

# QDIA Validation

NextCapital Advisers, Inc.

Digital Advisory Solution

October 14, 2020



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# QDIA Validation – Status as of October 14, 2020

## DALBAR APPROVED

VALIDATED for QDIA

DALBAR has evaluated the **Digital Advisory Solution** offered by **NextCapital Advisers, Inc. (Manager)** to determine if it complies with the requirements to be used as a Qualified Default Investment Alternative (QDIA) as defined by the Employee Retirement Income Security Act of 1974, as amended [ERISA] Section 404(c)(5) and associated regulations.

**NextCapital's Digital Advisory Solution** is referred to as the Investment and is a managed account that is reported to be in compliance with all applicable regulations.



# The Investment

The **NextCapital Digital Advisory Solution** (*Investment*), was examined in relation to requirements for a Qualified Default Investment Alternative under ERISA Section 404(c)(5). The *Manager* operates within the meaning of section 3(38) of ERISA acting as a fiduciary. The *Investment* consists of managed accounts specifically constructed and maintained for each participant.

## Evaluation of Prudence

Federal regulations and common sense require that responsible plan fiduciaries make a prudent choice of the investments that are used by participants in ERISA plans. In order to facilitate the prudent choice, DALBAR has examined the *Investment* and rated the prudence of using it. The following table summarizes DALBAR’s findings regarding the prudence of using the *Investment* in an ERISA plan:

<b>Prudence Criteria</b>	<b>DALBAR Prudence Rating</b>	<b>Primary Basis for Prudence Rating</b>
<b>Benefit to Employees</b>	<b>Excellent</b>	Comprehensive scope of services offered. Personalized asset allocations.
<b>Cost Effectiveness</b>	<b>Excellent</b>	The range of fees are consistent with industry practices of low cost providers.
<b>Specific ERISA Requirements</b>	<b>Excellent</b>	Formal declaration of fiduciary responsibility. Adherence to generally accepted investment theories.
<b>Good Business Practices</b>	<b>Excellent</b>	Reasonable, arms-length arrangements. Independence avoids risk of self-dealing.
<b>Avoidance of Litigation</b>	<b>Excellent</b>	Formal declaration of fiduciary responsibility. Independence avoids risk of self-dealing. Background check of key personnel revealed no concerns.

## Validation Grid

The following table summarizes the ways in which the *Investment* qualifies as a QDIA.

In each case the *Investment* being validated may be applicable as the only one used (stand-alone) or may be used in conjunction with other investments (sleeve) in a model portfolio managed by an investment adviser that qualifies under ERISA section 3(38). The QDIA validation determines which QDIA alternative(s) apply and whether the *Investment* may be used stand-alone and/or as a sleeve in a portfolio.

### Appropriate Uses of NextCapital's Investment Management Service:

	QDIA Alternative	Stand Alone	Sleeve of Portfolio
1	Age Based	N/A	N/A
2	Risk Based	N/A	N/A
3	Managed Account	Yes <sup>1</sup>	N/A
4	Short Term	N/A	N/A
5	Grandfathered	N/A	N/A

## Noteworthy Observations

The following observations were made during the review and evaluation of NextCapital's Digital Advisory Solution as a Qualified Default Investment Alternative (QDIA).

- NextCapital's Digital Advisory Solution can provide a personalized asset allocation based on the individual participant's specific circumstances and needs.
- NextCapital's Digital Advisory Solution can also offer savings recommendations to optimize participants' likelihood of meeting their retirement needs.
- NextCapital's approach to investment management employs a consistent set of principles that are uniformly applied through its technology, minimizing the concern of occasional human failure.

<sup>1</sup> Under circumstances in which participant data is unavailable, asset allocation will be based solely on the participant's age.

# Introduction

This report contains DALBAR's independent analysis of *NextCapital's Digital Advisory Solution* and *NextCapital Advisers, Inc.* and is intended to supplement the duty of fiduciaries to prudently select investments for use as a Qualified Default Investment Alternative. Since this is a supplement, the contents of this report are intended to facilitate and not to replace the evaluation required by regulations.

