The Pakistan Credit Rating Agency

Asset Manager Rating Criteria

Assessment Framework

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Summary

This methodology outlines PACRA's approach to assigning Asset Manager ratings. The asset manager rating is an independent opinion on the expertise, quality of services, and potential vulnerability to investment management and operational challenges of an asset management company. PACRA's opinion is based on an evaluation of the following factors: Profile, Ownership, Governance, Management, Investment Risk & Portfolio Management, Customer Relationship, and Performance. PACRA also compares the standing of the asset management company with peers in its relative universe.

Analyst Contacts:
Momin Farooque
momin.farooque@pacra.com
+92 42 3586 9504

The Pakistan Credit Rating Agency:
Head Office
FB 1 Awami Complex
Usman Block, New Garden Town
Lahore
Phone: +92 42 3586 9504
Karachi Office
PNSC Building, 3rd Floor
M.T. Khan Road, Lalazar
Karachi
Phone: +92 21 3563 2601

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Introduction

Scope

The primary purpose of PACRA's asset manager rating is to provide investors with an independent opinion on a conventional or digital asset manager's expertise, quality of services, and its potential vulnerability to investment management and operational challenges. It is important to understand that the asset manager rating differs fundamentally from a traditional credit rating, which refers to an issuer's ability to meet its financial obligations. Moreover, the asset manager rating is not a determinant for the future performance of an AMC's funds, portfolio, or other investment vehicle.

> ***Digital Fund Management Companies*** *SECP issued a notification (S.R.O. 592(I)/2023) on 17th May, 2023, detailing regulatory requirements for newly formed digital fund management companies (digital AMCs) and for existing companies that intend to convert their operations to digital-only. There are currently 24 AMCs operating in Pakistan, while the digital AMC landscape is still in its nascency with only 1 digital-only AMC operating. This methodology is applicable to digital AMCs as well. For evaluation purposes, all factors that are considered for conventional AMCs, will also be evaluated for digital AMCs. In addition to that, PACRA will be incorporating specific regulatory requirements for digital AMCs, which include minimum equity requirement, Collective Investment Schemes fee and disclosures, total expense ratio (TER), etc. PACRA will also consider the digital infrastructure and technological tools in place to assess the overall capabilities and expertise of digital AMCs.*

Risks

AMCs are exposed to a wide variety of risks that can affect their operations and reputation. A major source of risks can be from inadequacies in the investment decision-making body, which can lead to inconsistent investment strategies, weak oversight, and ultimately suboptimal performance. Liquidity risk and asset-liability mismatches also pose major challenges which can result in delays in meeting redemption requests or force an AMC to distressed sale of assets at which can adversely impact the value of assets under management (AUM). Furthermore, poor communication with investors can erode client confidence and lead to unexpected withdrawals or reputational damage. AMCs also face operational risks, including settlement, data security, and redemption risks, as well as potential business disruptions from system failures or external events. Additionally, AMCs face broader market risks, where adverse movements in interest rates or market prices can negatively affect the performance of the AMC's funds.

Rating Framework

PACRA follows a comprehensive approach to form an opinion on the quality of services and expertise deployed by an AMC. PACRA analyzes AMCs not only on a standalone basis, but also by observing their relative position within the industry. Factors underlying the methodology to understand the design and objectives of AMCs include Profile, Ownership, Governance, Management, Investment and Portfolio Management, Customer Relationship, and Performance. These factors help to understand the perspective of an AMC's shareholders, board, and management team; since an AMC's design has to be a reflection of the objectives conceived by the shareholding group. Furthermore, PACRA's assessment also involves corroborating an AMC's compliance with all regulatory requirements and updates.

Rating Criteria						
Profile	Ownership	Governance	Management	Investment Risk & Portfolio Management	Customer Relationship	Performance

Profile

Background

PACRA reviews the background of the AMC to understand its evolution from where it started to where it currently stands. PACRA analyses how, and through what means, the AMC has achieved its desired expansion. PACRA looks at the progress of the AMC from its past to help determine the ability of the AMC to successfully realize its strategy. The significant factor here for PACRA is to assess whether the AMC has achieved its desired expansion through organic growth, or through acquisitions. Meanwhile, the source of funding for the growth is also critical.

