their Advisors to investor clients to comparatively evaluate and identify appropriate investment products for their clients. Investor clients may include fiduciaries to employee pension benefit plans ("Plan Fiduciaries") that are subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") or participants with one or more accounts in such plans. Investor clients may also include individuals with one or more individual retirement accounts ("IRAs"), other similar tax-advantaged accounts that are not subject to Title I of ERISA, and retail investment accounts.

Title I of ERISA requires fiduciaries of employer-sponsored retirement plans to act in accordance with a "Prudent Man Standard of Care."

On June 5, 2019, the Securities and Exchange Commission ("SEC") adopted Regulation Best Interest[1], which requires broker-dealers and their registered Reps to act in the best interest of their retail customers when making recommendations of any securities transactions or investment strategies involving securities. Regulation Best Interest has a compliance date of June 30, 2020.[2]

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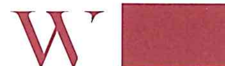
[1] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019).
[2] On September 10, 2019, two suits were filed in the Southern District of New York challenging the SEC's Regulation Best Interest. In the first, eight attorneys general filed suit against the SEC for failing to institute a uniform fiduciary standard and meet basic investor protections as required by the Dodd-Frank Wall Street Reform

Chicago ▪ Lincoln, MA ▪ Palm Beach Gardens, FL ▪ St. Louis ▪ San Francisco ▪ Tampa ▪ Washington, DC



You have asked for our opinion as to whether the use of DAT (a) by Firms, their fiduciary Advisors, and Plan Fiduciaries of ERISA plans may help them meet ERISA's prudence standard, and (b) by broker-dealers and Reps may help them to meet the standard of conduct as set forth in Regulation Best Interest owed to "retail customers."

I. EXECUTIVE SUMMARY OF ANALYSIS AND CONCLUSIONS

- ***ERISA's Prudent Man Standard of Care.*** Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") requires fiduciaries of employer-sponsored retirement plans (*e.g.,* 401(k), profit sharing, defined benefit, multiemployer, and Taft-Hartley plans) to act in accordance with a "Prudent Man Standard of Care." It provides, in part, that a fiduciary shall discharge its duties solely in the interest of participants and beneficiaries and (i) for the exclusive purposes of providing benefits to participants and beneficiaries and defraying reasonable expenses in administering the plan; (ii) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims; (iii) by diversifying investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Thus, a fiduciary must carry out its duties prudently with regard to all aspects of the retirement plan. With regard to an investment or an investment course of action taken by the fiduciary, a fiduciary is deemed to comply with the Prudent Man Standard of Care if the fiduciary gives "appropriate consideration" to relevant facts and circumstances and making a determination that the particular investment or investment course of action is "reasonably designed to further the purposes of the plan."

- ***Using Decision Assistance Technology to Meet Prudent Man Standard of Care.*** ERISA is silent with respect to the use of any particular type of investment tool to satisfy the Prudent Man Standard of Care. DAT ranks and scores universes of investment choices that have been filtered and shaped, using hierarchical blends of weighted performance factors solely based on the client's investment goals, risk tolerance, performance preferences, and other distinguishing factors. **In our view, use of DAT by fiduciary Advisors or Plan Fiduciaries, would assist them in giving (and demonstrating to regulators and in court proceedings that they have given) appropriate consideration as to whether a plan's investments or the investment course of action taken is reasonably designed to further the objectives of the ERISA plan.**

- ***Tibble's Duty to Monitor Investments.*** In *Tibble v. Edison International*, the U.S. District Court for the Central District of California ruled in favor of plaintiff 401(k) plan participants in a case involving prudence issues concerning the higher costs associated with retail class (in contrast to institutional class) mutual funds that had been in the plan's

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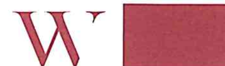
organization of financial planners working under registered investment advisers, filed suit challenging Regulation Best Interest as unlawful and injurious to registered investment advisors by creating a competitive disadvantage with respect to broker-dealers who are permitted to take into account their own personal interest in providing recommendations.



investment lineup for many years. The Supreme Court concluded that, under trust law, a fiduciary has a continuing duty to monitor trust investments and to remove imprudent ones. The District Court, in applying this standard, stated that the fact a plan fiduciary secured independent advice does not necessarily indicate that he acted prudently.

- ***Using Decision Assistance Technology to Satisfy the Duty to Monitor Investments.*** *Tibble* does not expressly describe the manner in which the ongoing duty to monitor plan investments must be met. Engaging and uncritically accepting and following the advice of an independent investment professional for the provision of investment advice with respect to ERISA plan investments does not necessarily mean that a Plan Fiduciary has acted prudently. Use of DTC's DAT involves the repeated use of its four-step process every quarter to comparatively evaluate how previously selected investments have performed since their selection. Securing the advice of an Advisor alone, without more, may not meet the Plan Fiduciary's or the Advisor's duty to monitor investments. DAT's comparative evaluation of investments by scoring and ranking them based on the client's investment objectives provides a process that could help ensure independent oversight of an Advisor's investment recommendations – a protective "second opinion," if you will – as encouraged by *Tibble*. **In our view, repeated use of DAT by fiduciary Advisors or Plan Fiduciaries on a quarterly basis or other appropriate periodic intervals to comparatively evaluate the performance of an ERISA plan's investments will help them satisfy (and help them demonstrate that they have satisfied) their fiduciary duty to monitor investments and identify chronically underperforming or imprudent ones so that they can be removed and replaced with more prudent ones.**

