

VIS

Credit Rating Company Limited

**MANAGEMENT QUALITY RATING
INVESTMENT ADVISOR**

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SUMMARY OF CRITERIA CHANGES

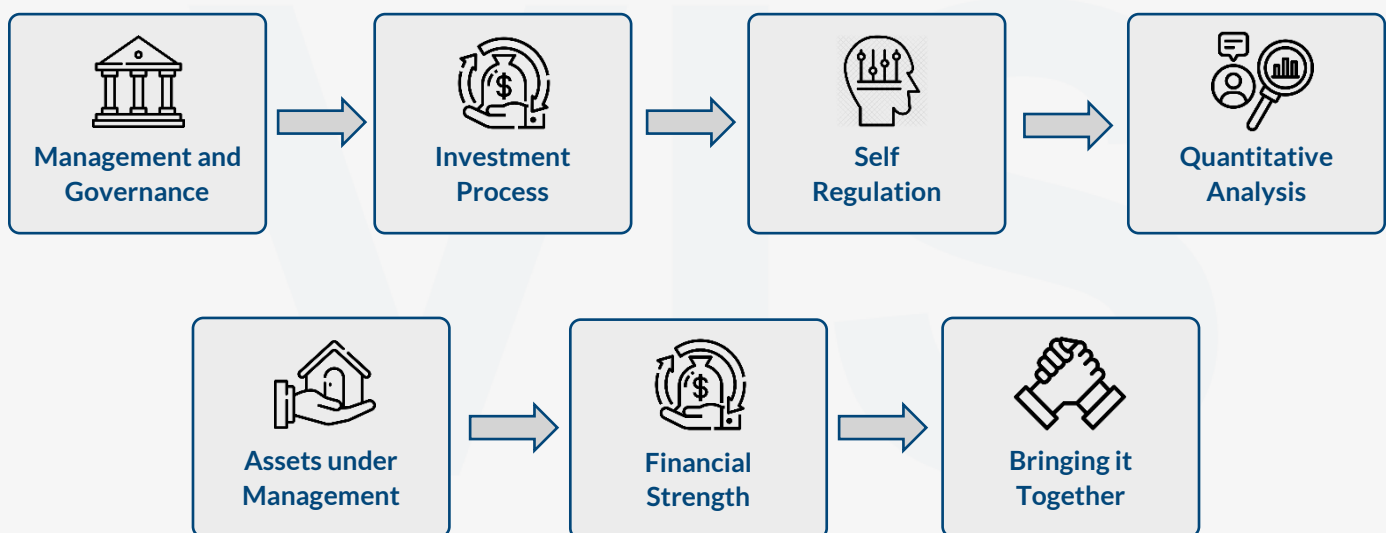
The Non-Banking Finance Companies and notified Entities Regulations, 2008 (NBFCR); have been amended up to February 22, 2024. The amended regulations covering the scope of operations of Investment Advisory Services have added Digital Investment Advisory Services to their scope. Digital Investment Advisory 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. 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.

In this updated Methodology, Environmental, Social, and Governance (ESG) considerations have been integrated to align with current assessment standards.

SCOPE OF CRITERIA

Management Quality (MQ) Ratings by VIS Credit Rating Company Limited (VIS) provide an opinion on a company’s operational and investment platform. Ability to manage assets is assessed with special emphasis on the extent to which management has been able to put in place sound governance practices and systems to facilitate the asset manager’s ability to meet stated investment objectives. While retaining most of the criteria factors from the MQ rating methodology applicable to asset managers, this methodology paper factors in the nuances specific to entities undertaking Investment Advisory Services alone. The Management Quality rating scale will be appended with the suffix (IA) to distinguish it from other MQ Ratings outstanding by VIS.

The factors considered by VIS during the rating process are in conformance with global best practices with regards to investment management. The business of investment management is based on trust. Accordingly, transparency and investment processes form the cornerstone of the rating methodology used by VIS for evaluating the MQ Ratings of Investment Advisors – AM (IA).



