Appendix to Criteria for Rating Financial Services Companies: Asset Management Issuer Credit Ratings

Contents

Introduction

1. This criteria appendix acts as a supplement to GCR's Criteria for Rating Financial Services Companies, published May 2024 and consequently must be read in conjunction with the criteria, which can be found at GCRratings.com/criteria.

Scope of the Criteria

2. GCR accords two types of ratings for Asset Managers, 'issue(r) credit ratings' and 'management quality' ratings. The below criteria explicitly describe how GCR formulates the issue(r) credit ratings for Asset Managers, which can support issue credit (debt) ratings. GCR also includes under the scope of this criteria more general 'Wealth Managers', that may not take Assets Under Management (AUM) but provide advice or brokerage services.

3. GCR will apply the Asset Management criteria (below) when the rated entity doesn't place assets under management on the balance sheet and it derives most revenues from the management (including management fees, brokerage fees and investment performance) of third-party funds or private retail wealth. When assets under management are placed on the balance sheet, GCR will typically use the Criteria for Rating Financial Institutions.

4. The management quality (MQ) ratings are accorded using different criteria and provide institutional investors with an independent appraisal of asset management companies. MQ ratings are not credit ratings, therefore they do not measure the relative ability of an entity to meet its financial obligations and cannot support debt ratings. To view the 'management quality' (MQ) rating criteria please see the criteria titled 'GCR Criteria for Management Quality Ratings'.

An Overview of the Ratings Framework

5. To ensure the comparability and transparency of the ratings, GCR have adopted a framework (see below) with publicly available scoring for the major rating components. The goal is to allow each stakeholder (issuer, investor, regulator, counterparty etc.) to know in detail, each of the major rating drivers and ultimately what factors may change the ratings in the future.

6. To achieve this, GCR score four major rating components (operating environment, business profile, financial profile and comparative profile), which are all broken down into two or three major factors and sub-factors, with a public positive or negative score assigned to each. The summation of the scores determines the GCR Risk Score, which is translated using the GCR Anchor Credit Evaluator into the Anchor Credit Evaluation and then using final rating adjustment factors into issue(r) credit ratings. It is important to note that there are no fixed weightings for the components, factors, or sub-factors.

7. The accumulation of the component scores will generate the GCR Risk Score. Typically, this score will range between zero (0: weakest) and forty (40: strongest). The lower the score, the weaker the assessment. Importantly, GCR can use decimal scoring (example 0,25, 0,50 or 0,75) to improve differentiation and rating relativities.

8. To understand the following criteria, GCR recommends that it is read in conjunction with the '*GCR Ratings Framework*' and the GCR *Rating Scales, Symbols & Definitions and the Anchor Credit Evaluator*, which is published on the GCR Website and will help translate the GCR Risk Score to the international and national scale ratings.

Country Risk Score

9. GCR assess the country risk score of an Asset Manager by weighing the Assets Under Management ("AUM") or brokerage revenues of the client base. This is processed in line with the country risk section within the Criteria for the GCR Ratings Framework.

Sector Risk Score

10. GCR will use the financial institutions risk score for the country of the Asset Managers domiciliation, as a starting point and then make up to three negative risk score adjustments to create the sector risk score for asset managers. GCR can make negative adjustments if any of the following exist:

- There is less prudential regulatory oversight for an Asset / Wealth Manager than a commercial bank operating in the same country,
- The manager is exposed to higher market conduct scrutiny or potentially sensitive to regulatory or legislative changes,
- Access to market funding is typically weaker,
- Industry profit margins are weaker for Asset/ wealth Managers than commercial banks,
- Replacement risk is very high or barriers to entry are lower than commercial banking.
- The sector is exposed to higher ESG risks than regulated banks.

11. Conversely, there may be a counteracting positive adjustment if the industry of the entity is prudentially regulated or has a protected or critical market infrastructure role or if the bank sector starting point is already very low.

Component 2: Business Profile

Component 2, Factor A: Competitive Position

12. The following underlying subfactors guide the competitive position score for an Asset/ Wealth Manager versus a Financial services company. These include:

I. Competitive Advantage: When assessing the competitive advantage of an Asset Manager, GCR looks at the scale (including measuring assets under management (AUM)), market position, track-record and brand strength of the company versus global, regional or national peers. We would also consider ESG franchise advantages within the element.