- ***SEC's Regulation Best Interest.*** Regulation Best Interest imposes a standard of conduct on registered broker-dealers and their Reps when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities. It requires the broker-dealer or Rep to act in the retail customer's best interest and not place its own interests ahead of the customer's interests ("General Obligation"). To satisfy the General Obligation, a broker-dealer or Rep must satisfy four component obligations: (i) the Disclosure Obligation, (ii) the Care Obligation, (iii) the Conflict of Interest Obligation, and (iv) the Compliance Obligation (collectively, the "Component Obligations"). Thus, the failure to meet any one of the Component Obligations (discussed in Section III.C.1) constitutes a violation of Regulation Best Interest.

- ***Using Decision Assistance Technology to Satisfy the Care Obligation Under Regulation Best Interest.*** Regulation Best Interest is silent with respect to the use of any particular process or type of interactive tool to satisfy the Care Obligation. When using DAT, the Rep will also apply client-specific factors (perhaps even those selected by the client) to "shape" and identify the qualified universe of investment choices that will eventually be scored and ranked. The Rep will then hierarchically arrange and weight client-specific investment performance parameters to reflect each parameter's relative importance to the client. The factors and parameters that are chosen, applied, arranged and weighted specific to the client will indicate and demonstrate what the client considers to be in the client's best

interests, and will likely be consistent with the information gathered from the client's investment profile. Any inconsistencies will prompt further productive discussions between the Rep and the client about the client's investment objectives, financial circumstances, risk tolerance, investment preferences, etc. **Assuming a Rep obtains an adequate investment profile of the retail customer (*i.e.,* "know your customer"[3]), the use of DAT can assist the Rep in complying with (and demonstrating compliance with) two of the components of the Care Obligation. Specifically, DAT will assist the Rep in exercising reasonable diligence, care and skill to (i) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the broker-dealer or Rep ahead of the interest of the retail customer; and (ii) have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile, and does not place the financial or other interest of the broker-dealer or Rep making the series of recommendations ahead of the interest of the retail customer.**

- ***Using Decision Assistance Technology to Satisfy the Conflict of Interest Obligation Under Regulation Best Interest.*** DAT scores and ranks investment products based on the performance parameters selected, hierarchically arranged and weighted to reflect their relative importance to the client. DAT recommends and provides a practical means to consider a broader universe of investments than just those limited by the broker-dealer's or Rep's inventory or "approved lists." Considering this broader pool of investment products, and comparatively evaluating the products, based solely on whether and how well they meet the client's composite weighted blends of performance criteria, may reduce the likelihood that recommendations made to retail customers place the interest of the broker-dealer or Rep ahead of the interest of the retail customers. Indeed, the use of DAT to comparatively evaluate the full range of available investment choices, based purely upon objective client-specific performance parameters, should effectively "filter out" or eliminate conflicts of interest that might otherwise encourage or incentivize recommendations of one investment choice over another and should enable the broker-dealer and Rep to demonstrate that such conflicts of interest have been eliminated. **In our view, the use of DAT by Reps when advising retail customers will be helpful in complying with (and demonstrating compliance with) components (i), (ii) and (iii) of the Conflict of Interest Obligation. In addition, the use of DAT can be referenced in the broker-dealer's reasonably designed policies and procedures as a means of reducing the likelihood that conflicts of interest may unduly influence Reps, including those associated with more limited product offerings.**

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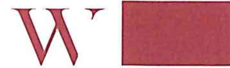
[3] In reference to FINRA Rule 2090, "Know Your Customer."



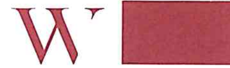
- ***Use of Decision Assistance Technology is Consistent with Best Practices.*** ERISA, to a great extent, is a process driven statute (although there is also a strong substantive prudence requirement). As such, it does not focus on the outcome of a decision by an Advisor or Plan Fiduciary, but instead on the process by which that decision was reached. DAT is an investment selection process that can take into account the broadest possible universe of investment products, and not only those investment products that are available to a particular Advisor (although it can also be used to comparatively evaluate even limited product universes). By applying an investor's preferences thereafter to "shape" the available investment universe (of qualified choices), and then applying a hierarchically arranged and weighted blend of performance parameters reflecting each specific client's needs, goals, and preferences, the results of such a process may also result in improved investment performance and thus make actual achievement of investment and retirement goals more likely. Taken together with its recommended focus on the broader universe of investment options rather than restricting its analysis to the products available to the Advisor, DAT's method approaches a best practice. **In our view, when all this is taken together with prudent policies and procedures, the use of a tool such as DAT may be an evolving best practice for use in selecting and monitoring the performance of investments for ERISA plans.**

II. FACTUAL OVERVIEW OF THE TECHNOLOGY

From your perspective, the investment selection process used by Advisors – how and why certain products are selected – has long lacked transparency. The critical question DAT is trying to answer for the investor client is: *Of all the available choices of investment products, which one is best for me?* Note that DAT is not limited to evaluating those products available to a particular Advisor, which it can certainly be applied to perform, but can be and ideally is utilized to evaluate the broadest possible universe of "qualified" investment products, as discussed below.

