

ASSET MANAGER RATING METHODOLOGY

INTRODUCTION

To help investors better understand asset management structures, PACRA has developed a rating methodology intended specifically to provide clear indicators of their capabilities. The agency has selected criteria to measure an asset manager's qualifications and prospective capabilities and to address the explicit concerns and interests of investors. The agency's multi-criteria approach provides for the aggregation of the rating factors into five distinct groupings to present a clear profile of an organization's strengths and weaknesses. To achieve these objectives, PACRA has designed a rating process based on the five following qualitative attributes.

- Business structure;
- Independence and controls;
- Communication;
- Investment;
- Risk management.

PACRA's rating methodology represents a systematic framework to assess the quality of the financial condition, organization, business processes, staffing, systems and controls employed by asset managers. PACRA's Asset Manager ratings are announced through press releases and followed by entity reports published on the agency's website, www.pacra.com. Each profile the rated organization – its staff, operations, product range and investment philosophy – and summarizes PACRA's assessment of its capabilities.

PROCESS OVERVIEW

PACRA's Asset Manager rating review process is designed to systematically capture the required information, consistently apply criteria and uniformly disclose the agency's ratings rationale. The process incorporates five stages, as listed below.

Pre-Review

- Review and assessment of requested documentation and information.

On Site Review

- Meeting with the management.
- Review of the infrastructures, financial condition, processes, staffing, systems, and front-, middle and back-office operations.

Analysis

- Final evaluation of all documentation
- Completion of internal assessment
- Rating Committee validation

PACRA's comprehensive offerings include instrument and entity credit ratings, insurer financial strength ratings, fund ratings, asset manager ratings and real estate gradings.

PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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Rating Methodology

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Ratings Assignment

- Press release announcing the rating
- Report published

Surveillance

- Ongoing surveillance
- Quarterly review of rating
- Annual formal meeting and rating review

Prior to the scheduled review, the asset manager is required to respond to a questionnaire designed to capture organizational, operational, portfolio and personnel related information, along with supplying supporting documentation. This information is reviewed to create an agenda for the on-site review.

The on-site review typically consists of meeting with the CEO, Managing Directors and key staff in the different departments (Fund Management, Research, Sales, Middle-Office, Back-Office, Reporting, Audit, Risk Control, etc). The review serves to strengthen PACRA's understanding of the organization's investment management processes and controls. In addition, the agency will be given system demonstrations.

A PACRA Rating Committee comprising top management and the lead analyst validates the analysis and rating rationale. Upon committee approval, the rating is issued. All Asset Manager ratings are valid for one year from the date of issuance, during which time PACRA continues to monitor the organization's characteristics and evolution through surveillance and quarterly updates.

RATING CRITERIA

PACRA recognizes that, due to differences between asset management organizations in terms of size, geographic coverage, operating strategy and assets under management, the application of the rating criteria requires careful consideration of the context in which they are applied. For example, larger organizations typically have more formalized processes and controls. However, smaller organizations can be judged to have similar, or stronger, processes and controls if they can demonstrate that the necessary elements are in place to

achieve the required objective, albeit in a less bureaucratic manner.

The following subsections describe the areas of focus for PACRA within each grouping of rating factors.

BUSINESS STRUCTURE

Viability: The analysis of a business structure begins with the examination of the reference shareholder. PACRA assesses both the financial strength and regulatory authorities recognition of this shareholder and its commitment to asset management, as well as the relative importance of this business line to its activities. When available, the credit rating is used to assess the parent company's financial condition.

In a service industry such as asset management, the franchise of a company is of paramount importance, though hard to evaluate. In its analysis, PACRA considers market share, ability to manage various asset classes, and business development. Strategic risks are also assessed, should they stem from mergers, restructuring or potentially risky strategic decisions. Asset managers also face risks in the daily running and development of the business. Senior management, financial controls and corporate governance are thus carefully examined.

PACRA looks at profit sustainability. Several aspects of the company's income statement are considered: revenue and expense trends, income volatility, concentrations by client and product. Stability is also analyzed in terms of balance sheet, to which end, PACRA calculates equity to AUM (Assets under management) and overheads, taking the regulatory requirements as the minimum acceptable criteria.

