

COMPUTER MODEL CERTIFICATION PROCESS

May 2011

PURPOSE OF CERTIFICATION

Firms that provide advice to IRAs and Defined Contribution Plan Participants (“DCPP”) and receive compensation that is linked to the investments about which they advise must do so through a certified computer model.

The process described here provides the certification that is necessary to provide such advice.

Certification is valid for one year.

APPLICATION

Candidates for certification submit an application and attachments with payment or billing instructions.

Payments are accepted after a pre-qualification review. If the review indicates that certification is not likely, the application is not accepted and no payment is collected.

PRE-QUALIFICATION REVIEW

Upon receipt of application the following is performed:

- Application, including attachments, is reviewed for completeness, consistency and any disqualifying factors.
- A preliminary background check is performed.
- Identify and request additional disclosures that will be required (if any)

ADDITIONAL DISCLOSURES

It may be necessary to request additional information during the certification process. Such request may be needed simply because information is omitted or unclear; or may be derived from analysis of information provided or from DALBAR’s independent investigation.

INVESTMENT THEORY EVALUATION

Investment theories can qualify as being “Generally Accepted” in one of two ways:

- Use of the theory is familiar to DALBAR experts, or
- A poll of investment managers that are unrelated to the model provider being certified.

PERFORMANCE RECORD

Representative investment performance of the model since its inception is evaluated for the ability of the model to:

- Preserve capital during market downturns
- Participate in appreciation during up-markets

COST EVALUATION

Model provider pricing is compared to other such available tools.

CERTIFICATION CHECKLIST

	Test	Finding
A	A generally accepted investment theory that takes into account the historic risks and returns of different asset classes over defined periods of time	
B	Takes investment management and other fees and expenses into account	
C	Requests and utilizes participant information about age, time horizons, risk tolerance, current investments, other assets, sources of income and investment preferences.	
D	Utilize objective criteria to select and allocate designated plan investments.	
E	Does not: <ol style="list-style-type: none"> 1. Favor investments that compensate model provider or affiliates 2. Favor investments that result in greater compensation to model provider or affiliates. 3. Base investment selection on criteria that cannot be expected to persist. 	
F	Does: <ol style="list-style-type: none"> 1. Consider all designated investments except those noted below 2. Exclude employer securities 3. Excludes investments that vary asset mix 4. Exclude retirement income annuities 5. Provide participant with a list of exclusions 	

MODEL TEST

The model is tested to establish that it meets the criteria specified in the Certification Checklist.

Testing consists of using a set of designated investments that include the conditions specified in the Certification Checklist and entering data about five participants with different variables and obtaining recommendations from the computer model.

Recommendations are evaluated and the Certification Checklist completed.

MANAGEMENT LETTER

After the evaluation is completed, any exceptional conditions are included in a letter to the model provider. The letter will indicate:

- Whether the computer model can be certified as is or
- Items that must be corrected to receive certification and
- Concerns or suggested improvements that do not prevent certification

PUBLIC DOCUMENTS

Successful certification is evidenced by three documents and the rights to use the DALBAR Seal, all being valid for one year from the date of issuance. The documents are:

- A **Certificate**, that is suitable for framing to illustrate the achievement to office visitors.
- An **Opinion Letter**, which can be delivered to clients and prospects, reflecting top level findings.
- A **Credential document**, that provides the details of the certification results and includes all regulatory requirements consisting of:
 1. Methodology applied in determining whether the computer model meets the requirements;
 2. Explanation of how the applied methodology demonstrated that the computer model met the requirements;
 3. A description of any limitations that were imposed by any person on the eligible investment expert's selection or application of methodologies;
 4. A representation that the methodology was applied by or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements; and
 5. A statement certifying that the eligible investment expert has determined that the computer model meets the requirements.

REGULATORY REQUIREMENTS

IRC 4975(d)(17) and ERISA 408(g) have parallel regulations that apply to IRAs and DCPPs, respectively.

Requirements for Computer Model

In order to qualify, computer models must meet certain criteris. The following extract from the regulations define requirements for a computer model:

(b)(4) Computer Model Requirements

(4) Arrangements that use computer models. For purposes of this section, an arrangement is an eligible investment advice arrangement if the only investment advice provided under the arrangement is advice that is generated by a computer model described in paragraphs (b)(4)(i) and (ii) of this section under an investment advice program and with respect to which the requirements of paragraphs (b)(5), (6), (7), and (8) [*5 is "Arrangement must be authorized by a plan fiduciary", 6 is "Annual audit", 7 is "Disclosure", 8 is "Other Conditions (securities laws, solely at the direction of the recipient of the advice, compensation... is reasonable, terms... as favorable to the plan as an arm's length transaction)"*] and paragraph (d) [*d is Retention of records*] are met.