The activities at any investment advisory firm can broadly be broken down into three; those involving client interaction; secondly, the investment management process itself and thirdly, administrative functions. While evaluating the processes at a company, the following attributes, among others, will be viewed favorably by VIS from a rating's perspective:

- Marketing material & other modes of external representation by the company present a true and fair picture of the past performance of the company's investment management capabilities;

1- The NBFCs rules define "investment advisory services" as the services provided for, managing discretionary or non-discretionary portfolios for both individual and institutional clients and include the business of advising others as to the value of securities or as to the advisability of investing in, purchasing or selling of securities, for remuneration

- The investment mandates clearly stipulate the investment objective and constraints of the clients;
- The investment process is designed such to ensure that all relevant factors are considered while taking investment decisions, while the company has adequate resources with the necessary skill set to undertake its activities; Investment recommendation and trade execution practices ensure fair dealing to all clients;
- Demonstrated ability to deliver consistent returns in line with stated client objectives;
- Conformance with best practices regarding self-regulation and transparency, as reflected in the company's policy framework;
- A formal mechanism to solicit clients' feedback with regards to the quality of services provided by the company, with the same feeding into the review mechanism of the company's own internal practices.

The methodology is organized into four broad areas, with relevant attributes for each detailed hereunder. It is important to recognize that rating attributes may evolve in line with changes in investment management industry over time

MANAGEMENT AND GOVERNANCE

The governance practices instituted at any organization are evaluated with keen interest by VIS. Board of Directors (BoD) comprising a blend of professionals with relevant industry experience may provide better guidance in strategic matters to the management team, to benefit all stakeholders. While VIS views an independent management favorably, which has powers to manage the day-to-day operations of the company; the quality of input provided by the Board in terms of the broad policy guidelines is also important. Moreover, VIS also evaluates the Board's access to information, which is necessary to fulfill their duties, and the extent to which the Board exercises investment mandates oversight, either directly or through committees.

VIS evaluates how the organizational structure facilitates decision-making and timely response to environmental influences. To avoid ambiguity, the organization's hierarchical pattern must be distinctly defined so that the employees are aware of their job definitions, responsibilities and authorities and there is sufficient segregation of functional duties.

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 company. They are assessed for their educational background and experience of portfolio management, research & financial analysis. This also involves appraising senior management and any committees involved in investment decision making. A company must possess staff skill set in line with its current or planned product offering; for instance, a company offering portfolio management services to employee retirement plans would be expected to have personnel with quantitative skills. Reliance on few key personnel and lack of succession planning may adversely impact ratings; opportunities for employee development are keenly reviewed by VIS.

INVESTMENT PROCESS

At the core of an investment advisory firm's activities are the investment processes put in place to manage client portfolios. The areas covered here include research capabilities, risk management infrastructure, investment decision making process, trade execution practices and portfolio monitoring mechanisms. In addition to clients having the right to appoint third party service providers such as brokers/custodians, a company itself may also engage the services of such outside firms; the criteria for the same must be clearly stipulated. Moreover, compensation arrangements, if any, must be disclosed to clients, in order to ensure transparency. VIS reviews in-house research capabilities, including stress testing capacities. Access to economic data and analysis can help the company in taking informed decisions. Management quality rating process also involves review of the practices and procedures to identify and analyze risks that are inherent in the business of investee companies, pricing policies, must-sell limits and exposure restrictions in addition to analytical techniques employed to arrive at fair values. Evaluation of the risks associated with the models employed to arrive at fair values or take portfolio allocation decisions can provide meaningful contribution to the investment decision making at any firm. The company's policy framework must also clearly delineate procedures to monitor trading positions and buy/sell approval processes.

VIS Management Quality assessment is also evolving rapidly with the integration of ESG considerations. Environmentally, Investment advisors are increasingly focusing on sustainable investment strategies, ensuring that their portfolios align with global environmental goals. This includes screening for companies with sustainable practices or avoiding those with significant environmental risks. Socially, IA's are looking beyond financial returns, assessing the broader societal impact of their investments, ensuring they promote inclusivity, and do not inadvertently support harmful practices. Furthermore, Governance has become central with greater emphasizes on transparent operations, ethical investment criteria, and robust risk management processes.

Framework for identifying, measuring, managing and reporting investment and operations related risks is reviewed thoroughly by VIS. The risk and control functions must be represented at the executive level, with regular review of risk indicators. A well-sourced and independent risk function is considered favorably from a rating's perspective.

A disciplined investment environment also involves evaluation of own performance through various tracking mechanisms. Use of such techniques ensures internal monitoring on a continuous basis.

