

# fi360<sup>®</sup> *global fiduciary insights*

## for *SponsorGuard*<sup>™</sup>

### **fi360 Tools: The fi360 Fiduciary Score<sup>™</sup> Methodology for Mutual Funds and Exchange-Traded Funds**

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## What is the fi360 Fiduciary Score<sup>™</sup> ?

The fi360 Fiduciary Score<sup>™</sup> is an investment rating system born out of Practice 3.1 in the *Prudent Practices for Investment Fiduciaries* handbook series. It helps quickly identify a short list of Mutual Funds and/or ETF's (funds) that merit further research in the selection process and also facilitates the ongoing monitoring process by highlighting funds that contain potential deficiencies.

The Score evaluates funds on nine different screens across a spectrum of quantitative data points to determine if the fund meets a minimum fiduciary standard of care. The nine screens include: regulatory oversight, track record, assets in the fund, stability of the organization, composition consistent with asset class, style consistency, expense ratio/fees relative to peers, risk-adjusted performance relative to peers, and performance relative to peers.

The Score is a flash-report on a selected mutual fund or ETF. It is a useful tool for investment decision-makers to identify and monitor funds in the exercising of their duties. **It represents a suggested course of action and is not intended, nor should it be used as the sole source of information for reaching an investment decision.**

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## Peer Groups and Share Classes

The fi360 Fiduciary Score<sup>™</sup> process relies heavily upon peer group comparison. Determining a fund's appropriate peer group or sub-asset class is subjective. There are no industry standards for determining a money manager's investment style, or peer group, which makes it difficult to track some managers across different databases. Fi360 utilizes Morningstar data in the calculation of the Fiduciary Score and therefore uses the Morningstar Category<sup>™</sup> as the fund's peer group.

However, categorization into peer groups is the first step. To make the peer group analysis meaningful, the data set should be substantial enough to draw comparisons. With that in mind, fi360 requires at least five distinct funds with a three year history in order to calculate Fiduciary Scores for the funds in that peer group. Funds within peer groups that do not meet the requirement will not receive a Score.

Finally, due to the reporting requirements of mutual funds, fi360 calculates and assigns a Fiduciary Score to each share class of a mutual fund. As a result, share classes inception less than three years ago will not receive a Fiduciary Score even though the parent share class may have been in existence for a longer period. Also, although infrequent, due to the expense differences between a fund's share classes, one share class may receive a good (low) Fiduciary Score while the other class receives a poor (high) Fiduciary Score.

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## Calculating the fi360 Fiduciary Score

The fi360 Fiduciary Score<sup>™</sup> is a quantitative evaluation of how well a fund meets a minimum set of due diligence criteria defined by fi360 to reflect prudent fiduciary management. The Score ranks the fund relative to its peer group. Funds with less than a three year history are not considered in any calculations and are not scored.

The fi360 Fiduciary Score<sup>™</sup> Quarter is calculated on a quarterly basis by first combining the Morningstar mutual fund and ETF databases. Each fund's specific share class is then evaluated against the thresholds and point system identified in the following section. The points are totaled and ordered from lowest to highest within each peer group. Each fund's share class is then given a percentile ranking based on where their total points fall in the distribution of their peer group. Funds with 0 points are automatically given a Score of 0. Every other fund is given a Score from 1-100 representing their percentile ranking.

A Score of 0 is most favorable. It represents a fund that meets or exceeds all of fi360's recommended due diligence thresholds. A Score of 100 is least favorable. For example, a Small Value fund with a fi360 Fiduciary Score<sup>™</sup> of 37 would place in the 37<sup>th</sup> percentile of its Small Value peers.

The fi360 Fiduciary Score<sup>™</sup> Average is a three year rolling average of a fund's quarterly Scores. If the fund does not have three years worth of Scores, all available historical quarterly Scores are used to calculate the Average Score. The Average Score is also calculated on a quarterly basis.