PACRA considers an asset manager's experience in the industry and favorably views asset managers with established track records of several years of navigating through market cycles, developing sound processes, and having well-nurtured expertise to offer asset management services.

Market Share

The market share of Assets Under Management (AUM) serves as a key indicator for an AMC's scale and competitive positioning. Higher market shares typically indicate greater investor confidence, brand recognition, and the AMC's ability to attract or retain clients. Size therefore provides sustainability to an asset manager and longevity to its operations. Thus, the analysis of market share of AUM, and growth of the market share over time (relative to the industry), is central to PACRA's assessment. Category-wise composition of AUM is analyzed to detect significant changes in trends and possible concentration. In some cases, PACRA also evaluates the projected AUM of an AMC.

Diversification of Funds Mix

PACRA considers that, apart from sheer size, a good investment manager has a well-diversified product slate. PACRA expects asset managers to not only offer a diverse set of investment products, but have adequate diversification of assets within each product offering. A high-quality AMC is expected to boast a variety of shariah compliant and conventional collective investment schemes, voluntary pension schemes, dedicated equity funds, exchange traded funds, etc. Moreover, the number of unique funds on offer, alongside the AUM represented by the top fund are also closely monitored.

Investor Concentration

PACRA considers the composition and concentration of the AMC's investor base. Investor concentration is analyzed to judge the potential redemption risk an asset manager may face in the event of withdrawal of funds, crisis, or a redemption run. PACRA assesses investor concentration by observing the AUM represented by the top ten investors of the AMC. The lower the concentration, the better the AMC's relative standing. Moreover, the share of retail investors verses institutional investors is also assessed. High net worth individuals (HNWs) are sometimes included in the retail client classification, but PACRA tends to classify them as institutional investors. PACRA looks at the pure number of

retail investors to distinguish between financially savvy and general investors. The run-rate of retail AUM and fees from retail are important indicators evaluated by PACRA.

Information Required on Profile:

- AMC Fund Slate (including PKR size, number of investors, etc.)
- Information of Top 10 customers
- Investment details of retail and institutional clients

Ownership

Ownership Structure

The assessment of ownership begins by looking at the legal status of an AMC. The level of perceived stability gradually increases from a sole proprietor to a listed AMC. An in-depth study of the shareholding mix is then conducted to disentangle the structure of ownership of the AMC. Key factors considered for this purpose include: i) the shareholding structure, which includes whether the individual(s) own the AMC directly or indirectly, ii) the composition of foreign and local shareholders, iii) whether the AMC is owned by a single group or through a combination of entities and individuals, and iv) whether it is part of a group or is a standalone AMC. All these deliberations are done to identify the man at the last mile. PACRA further considers how an AMC is actually run as, despite being legally structured as companies, some AMCs are run as family concerns.

Complex shareholding/ownership structures: *In cases where an AMC has a complex ownership structure, there are unique challenges in evaluating the decision-making processes, lines of hierarchy, and financial obligations and liabilities. In analyzing these AMCs, the fundamental issue is to explore the underlying reason or motivation for the complexity of the structure.*

AMCs that are owned by private individuals and families: *On the one hand, the concentration of equity ownership might indicate that the majority of shareholders have a strong vested interest in creating long-term value and closely monitoring management behavior. On the other hand, a potential concern in such cases is that the owners might rely heavily on extracting funds from the AMC as a source of income or to fund other business activities - potentially undermining the financial stability of the AMC.*

Stability

In order to analyze the stability of ownership, a particularly important factor taken into account is succession planning. An important part of PACRA's analytical process is assessing whether the AMC's prospects would be supported under a the right of succession, and identifying who that support would come from. This is particularly relevant in the case of family-owned businesses and joint ventures, where ambiguity of ownership succession could pose contagion risks on the AMC's sustainability. An AMC with stable ownership and clarity in succession – perhaps with major stakes residing with one family/group – is considered positive for ratings. On the contrary, AMCs with high free float (in case of listed concerns) or fragmented shareholding, can possess a high risk of takeover, which may anchor lower ratings.

Business Acumen

PACRA gauges the business acumen of the AMC's sponsors. Having a strong business acumen set among the AMC's key ownership is critical for sustainable success. PACRA analyzes business acumen through two primary areas: i)

industry-specific working knowledge, and ii) strategic thinking capability. A deep and applicable understanding of the system is critical in determining how a business achieves its goals and objectives. PACRA's scope includes the assessment and understanding of how shareholders of the AMC deliberate over, and successfully make the right business decisions. In the case of digital AMC, PACRA also evaluates the owner's experience in digital services to ascertain their ability to provide strategic guidance. This is especially critical in the case of newly formed digital AMCs.