II. Diversification: GCR looks at the diversification of revenues and AUM by asset class, distribution channel, geography, investors (typically a diversified retail investor base is seen more positively than an institutional investor base) and products.

Table 1: Competitive position

Assessment	Score	Description*
Highest	4 to 5	A globally diverse Asset Manager, with AUM of over $500bln, strong brand and long track-record. AUM is well-diversified by asset class, distribution and investor base, and geography.
High	2 to 3	A top tier regional Asset Manager, with AUM of over $250bln, well-established brand and track-record. AUM is diversified by asset class. There is a material amount of geographic diversification, a broad range of investors and no clear product or asset class concentrations. No key transitional, physical, regulatory, or legislative risks. May benefit from transitional changes
Intermediate	-1 to 1	A top tier national asset manager, or a second-tier asset manager with substantial AUM, operating materially across more than one country. Typically, will have a strong national brand and a long track-record. Relative to its core markets, there is good diversification of AUM by asset class and investor base. . Transition and physical risks in line with the market average.
Low	-4 to -2	A second or third tier national asset manager, typically with no material geographic diversification. Developing brand and/ or track-record versus local peers. GCR would expect some diversification of the AUM by asset class, investor base or products. Moderately high transitional, physical, or regulatory risks.
Lowest	-10 to -5	A lower tier asset manager, with a limited track-record or brand. There may be significant asset class, distribution or investor base concentrations. High transitional, physical, or regulatory risks.

*the above highlights typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity could have one or more characteristics, which lie across the ranges. GCR allows analytical decision making to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score, the entity is likely to have several cumulative strengths. Conversely, any one risk can bring the score down to the lowest levels. *GCR can use decimal scoring (example 0,25, 0,50 or 0,75) to improve differentiation and relative credit ranking.*

13. GCR may also make an adjustment to the initial competitive position score for any of the following factors:

a) Investment Performance & AUM Growth: The success of an asset manager can best be assessed on the stability of its investment performance against major indices or benchmarks and the growth of its assets under management. If the company is outperforming or underperforming the market or growing or shrinking AUM quicker than the market, GCR can make a positive/ negative adjustment to the initial score.

b) Distribution networks: GCR view positively controlled distribution networks, with low fees and commissions paid to brokers. Conversely, limited control over distribution or price sensitive brokerage activity is viewed more negatively.

c) Protected government role: If the Asset Manager has a protected role by one or more government, which leads to more stable AUM than the market average, GCR could raise the risk score.

d) ESG: GCR may also make any adjustments seen for Environmental or Social risks facing the entity. GCR will adjust for these factors, on a case-by-case basis.

Component 2, Factor B: Sustainability Assessment

14. Full adoption of the criteria from the GCR Ratings framework.

Component 3: Financial Profile

Component 3, Factor A: Leverage & Cash Flow

15. When assessing the initial cash flow leverage of an Asset / Wealth Manager, GCR use the same approach, including all ratios and adjustments stated in the main financial services companies ("FSC") criteria.

16. However, typically, GCR will cap the cash flow and leverage assessment within the high category (+2 to +3) if the asset or wealth manager doesn't have a strong and diversified competitive position and investment track-record, or if it has a limited track-record in raising and managing wholesale debt.

17. GCR can also make an adjustment if the asset/ wealth manager takes on a significant amount of on-balance sheet investment risk. In this case, cash flow wouldn't provide a full picture of the risk. As a result, GCR may choose to use an adjusted leverage ratio from the non-bank financial institutions criteria.

18. Sustainability linked funding: Sustainability-linked funding provides a unique opportunity to consider environmental, social, and governance (ESG) factors alongside traditional financial metrics. By incorporating sustainability targets and performance indicators into the funding structure, companies can demonstrate their commitment to responsible business practices and long-term sustainability. Furthermore, by integrating sustainability into their business strategies. Asset Managers may achieve greater funding stability and access funding at lower costs. Evidence of these advantages could support the assessment.

Component 3, Factor B: Earnings versus Risk

19. When assessing the earnings versus risk score for an asset/ wealth manager, GCR firstly considers the level of profitability, on a margin basis, in line with the FSC criteria.