SELF-REGULATION

Given the varying level of regulatory oversight for different companies, with this being less stringent for investment advisory firms, the internal policy framework in relation to the control environment assumes added significance during the rating process. VIS places special emphasis on controls relating to conflicts of interest (including policies to prevent self-dealing) and overall control environment in a company, including internal audit and compliance set up and reporting mechanisms. Among others, this includes appropriate segregation between front and back-office functions in addition to which the role of middle office must also be clearly defined, including order matching/confirmation and reconciliation; the policy framework must address all work flows. Where the company is involved in activities other than management of clients' funds, the extent of firewalls between the various functions to guard against potential sources of conflict is also evaluated.

VIS analyzes the operating procedures and management's ability to effectively carry out operating functions in line with the defined policies. This analysis includes historical review of company's compliance with regulations and internal policy framework. An inquiry is made as to the existence, frequency and causes of any violations.

A review of information systems is also carried out to evaluate company's ability to efficiently conduct day to day activities and generate the relevant reports for management's review; this includes analytical tools for performance and risk analysis. VIS favors automated monitoring procedures and reviews interface between transaction entry, portfolio management and back office systems. Back-up procedures must be adequately defined, implemented and tested to ensure un-interrupted operations. The level of client services may also be impacted by the quality of information systems; seamless workflow for Net Asset Value calculation, validation and assessment is considered favorably by VIS. In addition to this, companies are increasingly providing value added services including same day & debit card redemption and online interface to clients for ready access to portfolio and trade details; VIS will review client servicing as it may enhance a company's ability to attract and retain clients.

QUANTITATIVE ANALYSIS

A. PERFORMANCE OF ASSETS UNDER MANAGEMENT

Investors can have varying objectives from return maximization to asset liability matching; investment strategies should be designed to ensure that the stated objectives are met. Adherence to the clients' stated investment objectives, as well as constraints is evaluated. The ratings are not just based on investment performance but depend primarily on the company's ability to achieve consistent results under different market scenarios and for different asset classes. During the review, performance of discretionary and non-discretionary mandates is evaluated independently. Performance on agreed parameters takes precedence rather than absolute returns in case of discretionary portfolios. In non-discretionary mandates, the reference investment advice & its impact on returns is measured against the benchmark portfolio in order to assess the competency of the investment advisor.

Performance disclosures in line with global performance presentation standards stipulated by the investment management industry are also considered positively.

B. ASSETS UNDER MANAGEMENT

The size of assets under management, though not the only indicator of a company's franchise correlates strongly with market position; VIS looks for consistency in growth trends. Diversity in client mandates and revenue stream is viewed favorably as it is likely to make an institution less vulnerable to the risk associated with termination of a few large mandates.

C. FINANCIAL STRENGTH

Akin to other MQ rating assessments by VIS, AM (IA) is also primarily driven by qualitative factors. VIS considers the financial strength of a company in terms of its continuing ability to manage assets and sustainability of its operations. Any form of external support available to the management company is factored in where appropriate.

While the regulations stipulate minimum capital requirements for companies undertaking investment advisory services, we believe that start-up capital requirements could be higher than the stipulated minimum capital, even though there

are minimal infrastructure related costs that need to be incurred. This is because the company may require capital to sustain operating costs in the initial years while a client base is built; hiring and retaining qualified staff may be hindered by the absence of adequate financial resources with a company.

VIS evaluates both business and financial sustainability of any organization. Earnings from core operations should be sufficient to meet operating costs on an on-going basis. Revenues from advisory services could be performance based or linked to the quantum of assets under management or a combination of both. There could be potential for conflict of interest in either of these, motivating management to undertake investment decisions with a short-term investment horizon in case of former or delivering just mediocre returns in case of latter; these need to be managed to ensure that clients' interests remain well protected. In this context, VIS reviews the compensation arrangement of management personnel involved in investment decision making and its relationship with the performance of assets under management and conflict of interest arising from the same, if any.

D. BRINGING IT TOGETHER

It is important to recognize that rating attributes may evolve in line with changes in investment management industry over time. However, as stated earlier, the core driver of ratings are expected to continue to be the level of transparency and investment management processes.

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.



Sara Ahmed

Director - Ratings

Sara Ahmed possesses 17+ years of experience in financial risk assessment and credit structuring. She has worked in Corporate Banking & Risk Management functions locally as well as internationally. Sara has been involved in the entity ratings of numerous corporate organizations as well as financial institutions besides being part of the Methodology and Criteria Development team. She holds a Master's degree in Business Administration from the Institute of Business Administration, Karachi (2001).



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 genrosity 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
 Credit Rating Information & Services Ltd. – **Bangladesh** – crislbld.com

Collaborations

Japan Credit Rating Agency, Ltd. - **Japan**
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