Scope of Activities: Analysis of Assets Under Management (AUM) and the client base is central to the process, the aim being to assess ability to work with clients and to provide asset management services suited to the needs of its target clients and their selected investment products. Recent growth in institutional AUM, the split between single-investor and collective funds, and client reputation form the main criteria incorporated in PACRA's assessment.

Business Management: Optimum portfolio management requires adequate and sufficient resources (human, technological), whether internal, provided by



the parent company or affiliate, and/or an external third party (e.g. vendors). Most critical in terms of IT resources are unquestionably the portfolio management and order management systems. Various features of the portfolio management system are explored; robustness, coverage of instruments, time delay before transactions are entered, timely and accurate 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 secure, timely and fair handling of multiple transactions. Electronic order and confirmation also clearly adds value and security, notably when trading is brisk. The integration of custodians and fund administrators within the systems is also cautioned.

Asset management relies heavily on human expertise. The experience, turnover and ease of replacement of portfolio managers and client relationship managers are of particular importance to ensure consistency and continuity. Any use of temporary staff is also explored.

INDEPENDENCE AND CONTROLS

Independence: PACRA determines the asset manager's relative independence from its reference shareholder. Only unequivocal independence is likely to prevent any conflict of interest in advising or working for a client. Asset managers should avoid conflicts of interest to guarantee fair treatment for all customers and ensure their interests are placed above all else. To determine the degree to which the asset manager guards against such potential conflicts of interest, PACRA examines the quality of the firewalls, procedural protections, and compliance monitoring practices.

PACRA examines the reference shareholder's operational independence, both in terms of resources (control, marketing and sales teams) and intermediation. The relative size of the inflows arising from a parent group or reference shareholder is also a good indicator.

Controls: A true risk management and monitoring culture and platform are the hallmark of seasoned and mature asset management organization. Therefore, PACRA assesses the various resources employed to identify, manage and mitigate various risks (market,

credit and operational), specifically resources in terms of staff, procedures, IT systems and, as importantly, senior management. In this way and beyond mere facts, PACRA measures the efficacy of the risk management systems. Full risk mapping with in-depth coverage and highly experienced risk management resources are among the differentiating factors. In addition, PACRA evaluates capacity to promote ethics and monitor enforcement thereof.

PACRA also assesses the resources, procedures, control points and reporting lines to manage conflicts of interest, and the exercise of fiduciary responsibility. Key issues here are trading activities for the parent account and client accounts, policy regarding securities related to the group or reference shareholder, which is expected to be formalized, monitored and communicated to clients.

COMMUNICATION

Products and Services: Examining client relationships focuses on the asset manager's ability to manage relations through determination of investment objectives and a thorough understanding of constraints, and then to day-to-day relationships.

PACRA evaluates the asset manager's capacity to provide appropriate responses tailored to client requests, as well as keeping abreast of local regulations. Criteria are, *inter alia*, staffing, technical knowledge of sales people, systems such as Client Relationship Management (CRM tool) or intranet, and access to information e.g. reporting. Financial modeling and asset/liability management often play an important role and aid the quality of services provided.

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. The agency, therefore, looks at accuracy of performance attribution and consistency with the investment process. PACRA



reviews the resources and the procedures used in the production of reports, particularly with respect to front-office independence and to data accuracy.

INVESTMENT

Investment Process: 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 performance and meeting various constraints. Within this framework, PACRA specifically focuses on clarity of investment styles, adherence to stated investment strategies, presentations and pertinence of the various steps of the process (meetings, investment committees, quantitative optimization or modeling, etc.), documentation of decisions (reports, minutes of committees, etc.) and consistency.

Measurement of Efficiency: PACRA focuses on ability to identify and quantify value added sources through performance attribution or other profit and loss analysis. The agency looks at IT and staff available; equity and credit research, the macroeconomics team, strategists, quantitative analysts, etc. Inputs are also expected to be recorded and minuted.

Over the long run, poor performances lead to a poor reputation; poor reputation leads to outflows; and outflows lead to deterioration in profitability and ultimately in the standing of the asset manager. Therefore, PACRA believes that an asset manager's overall track record, rather than simply within its flagship portfolio, should be thoroughly assessed on a risk-adjusted basis. PACRA compares this performance to the relevant benchmarks and peer groups.

