GCR GLOBAL CREDIT RATING CO.
Local Expertise • Global Presence

Rating Methodology

Financial Institutions

Global Master Criteria for Rating Funds and Asset Managers

Updated March 2017

Criteria Summary

GCR's asset manager ("management quality" or "mq") ratings assess an asset manager's organisational structures, management characteristics, client and market profile, financial sustainability, risk management capabilities, portfolio management, and operational practices/controls, in order to determine the organisation's overall quality. GCR's asset management ratings are intended to assist investors in comparing portfolio managers' skill sets, and facilitate the process of evaluating investment management firms' overall quality, regardless of size, ownership structure, and scope of operations.

GCR's fund ("f") ratings are an independent assessment of a specific fund's exposure to factors that could lead to unexpected net asset value ("NAV") and total return volatility, taking into consideration the critical role that the fund's manager plays in determining fund value and variability. The fund quality assessment includes qualitative analysis of the fund's management, and a quantitative evaluation of the fund portfolio's historical performance in terms of price/return volatility, underlying asset quality, and market risk exposures. A fund's published investment mandate/objectives and policies give context to the quantitative assessment. GCR's fund ratings provide an opinion regarding the fund's ability to preserve principal value under varying market conditions, with reference to the relevant asset management environment.

GCR's management quality and fund ratings differ from its credit ratings, which refer to an issuer's ability to meet its debt/liability obligations. The definitions for asset manager and fund ratings are set out in Annexure 1.

This criteria report (the "Criteria") is an update to the version published in March 2016. There are no significant amendments to the Criteria since the date of previous publication. The update of this Criteria will not have an impact on any existing ratings. Going forward, this Criteria will be applied to ratings of funds and asset managers.

GLOBAL CREDIT RATING CO.

Introduction

The Criteria uses the terms 'asset manager' and 'fund manager' interchangeably throughout the report. In this regard, these terms refer to the entity which has primary legal or regulatory responsibility for the management and safekeeping of investor monies within a fund. In reality, however, the broad fund management function comprises a number of roles, which vary according to the regulations prevailing in the country of a fund's domicile. Furthermore, the roles within the fund management function may be performed by one or more entities, depending on legal/regulatory requirements and corporate preferences.

Fund management functions typically include a licenced management company ("manco"), and investment (portfolio) manager, which are often (but not always) the same entity. Some funds may also have co-investment managers. A trustee usually exercises an oversight role, for the protection of the fund's investors, and an independent custodian of the assets is typically appointed. Within the manco/ investment management roles, compliance, asset and/or investor administration functions may be performed in house, or outsourced to third parties.

GCR's management quality and fund ratings incorporate a holistic assessment of the asset management function. Therefore, where components of this function are performed by different parties, GCR obtains an understanding of the parties performing the various asset management roles. Subsequently, GCR assesses: the appropriateness and adequacy of the overall asset management structure; the suitability of mandates/legal agreements between the parties; whether each party has the necessary skills, experience and regulatory status to perform its specified functions; and the adequacy of oversight, communication, and systems interfaces (including reconciliation and exception reporting/resolution) between different parties.

Criteria for Rating Asset Managers

Rating methodology

GCR's management quality ratings are not credit ratings, and are also not intended to be used in the determination of the future performance of a fund, portfolio or other investment vehicle, or as an indicator of future volatility. Although GCR's analysis of an asset manager's quality takes into account quantitative factors, including the historical performance of funds under management, the financial strength of its balance sheet, and its profitability and prospects, the ratings emphasise qualitative over quantitative analytical factors.

As such, the rating process focuses on the following areas:

1. Corporate profile;
2. Financial sustainability;
3. Portfolio management (the investment decision-making process); and
4. Risk management, controls and systems.

1. Corporate profile

GCR initiates its review of an asset manager's corporate profile by considering organisational structure, which encompasses *ownership, governance and control structures*, and its *human resources and staffing* requirements/resources. The business environment, in particular *client and market profile* are also considered.