20. However, GCR will routinely make haircuts to the EBITDA line for revenues that GCR consider to be less stable. Broadly, GCR will include 100% of management fees, 75% of investment performance fees, 75% of realized of balance sheet driven investment income and 35% of unrealized balance sheet driven income. All other income will be assessed on a case-by-case basis, measured on their long-term stability.

21. Furthermore, GCR may make an adjustment to the initial score if the balance sheet risk exposes the Asset Manager to any of the risks detailed in paragraph 28 of the FSC criteria or generally higher amounts or unrealized/ realized valuation gains. GCR may also choose to make a negative adjustment if the investment risk exposes the manager to interest rate, currency, commodity, equity, or any other market-based movements.

22. GCR may also make negative adjustments if the asset manager has a high fixed cost base or runs inefficient operations.

23. Underwriting, Financial, Environment and Social Risk Management in the funds: GCR will look to see if the Asset Management underwrites, monitors, and survey's investment risk with consideration to financial, physical and transition risks, including the borrowers/ equity participants impact on the physical and social environment and governance concerns. GCR will see how such risks impact the PD, LGD and EL of underlying funds. Typically, we assess the Asset Manager against the market it operates in to assign positive or negative adjustments. However, if the Asset Manager doesn't monitor such governance, physical or transition risks or the impact of the counterparty as part of the underwriting process, we will typically not allow a bank to attain the highest risk scores.

24. Operational risk: The risk of direct or indirect losses resulting from the inadequate or failed internal processes, people, and systems from external events. Within this section we will also look at legal or reputational risks and exotic products, the management of risks around Treating Customers Carefully, including miss-selling, protecting information, and any other activities that undermine customer trust/ reputation. Technological issues and cyber security management will also be assessed.

25. Trading/ Investment risk: the risk of adverse deviations of the mark to market value of the trading portfolio and other investment securities, including unlisted equities. Entities with significant trading operations, when revenues from such activities account for more than one third of revenues or trading assets more than 50% of assets, will typically attract a lower score than peers. Furthermore, GCR views significant exposure to listed and unlisted equity investments to be a weakness because it can add volatility to earnings and capital from a market and credit perspective. GCR could make a negative adjustment for risk (which may be mitigated by other factors).

26. Foreign exchange risk: The currency risk is that of incurring losses due to changes in exchange rates. The losses can occur in one of three ways:

27. Credit losses: A sharp change in exchange rates can deteriorate a counterparty's ability to pay, as leverage becomes artificially higher or access to foreign currency (FX) becomes harder in a time of stress. Typically, if more than 30% of balance sheet assets are in FX, GCR would consider this to be a weakness, depending on the sector wide trend.

28. The changing value of currencies has a direct impact on the value of the balance sheet. Depending on the type and classification of the assets, this can be accounted either through trading income in the income statement or other comprehensive income (if there're fair value loans which are backed by fair valued debt or have foreign subs (*which can materialise upon sale of foreign subs*)). Both can quickly deteriorate capitalization and therefore ascertaining the management of the banking books 'open position' is an important factor.

29. Trading risks, especially if they are trading hard, volatile currencies.

30. Interest rate risk: the impact on earnings due to the movements of interest rates, either directly from interest earning assets or interest-bearing liabilities or indirectly from the impact on loan losses from changes to base rates.

Component 3, Factor C: Liquidity

31. GCR will analyse balance sheet liquidity for Asset Managers broadly in line with FSC criteria or FI Criteria, depending on nature of the company. However, we will also analyse the liquidity of the invested assets to ensure that the asset manager can adequately cope with AUM outflows from investor concentrations, country or market-led stress events, seasonal demands, and other potential liquidity events, especially if the AUM have a defined term of repayment.

32. Typically, GCR will cap (i.e. no higher than) asset / wealth managers at the intermediate range (-1, 0, +1) as GCR believes such entities should maintain inherently higher balance sheet and invested asset liquidity than other FSCs, given their potentially confidence/ market sensitive nature of future cash flows.

Component 4: Comparative Profile

33. All elements are the same as the FSC criteria.

Final Rating Adjustment Factors

34. Broadly in line with the FSC criteria, although if structural subordination exists due to regulatory oversight, GCR may reflect this risk in line with the Financial Institutions criteria.

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