

Introduction

FE's recommended list of funds – known as the Approved List – undergoes a process of continuous monitoring between rebalancing's. FE employs its own cutting edge governance technology that captures all aspects of a fund's performance, behaviour, structure and risk.

This process ensures that FE becomes aware of any problems before they become readily apparent, allowing our experienced analysts plenty of time to analyse and interrogate the fund and its managers to truly understand what is happening behind the scenes.

Once investigation has been completed a decision regarding the funds future can be taken. All findings are detailed in a monthly governance report produced by the FE Research team. This frequent and concise reporting helps keep clients up to date and informed of all potential issues, their causes and our recommended course of action. Permanently in the loop, clients have full awareness of what's going on and are informed enough to field any inquiries.

FER Governance Tool

Monitoring the Approved List using any of FE's existing tool-sets would be too restrictive and time-consuming to produce the detailed analysis required, so we have constructed our own purpose-built governance tool for use by the research team.

The tool currently monitors a large number of measures (a list of which can be found in Appendix A) using a combination of cumulative probability and binary calculations, different for each one. Funds are compared against their benchmark and sector for appropriate measures, where available. These can be changed or suppressed if necessary; for example, we may want to exclude a sector calculation if the fund sits in IMA Specialist. The fund can be assigned to a more relevant sector or the measure can be ignored entirely.

Calculations for Z scores are done over one, three and five years where possible. This allows trends to be assessed and should make potential problems easily identifiable. The data-set used is weekly one-year rolling data.

Combining Governance Measures

Each governance measure is assigned to one of four characteristics: risk, performance, behaviour and structure. The scores are then combined to give an overall figure for each characteristic. These are the four basic results the governance tool uses.

Different weightings are attached to each measure, depending on the perceived importance of each one.

For measures using Z scores, the raw number is used. For binary measures, a fail would represent a 100 per cent chance of a problem and a pass 0 per cent. Each characteristic is assigned a threshold to identify a high and low chance of a problem.

The Process

The calculations in the governance tool are re-run and examined at least once a week. Major issues are flagged up as red and minor ones as yellow. All new issues are recorded in the governance log, which identifies: the fund name, the date, the type of issue and a detailed description of what has been flagged up. The issues are then distributed to the relevant analyst responsible for the monitoring of each particular fund.

Analyst Investigation

Appropriate investigation must be undertaken on each fund. This may include greater quantitative analysis of the fund or reviewing logs of previous meetings with the fund manager to see if they had forewarned of the change. If no explanation is readily available, the fund management group will be contacted to explain the anomaly.

Once the investigation is completed, the analyst will summarise their findings. If they are still concerned by a fund, it is communicated to the head of research.

The Watch-List

During the course of their investigations, the fund analysts may identify funds they believe will need careful monitoring. These funds will be added to FE's internal watch-list. It will be the analysts' responsibility to regularly monitor such funds until they are happy the original issue is resolved. If they have immediate concerns regarding the continued suitability of the fund, it will be assigned the status of "critical" and escalated to the highest level.

The Investment Committee

The investment committee is involved in the governance process if the analysts identify a critical issue with a fund. At this point, based on the governance tool and the analysts' findings, the committee's members will need to make a decision on the fund's continued participation in the Approved List. If they are not satisfied, they can remove it from the list.

The Governance Report

A detailed governance report based on the analysts' findings is distributed once a month to FE Research clients. The report includes all the funds that have been highlighted by the governance tool, along with the findings from the fund analyst. The report is written in easy-to-understand language so that it can be read by the average investor.

Appendix A: List of Governance Measures

Measurement	Characteristic	Time Period
Beta vs Benchmark	Risk	1, 3 & 5 Years
Beta vs Sector	Risk	1, 3 & 5 Years
Historic Value at Risk	Risk	1, 3 & 5 Years
Historic Value at Risk vs Benchmark	Risk	1, 3 & 5 Years
Historic Value at Risk vs Sector	Risk	1, 3 & 5 Years
Max Drawdown	Risk	1, 3 & 5 Years
Max Drawdown vs Benchmark	Risk	1, 3 & 5 Years
Max Drawdown vs Sector	Risk	1, 3 & 5 Years
Volatility	Risk	1, 3 & 5 Years
Volatility vs Benchmark	Risk	1, 3 & 5 Years
Volatility vs Sector	Risk	1, 3 & 5 Years
Alpha Manager Change	Performance	Once a year
Alpha vs Benchmark	Performance	1, 3 & 5 Years
Alpha vs Sector	Performance	1, 3 & 5 Years
Bottom Quartile	Performance	Measured over previous four quarters
Crown Rating Change	Performance	Twice a year
Return	Performance	1, 3 & 5 Years
Return vs Benchmark	Performance	1, 3 & 5 Years
Return vs Sector	Performance	1, 3 & 5 Years
rSquared vs Benchmark	Behaviour	1, 3 & 5 Years
rSquared vs Sector	Behaviour	1, 3 & 5 Years
Tracking Error vs Benchmark	Behaviour	1, 3 & 5 Years
Tracking Error vs Sector	Behaviour	1, 3 & 5 Years
Asset Inflows/Outflows	Structure	As provided by provider
Benchmark Change	Structure	Constantly monitored
Group Change	Structure	Constantly monitored
Manager Change	Structure	Constantly monitored
Sector Change	Structure	Constantly monitored
TER Change	Structure	Constantly monitored