## The fi360 Fiduciary Score<sup>™</sup> Screens

- **Regulatory oversight:** The product should be managed by: (a) a bank, (b) an insurance company, (c) a registered investment company (mutual fund), or (d) a registered investment adviser.
    - Unregistered products are excluded from fi360's calculations.
  - **Minimum track record:** The product should have at least three years of history so that performance statistics can be properly calculated.
    - Share classes incepted less than three years ago are excluded, even if the parent share class has been in existence for a longer period.
  - **Stability of the organization:** The same portfolio management team should be in place for at least two years. In a management team setting, the most senior manager's tenure should be at least two years.
    - 5 points if there has been manager turnover in the past two years
    - 10 points if there has been manager turnover in the past year
  - **Assets in the fund:** The product should have at least \$75 million under management (across all share classes.)
    - 5 points if the product has less than \$75 million in assets
    - 10 points if the product has less than \$50 million in assets
  - **Composition consistent with asset class:** At least 80% of the underlying securities should be consistent with the broad asset class. For example, a Large-Cap Growth product should not hold more than 20% in cash, fixed income and/or international securities (Only applicable to certain peer groups – see the [Appendix](#) for more information).
    - 10 points if more than 20% of the portfolio is inconsistent with the broad asset class
- Note:** The broad asset classes used in the composition screen include: U.S. Stocks, U.S. Bonds and Non-U.S. Stocks. The Long-Short peer group is evaluated on the U.S. Stock and Cash composition.
- **Style consistency:** The product must be highly correlated to the asset class of the investment option. This means the Morningstar Style Box<sup>®</sup> for the current quarter must match the peer group of the fund. (Only applicable to certain peer groups – see the [Appendix](#) for more information)
    - 10 points if the product is not highly correlated to the peer group
  - **Expense ratios/fees relative to peers:** The product's fees should not be in the bottom quartile (most expensive) of their peer group. The metric used in this evaluation, Prospectus Net Expense Ratio, includes all fund management costs, 12-b1 fees, administrative fees, and all other asset-based costs incurred by the fund, except brokerage costs. If the product is purchased within a group annuity product, any recordkeeping fees added to the underlying fund expense ratios by the group annuity provider are not included in this ratio.
    - 10 points if the product's expense ratio is in the bottom quartile
  - **Risk-adjusted performance relative to peers:** The product's risk-adjusted performance (Alpha and Sharpe Ratio – see [Appendix](#) for more information) should be above the peer group median manager's risk-adjusted performance.
    - 2.5 points if the risk-adjusted performance is in the third quartile
    - 5.0 points if the risk-adjusted performance is in the fourth quartile
    - 7.5 points if the risk-adjusted performance is in the bottom decile
    - 7.5 points if not calculated

## The fi360 Fiduciary Score<sup>™</sup> Screens (continued)

- **Performance relative to peers:** The product's performance should be above the peer group's median manager return for 1-, 3- and 5-year cumulative periods.
  - One-year performance relative to the median value for the peer group:
    - 2.5 points if in the third quartile
    - 5.0 points if in the fourth quartile
    - 7.5 points if in the bottom decile
    - 7.5 points if not calculated
  - Three-year performance relative to the median value for the peer group:
    - 5.0 points if in the third quartile
    - 7.5 points if in the fourth quartile
    - 10.0 points if in the bottom decile
    - 10.0 points if not calculated
  - Five-year performance relative to the median value for the peer group:
    - 7.5 points if in the third quartile
    - 10.0 points if in the fourth quartile
    - 12.5 points if in the bottom decile
    - If the fund does not have a five-year performance history:
      - 7.5 points if the three-year performance is in the third quartile
      - 10.0 points if the three-year performance is in the fourth quartile
      - 12.5 points if the three-year performance is in the bottom decile
      - 12.5 points if the three-year performance not calculated

## Interpreting the fi360 Fiduciary Score<sup>™</sup>

The fi360 Fiduciary Score<sup>™</sup> Quarter and Average bar charts, used in many of fi360's reports, provide a visual representation of the funds status. The following thresholds provide the user with an easy to view assessment of the fund and a suggested course of action.

### **Fiduciary Score<sup>™</sup>: 0 – Passed**

No fiduciary due diligence shortfalls.

### **Fiduciary Score<sup>™</sup>: 1–25 – Appropriate**

The fund may be an appropriate choice for use in a fiduciary account.

### **Fiduciary Score<sup>™</sup>: 26–50 – Watch(2)**

The fund has noteworthy shortfalls. It may not be an appropriate choice if being considered in a search. However, if already in use, the fund may not need to be replaced.

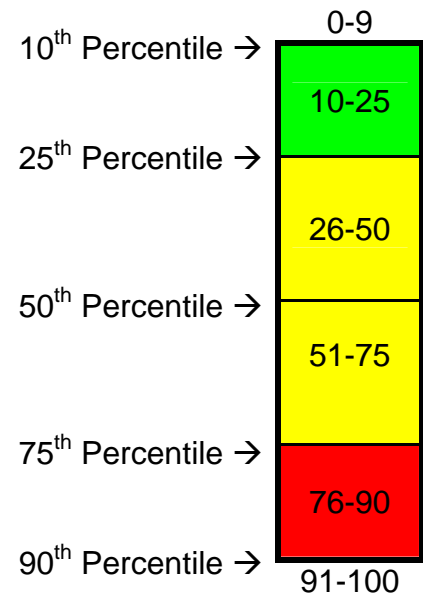
### **Fiduciary Score<sup>™</sup>: 51–75 – Watch(3)**

The fund has considerable shortfalls. It may not be an appropriate choice if being considered in a search. However, if already in use, the fund may not need to be replaced.

### **Fiduciary Score<sup>™</sup>: 76–100 – Watch(4)**

The fund has significant shortfalls and may not be appropriate for use in a fiduciary account. Strongly consider replacing the fund if already in use.

