

VIS

Credit Rating Company Limited

ASSET MANAGEMENT COMPANIES

Table of Contents

SUMMARY OF CRITERIA CHANGES	3
SCOPE OF CRITERIA.....	3
A. GOVERNANCE, FINANCIAL CONDITION AND MANAGEMENT	4
B. PORTFOLIO MANAGEMENT ACTIVITIES	5
C. MARKET POSITION	6
D. PERFORMANCE TRACK RECORD.....	7
E. INVESTMENT ADMINISTRATION	7
F. CLIENT SERVICING	8
RATING SCALE & DEFINITIONS	8



SUMMARY OF CRITERIA CHANGES

The Non-Banking Finance Companies and notified Entities Regulations, 2008 (NBFCR); have been amended up to May 17, 2023. The amended regulations covering the scope of operations of Asset Management and Investment Advisory Services have added Digital Fund Management and Digital Investment Advisory Services to their scope. Digital Asset Management Services and Digital Investment Advisory Services would be operated independently of conventional services or through regulatory approvals for conversion of conventional into digital services. Digital Asset Management Companies would be able to float Digital funds. A Digital Fund Management NBFC has been defined as “Digital Fund Management NBFC” means services provided by fund management NBFC through digital technology based or internet-based channels, apps or tools, with limited or no human interaction”. The detailed scope of operations of conventional and digital Asset Management and Advisory Services and the regulatory requirement on them are detailed in the related sections in the amended regulations.

SECP has Introduced Regulatory Framework for Investment Plans to Facilitate the Mutual Fund Industry through its Circular No 25 of 2024 dated December 23, 2024.

The Regulatory Framework specify the eligible categories of Collective Investment Schemes (CIS) under which Asset Management Companies (AMCs) can offer Investment Plans, including Fund of Funds, Fixed Rate/Return, Sovereign Income, Asset Allocation Schemes, Capital Protected and Exchange Traded Funds. Operational requirements provide clear guidelines on the maximum number of Investment Plans, their duration, exposure limits, investment restrictions, and performance benchmarks. It also obligates the AMCs for issuance of a separate Investment Plan report within the Fund Manager Report (FMR).

The above regulatory measures support a transparent, efficient, and investor-friendly environment in the mutual fund industry.

The words Funds and Investment Plans are being interchangeably used in this methodology, except where identified.

Maintaining its alignment with the International Best Practices particularly in the perspective of investment in Green Bonds by funds of Asset Management Companies VIS has written an independent and comprehensive methodology for review and assessment of ESG framework in a wide variety of Institutions.

The Methodology is termed as “ESG RATING METHODOLOGY” and is available at our website on the following link,

The comments and assessment on ESG are presented in the Management Quality Report of Asset Management Companies in a concise manner providing VIS assessment of the status of ESG investment policies, achievements and risks in Environmental, Social and Governance areas applicable to the rated entity.

The significance of the status of achievements and risks in the Environment, Social and Governance segments is captured in the overall rating determination.

SCOPE OF CRITERIA

Management quality (MQ) rating from VIS provides a relative assessment of an asset management company’s (AMC) investment capabilities and the strength of its operational platform. MQ ratings are appropriate for any investor seeking to understand how well a given AMC’s capabilities and operational characteristics support the delivery of returns that are

consistent with stated investment strategies. However, MQ ratings are especially valuable to institutional investors that have an obligation to fully vet and monitor the investment managers they engage.

MQ ratings have six key pillars: governance, financial condition and management, portfolio management activities, market position, track record, investment administration and client servicing. MQ ratings are, therefore, primarily based on a qualitative assessment but also include a quantitative analysis of the risk-adjusted performance of the asset manager. The six parameters are further divided into sub-parameters and factors to analyze in detail the processes and practices followed by the AMC.