Financial Strength

PACRA analyzes the ability and willingness of the major shareholders to support the AMC on a continuing basis, and more importantly, in times of distress. In this context, support refers strictly to financial support and not operational support. PACRA gives due importance to the behavior of the major shareholders to provide timely and comprehensive support in times of need in the past, the perspective view of key shareholders in the case that such need arises, the other businesses of shareholders (strategic importance of AMC in the shareholders' portfolio), and the level of commitment of the AMC's major shareholder in providing capital support. The scope for looking at other businesses of shareholders include overall profiling of the key shareholders in the context of identifying their resources outside the AMC. If, in a group structure, the financial strength of the shareholder is deemed to be weaker than that of the AMC, it may bode negatively for the AMC's standalone rating given the possibility that the AMC may at some point in time be bound to extend financial support to its weaker parent.

Information Required on Ownership:

- Shareholding pattern
- Details of major shareholders' other businesses
- Shareholders' financial information
- Shareholders past experience in digital or fintech space, if applicable
- Past pattern of support provided by the shareholders

Governance

Board Structure

PACRA conducts the assessment of a board on various criteria, including its overall size, the presence of independent members, duration of board members' association with conventional or digital AMC, overall skill mix, and the structure of board committees. The size of the board may vary as per the scope and complexity of the operations of the AMC. While a very small board is not considered optimal, effective and efficient decision-making may not be possible in the case of a very large board either. A healthy composition of a board includes the presence of independent and non-executive members with limited association with the shareholding group of the AMC. The chairman of a board is expected to have a non-executive role and preferably should be an independent board member. Moreover, having one individual holding both the chairman and CEO (or equivalent) positions is considered a weak governance practice. The AMC's compliance with the code of corporate governance and NBFC regulations is also examined. PACRA also closely examines the independence of governance from major shareholders. Lastly, PACRA evaluates the number of board committees, their structure, and how these committees provide support to the board. A board with a higher number of members should have a higher number of committees in place to assist in performing its role.

Members' Profile

PACRA collects information regarding the profile and experience of each board member. This helps in forming an opinion about the overall quality of the board. Diversification in terms of knowledge background and experience is considered positive; however, a fair number of board members should have related experience.

Board Effectiveness

In PACRA's view, the role of the board is to work with management in steering the AMC to its performance objectives and to provide critical, impartial oversight of management performance. PACRA analyzes the type and extent of information shared with board members, and the quality of discussions taking place within the board and its committees. Effective oversight requires frequent sharing of detailed information covering various aspects of business and market development. PACRA also reviews the number of board meetings held during the year as these should be justified with the number of issues/matters arising. Board members' attendance and participation in meetings are important and are gauged by viewing board meeting minutes.

Transparency

Quality of the governance framework is also assessed by the procedures designed by the board to ensure transparent disclosures of financial and other information by conventional and digital AMCs. This can be achieved through: i) ensuring the independence of the audit committee, ii) strengthening the quality of internal audit function – which may be in-house or outsourced, and iii) improving the quality of external audits by engaging auditors which are included in the State Bank of Pakistan's panel of auditors and/or have a satisfactory Quality Control Review (QCR) rating.

Accounting Quality: *PACRA reviews the quality of an AMC's accounting policies as reflected in its notes to accounts, auditors' comments and other disclosures that are part of its financial statements. Adherence to accounting standards is assessed, particularly for unlisted concerns.*

Information Required on Governance:

- Size and composition of board
- Details of board committees including TORs
- Profile of board members
- Information packs used by the boards
- Minutes of board meetings
- Internal auditor detail (if outsourced)
- External auditor detail

Management

Organizational Structure

PACRA's analysis of the organizational structure focuses on how the AMC is organized while keeping in view the scope of its operations and the diversity of its product base. PACRA believes that departments should be structured in an AMC while keeping in view the segregation of duties and the importance of the functions to be performed. In this

respect, functional separation of the front office from the middle and/or back offices is considered important. Furthermore, it is key for PACRA that the risk management function of the AMC is separate and independent.