In your opinion, DAT identifies the best investment product for the client because it accomplishes three things: (i) it cuts through all of the "noise" from advertising and marketing materials, (ii) it filters out all conflicts of interest, both known and unknowable, and (iii) it comparatively evaluates all existing investment choices in a manner specific to a client's needs, investment goals, preferences, and risk tolerance.

DAT enables any user, whether an IAR, Rep, Plan Fiduciary, IRA account holder, or retail investment account holder to comparatively evaluate thousands of mutual funds, money managers, annuities and other financial products based on the client's unique needs, goals and preferences. The client and/or the client's Advisor can select any number of performance parameters, which can then be hierarchically arranged and weighted, in order to score and rank thousands of existing investment choices. In your view, the transparency of the process – the fact that clients can see and directly participate in selection, arrangement, and weighting of the factors important to them – empowers clients, engendering trust in the investment selection and performance monitoring processes.



In its original design and recommended application, DAT begins with the broadest possible universe of investments, which are those products for which data can be gathered from the largest publicly available databases covering both mutual funds and money managers.

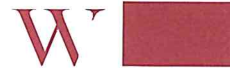
Application of DAT involves several steps:

Step 1: "Filtering" to "shape" the universe of investment choices. First, an appropriate database is selected. This can be based upon the user's preference – *i.e.,* the database the Advisor is currently using or wishes to use, or the choice of database can be based on the client's preference. At this juncture, "filtering" is applied to define the universe of investment choices relevant to the client. For example, if the client is seeking a domestic U.S. Large Cap Value mutual fund or separately managed account ("SMA"), filters are used to exclude any mutual fund or SMA that would not legitimately qualify as a domestic U.S. Large Cap Value mutual fund or SMA.

In your view, virtually all investment advisors utilize progressive "filtering," which is the successive application of single factor-based filters to disqualify certain investment choices to arrive at the final recommendation. For example, if the 5-year average annual return above a certain level is the factor in question, all investment options that do not meet this criterion are filtered out of the universe of potential investment recommendations. In your view, this "single factor disqualification" can too often exclude otherwise strong performing investments choices – choices that may have exceptional performance characteristics in other areas that would (in total) be potentially stronger choices that the client would logically wish to see.

With DAT, the client can select from a menu of filters that can be applied to "shape" the investment universe – that is, to define the asset class by eliminating all choices that would not legitimately qualify for inclusion. Some examples of applicable filters are: excluding investment choices where the amount being managed is less than $500 million, excluding investments where sector focus is greater than 50, identifying an investment with a certain ticker symbol, and identify investments that are socially responsible. "Qualified" or "relevant" investment products remain (*i.e.,* the relevant universe of choices is "defined") after the filters are applied. Filters are selected by the Advisor and/or the investor client, and may be added, removed, and/or changed at any time.

Step 2: The selection, hierarchical arrangement and weighting of performance parameters within each asset class. The construction of an investment portfolio necessitates the selection and blending of various classes of investments in order to achieve the highest rate of return, taking into account the client's risk tolerance. Each class of assets selected is expected to produce and contribute a particular "investment effect" to overall investment performance as desired by the client. Thus, with respect to each asset class in the portfolio, the client would ideally wish to know which of the investment choices (within any such asset class) had been the best at producing the desired composite investment effect (within that asset class) over time. In your view, DAT provides a way to objectively and transparently determine this.



At the outset, the Advisor and/or investor client will be provided with a default hierarchical arrangement of weighted performance parameters and/or other distinguishing characteristics. These default settings are based on DAT's experience with patterns of client preferences, *i.e.*, typical patterns in the ways in which investors arrange and weight such factors, as well as the results typically produced by such patterns. These default settings can be adjusted by the Advisor and/or client to better reflect that client's unique investment profile, that is, the client's individual financial situation, goals, risk tolerance, and preferences. This step is often done interactively with the Advisor, but can be completed by the client independently.

Note that an Advisor typically obtains the client's investment profile in advance of Step 2.

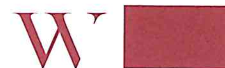
Examples of performance parameters include risk tolerance (*e.g.,* willingness to tolerate moderate short-term declines in the portfolio): 1-year ASD, 3-year ASD, 5-year ASD; desired degree of emphasis on return-related parameters: 1-year average return, 3-year average return, and 5-year average return; up market and/or down market capture (*i.e.,* how the product has performed in the last up or down market); etc. These performance parameters are then hierarchically arranged and weighted by the Advisor and/or investor client based on their relative importance to the investor client. The greater the percentage weight assigned to the parameter, the greater the importance to the client and the greater influence it has on the ultimate investment ranking generated by DAT. Increasing the weight of any performance parameter will result in a corresponding decrease of other parameters. The parameters' respective hierarchical position and weight, and the performance parameters themselves, may be added to, removed and/or changed at any time.