As an independent expert, DALBAR has no affiliation with *NextCapital's Digital Advisory Solution* or *NextCapital Advisers, Inc.* and has the training, experience and proficiency to conduct this analysis. DALBAR has a history of over 40 years and is generally recognized by industry and government as an independent third-party expert in the business of providing evaluations, ratings and due diligence. DALBAR certifications are recognized as marks of excellence in adviser services, communications, electronic and telephone services. DALBAR is the only ratings firm with an SEC no-action letter exempting certain of its evaluations from the testimonial rule.

This analysis consists of *four* separate evaluations that are designed to validate if *NextCapital's Digital Advisory Solution* and the *NextCapital* meet the requirements of ERISA section 404(c)(5) and related regulations. These evaluations are:

- **Capital Preservation/Appreciation Analysis:** Compares ability of the *Investment* to preserve capital in a down market and realize appreciation in an up market.
- **Applicability as QDIA Alternative:** A determination of which class or classes of QDIA are appropriate uses of *NextCapital's Investment Management Service*.
- **Qualification Analysis:** An evaluation of the qualifications of *NextCapital* to meet the regulatory requirements for a QDIA manager.
- **Reasonableness as an Investment:** An assessment of whether *NextCapital's Digital Advisory Solution* meets the DALBAR standard of reasonableness.

For more information concerning this report, please contact DALBAR at:



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# Capital Preservation/Appreciation Analysis

This analysis addresses the fundamental requirement of every asset allocation strategy to preserve capital while realizing appreciation.

A test of the process was conducted with the following findings:

### Capital Preservation/Appreciation Findings NextCapital’s Digital Advisory Solution

Employment Stage of Participant	Target Investment Profile	Actual Investment Profile
<b>New to Workforce</b>	Moderate to Very Aggressive	Very Aggressive
<b>Minimum Investment Threshold</b>	Moderate to Very Aggressive	Very Aggressive
<b>Key Employee</b>	Moderate to Very Aggressive	Aggressive
<b>Pre-Retiree</b>	Moderate to Aggressive	Moderate
<b>Retired</b>	Conservative to Aggressive	Conservative

# Applicability as QDIA Alternative

There are five types of investments that are named as possible QDIA alternatives. In each case the Investment being validated may be applicable as the only one used (stand-alone) or may be used in conjunction with other investments (sleeve). The alternatives are:

1. Age Based
2. Risk Based
3. Managed Account
4. Short Term (Omitted: Not suitable for this Investment)
5. Grandfathered (Omitted: Not suitable for this Investment)

The Applicability phase of the QDIA validation examines the Investment to determine which alternatives apply and whether it may be used stand-alone and/or as a sleeve.

## A. Applicability as QDIA Alternative


Requirement for QDIA Alternative	Stand Alone	Sleeve	Comments
<b>1. Managed Account – An investment management service:</b>			
a) ... with respect to which a fiduciary that is either, <ol style="list-style-type: none"> <li>I. an investment manager, within the meaning of section 3(38) of ERISA;</li> <li>II. a trustee of the plan that meets the requirements of section 3(38)(A), (B) and (C) of ERISA; or</li> <li>III. the plan sponsor who is a named fiduciary, within the meaning of section 402(a)(2) of ERISA,</li> </ol>	Yes	Yes	The <u>Investment</u> is appropriate as a managed account QDIA, which is managed by an investment manager within the meaning of section 3(38) of ERISA. <u>Manager</u> has been vetted by DALBAR and found to meet and exceed the requirements.