Management Team

PACRA's evaluation of human resources is based on an objective criterion that focuses on the background of management and staff both individually and collectively. Assessment is based on the years of relevant work experience, prior track record, and tenure with the AMC. Additionally, for digital AMCs, more attention is paid to the management's experience in providing digital services. Each functional area is covered, including portfolio management, risk management, investment research, sales and distribution, marketing, internal audit, and compliance. Loss of key personnel, particularly members of senior management and senior portfolio managers, can have potentially adverse effects on the performance of funds under management and the overall standing of the AMC relative to peers. Hence, human resource turnover is reviewed to determine the stability of critical staff, with a particular focus on key departments. In addition, the AMC's human resource policies are also reviewed to gauge its emphasis on retaining and recruiting vital staff members, and ensuring their continuation in the structure. It is important for AMCs to ensure adequate knowledge and training of staff/employees when dealing with clients, potential clients, or managing client portfolios and assets.

Key Person Risk: *Key-man risk occurs when an AMC is heavily reliant on an individual, or a limited number of individuals, who are accepted as the key holder(s) of important intellectual capital, knowledge or relationships. While this type of risk is more commonly identified in small to medium-sized entities, it can also exist in larger entities and is relatively challenging to benchmark, and hence, mitigate. PACRA attempts to identify the extent to which an AMC is dependent on the expertise of such individual(s) and to ensure policies exist for managerial succession to limit the adverse impact of such a person unexpectedly leaving the AMC.*

Management Effectiveness

Optimum portfolio management requires adequate technological resources, provided by the parent AMC, an affiliate, and/or an external third party (e.g., vendors). The most critical IT resources are portfolio management and order management systems. Various features of the portfolio management system are explored including its robustness, coverage of instruments, time delay before transactions are entered, timeliness and accuracy of portfolio pricing, and ability to monitor value-added indicators and order simulation. PACRA assesses the quality and reliability of the order management process in terms of systems and procedures to ensure the security, timeliness, and fair handling of multiple transactions. Electronic ordering and order confirmation also add value and security, notably when trading is a risk. The integration of custodians and fund administrators within the systems is also cautioned. PACRA places high value on management information systems (MIS) - system-generated MIS reports are considered superior. Another key measure of management effectiveness is the management's track record of delivering on past projections and sticking to strategies.

MIS: *System generated – real-time based – MIS reports add more efficiency in decision making whether related to operational, financial or strategic issues. PACRA evaluates the quality and frequency of the MIS reports used by the management team to ascertain that decision-making within the AMC is information-based.*

Control Environment

An analysis of the overall Compliance and Internal Control framework (including Internal Audit procedures) of the AMC helps in identifying the procedures, control centers, and reporting lines in order to manage conflicts of interest, meet fiduciary responsibilities, and verify the accuracy of financial and accounting information prepared for unit-holders and other stakeholders. This analysis would assess the strength of the overall compliance and control environment beyond regulatory requirements. Positive factors for AMC rating include having well-documented and comprehensive internal policies overseeing: investment, risk management, segregation of duties, the information barriers between various functions of the internal audit, safeguarding (cybersecurity) of the flow of sensitive information within the company (by establishing necessary firewalls) along with having a structured internal control program. The compliance function is evaluated on an enterprise-wide basis. More value would be given to the independence of the compliance function and its integration into the overall systems of the AMC.

In the case of digital AMCs, the reliability of digital infrastructure is critical. Therefore, for digital AMCs, PACRA pays more attention to core software deployed, front-end and back-end applications, vendor details for software services, user interface and channels used by the customers, in-house development capabilities, system back-up and business continuity plan and measures taken for data security. Similarly, risk management mechanisms and controls established are examined.