Step 3: Scoring and ranking of all of the qualified investment choices. Using the hierarchically arranged and weighted performance parameters as indicated by the Advisor and/or investor user, DAT scores and ranks all the qualified investment choices identified in Step 1. It is here, according to DAT, that the best investment products for the investor client from all qualified investment choices are identified and ranked.

The top-ranked choices, based on the application of the selected filters and the hierarchical arrangement and relative weights of the client's performance parameters, will be ranked as "1," and remaining choices will be ranked in descending order. The highest-scoring product with respect to each performance parameter will also be identified. In other words, after products are scored and ranked, the investor client will see which mutual funds and managers have been the most effective at producing the desired composite "investment effect" over time.

According to you, the scoring and ranking of investment choices that best meet the client's performance parameters, based purely on their merit, effectively filters out any conflicts of interest, both known and unknowable, on the part of the Advisor, and renders them moot.

In your view, the order in which the Advisor performs due diligence on investment products is critical to creating beneficial efficiencies for both the Advisor and client. Rather than performing laborious qualitative due diligence on hundreds of available investment choices (in



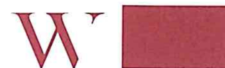
an effort to produce a "vetted" list of investment choices from which to recommend), which is the more prevalent practice, the Advisor using DAT can apply the Advisor's due diligence process at this stage to a more tightly targeted group of scored and ranked investment choices (*e.g.,* to the top three to five most highly scored and ranked products). Thus, this step does not replace the qualitative due diligence examination that must be performed by the Advisor on the investments identified at this step; it simply makes it much more efficient. Moreover, with such a process, qualitative due diligence no longer becomes the limiting factor on universe size – the principal factor cited as justifying smaller universes from which a client must select.

Step 4: Repeated application of DAT each quarter. Application of DAT to comparatively evaluate, score and rank all existing investment choices on a quarterly basis will demonstrate how previously selected investments have performed relative to their peers since their selection and, specifically, how their rankings may have declined or improved.

The top-ranking choices within each asset class, based on the client-specific filters and blended weighted performance parameters, appear in a Quarterly Investment Review report ("Report") that is delivered to the investor client. According to you, the Report is unique in that it provides valuable information to the Advisor and investor client – an answer to the question: "How did our fund and/or fund manager perform relative to all the others that could have been selected?"

Placing such results side-by-side for four consecutive quarters, enables the Advisor and investor client to see information that appears to have never before been available to either. If the investor client's mutual fund or manager begins to drop in relative rank, the Report will reveal those that are rising in the rankings, in the same asset class, with the same investment goals, and in the same market conditions. This can help prevent what DTC believes to be one of the most common causes of chronically poor investment performance, characteristic of even the largest of pension funds (both public and Taft-Hartley) and that is the holding of poor performing choices for far too long.

In most instances, retaining poor performing investment(s) for too long is a result of the lack of readily accessible information on the part of the Plan Fiduciary as to better performing alternative funds or managers. New fund manager searches are often time-consuming and expensive. DAT's review process provides a readily available and functional equivalent of information obtainable only through new fund manager searches, which it provides every quarter. Because information as to mutual funds and managers that are rising in rankings is provided by DAT, investors and Plan Fiduciaries can make investment replacement decisions far more rapidly and with a much higher degree of confidence.



III. LEGAL STANDARDS

A. PRUDENT MAN STANDARD OF CARE UNDER ERISA

Title I of ERISA requires fiduciaries of employer-sponsored retirement plans to act in accordance with a "Prudent Man Standard of Care."[4] It provides, in part, that a fiduciary shall discharge his duties solely in the interest of participants and beneficiaries and (i) for the exclusive purposes of providing benefits to participants and beneficiaries; and defraying reasonable expenses in administering the plan; (ii) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims; (iii) by diversifying investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Thus, a fiduciary must carry out its duties prudently with regard to all aspects of the retirement plan.

With regard to an investment or an investment course of action taken by the fiduciary, longstanding "U.S. Department of Labor" ("DOL") regulations provide that a fiduciary is deemed to comply with the statutory duty of prudence if the fiduciary gives "<u>appropriate consideration</u>" to the facts and circumstances that the fiduciary knows or should know are relevant with respect to a particular investment or investment course of action, and has acted accordingly.[5] "Appropriate consideration" includes, but is not limited to, making a determination that the particular investment or investment course of action is <u>reasonably designed, as part of the portfolio, to further the purposes of the plan</u>, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action. Factors that a fiduciary should take into consideration include (i) the composition of the portfolio with regard to diversification; (ii) the portfolio's liquidity and current return relative to the plan's anticipated cash flow requirements; and (iii) the portfolio's projected return relative to the plan's funding objectives.[6]