Analysis of organisational structure is based on identification and assessment of the quality of the reporting structure, and the efficiency of the various organisational functions and responsibilities. It is also a study of the relationships that exist within the firm, with its service providers, clients and with any affiliated entities including parent companies and/or shareholders. This analysis is a critical component in the overall process of assigning asset management quality ratings.

Ownership structure and support
The question of whether an asset manager operates as a separate business unit within its corporate structure is addressed. Whether it is a subsidiary, affiliated company, or a joint venture, it is important to determine if the relationship with its parent or shareholders enhances (or places undue pressure on) the manager's operations. If a firm or its parent is publicly listed, this could influence the extent of information available in the public domain, the ability to raise additional capital for planned or unforeseen demands, and its exposure to certain event risks (including the probability of mergers or takeovers). A recent or upcoming change in corporate ownership can have a major impact on an asset manager's investment philosophy, business culture and overall operating environment. The relationship between the parent company and asset manager can also have a direct impact on the outcome of the rating. A strong parent operating within a vigilant and clear regulatory environment, with a strong financial profile, and demonstrating a willingness to support its affiliates, can enhance an asset manager's rating. On the other hand, a weak parent represents heightened risk as it may look upon its affiliates as a potential funding resource, thereby negatively impacting the rating. Another aspect of the relationship which GCR reviews is the extent to which there are proper and institutionalised 'Chinese

walls' between affiliated companies and also how stringently fiduciary responsibilities are maintained and promoted within the respective entities.

Governance and control structure
In assessing whether the size and structure of the organisation provides for an efficient use of resources, GCR looks to identify if there are clear reporting lines between departments. In addition, GCR determines whether the reporting structure provides enough independence to allow issues/ concerns to be readily identified and reported (without the need for burdensome structural mechanisms that are likely to suppress effective risk management). Compliance control is always a fundamental issue within any fund manager's organisational structure. Dual control systems, which facilitate redundancy in oversight, can enhance the rating.

Human resources and staffing
An in depth review of management characteristics with regard to experience, track record, independence, style, approach and relationships within management teams is undertaken. GCR reviews management biographies and interviews key senior managers in order to assess the level of experience/qualification present within the firm. Although typically a long track record of success is a positive indicator, it is even more important if that prior management experience matches and is relevant to the current strategy and style of the organisation. Interviews focus on determining the investment approach of the firm's managers, and their specific views on the investment culture within the organisation.

It is particularly important in those organisations that rely heavily on individual managers, to understand the level of risk present in the event of key personnel departures. For those organisations which operate with a more team-based approach, GCR discusses in detail the functions and responsibilities of each of the team members. A breakdown of responsibilities is performed to determine the existence of non-core activities that could distract or divert resources from the efficient management of the firm. Many of these teams or key individuals may also manage a number of different funds. The universe of funds under management is assessed, and any disparities in performance are analysed and questioned.

Client and market profile
An analysis of the business environment includes identifying the asset manager's client base. Funds geared toward the retail market may require a different operational structure and approach from funds targeting institutional investors. The nature of a fund's client base introduces different risks that must be addressed adequately. For example, an asset manager with large exposures to an institutional client base is prone to large fund flows (both inflows and outflows), and as such the firm should have specific structures and operational procedures in place to handle fund flows efficiently, and a risk management environment which takes the heightened liquidity requirements into consideration.

The extent of relationships with clients is another important consideration. A retail operation may rely heavily on its relationships with intermediaries or directly with investors. GCR tries to gauge to what extent those relationships are vital to the firm's operations. Relationships can also be heavily dependent on key personnel. This aspect is further detailed in our analysis of the management team in particular, but here we focus on management's efforts to protect key relationships from risk of personnel turnover and on its personnel policies in regards to retention, compensation and other human resource issues. Another facet of the business environment is an assessment of whether 'brand' is a significant factor in its operations. GCR looks at how the firm markets its brand and what internal procedures are in place for monitoring its markets and its sales processes.