(i) A computer model shall be designed and operated to —

(A) Apply generally accepted investment theories that take into account the historic risks and returns of different asset classes over defined periods of time, although nothing herein shall preclude a computer model from applying generally accepted investment theories that take into account additional considerations;

(B) Take into account investment management and other fees and expenses attendant to the recommended investments;

(C) Request from a participant or beneficiary and, to the extent furnished, utilize information relating to age, time horizons (e.g., life expectancy, retirement age), risk tolerance, current investments in designated investment options, other assets or sources of income, and investment preferences; provided, however, that nothing herein shall preclude a computer model from requesting and taking into account additional information that a plan or a participant or beneficiary may provide;

(D) Utilize appropriate objective criteria to provide asset allocation portfolios comprised of investment options available under the plan;

(E) Avoid investment recommendations that:

(1) Inappropriately favor investment options offered by the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser over other investment options, if any, available under the plan;

(2) Inappropriately favor investment options that may generate greater income for the fiduciary adviser or a person with a material affiliation or material contractual relationship with the fiduciary adviser; or

(3) Inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future; and

(F)(1) Except as provided in paragraph (b)(F)(2) of this section [*2 is “employer securities... varying investments that depend on retirement age or life expectancy or level of risk... income annuities”*], take into account all designated investment options, within the meaning of paragraph (c)(1) of this section, available under the plan without giving inappropriate weight to any investment option.

(2) A computer model shall not be treated as failing to meet the requirements of this paragraph merely because it does not make recommendations relating to the acquisition, holding or sale of an investment option that:

(i) Constitutes an investment primarily in qualifying employer securities;

(ii) Constitutes an investment fund, product or service that allocates the invested assets of a participant or beneficiary to achieve varying degrees of long-term appreciation and capital preservation through equity and fixed income exposures, based on a defined time horizon (such as retirement age or life expectancy) or level of risk of the participant or beneficiary, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such funds, products or services and how they operate; or

(iii) Constitutes an annuity option with respect to which a participant or beneficiary may allocate assets toward the purchase of a stream of retirement income payments guaranteed by an insurance company, provided that, contemporaneous with the provision of investment advice generated by the computer model, the participant or beneficiary is also furnished a general description of such options and how they operate.

Requirements for Certification

Computer models must be certified before they can be used. The following extracts from the regulations define to the certification requirements:

(b)(4)(ii) Computer Model Certification Requirements

(ii) Prior to utilization of the computer model, the fiduciary adviser shall obtain a written certification, meeting the requirements of paragraph (b)(4)(iv) [*iv is “certification by an eligible investment expert shall”*] of this section, from an eligible investment expert, within the meaning of paragraph (b)(4)(iii) [*iii is “term “eligible investment expert” means”*] of this section, that the computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section. If, following certification, a computer model is modified in a manner that may affect its ability to meet the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*], the fiduciary adviser shall, prior to utilization of the modified model, obtain a new certification from an eligible investment expert that the computer model, as modified, meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*].

(b)(4)(iii) Eligible Investment Expert Requirements

(iii) The term “eligible investment expert” means a person that, through employees or otherwise, has the appropriate technical training or experience and proficiency to analyze, determine and certify, in a manner consistent with paragraph (b)(4)(iv) [*iv is “certification by an eligible investment expert shall”*] of this section, whether a computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section; except that the term “eligible investment expert” does not include any person that has any material affiliation or material contractual relationship with the fiduciary adviser, with a person with a material affiliation or material contractual relationship with the fiduciary adviser, or with any employee, agent, or registered representative of the foregoing.

(b)(4)(iv) Certification Content

(iv) A certification by an eligible investment expert shall –

(A) Be in writing;

(B) Contain –

(1) An identification of the methodology or methodologies applied in determining whether the computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section;

(2) An explanation of how the applied methodology or methodologies demonstrated that the computer model met the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section;

(3) A description of any limitations that were imposed by any person on the eligible investment expert’s selection or application of methodologies for determining whether the computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section;

(4) A representation that the methodology or methodologies were applied by a person or persons with the educational background, technical training or experience necessary to analyze and determine whether the computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*]; and

(5) A statement certifying that the eligible investment expert has determined that the computer model meets the requirements of paragraph (b)(4)(i) [*i is “computer model shall be designed and operated to”*] of this section; and

(C) Be signed by the eligible investment expert.

(v) The selection of an eligible investment expert as required by this section is a fiduciary act governed by section 404(a)(1) of ERISA.