B. *TIBBLE'S* ONGOING DUTY TO MONITOR INVESTMENTS

In *Tibble v. Edison International,* plaintiff 401(k) plan participants alleged that defendants violated their fiduciary duties with respect to three mutual funds added to the plan in 1999 and three mutual funds added to the plan in 2002. They argued that defendants violated their duty of prudence (*i.e.,* the Prudent Man Standard of Care) by offering six higher-priced retail-class mutual funds as plan investments when materially identical lower-priced institutional-class mutual funds were available. The U.S. Supreme Court noted in its 2015 decision that the Prudent Man Standard of Care is "derived from the common law of trusts" and that "in determining the contours of an ERISA fiduciary's duty, courts must often look to the law of trusts."[7] The Supreme Court concluded that under trust law, a fiduciary has a continuing duty to

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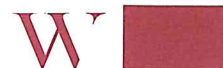
[4] ERISA Section 404(a)(1).
[5] Section 2550.404a-1(b)(1) of DOL Regulations.
[6] Section 2550.404a-(1)(b)(2) of DOL Regulations.
[7] *Tibble v. Edison International*, 135 S.Ct. 1823 (2015).



monitor trust investments and to remove imprudent ones.[8] This means that the trustee must systematically consider all investments of the trust at regular intervals to ensure they are appropriate.[9] The case was ultimately remanded to the U.S. District Court of the Central District of California to consider whether there was a breach of fiduciary duty in light of the ongoing duty to monitor investments as articulated by the Supreme Court.

In finding for the plaintiffs, the District Court observed that "[i]n order to determine whether an investment decision is prudent, a fiduciary has a duty to investigate, and may secure independent advice from financial advisors or other experts in the course of the investigation. However, the fact that a fiduciary secured independent advice does not necessarily indicate that he acted prudently."[10]

C. REGULATION BEST INTEREST

On June 5, 2019, the SEC released, among other guidance, Regulation Best Interest ("Regulation BI"), which imposes a standard of conduct on registered broker-dealers and their Reps when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities.[11] In general, it requires the broker-dealer or Rep to act in the retail customer's best interest at the time the recommendation is made and not place its own interests ahead of the retail customer's interests ("General Obligation")[12]. The SEC declined to expressly define "best interest" in Regulation BI.[13] Instead, the SEC clarified that the specific Component Obligations expressly set forth what it means to "act in the best interest" of the retail customer.[14] The four Component Obligations are: (i) the Disclosure Obligation, (ii) the Care Obligation, (iii) the Conflict of Interest Obligation, and (iv) the Compliance Obligation. The failure to meet any one of the Component Obligations constitutes a violation of Regulation BI.[15] Whether a broker-dealer or Rep has acted in the retail customer's best interest under the General Obligation will turn on an objective assessment of the facts and circumstances of how these specific components of Regulation BI are satisfied at the time the recommendation is made (and not in hindsight).[16]

Regulation BI has a compliance date of June 30, 2020.

1. Component Obligations

Below is a general description of the Component Obligations of Regulation BI.

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[8] *Id.*
[9] *Id.*
[10] *Tibble v. Edison International*, No. CV 07-5359 SVW (AGRx), 2017 WL 3523737, at *11-12 (C.D. Cal. Aug. 16, 2017).
[11] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019).
[12] *Id.* at Section II.A.
[13] Id. at 33333.
[14] *Id.* at 33333.
[15] *Id.*
[16] *Id.* at 33325.

Disclosure Obligation. The broker-dealer or Rep, prior to or at the time of the recommendation, must provide to the retail customer, in writing, "full and fair disclosure" of (i) all material facts related to the scope and terms of the relationship with the retail customer, including (a) that the broker-dealer or Rep is acting as a broker dealer or Rep with respect tot he recommendation; (b) the material fees and costs that apply to the retail customer's transactions, holdings, and accounts; and (c) the type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer; and (ii) all material facts relating to conflicts of interest that are associated with the recommendation."[17] The SEC defined a "conflict of interest" as "an interest that might incline a broker, dealer, or a natural person who is an associated person of a broker-dealer – consciously or unconsciously – to make a recommendation that is not disinterested."[18]

Care Obligation. Under the Care Obligation, a broker-dealer or Rep, in making a recommendation, must exercise reasonable diligence, care and skill to (i) understand the potential risks, rewards and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; (ii) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the broker-dealer or Rep ahead of the interest of the retail customer; and (iii) have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile, and does not place the financial or other interest of the broker-dealer or Rep making the series of recommendations ahead of the interest of the retail customer.[19]

Conflict of Interest Obligation. The broker-dealer is required to establish, maintain, and enforce written policies and procedures reasonably designed to (i) identify and at a minimum disclose or eliminate all conflicts of interest associated with its or the Rep's recommendation; (ii) identify and mitigate any conflicts of interested associated with its or the Rep's recommendations that create an incentive for it or the Rep to place its or the Rep's interest ahead of the retail customer's interest; (iii)(a) identify and disclose any material limitations placed on the securities or investment strategies that may be recommended to retail customers and any conflicts of interest associated with such limitations, and (b) prevent such limitations and associated conflicts of interest from causing it or the Rep to make recommendations that place its or the Rep's interest ahead of the retail customer's interest; and (iv) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities within a limited period of time.[20]

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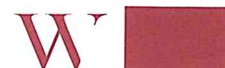
[17] Regulation best Interest, paragraph (a)(2)(i).
[18] Regulation Best Interest, paragraph (b)((3).
[19] Regulation Best Interest, paragraph (a)(2)(ii).
[20] Regulation Best Interest, paragraph (a)(2)(iii).