## A. Applicability as QDIA Alternative

Requirement for QDIA Alternative	Stand Alone	Sleeve	Comments
b)... applying generally accepted investment theories,	Yes	Yes	<i>Investment</i> uses generally accepted investment theories. The model starts with a baseline glide path generated from consensus allocations of a universe of target date funds. The glide path is then adjusted based on the following factors: (i) participant age, (ii) participant life expectancy, (iii) participant salary, education and salary risk, (iv) participant's financial status, (v) participant's state of residence, and (vi) participant's other income sources. Investment selection recommendations are constructed from the plan's investment lineup by optimizing the asset class exposure, regularized fund diversification, and applying a fee emphasis component.
c) ... allocates the assets of a participant's individual account	Yes	Yes	<i>Investment</i> is diversified across multiple asset classes, subject to the plan's investment lineup. Service requires an investment lineup with a minimum of 4 asset classes: (1) domestic equity, (2) international equity, (3) US core bonds, and (4) short-duration fixed income.
d)...to achieve varying degrees of long-term appreciation and capital preservation,	Yes	Yes	<i>Investment</i> is designed to manage the risk of capital loss and produce appreciation that is consistent with capital preservation.
e) ...through a mix of equity and fixed income exposures,	Yes	Yes	<i>Investment</i> contains both equities and fixed income securities.
f) ...offered through investment alternatives available under the plan,	Yes	Yes	The <i>Investment</i> is appropriate for inclusion in the plan and thus be made available as a qualified QDIA.
g) ...based on the participant's age, target retirement date, (such as normal retirement age under the plan) or life expectancy.	Yes	Yes	The <i>Investment</i> is managed based on a baseline glide path, which is based on the participant's time horizon.

## A. Applicability as QDIA Alternative

Requirement for QDIA Alternative	Stand Alone	Sleeve	Comments
h) Such portfolios are diversified so as to minimize the risk of large losses and	Yes	Yes	The <i>Investment's</i> portfolios are diversified in a manner consistent with Modern Portfolio Theory as to minimize the risk of large losses.
l) ...change their asset allocations and associated risk levels for an individual account over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age.	Yes	Yes	The <i>Investment</i> decreases its equity exposure over time as to become more conservative with the participant's increasing age.
 <b>SUMMARY:</b> NextCapital's Digital Advisory Solution qualifies to be used as a MANAGED-ACCOUNT QDIA by itself and may be used as part of a qualified model portfolio in conjunction with other investments.			

# Qualifications Analysis

No violations of self-dealing prohibitions were found and the *Investment* was found to meet the QDIA requirements for the alternatives shown in the Validation Grid section of this report. The analysis included the following findings:

## B. Qualification Analysis

Regulatory Guideline	DALBAR Evaluation	Result	Comments
<b>1. Self-dealing Prohibitions – A fiduciary with respect to a plan:</b>			
a) ..., shall not deal with the assets of the plan in his own interest or for his own account	Does <i>Manager</i> have discretion to vary its compensation based on changing holdings within the <i>Investment</i> ?	Pass	<i>Manager's</i> compensation is unaffected by investment decisions made for the <i>Investment</i> .
b)... in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or,	Does <i>Manager</i> have interests that are adverse to those of participants?	Pass	<i>Manager's</i> interests are not adverse to participants' by virtue of the fact that <i>Manager's</i> compensation increases with growth in asset value in participants' accounts and decreases if assets decline.
c) ... receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.	Does <i>Manager</i> receive compensation from another party for managing the <i>Investment</i> ?	Pass	<i>Manager's</i> compensation is unaffected by investment decisions made for the <i>Investment</i> .
<b>2. Conditions for QDIA Fiduciary Relief:</b>			
a) Consider investment fees and expenses in choosing a QDIA	Do expenses for this <i>Investment</i> fall within the normal range of other investments of this type?	Pass	Fees are based on a percentage of assets under management, ranging from 0.05%-0.75% and are within industry norms.
b) Material is provided to participant relating to his/her QDIA.	Is <i>Investment</i> material appropriate for plan participants?	Pass	Material contains descriptions that can be extracted to be appropriate for participants with only minimal investment knowledge.

