

# **Fund Management Rating Approach**

## **Scope of Work**

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Our Fund Management Rating (FMR) provides a relative assessment of a portfolio management company's investment capabilities and the strength of its operational platform. FMR is structured around four key pillars: a) Fund Management Capabilities in terms of asset valuation principles deployed, fund risk management and monitoring procedures, investment/asset selection criteria, investment returns against pre-defined benchmarks and market position. b) Corporate Governance, c) Strength of other service providers, and d) Client servicing. FMRs are therefore based on a qualitative assessment of investment discipline but also rely on a quantitative investment performance analysis of the risk-adjusted performance of the fund.

### **1) Portfolio Management Activities**

An assessment of portfolio management capabilities is driven by the width of asset classes in which funds are operative. Comprehensive risk monitoring guidelines for the whole range of funds in various asset classes must be available. Ratings are primarily informed by the rigor in processes laid out to select, manage and monitor investments, the degree of caution exercised and the extent to which management complies with expectations laid out in an offer document to investors. Research enabling the fund managers to evaluate the interaction of asset values with economic variables, is an essential ingredient in investment decision making. Acquiring and generating high quality research provides a clear direction to fund management. Procedures involving periodic, accurate valuation of underlying assets are important considerations. Assessment of the fund's management strategies, policies and procedures are critical elements for measuring management quality. Adherence to the fund's investment policies, as well as its risk management policies are evaluated.

Fund management capabilities are reflected in market confidence and translate into a strong market position. Experience in managing a range of asset classes adds to market strength and deepens management capacity.

Ultimately managers' capability is reflected in risk adjusted returns and whether these are superior or not vis-à-vis a range of benchmarks including peer performance or other market based benchmarks. A longer-term focus on performance is key here. The use and sophistication of systems and controls can be a factor in assessing whether good fund performance can be dependably repeated. An overview of the performance of all funds comments on the aggregate performance of portfolio companies rather than short-term outperformance or where performance record across funds is checkered. Most importantly

fund management is tracked and viewed in a local context i.e. vis-a-vis the larger asset management industry in Turkey.

## **2) Corporate Governance**

IIRA assesses the level of independence and governance practices that support the process of funds management. The review includes oversight and controls mechanisms and transactions conducted by or on behalf of group affiliates. Adherence to a code of ethics must be evident, that necessitates safeguarding the best interests of investors and avoiding situations where unintended benefits may be derived by the management company or its promoters to the detriment of investors. Equal and fair distribution of returns must be assured. In the same sense, IIRA evaluates the extent and nature of activities conducted with group affiliates to ensure an absence of conflict of interest.

Our assessment also includes historical review of a portfolio management company's compliance with regulations.

## **3) Strength of other Service Providers**

Reputation and track record of valuation firms, research providers and sales and banking arms also fall within the scope of evaluation. The portfolio company under evaluation may be utilizing the services of a mix of internal or external service providers. Portfolio companies managed by larger commercial institutions have an added advantage in terms of having sufficient financial resources at their disposal to manage unplanned liquidity needs of the funds. A liquidity line is essential towards this end.

## **4) Client Servicing**

IIRA reviews distribution and servicing abilities of the portfolio companies given its role in customer outreach. Innovation in tapping new distribution channels, whether in-house or through third parties is considered. IIRA also reviews the level of transparency and disclosures in its communication with clients, and whether it conforms to international standards of transparency, in terms of timeliness of reporting, comprehensiveness of information and consistency in risk and return workings, both vis-à-vis internationally adopted principles (like GIPS®) and over time.

## **Shari`ah Governance Rating**

In its Shari`ah Governance Rating, IIRA evaluates Shari`ah Compliance related features for funds held out as such. While fund structures, being participative in nature are inherently compliant with precepts of Islamic jurisprudence, investment screening criteria employed, proportion of investments considered compliant and mechanisms instituted to weed out investments that become non-compliant over time, will be the key focus here.

Our approach to Funds Management Ratings and Shari`ah Governance is adopted to AAOIFI GSIF10 to the extent applicable.

## **Credit Rating of Funds**

IIRA also extends a credit rating for assessment of repayment capacity of funds against credit lines raised or proposed to be raised. While these are essentially aimed at judging the capacity of timely repayment against terms of credit, these may inter alia, provide assurance to investors of the quality of underlying investments. Credit rating methodology used to assess funds is tailored to the asset class represented in the fund, given the differing business risk factors embedded in each asset class. Our credit ratings are most likely to be assessed for credit lines in funds invested in Real Estate, Venture Capital or Private Equity Funds and Bond Funds.

## **Deliverables and Rating Scales & Definitions**

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### **RATING SCALE – FUND MANAGEMENT RATINGS**

**FM1:** Superior fund management capacity and governance practices

**FM2:** Good fund management capacity and governance practices

**FM3:** Sound fund management capacity backed by appropriate organizational systems and practices

**FM4:** Developing organizational infrastructure and fund management capacity

**FM5:** Significant enhancement required in organizational infrastructure and fund management capacity

Single plus (+) may be added to each of the above rating bands to indicate relative standing within the same category.