Compliance Obligation. The broker-dealer must establish written policies and procedures reasonably designed to achieve compliance with Regulation BI as a whole.[21] This obligation does not articulate specific requirements that must be included in their policies and procedures. Each broker-dealer should instead consider the scope, size, and risks associated with the operations of the firm and the type of business in which the firm engages when adopting policies and procedures.[22] The SEC has stated that a reasonably designed compliance program generally would also include controls, remediation of noncompliance, training, and periodic review and testing.[23]

2. Retail Customer

A "retail customer" is owed the standard of conduct set forth in Regulation BI. A "retail customer" is a natural person, or the legal representative of such natural person, who: (i) receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) uses the recommendation primarily for personal, family, or household purposes.[24] The preamble to Regulation BI makes clear that the definition of a retail customer would cover participants in plans covered by ERISA.[25]

The SEC interprets "legal representative" to mean non-professional legal representatives of a natural person.[26] Institutions and certain professional fiduciaries are not covered for purposes of Regulation BI.[27]

Furthermore, "personal, family, or household purposes" would include retirement accounts because retirement savings is a personal, household or family purpose.[28] Accordingly, the definition of a retail customer will include a natural person receiving a recommendation for the customer's own retirement account, including but not limited to IRAs and individual accounts in workplace retirement pans, such as 401(k) plans and other tax-favored retirement plans.[29] For example, plan participants receiving recommendations about whether to take a distribution from a 401(k) plan or other workplace retirement plan and how to invest that distribution would be covered as retail customers.[30] Similarly, a plan participant receiving a recommendation for the participant's individual account held in a 401(k) plan or other workplace retirement plan would be a retail customer for purposes of Regulation BI.[31]

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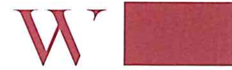
[21] Regulation Best Interest, paragraph (a)(iv).
[22] 84 Fed. Reg. 33397 (July 12, 2019).
[23] *Id.* at 33398.
[24] Regulation Best Interest, paragraph (b)(1).
[25] 84 Fed. Reg. 33325 (July 12, 2019).
[26] *Id.* at 33342.
[27] *Id.*
[28] *Id.* at 33343.
[29] *Id.*
[30] *Id.*
[31] *Id.*



IV. CONLUSIONS

A. USING DTC'S DECISION ASSISTANCE TECHNOLOGY TO MEET PRUDENT MAN STANDARD OF CARE

As stated above, the Prudent Man Standard of Care is the governing principle for Plan Fiduciaries as they carry out plan responsibilities. With respect to an investment or an investment course of action, the Prudent Man Standard of Care requires that the fiduciary give "appropriate consideration" to the facts and circumstances that the fiduciary knows or should know are relevant with respect to a particular investment or investment course of action and has acted accordingly. This includes making a determination that the particular investment or investment course of action is reasonably designed, as part of the portfolio, to further the purposes of the plan. Investment tools and technology that have not been designed with the Prudent Man Standard of Care in mind may fail to give appropriate consideration to the relevant facts and circumstances and to whether the recommended investment or investment course of action is reasonably designed to further the purposes of the plan, thus causing the Plan Fiduciary (or its delegate) to be in breach of their fiduciary responsibilities.

ERISA is silent with respect to the use of any particular type of investment process or tool to satisfy the Prudent Man Standard of Care. DTC's DAT ranks and scores a universe of investment choices that has been shaped and filtered, using blends of performance parameters that have been hierarchically arranged and weighted solely based on the client's needs, investment goals, risk tolerance, and performance preferences, among other factors. **In our view, use of DAT by fiduciary Advisors or Plan Fiduciaries would assist the fiduciary Advisors and Plan Fiduciaries in giving, and in demonstrating (to regulators and in court proceedings) that they have given, appropriate consideration as to whether a plan's investments or the investment course of action taken is reasonably designed to further the objectives of the ERISA plan.**

B. USING DTC's DECISION ASSISTANCE TECHNOLOGY TO SATISFY THE ONGOING DUTY TO MONITOR INVESTMENTS

In *Tibble v. Edison International,* the U.S. Supreme Court concluded that, under trust law, a fiduciary has a continuing duty to monitor trust investments and to remove imprudent ones.[32] This means that the trustee must systematically consider all investments of the trust at regular intervals to ensure they are appropriate.[33] On remand, the District Court observed that "[i]n order to determine whether an investment decision is prudent, a fiduciary has a duty to investigate, and may secure independent advice from financial advisors or other experts in the course of the investigation. However, that fact that a fiduciary secured independent advice does not necessarily indicate that he acted prudently."[34]

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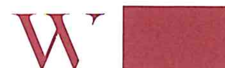
[32] *Id.*
[33] *Id.*
[34] *Tibble v. Edison International*, No. CV 07-5359 SVW (AGRx), 2017 WL 3523737, at *11-12 (C.D. Cal. Aug. 16, 2017).