A. GOVERNANCE, FINANCIAL CONDITION AND MANAGEMENT

VIS assesses the level of independence and governance practices followed by the asset management company and its mutual funds. The review includes corporate and fund governance bodies, regulatory and third party, oversight and controls, activities conducted with group affiliates and relationships with external service providers. Composition of board regarding number of independent directors as per best practices, the profile of directors and their experience in the relevant fields are important considerations.

The level of oversight by the board is also assessed in terms of statutory approvals or discussion of financial statement, business plan and launch of new funds.

VIS considers the extent of activities conducted with group affiliates regarding conflict of interest. Focus on the conflict of interest policy, the extent of its comprehensiveness beyond the regulatory minimum requirement and whether it defines the sources of conflict and procedures implemented to deal with the same are emphasized.

Results of the inspection conducted by the regulator, if any, is also considered. Quality of external auditors is also an important factor. VIS mainly relies on the panel of auditors maintained by the State Bank of Pakistan for categorization.

The asset manager's relationship with its parent company, financial statements with a particular focus on profitability and working capital requirement, client base, product range, and ultimately its business resilience under stress scenarios on assets under management are important indicators. Sustainability in revenue stream is ascertained along with sufficiency to support current operations and future activities and needs.

VIS evaluates the ownership structure of an AMC with a view to understand the business objective of its owners, their financial strength, the extent of their commitment to the business and their track record. The owners' ability and willingness to infuse capital in the AMC to address its business or growth requirements is viewed as critical.

While an independent management, which has powers to manage the day-to-day operations of the company is viewed favorably; the quality of input provided by the Board of Directors (BoD) in terms of the broad policy guidelines is also important. A BoD comprising a blend of professionals with relevant industry experience can provide better guidance in strategic matters to the management team, to benefit all stakeholders.

An important aspect of the rating process includes in-depth review of profile of key personnel. The experience and discipline of key personnel are critical to the success of the fund. They are assessed for their educational background and experience of portfolio management, research and financial analysis. This also involves appraising senior management and any committees involved in management of the funds. The presence of succession planning with respect to all major key positions including the CEO is noted. Key position vacancies and the duration of vacant position are also observed.

The ESG policies of the Asset Management and Advisory companies are reviewed, where applicable. In those operating on a digital platform the strength of its digital platform is also reviewed.

B. PORTFOLIO MANAGEMENT ACTIVITIES

Besides CIO and fund managers, the presence of voting members from risk and research department in the investment committee(s), with the expansion in scope of services, provides strength to its composition. In the decision-making process, the level of discussion by all IC members related to capital market and various industrial sectors is noted.

Assessment of the fund's management strategies, policies and procedures are critical elements for measuring management quality. Adherence to the fund's/Investment Plan investment policies, as well as its risk management policies are evaluated. Actual asset allocation vis-à-vis restrictions laid down in regulations and constitutive documents are also taken into consideration. Significant and consistent breaches in investment policy are also noted. The rating is not just based on investment performance but mainly depends on the fund manager's ability to achieve consistent results under different market scenarios. The objectives stated by mutual funds are also reviewed and the strategies implemented by the investment committees are evaluated in accordance with these objectives.

VIS also reviews whether the company has an in-house research function or only secondary sources of research are utilized. The extent of primary and secondary research conducted by the department is considered and also whether sector and stock reports are developed or not. Quality of fundamental and technical analysis as depicted by stock

selection and timing of investment is also considered important. In case of selection of debt instruments, consistency in its performance, based on cash flow analysis of the issuer is noted.

VIS believes that access to economic data and analysis can help the fund manager in taking informed decisions. It is also noted whether research function is independent or done in the umbrella of another activity like risk or fund management. In the latter case, presence of a separate section/head for research in that department is noted including reporting channels of the said personnel. The professional profile of the head of research along with the structure and professional quality of HR is ascertained. Quality coverage of research reports are evaluated particularly in the areas of equity valuations and fixed income market risk assessment. Existence of distinctive reports/procedures being adopted by the research function is also assessed. Future plans are also noted for improvements. The depth of coverage in the regular Fund Manager's Report relating to the ongoing dynamics of Capital Markets and comments of Fund Manager on each Fund/Plan managed is also of significance.