### **Bar Chart Example:**



## Appendix

### **Composition consistent with asset class**

This screen is only applied to the following peer groups: Large Value, Large Blend, Large Growth, Mid-Cap Value, Mid-Cap Blend, Mid-Cap Growth, Small Value, Small Blend, Small Growth, Long Government, Long-term Bond, Intermediate Government, Intermediate-term Bond, Muni National Long, Muni Single State Long, Muni National Interm, Diversified Emerging Mkts, Europe Stock, Diversified Pacific/Asia, Pacific/Asia ex-Japan Stk, Japan Stock, Latin America Stock, Foreign Large Value, Foreign Large Blend, Foreign Large Growth, Foreign Small/Mid Value, Foreign Small/Mid Growth, Muni California Long, Muni New York Long, Muni Single State Interm, Inflation-Protected Bond and Long-Short.

### **Style consistency**

This screen is only applied to the following peer groups: Large Value, Large Blend, Large Growth, Foreign Large Value, Foreign Large Blend, Foreign Large Growth, Foreign Small/Mid Value, Foreign Small/Mid Growth, Mid-Cap Value, Mid-Cap Blend, Mid-Cap Growth, Small Value, Small Blend, Small Growth, Long Government, Intermediate Government, Short Government, Long-term Bond, Intermediate-term Bond, Short-term Bond, High Yield Bond, Muni California Long, Muni California Interm/Short, Muni National Long, Muni National Interm, Muni National Short, Muni New York Long, Muni New York Interm/Short, Muni Single State Long, Muni Single State Interm, Muni Single State Short and Inflation-Protected Bond.

### **Risk-adjusted performance relative to peers**

Morningstar calculates the Alpha and Sharpe Ratios used in the calculations. Alpha is calculated using one of the six broad asset class indexes shown below.

<b>Broad Asset Class</b>	<b>Broad Asset Class Index</b>
U.S. Stock	S&P 500 TR
International Stock	MSCI EAFE NR USD
Balanced	Morningstar Moderate Target Risk
Taxable Bond	BarCap US Agg Bond TR USD
Municipal Bond	BarCap Municipal TR USD
Commodities	Morningstar Long-Only Commodity TR
Alternative	ML USD LIBOR 3 Mon CM

The broad asset classes shown above correspond to the peer groups in the following manner:

#### **U.S. Stock**

Large Value  
 Large Blend  
 Large Growth  
 Mid-Cap Value  
 Mid-Cap Blend  
 Mid-Cap Growth  
 Small Value  
 Small Blend  
 Small Growth  
 Communications  
 Consumer Discretionary  
 Consumer Staples  
 Equity Energy  
 Financial  
 Health  
 Industrials  
 Natural Resources  
 Real Estate  
 Technology  
 Utilities  
 Miscellaneous Sector  
 Leveraged Net Long

#### **International Stock**

Foreign Large Value  
 Foreign Large Blend  
 Foreign Large Growth  
 Foreign Small/Mid Value  
 Foreign Small/Mid Growth  
 World Stock  
 Diversified Emerging Mkts  
 Latin America Stock  
 Europe Stock  
 Japan Stock  
 Pacific/Asia ex-Japan Stk  
 Diversified Pacific/Asia  
 Global Real Estate

#### **Balanced**

Convertibles  
 Conservative Allocation  
 Moderate Allocation  
 World Allocation  
 Target-Date 2000-2010  
 Target-Date 2011-2015  
 Target-Date 2016-2020

#### **Municipal Bond**

Muni National Long  
 Muni National Interm  
 Muni National Short  
 High Yield Muni  
 Muni Single State Long  
 Muni Single State Interm  
 Muni Single State Short  
 Muni California Long  
 Muni California Int/Sh  
 Muni Massachusetts  
 Muni Minnesota  
 Muni New Jersey  
 Muni New York Long  
 Muni New York Int/Sh  
 Muni Ohio  
 Muni Pennsylvania

#### **Commodities**

Commodities Agriculture  
 Commodities Broad Basket  
 Commodities Energy  
 Commodities Industrial Metals

#### **Taxable Bond**

Long Government  
 Intermediate Government  
 Short Government  
 Inflation-Protected Bond  
 Long-Term Bond  
 Intermediate-Term Bond  
 Short-Term Bond  
 Ultrashort Bond  
 Bank Loan  
 Stable Value  
 High Yield Bond  
 Multisector Bond  
 World Bond  
 Emerging Markets Bond

#### **Alternative**

Bear Market  
 Currency  
 Long-Short  
 Market Neutral  
 Equity Precious Metals

Target-Date 2021-2025  
Target-Date 2026-2030  
Target-Date 2031-2035  
Target-Date 2036-2040  
Target-Date 2041-2045  
Target-Date 2050+  
Retirement Income

Commodities Miscellaneous  
Commodities Precious Metals