Tibble does not expressly describe the manner in which the ongoing duty to monitor plan investments must be met. Engaging an independent investment professional for the provision of investment advice with respect to ERISA plan investments, does not necessarily mean that a Plan Fiduciary has acted prudently. DTC recommends the repeated use of the DAT four-step process every quarter to comparatively evaluate how previously selected investments have since performed, not just to a "benchmark index" but relative to all other qualified choices within each asset class. The hiring of an Advisor alone, without a means to properly evaluate the investment advice given by the Advisor, may not meet the Plan Fiduciary's or the Advisor's duty of prudence in the monitoring of plan investments. DAT's comparative evaluation of investments by scoring and ranking them based on the client's objectives may provide the oversight and means by which trustees can "vet" their Advisor's investment recommendations – a protective "second opinion," if you will – as encouraged by *Tibble*. **In our view, repeated use of DAT by fiduciary Advisors or Plan Fiduciaries, on a quarterly basis or other appropriate periodic intervals, to comparatively evaluate the performance of an ERISA plan's investments, will help them satisfy (and help them demonstrate that they have satisfied) their fiduciary duty to monitor investments and identify chronically underperforming or imprudent ones so that they can be removed.**

C. USING DTC'S DECISION ASSISTANCE TECHNOLOGY TO SATISFY THE CARE OBLIGATION UNDER REGULATION BEST INTEREST

Under the Care Obligation, a broker-dealer or Rep has a three-part obligation. The Rep, in making a recommendation, must exercise reasonable diligence, care and skill to (i) understand the potential risks, rewards and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; (ii) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the broker-dealer or Rep ahead of the interest of the retail customer; and (iii) have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together, in light of the retail customer's investment profile, and does not place the financial or other interest of the broker-dealer or Rep making the series of recommendations ahead of the interest of the retail customer.[35]

Reps must obtain and analyze sufficient customer information to form a reasonable basis to believe that the recommendation is in the client's best interest.[36] This information is typically obtained by the Rep through an investment profile or questionnaire. The SEC has declined to provide an exhaustive list of factors to be used in an investment profile, instead opting to give Reps the flexibility to consider a broad range of factors based on the unique nature of its particular securities products, investment strategies, and retail customers.[37]

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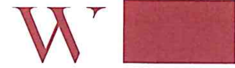
[35] *Id.* at 33372.
[36] *Id.* at 33379.
[37] *Id.*



Regulation BI is silent with respect to the use of any particular process or type of interactive tool to satisfy the Care Obligation. When using DAT, the Rep will apply client-specific factors (perhaps even those selected by the client) to "shape" and identify the qualified universe of investment choices that will eventually be scored and ranked. The Rep will then use client-specific investment performance parameters and hierarchically arrange them and weigh them in order to reflect each parameter's relative importance to the investor client. These factors and parameters will indicate, demonstrate and likely be consistent with the information gathered from the client's investment profile, and any inconsistencies will prompt further productive discussions between the Rep and the client about the client's investment objectives, financial circumstances, risk tolerance, performance preferences, etc. **Assuming a Rep obtains an adequate investment profile of the retail customer, the use of DAT will assist the Rep in complying with two of the components of the Care Obligation. Specifically, DAT will assist the Rep in exercising reasonable diligence, care and skill to (i) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on the retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, without placing the financial or other interest of the broker-dealer or Rep ahead of the interest of the retail customer; and (ii) have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile, and does not place the financial or other interest of the broker-dealer or Rep making the series of recommendations ahead of the interest of the retail customer.**

D. USING DTC'S DECISION ASSISTANCE TECHNOLOGY TO MEET THE CONFLICT OF INTEREST OBLIGATION OF REGULATION BEST INTEREST

Under the Conflict of Interest Obligation, the broker-dealer is required to establish, maintain, and enforce written policies and procedures reasonably designed to (i) identify and, at a minimum, disclose or eliminate all conflicts of interest associated with its or the Rep's recommendations; (ii) identify and mitigate any conflicts of interested associated with its or the Rep's recommendations that create an incentive for it or the Rep to place its or the Rep's interest ahead of the retail customer's interest; (iii)(a) identify and disclose any material limitations placed on the securities or investment strategies that may be recommended to retail customers and any conflicts of interest associated with such limitations, and (b) prevent such limitations and associated conflicts of interest from causing it or the Rep to make recommendations that place its or the Rep's interest ahead of the retail customer's interest; and (iv) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities within a limited period of time. [38]

[38] *Id.* at 33385.