As markets deregulate and become globally integrated, risk management is draws increasing attention from investors due to growing complexity and volatility. Regulators have also become proactive while closely monitoring risk management practices followed by industry participants. Under the review of risk management practices, VIS evaluates the adequacy and effectiveness of the practices and procedures the fund uses to manage various types of risks inherent in the business. VIS also looks closely at the attitude and approach of the management as well as active participation of all the relevant departments in implementing sound risk management practices. VIS will track compliance with recently issued risk management guidelines for AMCs by the regulators.¹

VIS reviews the enterprise-wide framework for identifying, measuring, managing and reporting investment risks (market, liquidity and counterparty risk embedded in investments), with a particular focus on second-level of controls. The independence of risk function is also evaluated. Professional profile of the head of risk and the structure and professional quality of HR are assessed. Extent of their coverage and quality of risk reports are reviewed. Assessment of the integration of risk management tools with overall investment-decision making process along with the IT platform is considered important.

While existence of risk management manual is noted, VIS also assesses comprehensiveness of the manual in terms of relevance and whether it lays down a variety of risk measurement and management tools. Composition of the department is assessed in terms of dedicated resources. Deployment of risk measurement tools and the level of input of risk management department in the decision-making process are evaluated alongside.

C. MARKET POSITION

VIS reviews the company's marketing expertise in terms of growth in the aggregate size of portfolio under management and penetration in the market over time. Overall market share in assets under management, adjusted for investment by associated parties and fund of funds investment, is an important rating factor. Market share is also calculated separately for each category of funds. VIS also compares sales vis-à-vis redemptions in a given time period while sales are adjusted for additional investment by associated parties. Pace of increase/decline in assets under management of the AMC is compared to the pace of increase/decline in assets under management of the industry.

Granularity and stickiness of the investor base in the funds are critical rating factors. Granularity is primarily related to the proportion of retail investors in the investor base vis-à-vis corporate and other investors. Similarly, level of investor concentration provides sufficient insight about the stickiness of investor base.

Breadth and diversification of a firm's products and services contribute to growth and sustainability of fee revenue. A company with limited diversification in terms of a specific fund, type of fund or investment style, would have higher risk of losing AUMs when such focused investments are less favored by the market. A diversified product offering, therefore, allows for product switching rather than outright redemptions and maintenance of AUMs. Complementary products are also a potential source of earnings diversification, as well as a competitive advantage in serving the distribution channel. Asset management companies having international portfolio as well may have added advantage.

- Risk management and control guidelines for asset management companies, SECP July 17, 2018

D. PERFORMANCE TRACK RECORD

Maintaining competitive long-term fund performance against benchmarks and peers is important as investors frequently chase top-performing funds and managers. Institutional long-term clients are often more focused on the managers' process and investment disciplines as much as on performance, given their more strategic and longer-term focus. The use and sophistication of systems and controls can also be a factor in assessing whether good fund performance can be dependably repeated. A disciplined approach with controls that ensure investments follow mandates and procedures in a consistent manner can be positive as it may demonstrate the model is sustainable, longer term and without overreliance on any one outperforming fund.

It is important to reiterate here that substantial weightage is assigned to actual performance of funds being managed either through the use of performance rankings or any other indicators deemed relevant for the type of funds under study. VIS compares returns of all funds under management against benchmark and peer group. An overview of the performance of all funds comment on the aggregate performance of AMC, i.e. how many funds out/underperformed benchmarks over an extended period, say three years, relative performance ranking in peer group – number of funds in top percentile, quartile, etc. Often enough, better AMC scores are directly relatable to being a sustainably, superior performer, across the entire range of funds, relative to an asset manager which outperforms for short periods or where performance record across funds is checkered. Factors underlying superior performance as well as performance below par need to be fully understood, both via an attribution analysis, as well as a study of the fundamental characteristics of the funds that may have led to performance results.