Operational Risk: *Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. An analysis of the AMC's Disaster Recovery (DR) procedures, infrastructure security and monitoring of third-party activities helps to determine the viability of the operational control environment against unanticipated business disruptions, personnel slippage and inadvertent data entry errors. In addition, PACRA evaluates its capacity to promote ethics and monitor enforcement thereof.*

Information Required on Management:

- Latest organogram
- Details of management committees
- Profile of senior management
- Redundancy pattern
- MIS reports
- Minutes of management committees' meetings
- AMC's policies and SOPs
- Details of the digital platform implemented
- Vendor details along with key terms agreed with
- Core software details
- Back-up and Business continuity plan
- Copy of system audit report and key observations

Investment Risk and Portfolio Management

Investment Risk Management Framework

A strong risk management framework, monitoring culture, and platform are the hallmarks of a seasoned and mature AMC. Evaluating the overall risk management framework of the AMC enables determining how various risks are identified, monitored, and mitigated across the AMC. The efficiency of controls and risk management within an AMC is instrumental in mitigating risks arising from operational and investment management activities. The analysis considers the role of the board in formulating risk management policies, the independence of the risk management function, and the IT systems and key risk indicators employed by the AMC to monitor risk. At the same time, the involvement of senior management in the overall risk management function is assessed to understand the organization's emphasis on risk and its overall risk culture. PACRA also evaluates the business plan for digital AMCs including, products and services being offered, customer acquisition strategy, operational plan, business feasibility and peer comparison.

Investment Risk Management permeates the entire investment management process and consists of two pillars – macroeconomic risks, and portfolio risks. Macroeconomic risks are the risks to the operating environment of the asset management industry and the overall economy of the country. Portfolio risks are risks related to the portfolio investments of the AMC. Portfolio risk may be reflected in the overall structure of the investments at AMC level, the exposure to different sectors, and redemption pressures on the investments.

Financial Risks

PACRA reviews the coverage and appropriateness of risk indicators used by an AMC, the capacity of the portfolio managers to measure such indicators and monitor the exposures against explicit and meaningful limits. The extent of risk indicators used by the AMC depends on the scope of activities and nature of product base. Reconciliation between expected and actual risk levels is equally important and requires regular comparisons, analysis of discrepancies, and corrections. Three main categories of an AMC's risk are Credit Risk, Market Risk, and Liquidity Risk. Each of these is viewed separately to gauge the nature and source of a particular risk factor along with the controls in place to mitigate the risk.

Credit Risk: For credit risk, it is important to periodically monitor the financial strength and creditworthiness of the various *counterparties* and to take appropriate actions in case of any adverse changes. Credit risk can arise from breaches of internally defined allocation limits, internal rating guidelines for investment purposes, credit quality of portfolio assets, and concentration of individual investments, sectors, and/or groups. Moreover, the credit risk of an AMC's portfolio could lead to losses from defaults or rating downgrades of invested securities.

Liquidity Risk: Liquidity risk management is a key challenge for AMCs. The liquidity profile of the underlying investments in a particular fund, and asset/liability mismatches that could trigger a potential liquidity wipeout are factors in the liquidity risk assessment. The AMC's ability to meet investor redemptions without harming portfolio value is the key indicator being evaluated. Effective liquidity management demonstrates strong oversight and protects fund performance by avoiding forced sales at distressed prices.

Market Risk: Market risk can arise primarily from adverse movements in interest rates and asset prices. High volatility in market conditions may result in significant losses in AMC's investment portfolio. Therefore, it is important to assess

the measures used by an asset manager to mitigate market risks (e.g., stress testing for interest rate shocks, duration analysis, beta analysis, cut-offs for exit from the stock market, repositioning strategy, etc.) that can adversely impact the value of the overall portfolio.

The importance of having a clear investment objective was highlighted during the liquidity crises of 2008. Investors were inadvertently misled to believe that income funds were a highly liquid asset class. However, owing to the evaporation of liquidity of the underlying investments (mostly TFCs) in the market and the ensuing panic redemption, some asset managers had to resort to distressed sales and/or suspend their funds altogether. This, while highlighting increased investor aversion to liquidity risk, also led to strict regulatory guidelines that distinguished highly liquid money market funds as a separate asset class from income funds.

Portfolio Management

The complex nature of financial markets requires asset managers to have clearly defined and solid investment processes and the ability to demonstrate consistency in implementation while maximizing risk-adjusted performance and meeting various qualitative benchmarks. Within this framework, PACRA specifically focuses on clarity of investment styles and adherence to stated investment strategies.

Investment Committee (IC) Composition: PACRA assesses how investment/divestment decisions are formulated, reasoned, and analyzed. From this perspective, the composition of an IC, the experience of its members, the frequency of its meetings, its independence from other functions, and the composition of IC packages are reviewed to determine the overall effectiveness of AMC's decision-making process. IC and its functions are an integral part of the decision-making process, as the IC is the primary point of reference for any investment decisions made and implemented. PACRA reviews the quality of IC composition by reviewing the profile of individual IC members in order to gauge the investment acumen of the IC. Meanwhile, dominance of any particular member is carefully scrutinized through a review of Investment Committee minutes.

