

## **FirmPlus Migration: 12 Point Scorecard Frequently Asked Questions**

As recently shared, Broadridge Fi360 is merging the best of FirmPlus with the Fiduciary Focus Toolkit™ (FFTK). This planned software merger has been in the works for several years, as Fi360 looks to sunset FirmPlus later this year.

LPL Retirement Partners considered the implications of this merger on the 12 Point Scorecard and sought to minimize disruptions to its process. In addition, LPL Retirement Partners considered potential ways in which the new software could help improve the 12 Point Scorecard.

Below is a summary of the primary change, a rationale for the change, and how to address any questions that may arise.

### **Q: How often is the methodology reviewed?**

The LPL 12 Point Scorecard methodology process is reviewed on a periodic basis. Given it is meant to be a tool for performance monitoring, the need for consistency is balanced with the alignment of industry best practices. LPL Retirement Partners, coupled with consultations with LPL Research, considers the current 12 Point Scorecard performance monitoring processes, evolving industry best practices, LPL advisor questions, and LPL Compliance concerns when considering methodology changes.

The recent transition from the FirmPlus reporting engine to the Fi360 FFTK engine was a catalyst for further considerations given the new Fi360 FFTK system offered functionalities that the legacy FirmPlus system did not.

- Primary Catalyst for Change:
  - 12 Point Transition from FirmPlus to Fi360 FFTK.

### **Q: What was the primary change?**

The Original 12 Point Scorecard relied only on one methodology to monitor all investments. As the popularity of passive funds increased, a Passive Score Methodology was considered and then added to address concerns that passive funds were often landing on the Watch List. At the time of the initiation of the Passive Score Methodology, there were some others in the industry that had incorporated a similar methodology, so the creation of a Passive Score Methodology was not considered an industry outlier. Given passive index funds investment objective is to deliver index-like performance at a low cost, the result of trailing the benchmark by its expense ratio is generally expected.

With the migration from FirmPlus to the Fi360 FFTK, LPL Retirement Partners is dropping the Passive Score Methodology and reverting to using the Original 12 Point Scoring Methodology for all investments.

- Primary Change:
  - Reverting the Passive Score Methodology back to the Original 12 Point Scoring Methodology.

### **Q: Why change the passive score methodology now?**

The execution of the Passive Score Methodology requires additional data and analytics to create a custom passive index for all categories. Several third-party data providers have indicated that they cannot begin working on the needed analytics until three to four weeks after quarter end, which results in the final Passive Score Methodology datapoints not being ready until 40 to 45 days after quarter end. This consistent delay has led to growing escalations from advisors – “why the delay in getting quarterly 12 Point Scorecard reports completed?”

Reverting to the original 12 Point Scorecard methodology allows for the initial analysis to begin 10 days after quarter end, which should result in the final analysis being completed approximately 21 days after quarter end.

- Primary Rationale for the Change:
  - By dropping the additional analysis, the time required for the 12 Point Scorecard to be produced is expected to drop from 40-45 days to 21 days after quarter end.

### **Q: How do I explain greater volatility on the Watch List?**

The original consideration for a Passive Score Methodology was to address concerns that passive funds were often landing on the Watch List. Reverting to the Original 12 Point Scoring Methodology means some passive funds may exhibit greater volatility on the Watch List.

LPL Research analyzed scoring of passive funds using the legacy FirmPlus Passive Score Methodology as compared with the legacy FirmPlus Active Score Methodology. Reverting to the original methodology led to more expected results in categories where active management works well relative to passive management. Specifically, using the legacy FirmPlus Active Score Methodology, LPL Research found that passive funds' relative performance was competitive in categories where active management struggles (i.e., large blend), but had wider ranges of outcomes in categories where active management is more competitive (i.e., small growth and short-term bond). Further, LPL Research noted there were short periods of time when market leadership was very narrow, resulting in a more challenging environment for active management and better relative performance for passive management.

This performance experience is consistent with what the plan participant experience and aligns with market expectations. In addition, this performance experience helps advisors relate the benefits of low fees typically associated with passive funds relative to the benefits of active management in certain categories (i.e., active management in small growth does well over the longer term but may occasionally struggle when market leadership is very narrow).

- Additional Benefit:
  - Aligns expectations by helping identify categories where the low fees of passive management may outweigh the benefits active management.

### **Q: Any additional benefits with the Passive Score Methodology change?**

One area of consistent frustration with the Passive Scoring Methodology has been the penalization of passive funds that are implementing their objective successfully by tightly tracking their index but are receiving low scores due to having lower peer group rankings.

An example below illustrates one fund that is often discussed, the iShares Russell 1000 Large-Cap Index fund. As seen below, this fund tightly tracks its benchmark, the Russell 1000 Index, as evident with its 3-Yr R2 of 100, nearly identical 1-Yr and 3-Yr standard deviation, and 1-Yr and 3-Yr tracking error of four and five basis points, respectively. Yet, given the peer group contains index funds of indices that may be more in favor than the Russell 1000 Index due to changing market leadership, the fund scores a six and is a candidate for being placed on Watch.

We believe that removing a peer ranking methodology based upon performance for passive funds will help eliminate this confusion and make it clearer for plan sponsors to see the potential benefits (and potential costs) of passive funds.

PASSIVE													
INVESTMENT	FUND ASSETS	3 YR	3 YR UP/DN	1 YR SHRP	3 YR SHRP	3 YR R-SQ	3 YR BETA	1 YR STDDEV	3 YR STDDEV	NET EXP	1 YR PEER TRK ERROR	3 YR PEER TRK ERROR	SCORE OF 12
<b>Large Value</b>													
Nuveen Large Cap Value Idx R6 (MF)	\$11,067.34	8.99	1.00	1.74	0.31	100.00	1.00	12.73	16.62	0.05	0.04	0.07	8
Russell 1000 Value TR USD	-	9.03	-	-	-	-	-	12.75	16.65	-	-	-	-
Peer Group Median (50th Percentile)	-	9.49	-	1.80	0.32	-	-	12.73	16.65	0.26	0.05	0.06	-
<b>Large Blend</b>													
iShares Russell 1000 Large-Cap Idx K (MF)	\$1,445.71	10.80	1.00	2.45	0.39	100.00	1.00	12.32	17.68	0.07	0.04	0.05	6
Russell 1000 TR USD	-	10.83	-	-	-	-	-	12.32	17.70	-	-	-	-
Peer Group Median (50th Percentile)	-	11.31	-	2.51	0.42	-	-	11.94	17.53	0.20	0.04	0.04	-

- Additional Benefit:
  - Removes confusion of certain Passive Scoring Methodology outcomes.

### Q: Any additional benefits with the Passive Score Methodology Change II?

Reverting to the original methodology reestablishes a consistent peer group in analyzing the funds in the category. A common concern with the Passive Score Methodology was that just because you picked a passive fund does not mean that you also get to pick the relative peer group for performance monitoring. Creating custom peer groups is often an area of concern with compliance groups, which are concerned with issues such as transparency and who controls the composition of the peer group.

Reverting to a broader peer group defined by a third party such as Morningstar aligns with the benefits of comparing investment options with the entire category available.

- Additional Benefit:
  - Removes lack of transparency of custom peer groups.

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