E. INVESTMENT ADMINISTRATION

VIS analyzes the adequacy of the management procedures and its ability to effectively carryout the operating functions. This analysis includes historical review of fund manager's compliance with regulations. An inquiry is made as to the existence, frequency and causes of any violation with respect to regulations. Any deficiency with respect to a fund's policies and operations from a regulatory perspective are highlighted. While compliance with regulatory minimums is mandatory, VIS also reviews additional internal requirements and written policies in this regard. Where the management company is involved in activities other than management of its own funds, the extent of firewalls between the various functions to guard against potential sources of conflict is also evaluated.

The assessment of the management company's internal control procedures includes adequacy of written policies and procedures designed to monitor trading positions and buy/sell approval processes. Comprehensiveness of policies related to personal trading activity and fair dealing in treatment with clients is assessed and their effectiveness as measured by the compliance with the stated policies. These policies must specifically highlight prevention of rogue

trading, by ensuring that systems are available to reflect all trades executed and continuous oversight of all transactions undertaken.

A review of information systems is also carried out to evaluate fund manager's ability to effectively conduct day to day trading activities and generate the relevant reports for management's review. VIS favors automated monitoring procedures and reviews interface between transaction entry, portfolio management and back-office systems. Integration of investment management and administration functions into the systems is assessed. Integration of client servicing activities with IT platform is also reviewed. VIS encourages presence of flexibility in system for customization and upgradation. Moreover, higher flexibility of system is assessed in terms of regular, user defined and spot report generation.

VIS reviews the resources in terms of dedicated staff available for application support and development. VIS considers the degree of integration, coverage and scalability of the databases. The review also covers the level of integration achieved between internal systems and external applications provided by third parties. Data back-up and disaster recovery procedures are reviewed to assess the company's vulnerability to technological failures.

F. CLIENT SERVICING

Like any other business, marketing, distribution and servicing remains the main interface with clients and therefore one of the most critical areas based on which service standard perceptions are formed by the investors. Strong marketing and distribution and good selling practices are key components for success. With increasing competition and growing awareness, customer expectations for consistent, high-quality services have also increased. Reach and innovation in tapping new distribution channels, ability to conceive and quickly launch new products are critical in an increasingly competitive business environment.

Whether performed in-house or through third parties, the nature of the distribution efforts is a key consideration in the rating. Asset management companies approach the market in a variety of ways. Institutional relationships are often direct between the asset manager and clients. This one-on-one relationship often creates a better understanding of expectations from both sides. Other asset management companies sell through parent/associate company or third party and other channels. The ability to access multiple distribution channels should enable an asset manager to maximize its sales potential and reduce its dependence on any single channel for new sales.

More recently, asset managers tend to focus more on the quality of investor services and service innovation, which plays a pivotal role in attracting retail as well as corporate clients. An asset manager with various value-added services offering through internet, cellular phones and other channels tend to surpass others having basic levels of services. At the same time, the level of transparency and disclosures in communication with clients are of utmost importance. Asset management companies have to deal with ever increasing pressure from customers and regulators for improved disclosure practices. Excellent quality of correspondence with feedback process in place would fetch an added advantage.

In companies operating on digital platforms beside the robustness of the security modules of the platform the ease of access to client of transaction platform is also important.

RATING SCALE & DEFINITIONS

Rating scale and Definitions may be accessed at (<https://docs.vis.com.pk/docs/VISRatingScales.pdf>)



Faheem Ahmad

President & CEO, VIS Credit Rating Company Limited
Founder, VIS Group Chairman,
Vice-Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.



Javed A. Callea - Member

Advisor

Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate. Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.





Jahangir Kothari Parade (Lady LLOYD Pier) Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.

VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, VIS is positioned to aim for an international mark. In this regard, the global experience of our international affiliates and partners have been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors. The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, VIS continues its endeavour to remain an emblem of trust.

INTERNATIONAL

Affiliates

Islamic International Rating Agency – **Bahrain** – iira.com

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