## B. Qualification Analysis

Regulatory Guideline	DALBAR Evaluation	Result	Comments
c) Notice must be written in a manner calculated to be understood by the average plan participant.	Is the information provided for inclusion in the required notice understandable to an average participant?	Pass	Under most circumstances, the average plan participant will be able to understand the information extracted from the materials.
<b>3. QDIA Requirements:</b>			
a) QDIA shall not permit employer securities except as investments within regulated investment companies or as employer match.	Does <i>Investment</i> permit use of employer securities outside of the QDIA exceptions?	Pass	Plan sponsor agreement requires that participant accounts cannot hold company stock, subject to limited exceptions. In rare instances in which a participant's account holds company stock, the <i>Investment</i> treats the company stock as "restricted," and does not consider it in the construction of the portfolio.
b) QDIA may not impose financial penalties or restrict the ability of a participant to transfer.	Are there restrictions or fees to transfer out of <i>Investment</i> which are prohibited under QDIA regulations?	Pass	Participant has the right to terminate the managed account service without penalty at any time.
c) QDIA is either managed by an investment manager, as defined in section 3(38) of ERISA, or plan trustee, or plan sponsor who is a named fiduciary or is a registered investment company or a stable value fund under State or federal regulation.	Does the <i>Manager</i> meet the criteria appropriate for the type of QDIA being validated?	Pass	<i>Manager</i> acts in the capacity of an ERISA 3(38) investment manager. <i>Manager</i> has been vetted by DALBAR and found to meet and exceed the requirements.

# Reasonableness as an Investment

QDIA regulations require that investments be reasonable, which DALBAR has further defined as falling within a normal range of comparable investments. The Reasonableness Analysis presented reflects this standard.

Plan fiduciaries are responsible for reviewing current investment information and making the determination that *NextCapital's Digital Advisory Solution* is a reasonable investment for the plan. Plan fiduciaries, including plan sponsors, are encouraged to seek independent expert advice in making the selection and monitoring of investments.

In order to assist in the determination DALBAR provides the following observations based on information available at the time of this evaluation.

## C. Reasonable Investment Analysis

DALBAR Investment Criteria	Observations
<b>1. Minimum Track Record</b>	
The average history for each underlying asset class investment strategy should be at least three years.	Underlying investments are designated investment alternatives of the plan and are selected by the plan sponsor or co-fiduciary prior to use in the QDIA.
<b>2. Stability of Organization</b>	
The average tenure of the portfolio management team for each underlying asset class investment strategy should be at least two years.	See C1.
<b>3. Assets in Product</b>	
The average underlying asset class investment strategy should have at least \$75 million under management (can include assets in other funds with the same strategy).	See C1.
<b>4. Holdings Consistent with Style</b>	
a) The allocation to equities is evaluated against the peer group – highest allocation to least - the screening threshold being set at the bottom quartile;	Defined by consensus allocations of a universe of target date funds.
b) The allocation to fixed income is evaluated against the peer group – highest allocation to least - the screening threshold being set at the bottom quartile.	Defined by consensus allocations of a universe of target date funds.
<b>5. Correlation to Style or Peer Group</b>	
The number of asset classes that make up the QDIA are evaluated against the peer group - most asset classes to least - the screening threshold being set at the peer group median.	Investment requires a minimum of 4 asset classes: (1) domestic equity, (2) international equity, (3) US core bonds, and (4) short-duration fixed income.

## C. Reasonable Investment Analysis

DALBAR Investment Criteria	Observations
<b>6. Expense Ratios/Fees</b>	
a) The wrapper expense is evaluated against the peer group – cheapest to most expensive - the screening threshold being set at the bottom quartile.	The fee charged for the model is within industry norms.
b) The average expense ratio of each underlying asset class investment strategy is evaluated against the peer group - cheapest to most expensive - the screening threshold being set at the bottom quartile.	See C1.
<b>7. Performance Relative to Assumed Risk</b>	
This analysis evaluates historical performance within the context of overall risk. It examines the number of positive and negative annual returns, the average of the positive and negative annual returns, and the best and worst annual returns, for a minimum of three years (max: 10 years).	Investment performance of the <i>Investment</i> varies from one plan to another. Historical performance is based on the investment selections and monitoring of the designated investment options and asset allocations derived from the plan's investment policy statement.
<b>8. Performance Relative to a Peer Group</b>	
The average 1-, 3-, and 5-year performance of each asset class investment strategy is evaluated against the peer group's median.	See C7.

## Investment Committee

Committee Member	Total Years Experience	Credentials
Dirk Quayle	20+	Series 63, Chartered Financial Analyst (CFA)
Rob Forreger	20+	-
David Slusarski	20+	Series 63, 65
Tristan Linke	10+	MSc, PhD

