

COMPUTER MODEL CERTIFICATION

OVERVIEW





408(g) Computer Model Certification

January 2017

SUMMARY

The Fiduciary Rules go into effect April 10, 2017 and must be fully operational by January 1, 2018. These applicability dates set the timelines for decisions, preparation and implementation of alternatives to comply with these regulations.

The Conflict of Interest Rules (“COIR”) replace the 1975 definition of what constitutes a fiduciary for ERISA plans and IRAs. The effect of COIR is to transform currently permitted practices into prohibited fiduciary acts.

Institutions and individuals must cease these prohibited fiduciary acts or use an exemption to legitimize these activities.

Among the exemptions is the provision in the 2006 Pension Protection Act that exempts advice delivery by a certified computer model from prohibited conflicts of interest (408(g)).

The use of 408(g) has certain advantages when business circumstances permit its use and the requirements are achievable. Advantages can include:

- Overcome conflicts of interest and differential compensation from related businesses
- A superior solution for investors
- Lower risk for the fiduciary
- Lower cost to implement, operate and to maintain
- Shorter time to market
- Scalable to handle high volumes
- Flexibility to make changes and adapt to new investment types and practices.



DALBAR QUALIFICATIONS

Under 408(g), Computer Models can only be certified by an eligible investment expert, with the appropriate technical training or experience and proficiency to analyze, determine and certify, in a manner consistent with the regulation.

DALBAR has met these qualifications and has been performing certifications since the inception of the regulation in 2009.

SCOPE OF AUDIT

The certification attests to five dimensions:

- Regulatory Compliance
- Capabilities, strengths and weaknesses
- Performance
- Consistency with offers and agreements
- Reasonableness and cost

Compliance

In addition to compliance with securities laws the computer model may be certified as compliant with regulations as they apply to:

- ERISA Plans
- Managed account QDIAs
- IRAs

Capabilities

Capabilities are evaluated in three areas:

- Discovery... information gathered about the client and defaults used when information is not available
- Interpretation... how client information is applied
- Investments... universe of investments available

Performance

Historical Results:

- Participation in up markets
- Capital preservation in down markets



Consistency

Consistency of communication and model results:

- Contracts, descriptions, brochures and other materials
- Appropriateness for audience and expected knowledge to meet the requirement: “Calculated to be understood”.
- Tests run with multiple scenarios

Reasonableness

Reasonableness is an overall evaluation of all observations taken together in relation to the cost to users of the model.

REQUIRED STEPS FOR CERTIFICATION

- 1. Application**
 - Application with attachments received in good order
- 2. Pre-Qualification Review**
 - Review materials for disqualifiers and terminate engagement if uncorrectable
- 3. Additional Disclosures**
 - Determine and request any additional materials
- 4. Investment Theory Evaluation**
 - Determine if exception procedures will be required
- 5. Performance Record**
 - Examine samples in up and down markets
- 6. Cost Evaluation**
 - Determine if direct and indirect cost to the client is reasonable
- 7. Regulatory Checklist**
 - Review items specifically suggested by DoL
- 8. Model Tests**
 - Test models and communication for consistency
- 9. Management Letter**
 - Review any exceptions or deficiencies and determine if resolution is feasible
- 10. Certification**
 - Issue certification, good for one year from date of issue



Services Available to Enhance Use of Certified Computer Model

DALBAR offers a number of services to enhance the utility of the computer model and the effects of the Fiduciary Rule on the use of the model as an alternative to the Best Interest Contract Exemption. These services are separately purchased and are not included in the certification.

UPGRADE ANALYSIS

Current implementations of the computer model are examined for possible violations of the new Conflict of Interest Rules, Areas of concentration include handling of rollovers and potentially conflicting exemption requirements.

PRE-CERTIFICATION REVIEW

DALBAR will perform a subset of the certification process before changes are made to comply with 408(g). In this way, findings from the pre-certification can be incorporated add to or reduce the changes being made. The cost of pre-certification lowers the cost of the actual certification.

USABILITY ANALYSIS

The usability is based on criteria for a particular target audience. The access to, use of, exception conditions and the follow through are evaluated.

CONTACT CENTER MONITORING

Contact center representatives who use the certified computer model must comply with the requirements of 408(g). The contact center monitoring adds a level of oversight of the required practices and is evidence of “best efforts” in the event of a failure to comply or litigation.

CONSULTING

Consulting engagements may cover planning, diagnosis, cost/benefits, research and other services that utilize DALBAR’s expertise, knowledge of the market, practices and regulations.



About DALBAR

THE INDEPENDENT EXPERT

DALBAR, Inc. is the financial community's leading independent expert for evaluating, auditing and rating business practices, customer performance, product quality and service.

Launched in 1976, DALBAR has earned the recognition for consistent and unbiased evaluations of investment companies, registered investment advisers, insurance companies, broker/dealers, retirement plan providers and financial professionals.

DALBAR awards are recognized as marks of excellence in the financial community.

HIGHLIGHTS ADVISOR CERTIFICATION EXPERIENCE

- ✓ 1996: Launch "Excellence in Advice" –A mark of excellence for advisors
- ✓ 1997: SEC no-action letter –OK to advertise client ratings
- ✓ 1998: "Advisor Finder" joint venture with Microsoft –Due diligence to qualify advisors
- ✓ 2001: 401(k) Advisor Rating –Qualifying advisors for 401(k) leads
- ✓ 2007: Fiduciary Adviser Network (FAN) –ERISA § 408(g) compliant
- ✓ 2010: RF™ Certification –To provide compliance with Dodd-Frank § 913
- ✓ 2011: ERISA § 3(38) Certification –In answer to potential demand due to revised DoL fiduciary standards

Results to date: Zero miscues

EXPERIENCE, EXPERTISE, SCOPE

- ✓ In business since 1976... Certifications/audits since 1996
- ✓ Combined expertise in investments, regulation and evaluation
- ✓ Range of capabilities... multiple areas of specialization

MULTIPLE USE OF RESULTS

- ✓ Demonstrate compliance with ERISA and other regulatory requirements
- ✓ Provide protection from fiduciary liability
- ✓ Protect firm, advisor and plan from other risks
- ✓ Provide a marketing advantage for the firm and the advisor
- ✓ Facilitate compliance with ERISA requirement for plan sponsors to prudently select and monitor all investment managers, advisors and service providers