2. Financial sustainability

As an extension of corporate profile, financial resilience is a key element in the successful operation of an asset management organisation. As such, GCR conducts an analysis of a firm's *financial sustainability*, including its position, profitability and prospects.

GCR is particularly concerned with an asset management firm's ability to fund current and future operations and meet capital requirements through internal cash generation, and to be able to do so while supporting current and future business activities. GCR reviews the relative importance, financially, of each fund to the firm's overall business in terms of revenues and profits. This review is further analysed later in the context of questions to management regarding strategic direction within the firm's overall operating philosophy. GCR's assessment of financial fundamentals considers not only the current financial status of the company but also trends in earnings, cash flow, profitability, and capital adequacy.

Although size is a consideration when evaluating financial strength, as it can have a direct bearing on the firm's ability to withstand downturns in economic activity, it is not in itself a defining factor for the rating. Size, however, can be a contributing factor in the firm's operational efficiency and is further analysed in that context. Comparative analysis relative to other asset managers is undertaken, wherever possible, and is based on an appropriate sampling of peer groups. Financial strength also impacts the firm's ability to retain important staff through appropriate financial incentives, thereby maintaining competitiveness and retaining clients, particularly in the institutional market.

3. Portfolio management (the investment decision-making process)

A review of the historical performance of the various funds under the asset manager's control is an important tool when used as part of the overall analysis for determining the quality of management. However, GCR does not assign management quality ratings based on historical investment performance, but rather on a firm's ability to achieve solid targeted results consistently across a range of market conditions. The portfolio management assessment broadly considers the asset manager's *investment philosophy, strategy and style*, the *fund features, performance and management practices* within the funds under management, and whether these comply with investment philosophy, and the extent and quality of investment *research and related support structures*.

Investment philosophy, strategy and style
An analysis is conducted of an asset manager's investment and operational strategies in the context of its stated investment philosophy, policies and goals. Identifying the organisation's strategy and decision-making process is at the heart of this analysis. Questions are posed to understand the investment philosophy and to determine how investment objectives are established. The process undertaken for determining investment strategies is reviewed, including how the strategy is defined, quantified, and most importantly, how it is implemented. Asset allocation decision-making and the bases for identifying eligible securities are reviewed, as are the processes for monitoring strategy implementation, and the circumstances in which the strategy can be altered. Finally, GCR looks to determine the level of consistency with which the investment policy has been applied.

Fund features, performance and management practices
The specifics of each of the funds under management are also reviewed. A change in asset size in any fund, for instance, is flagged to determine if there has been any shift or drift in investment philosophy. Fund fundamentals, such as liquidity levels, rate of turnover and the expenses ratio, are reviewed and analysed. A more detailed investigation of the client base is undertaken in order to identify and explain changes in the investor base. Performance is highlighted in the context of broad market performance. Portfolio composition is reviewed and compared to the stated investment objectives of each individual fund. Style changes prompt questioning as to why such a shift has occurred. The specific practices utilised when building a fund portfolio are also reviewed (including identifying whether leverage or derivative products are used to enhance return). Questions regarding these practices are designed to determine the extent of their use, and their place within the investment philosophy and strategy of the organisation. It is also important that management demonstrates a clear and thorough understanding of the risks inherent in their application.

Research and related support structures
Ancillary support structures are also reviewed in order to examine the capabilities and breadth of those resources. In-house research teams are analysed to determine the extent and quality of the information used in investment decisions. Equally important is an examination of how external resources such as research from brokers are incorporated into internal research activities. Furthermore, access to company investment information is reviewed to see the extent of interaction that exists between research teams and companies in the portfolio, in terms of visits and timely communication.

4. Risk management, controls and systems

Assessing the firm's ability to exercise proper control over its operations in order to effectively identify and address the various forms of risk it faces is a fundamental part of GCR's analysis. In this regard, *compliance* with regulatory requirements, the firm's *risk management framework and controls*, and appropriateness of *operations and systems* are key areas of focus within GCR's assessment of an asset manager.