Investment Advisory: *The framework installed for separately managed accounts (SMA), discretionary and non-discretionary, is assessed. The emphasis is laid on independence of decision-making and fair treatment of the SMAs. The interests of funds under management and SMAs must be balanced, ensuring that neither is prioritized to the detriment of the other. An AMC may be designed to focus primarily on SMAs; hence such an AMC would be evaluated based on factors relevant to SMAs.*

IC Effectiveness: The investment decision-making process is the pivotal stone of portfolio management. PACRA reviews the degree of clarity in investment objectives and the philosophy on the part of asset managers. Adherence to the stated investment objectives and philosophy is important to ensure that investment avenues are consistent with the stated mandate of the collective investment schemes. While PACRA reviews the investment philosophy inscribed in the offering documents, these are normally generalized statements. Hence, PACRA considers the management approach and the philosophy of governing in the investment committees more relevant for the overall assessment. The effectiveness of the IC needs to be evaluated to ensure that it is discharging its responsibilities in the best possible manner and in the best interest of the unit holders.

Execution Quality: *The overall quality and transparency of AMC's trading and dealing practices are important in determining consistent implementation of investment decisions across funds. The quality of trading systems and*

criteria for the selection of brokers is evaluated to assess whether the asset manager provides fair price and best execution for investors. The quality of supervision over the trading function, and the extent of compliance with trading policies, provide insight on the monitoring and control environment instituted by the management team on the trading function.

Investment Research and Analysis: Strong investment research and analytical frameworks are critical for prudent investment management. The degree of independence enjoyed by the research staff in its operational activities and investment recommendations – both from the fund management team and from the reference shareholder – is an important determinant in assessing its effectiveness in the investment management chain. The structure of the research department is critical in identifying the reporting lines and how the roles and responsibilities of the division have been delegated amongst various staff members comprising the research division. In particular, the experience and educational profiles of the researchers are considered. A mix of different skill sets in the team is considered good when supervised by a strong head of the department. The quality, reliability, completeness, and relevance of quantitative models and statistical techniques employed and the complexity and extent of risk analysis and ratios commensurate with the investment scheme enable us to assess the overall quality and viability of the various tools used by the research department in formulating investment recommendations/decisions. Likewise, the extent and quality of the research output (including the scope of the investment universe and depth of analytical input) need to be assessed to determine the relevance and timeliness of the research to the investment process. An analysis of how research data gathered through various sources is documented for guidance and future reference is important to gauge the quality and extent of the research database for future investment-related decisions.

Information Required on Investment Risk & Portfolio Management:

- Investment policy and guidelines
- Risk policy/manual
- Details of risk management systems
- Details of investment committee (incl. members' profile and ToRs)
- Details of the research function
- Regulatory filings/compliance documentation
- Business plan

Customer Relationship

Investor Services

PACRA examines the investor services platform of an asset manager for evaluating overall service quality and resource availability for the education and facilitation of investors. Examining client relationships focuses on evaluating an asset manager's ability to manage relations through determining investment objectives, and thoroughly understanding client constraints, and then to manage day-to-day relationships. PACRA evaluates the asset manager's capacity to provide appropriate responses tailored to client requests and keep abreast of local regulations. The criteria include staffing, technical knowledge of sales people, systems (such as client relationship management tools), value-added services, and access to information. The platform afforded to advisory clients, if any, from the standpoint of its adequacy and robustness is also evaluated. A formal mechanism to solicit feedback from clients and handle complaints must also

be in place. Nature and number of complaints received is an important indicator to measure the quality of services provided and, in turn, client satisfaction. PACRA also looks at AMC's client attrition over time on a standalone basis and compares it to industry peers as a yardstick to judge the quality and effectiveness of investor services. In the case of digital AMCs, PACRA evaluates the channels used for client interaction and the process of onboarding clients.