With respect to (iii), above, examples of limitations placed on the securities or investment strategies that may be recommended to retail customers include providing a limited product menu or offering only proprietary products.[39] Whether the limitation is a "material limitation" will depend upon the facts and circumstances as to the extent of the limitation.[40] The SEC believes that the conflicts associated with the establishment of a product menu are most likely to affect recommendations made to retail customers and have the greatest potential to result in recommendations that place the interest of the broker-dealer or Rep ahead of the interest of the retail customer.[41]

DAT scores and ranks investment products based on the performance parameters selected, hierarchically arranged and weighted specific to individual clients according to their relative importance to the client. DTC recommends, and use of its DAT provides, a practical means to consider a broader universe of investments than just those limited by the broker-dealer's or Rep's inventory or product menu. Considering a broader pool of investment products than simply those that are available from the broker-dealer's or Rep's often limited inventory or investment menu, and comparatively evaluating the choices based solely on how well they meet the client's criteria, may reduce the likelihood that recommendations made to retail customers place the interest of the broker-dealer or Rep ahead of the interest of the retail customers. Indeed, the use of DAT to comparatively evaluate the full range of available investment choices, based purely upon objective client-specific performance parameters, should effectively "filter out" or eliminate conflicts of interest that might otherwise encourage or incentivize recommendations of one investment choice over another and should enable the broker-dealer and Rep to demonstrate (to customers, regulators and court proceedings) that such conflicts of interest have in fact been eliminated. **In our view, the use of DAT by Reps when advising retail customers will be helpful in complying with components (i), (ii) and (iii) of the Conflict of Interest Obligation (and demonstrating such compliance to regulators and in court proceedings). In addition, the use of DAT can be referenced in the broker-dealer's reasonably designed policies and procedures as a means of reducing the likelihood that conflicts of interest would unduly influence Reps, including those conflicts of interest associated with more limited product menus.**

E. USE OF DTC's DECISION ASSISTANCE TECHOLOGY IS CONSISTENT WITH BEST PRACTICES

In general, ERISA looks to the decision-making process employed by a fiduciary in order to determine the extent of fiduciary liability. As such, it does not focus on the outcome of a decision by a fiduciary – it does not require omniscience or that a fiduciary be right in all cases. Instead, ERISA focuses on whether the process utilized by a fiduciary to gather information and

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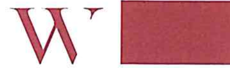
[39] *Id.* at 33393.
[40] *Id.* at 33394.
[41] *Id.* at 33393.



to make reasonable determinations is prudent and in the best interest of plan participants and beneficiaries.[42] This process is referred to as "procedural prudence."

A "best practice" is defined as a procedure that has been shown by research and experience to produce optimal results and that is established or proposed as a standard suitable for widespread adoption.[43]

DAT is an investment selection process that can, in its original and recommended form, take into account the broadest possible universe of investment products, and not only those investment products that are available to a particular Advisor (although it can also be used to objectively comparatively evaluate even limited product universes). By applying investor's preferences thereafter to "shape" the available investment universe (whether broader or limited) and then applying a composite blend of hierarchically arranged and weighted performance parameters that specifically reflect the needs, goals and preferences of individual investors, the investment selection and performance monitoring processes may be improved. It may also result in improvement in investment performance and thus could make actual achievement of investment and retirement goals more likely. With the above described capabilities and effects, DAT's method approaches best practice. **In our view, when all this is taken together with prudent policies and procedures, the use of a tool such as DAT may be an evolving best practice for use in selecting and monitoring the performance of investments for ERISA-plans.**

F. IMPENDING DOL PROPOSED FIDUCIARY RULE AND STATE ACTION

Although this opinion has largely focused on the SEC's new Regulation BI, it is important to note that, as of this writing, the DOL has announced its intention to propose a new version of its "fiduciary rule"[44] and that several states have adopted or are considering regulatory or legislative approaches to establish standards of care for investment advice as well. This may result in a patchwork of multiple and perhaps conflicting regulatory regimes that will be difficult for Advisors and other fiduciaries to navigate, especially for those with multi-jurisdictional exposure. However, to the extent that the intent and goal of each of these regulatory schemes is to require that investors' "best interest" are protected, it is our opinion that the use of DTC's DAT will likely be a helpful tool for the reasons stated above.

* * * * * * * *

The opinions and views included in this letter represent our view of the outcome in a court of law if a challenge were to be made to the conclusions set out above and do not represent a guarantee as to the outcome. The legal analysis included herein is based on the facts presented and the existing laws and regulations in effect as of the date of this letter. It is important to note

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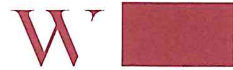
[42] *Donovan v. Mazzola*, 716 F2d 1226 (9th Cir. 1983); See also *GIW Industries, Inc. v. Trevor*, 895 F2d 729 (11th Cir. 1990).
[43] "Best Practice." *Merriam-Webster.com*. Merriam-Webster, n.d. Web. 12 September 2019.
[44] 81 Fed. Reg. 20946 (April 8, 2016), which has been vacated.



that there is no published interpretive guidance on Regulation Best Interest from the SEC, Financial Industry Regulatory Authority (FINRA), or the federal courts as of this date, and that our opinions and views with regard to Regulation Best Interest, therefore, are constrained by the lack of any formal authority. The addition of facts other than those described above and any material changes in the law or regulatory guidance may affect the legal analysis and conclusions set forth herein. Our opinions and views expressed in this letter are furnished to you solely for your benefit. Although we understand that you may wish to provide copies of this letter to third parties for their information only, to which we provide our consent, the opinions and views expressed in this letter may not be relied upon by any person other than you without our prior consent.

Sincerely,

The Wagner Law Group