Compliance
Regarding the regulatory environment, GCR undertakes a comprehensive analysis of the laws and regulations impacting the asset manager's operations. This is done for every market where GCR issues management quality ratings. Through direct contact with the relevant regulatory bodies and constant monitoring of new developments, GCR keeps abreast of key issues in regulatory oversight, and compares an asset manager's risk compliance to the relevant requirements of the environment in which it operates.

Risk management framework and controls
A review of a firm's regulatory compliance is an important part of assessing its capability to manage risk. GCR undertakes a comprehensive review of the firm's compliance structure in order to assess its capacity, as well as its compliance philosophy. This includes a review of its written internal procedures and guidelines, reporting systems, its track record with regulators and its compliance with licensing, capital and general reporting requirements. Any history of problems in this area is carefully reviewed for cause and correction. Management's processes for reviewing compliance issues and for updating its procedures are also investigated.

GCR analysts question individual managers on their own specific risk management procedures, including what oversight responsibilities and practices are employed over daily trading and investment decisions. It is important to determine who within the organisation is responsible for managing risk related activities and to what extent he or she has the appropriate levels of authority to deal effectively with that risk and to enforce the firm's risk management policies. GCR reviews the quality of the internal and external audit system and looks specifically at past compliance lapses to evaluate how they were addressed and eventually corrected.

Operations and systems
Within the context of the firm's organisational structure, as well as its risk management framework and control systems, GCR assesses the efficiency of the firm's operations given the existing infrastructure, systems and mechanisms in place to respond to any inherent challenges.

The quality of the asset manager's information systems can have a direct impact on the efficiency of its operations. In particular, GCR evaluates the level of sophistication and quality of the firm's information technology systems. Here, emphasis is placed on processing, storing and retrieval of data, in the front, middle and back-office systems. GCR also evaluates the procedures and policies in place in relation to data backup, computer security and technical support. As it affects both the quality of operations and services delivered, GCR examines the type of network, as well as the communication systems in place. An asset manager's level of technological flexibility, integration and sophistication relative to its peers may affect its market position and prospects. Furthermore, risk management procedures enhanced by high quality information systems provide for better monitoring and lower risk.

A review is conducted of the systems in place to communicate with the market, service providers and clients, providing the basis for measuring the efficiency of those processes. In addition, the asset manager's activities in the areas of: management reporting; trading; client servicing and administration; securities processing and custody; and asset valuation; are reviewed from an operations point of view.

Conclusion

The analytical process described above has the clear goal of assessing the overall quality of the asset manager in question. That assessment comes from evaluating the organisation's historical performance, financial strength, structure and environment, management characteristics, and strategies and operations. The rating assigned is based, to the extent possible, on a comparative analysis of all these factors within a universe of other comparable asset managers in the market.

With the above as a starting point, GCR is also in a position to undertake an independent assessment of a specific fund's exposure to factors that could lead to unexpected NAV and total return volatility. This adds considerable value to prospective investors in a specific fund or portfolio, as highlighted in GCR's Criteria for Rating Funds, set out in the section which follows.

Criteria for Rating Funds

Rating philosophy

Although fundamental analysis of fund performance is an important starting point in GCR's assessment, it is important to stress that GCR does not simply infer a rating based primarily on quantitative analysis or a rigid "checklist" of factors. Rather, the approach is to integrate quantitative analysis with a robust and thorough qualitative analysis, relying mainly on the latter to arrive at the appropriate rating. GCR's analytical process for its fund ratings focuses on the following areas:

1. Management assessment;
2. Historical performance analysis; and
3. Portfolio quality and market risk.

1. Management assessment

GCR's assessment of a fund's management quality focuses on whether the management is effective in maintaining an investment policy that is consistent with the fund's stated objectives, and with the expectations of its investors. A detailed description of the key factors that contribute to an assessment of fund management quality is set out in the preceding section of this Criteria (ie, the Criteria for Rating Asset Managers). While a formal "mq" rating is not required for the according of a fund rating, the analysis underlying an "mq" rating and the synthesis of the key rating factors is a precursor to according a fund rating.