INVESTMENT CONSTRAINTS AND RISK

Indicators: Investment risk management is given high priority. PACRA determines whether the asset manager has a strong risk indicator policy and checks its ability to adhere to explicit client guidelines. Specifically, PACRA reviews which risk indicators are selected, the capacity of the portfolio managers to monitor them, the limits set by management and the independence of controls. Portfolio managers' independence in making decisions is also considered,

taking into account limits, monitoring and controls. Reconciliation between expected and actual risk levels is equally important and requires regular comparisons, analysis of discrepancies and correction.

Trading: PACRA appraises an asset manager's dealing activities by looking at whether the procedures ensure best execution, taking into account fair order allocation, speed of execution and cost minimization. When asset returns are low, PACRA recognizes the importance of low transactions costs to profitability. When applying the related criteria, PACRA carefully takes into account the specificities of the various financial markets in which the asset manager is active.

RISK MANAGEMENT

Internal Controls: PACRA assesses the level of internal controls within various systems employed. This includes scrupulous selection processes for vendor software, comprehensive validations of internal development and regular reviews of existing decision-making tools. PACRA considers system documentation, frequency of updates and availability to the relevant groups within the organization. The agency also reviews business interruption plans, assessing availability of a fully functional emergency site and frequency of back-ups of key systems and data and regular disaster recovery testing.

Order flow is critical and should be closely monitored and controlled. PACRA monitors compliance with the authorized intermediary list, fair dealing and best execution (price and timeliness). PACRA also evaluates controls associated with the level of trading, transfers between portfolios as well as amended, cancelled and intra-day transactions.

Compliance with Investment Constraints: Within risk management, compliance with regulatory constraints and client guidelines is a particular focus. Procedures to correct breaches are also observed, with particular attention paid to formalization and implementation across the various teams involved, and the time taken for corrective action.

Follow-up of Market Risk: Risk can arise from peripheral instruments in investment management. In this respect, PACRA looks for clear-cut policies and



adequate daily monitoring (e.g. tools, risk controls, reconciliation procedures. etc.).

Finally, PACRA's analysis of the asset manager's risk management also includes a review of capacity to monitor risk in aggregate (market, credit or liquidity) across all portfolios. This relies on limits and adequate controls.

status within major rating categories bar the 'AM1' and 'AM5' rating categories.

CRITICAL ELEMENTS OF PACRA'S ANALYSIS

To summarize, PACRA's rating review process covers:

- History, including management experience, business strategy, market position and level of profitability on a long-term basis.
- Company's capitalization with financial resources and ownership;
- Level of independence from the reference shareholder and focus on corporate governance;
- Client relationship management; accuracy and transparency in all disclosures and reporting;
- Investment management and related processes supported by strong, extensive research and analysis;
- Organization, processes and procedures with respect to risk management and control at both first and second levels, as reflected in the following areas; market and operational risk monitoring, investment compliance, service provider controls;
- The experience of management and teams with staff turnover rates; and
- Integration and flexibility of systems providing support throughout the organization including risk management.

PACRA issues AM ratings to provide investors with an independent and professional assessment of an asset manager's capabilities. The ratings are on a scale of 'AM1' to 'AM5', with 'AM1' being the highest. "+" or "-" may be appended to a rating to denote relative

RATING SCALE & DEFINITIONS

AM1 *Asset manager meets or exceeds the overall investment management industry best practices and highest benchmarks in all criteria under review.*

AM2 *Asset manager meets very high investment management industry standards and benchmarks with noted strengths in several of the rating factors.*

AM3 *Asset manager meets high investment management industry standards and benchmarks.*

AM4 *Asset manager demonstrates an adequate organization that meets investment management industry standards and benchmarks.*

AM5 *Asset manager does not meet the minimum investment management industry standards and benchmarks.*

Note: *The ratings are on a scale of 'AM1' to 'AM5', with 'AM1' being the highest. "+" or "-" may be appended to a rating to denote relative status within major rating categories bar the 'AM1' and 'AM5' rating categories.*