Investor Reporting

Much of the information provided to investors is communicated through regular reporting, which PACRA examines in light of its comprehensiveness, clarity, consistency, accuracy, and timing. This capacity to adapt reports to meet varied investors' requirements is also examined. Beyond mere reporting, PACRA believes that all asset managers should offer performance presentations and performance attribution reports to their clients on a widespread and timely basis. PACRA, therefore, looks at the accuracy of performance attribution and consistency with the investment process. PACRA also reviews the resources and procedures used in the production of reports, particularly with respect to front-office independence and data accuracy. For digital AMCs, PACRA evaluates the frequency and mode of information provided to clients, its accuracy and its effectiveness.

Distribution and Sales Network

PACRA examines the distribution and sales network of an asset manager. Particular focus is given to an asset manager's association with commercial banks, third-party distributors, and the exclusivity of such arrangements. At the same time, an asset manager's emphasis on brand management, strength of the sales team, training routines for sales agents, and related performance reviews are also incorporated in PACRA's analysis. The presence of alternative sales channels, particularly online, or availability of a mobile application is viewed favorably.

Information Required on Customer Relationship:

- Details of value-added services
- Frequency, mode and information of client reporting
- Mechanisms for ensuring confidentiality of client information
- Complaint management policy and systems
- Details of Sales and distribution channels
- Details of channels used for client interaction
- Details of client onboarding mechanism
- Sample of reports provided to clients on a regular basis

Performance

Fund Performance:

Achieving competitive investment results to sustain and improve AUM is the principal objective of an AMC. Over the long run, poor performance leads to poor reputation and makes maintaining AUM challenging; this potentially lowers the level of income, and leads to deterioration in overall profitability, ultimately deteriorating the standing of the asset manager. PACRA's analysis of performance focuses on the star-rankings of all of the eligible funds of an asset manager. To achieve higher ratings, AMCs need to strive to have a high proportion of funds in the upper quartile of funds, and a low proportion in the bottom quartile.

With the availability of long-term performance results, PACRA covers three distinct time periods in star rankings i.e., a star ranking based on the fund's performance during the trailing 12 months (1-Year Ranking); a star ranking based on fund's performance during the trailing 36-months (3-Year Ranking); and a star ranking based on fund's performance during the trailing 60-months (5-Year Ranking). PACRA believes that in the long run, the funds of an asset manager with noted strengths in other rating factors will usually be superior or at par with peers.

AUM Sustainability:

AUM sustainability refers to an AMC's ability to retain existing AUM and attract consistent new inflows over time. It serves as a key indicator of investor confidence, fund performance, and the AMC's resilience to changing market dynamics. PACRA assesses AUM sustainability through two key metrics: the AUM retention rate, which reflects the persistency of the existing investor base, and the new AUM rate, which indicates the AMC's ability to replenish outflows through fresh investments. Strong performance on both fronts underscores long-term business stability and brand credibility.

Income Sustainability:

PACRA looks at the financial position of an AMC with the objective of assessing sustainability. For this, both balance sheet analysis and profit & loss analysis are undertaken. Several aspects of the AMC's income statement are considered, including revenue, and diversification of revenue streams such as from fees versus capital gains, expense trends, and concentrations by client and product. The fee revenue from retail investors is pivotal to PACRA's comfort, especially when it provides complete coverage against the AMC's operating expenses. The return on equity is analyzed in conjunction with peer to make a view as to the shareholders' satisfaction with the investment.

Information Required on AMC Performance:

- Performance ranking
- Stability rating
- Financial statements
- Financial projections
- AUM projections
- Withdrawal and Investment data

Asset Manager Rating Criteria

Scale

Asset Manager Rating

An independent opinion on an Asset Manager's expertise, quality of financial services, and potential vulnerability to investment management and operational challenges

Scale	Definition
AM1	Very high quality. Asset manager meets or exceeds the overall investment management industry best practices and highest benchmarks.
AM2++ AM2+ AM2	High quality. Asset manager meets the overall investment management industry standards and benchmarks with noted strengths in several of the rating factors.
AM3++ AM3+ AM3	Good quality. Asset manager meets investment management industry standards and benchmarks.
AM4++ AM4+ AM4	Adequate quality. Asset manager demonstrates an adequate organization that meets key investment management industry standards and benchmarks.
AM5	Weak. Asset manager does not meet minimum investment management industry standards and benchmarks.

Rating Modifiers | Rating Actions

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business / financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization
A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening. Rating actions may include "maintain", "upgrade", or "downgrade".

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