2. Historical performance analysis

A review of a fund's historical performance is an important factor when used as part of the overall analysis of a fund's quality and volatility. It is also an important factor in evaluating the investment style of a fund manager. However, it is important to stress that a fund's historical performance track record is not a predictor of the prospective performance of that portfolio. This is particularly the case when market conditions or volatility are significantly different from the historical period, or if the portfolio profile has changed.

The principal areas of analysis in the assessment of historical fund performance include:

- Quantifiable analysis of total returns over specified periods of time, generally a three and five year horizon, and a comparison of the fund's returns with a suitable benchmark of low risk fixed-income instruments (usually government securities), and/or other indices with characteristics comparable with the fund's portfolio); and
- Analysis of the relationship between historical volatility and the fund's investment objectives, portfolio selection parameters and existing market conditions over the relevant period.

The latter analysis is undertaken within the context of the portfolio quality and market risk assessment discussed in the following section of this Criteria.

GCR's quantitative analysis of a portfolio's historical performance uses traditional analytical tools and measures that summarise various aspects of fund performance over time. The primary measure is average return (calculated over a variety of time horizons), and returns relative to appropriate benchmarks. These measures are typically calculated as total returns, including and excluding any load/fee or expense charges. GCR believes that a fund's performance and total return metrics are most analytically relevant when calculations take into account fund expenses and costs associated with turnover.

3. Portfolio quality and market risk

One of the principal goals in the analysis of current portfolio quality or risk is to determine to what extent these factors compare historically with the fund's investment policies, and the portfolio's related historical risk profile. By reviewing the potential for short-term volatility in the form of possible principal gain/loss relative to the fund's historical performance, current market conditions or stated investment objectives, GCR is able to allocate the fund an ordinal ranking within a spectrum of volatility. Factors contributing to volatility in the fund's return include *interest rate movements*, *credit defaults*, *liquidity levels*, portfolio *concentrations*, *payment modification*, speculative *derivative use*, and *foreign currency exposure*.

When reviewing a fund's portfolio profile, GCR considers these factors. The effects of these factors/ risks on the overall price sensitivity of a fund are assessed. Ultimately, it is the total portfolio risk that is measured, after taking into account the fund's efforts to mitigate the individual risks through diversification or other risk management techniques. A brief description of each of these risks follows, along with GCR's views regarding their potential impact on a fund's rating.

Interest rate risk
Interest rate risk, expressed as a portfolio's sensitivity to interest rate movements, is a key determinant in a fund's potential volatility. As the maturity of a security (or portfolio) is extended, more uncertainty is introduced as to the direction and quantum of possible future movements in interest rates.

Therefore, additional risk is typically present as tenor increases, although this can often be mitigated by hedging. The sensitivity of a fixed income security's market price to changes in interest rates is measured by duration. Duration is calculated based on an instrument's original and remaining term to maturity, coupon and other contractual terms. The sensitivity of duration to changes in interest rates is measured by convexity. This aspect of portfolio risk is addressed by reviewing the specific characteristics of each of the securities in a fund's portfolio, in order to ascertain the aggregate portfolio sensitivity to interest rate changes.

Credit risk

Credit risk refers to the possibility that an issuer of a security will be unable or unwilling to meet its obligations to pay interest and principal on time and in full. GCR undertakes an analysis of the securities within a fund's portfolio, to determine the overall aggregate credit risk inherent in the portfolio. Available credit ratings accorded to the related issuer/issues by GCR will be included in the credit risk analysis. In addition, GCR may also utilise ratings not issued by GCR, if they are from a licensed, regulated rating agency operating in an area of their jurisdiction. In the case of unrated securities, GCR will attempt to assign preliminary (unpublished) ratings based on available information, but may 'haircut' the credit risk assessment of the portfolio by an appropriate factor to reflect higher uncertainty regarding the credit risk associated with unrated issuers/issues. The presence of high credit risk impacts the risk spread or yield at which these securities are traded. A risk spread, by definition, results in higher price volatility. Higher credit risk can also result in higher total returns and therefore, depending on the fund's investment objectives, can fall within acceptable ranges. Finally, the overall credit risk assessment takes into account the size and diversification characteristics of the portfolio.

Liquidity risk

The degree of liquidity in a security is often reflected, as is credit risk, in its yield/spread. How quickly a particular security can be sold, and whether it can be realised at a price close to the quoted market price immediately preceding the sale, is a function of its liquidity. Low liquidity securities will usually trade at a discount to comparable securities which are more liquid. Overexposure to illiquid assets increases the risk of a portfolio, and can be particularly problematic in funds where investor withdrawals are large and unpredictable.

Concentration risk

The risk reduction benefits of diversification are well documented in financial theory, and support the rationale for portfolio construction and management. The mutual fund/unit trust industry aims to make the benefits of diversification accessible to a broad range of investors. The guiding principle for creating a diversified portfolio (portfolio of disparate assets) is that each investment carries inherent risks, which are affected by given factors differently. These differences, once combined, should partially cancel each other (in the case of imperfect correlation), thereby reducing the total portfolio risk. Concentration in any particular area, such as security type, industry or currency, increases risk relative to that which would be found in a well-diversified portfolio, and ultimately could translate into volatile movements in price and value. The extent to which diversification is present is considered within the context of the fund's stated investment objectives.

Prepayment and extension risk

Some types of fixed income securities may be prone to prepayment or extension risk. In particular, selected structured finance transactions (mortgage-backed securities being the most obvious example) are particularly prone to prepayment risk, as repayment of the underlying mortgages is highly sensitive to interest rate movements. An analysis of the portfolio's holdings should identify securities held which exhibit this type of risk exposure, and reviewed to see if the amount of risk is significant or whether strategies are being employed to offset the risk through diversification, or other techniques, such as hedging.

Derivatives risk

The use of derivative products by investment funds has increased in recent years. Their use as hedging mechanisms are important in reducing risk within a portfolio and (subject to hedge effectiveness) positively influence a portfolio's risk profile. However, the use of derivatives for speculative purposes introduces additional risk, particularly if the products and their risk/payoff profiles are not adequately monitored or understood by the fund's management.

Currency risk

Currency risk appears when a fund holds deposits or securities within its portfolio denominated in a currency different from its base currency (the currency in which investor payments are denominated). Such a currency mismatch exposes these holdings to foreign exchange rate movements resulting in potential fluctuations in value and return. The amount of exposure and related risk is reviewed by GCR. The fund's historical volatility attributable to currency movements is identified while current exposure is assessed for its potential impact on current holdings. Derivatives or other hedging techniques may be used to reduce currency risk. The application of currency hedges is reviewed to determine their efficacy.

Typically, GCR’s fund ratings are accorded to funds containing fixed income securities and/or money market investments, and the abovementioned factors are most appropriate to the analysis of credit risk and NAV/return volatility in such funds. In the event that GCR is requested to provide fund ratings for funds with other types of portfolio assets (for example, funds containing property portfolios), GCR may consider additional factors on a case-by-case basis, or alternatively assess credit risk in accordance with separate Criteria for rating such assets. In such cases, the additional factors considered or the Criteria utilised will be highlighted in the relevant rating report.

Conclusion

The analytical process described above has the clear goal of assessing the overall quality of the asset manager in question, together with a specific fund’s exposure to factors that could lead to unexpected NAV and total return volatility. Together, management quality and fund characteristics enable a fund rating to be accorded in line with GCR’s Criteria for Rating Funds.

Annexure 1

Management Quality Rating Definitions	
AAA(mq)	Entities rated AAA(mq) are judged to exhibit an excellent management and control environment, which meets or exceeds best international practice and benchmarks.
AA(mq)	Entities rated AA(mq) are judged to exhibit a very good management and control environment.
A(mq)	Entities rated A(mq) are judged to exhibit a good management and control environment.
BBB(mq)	Entities rated BBB(mq) are judged to exhibit an adequate management and control environment.
BB(mq)	Entities rated BB(mq) are judged to exhibit a poor management and control environment.

Fund Rating Definitions	
AAA(f)	Funds rated AAA(f) possess levels of risk at that of a portfolio comprised of the highest quality government securities and demonstrate the lowest volatility.
AA(f)	Funds rated AA(f) possess very low levels of risk and demonstrate low to moderate volatility.
A(f)	Funds rated A(f) possess low levels of risk and demonstrate moderate volatility, although there is considerable variability in risk in periods of economic stress.
BBB(f)	Funds rated BBB(f) possess reasonable levels of risk and relatively high levels of volatility, with a much lower ability to withstand future stress situations.
BB(f)	Funds rated BB(f) possess high levels of risk and high volatility.

Note: a “+” or “-” modifier may be appended to a rating to denote relative status within the AA, A and BBB rating categories, in respect of both Management Quality and Fund ratings.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S FINANCIAL INSTITUTIONS GLOSSARY

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Balance Sheet	Also known as a Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.
Cash	Funds that can be readily spent or used to meet current obligations.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Correlation	A term that describes the degree to which two variables move together. A correlation of 1 means that they move together exactly, while a correlation of minus 1 means that they move in exactly the opposite direction from each other.
Coupon	The interest paid on a bond expressed as a percentage of the face value. If a bond carries a fixed coupon, the interest is usually paid on an annual or semi-annual basis. The term also refers to the detachable certificate entitling the bearer to the interest payment.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exchange Rate	The value of one country's currency expressed in terms of another.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Fixed Income Instrument	Any type of investment that produces regular or fixed returns. Also a generic term for debt instruments such as bonds that pay interest in the form of a coupon.
Hedge	A risk management technique used to reduce the possibility of loss resulting from adverse movements in commodity prices, equity prices, interest rates or exchange rates arising from normal banking operations. Most often, the hedge involves the use of a financial instrument or derivative such as a forward, future, option or swap. Hedging may prove to be ineffective in reducing the possibility of loss as a result of, inter alia, breakdowns in observed correlations between instruments, or markets or currencies and other market rates.
Hedging	A financial risk management process or function to take a market position to protect against an eventuality. Taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
Illiquid	Markets or financial instruments are described as being illiquid if there are few buyers and sellers. Assets may also be considered illiquid. It may be difficult, or even impossible, to find a reliable price for an illiquid security.
Inherent Risk	Inherent risk is the product of the impact of the risk on the objective(s) and the likelihood of the risk occurring should no management actions/controls be in place to mitigate the risk.
Institutional Investors	Financial institutions such as pension funds, asset managers and insurance companies, which invest large amounts in financial markets on behalf of their clients.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Interest Rate Risk	Interest rate risk in the banking book is the risk that earnings or economic value will decline as a result of changes in interest rates. The sources of interest rate risk in the banking book are repricing/mismatch, basis and yield curve risk.
International Scale Rating LC	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
Joint Venture	A project or other business activity in which two persons or companies partner together to conduct the project.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.

Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Long-Term	Not current; ordinarily more than one year.
Long-Term Rating	Reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Net Asset Value	The value of an entity's assets less its liabilities. It is a reflection of the company's underlying value and is usually quoted on a per share basis.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Prepayment	Any unscheduled or early repayment of the principal of a mortgage/loan.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest,
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Securities	Various instruments used in the capital market to raise funds.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short-Term	Current; ordinarily less than one year.
Short-Term Rating	An opinion of an issuer's ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Tenor	The time from the value date until the expiry date of a financial instrument.
Trustee	A person or firm that holds or administers property or assets for the benefit of a third party.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

For a detailed glossary of terms please click here