FitchRatings



# Investment Management Quality Ratings Criteria

## Assessing Active, Passive & Alternative Investment Managers, Strategies & Funds
## Master Criteria

## Scope

Fitch Ratings assigns Investment Management Quality (IMQ) ratings to investment management organizations collectively, investment strategies, and individual funds or investment mandates. These may be referred to as asset manager ratings in certain jurisdictions or regulatory frameworks. The ratings are applied to active, passive, and alternative investment managers and strategies. The ratings are forward-looking relative assessments of an investment manager's investment capabilities and the strength of its operational platform. The ratings are not credit ratings and are not comparable to the traditional credit ratings assigned to the debt issued by some investment managers.

## Key Rating Drivers

**Five-Pillar Approach:** The IMQ rating criteria has five key pillars: investment process; investment resources; risk management; the company, including client servicing; and investment performance. A rating committee assesses each pillar applying the rating scale detailed in Appendix A. In most cases, Fitch applies standard pillar weightings to the qualitative pillars (described below) to arrive at a final rating, where the performance pillar will have a neutral impact on the rating unless there is significant investment underperformance that could result in a downward rating adjustment. Moreover, where the agency identifies one or more material weaknesses a lower rating cap may be applied to the overall rating, irrespective of the weighted score. Refer to the Analytical Framework section on the next page for a description of changes being implemented in this criteria iteration.

**Investment Process:** The investment process pillar assesses the clarity and consistency of investment objectives, quality of the research process, investment decision-making and portfolio construction processes, and performance measurement and calibration processes.

**Investment Resources:** The investment resources pillar focuses on the experience, stability, and capacity of staff in key functional areas. Additionally, it considers the strength of front-office workflows, the degree to which the investment and risk management processes are appropriately supported by technology, middle-/back-office support and appropriate selection criteria and oversight of third-party service providers, i.e. custodians, auditors and pricing services.

**Risk Management:** The risk management pillar assesses the overall risk control framework, integration with the front-office, its independence and influence, risk monitoring and measurement, compliance, and whether the manager's incentive structure discourages excess risk-taking and promotes an alignment of interests with investment objectives.

**Company and Client Servicing:** The company component of this pillar focuses on the investment management company's market presence and franchise, financial stability and experience, while the client servicing component focuses on timeliness, transparency and accessibility of performance and market reporting.

**Investment Performance:** The investment performance pillar looks at historical measures of performance, with a focus on underperformance, for insights into how well the investment and risk management processes have been implemented in the past.

### Table of Contents



This report updates the criteria report titled "Investment Management Quality Rating", published Feb. 25, 2020.

### Analysts

**EMEA**
Alastair Sewell
+44 20 3530 1147
alastair.sewell@fitchratings.com

**Latin America**
Davie Rodriguez
+1 212 908 0386
davie.rodriguez@fitchratings.com

**Asia Pacific**
Li Huang
+86 21 6898 7978
li.huang@fitchratings.com

**North America**
Greg Fayvilevich
+1 212 908 9151
greg.fayvilevich@fitchratings.com

**Fund-, Strategy-, and Manager-Level Ratings:** Fitch assigns ratings at the fund level, firm level or, where appropriate, at the investment strategy/platform level. When assigning IMQ ratings to a diversified investment management organization, Fitch focuses on the investment manager's main strategies and analyzes historical performance of flagship funds/mandates or composites. Strategies with the greatest assets under management (AUM) and most representative of the firm's product offerings will have the most influence on Fitch's overall rating assessment.

**Rating Surveillance:** For monitored ratings, Fitch expects to receive updates on key developments — people, process and performance, etc. — that may influence the ratings.

## Investment Management Quality Ratings — The Analytical Framework

IMQ ratings are assigned on a five-point scale from 5 (Excellent) to 1 (Weak) weighting five key analytical pillars to provide a relative assessment of the investment manager, strategy or fund's investment capability. The five pillars and standard weightings are: investment process (25%); investment resources (25%); risk management (25%); and company and client servicing (15%), and investment performance (10%). Fitch uses an IMQ rating scorecard (see Appendix B) to perform this analysis.

The final rating may then be adjusted down, i.e. subject to a rating cap, if one or more material weaknesses are judged to outweigh other factors. For example, Fitch may assign a lower, capped rating if there are material governance, compliance or financial weaknesses that more substantively affect the manager's investment capabilities than captured by the standard scorecard weights.

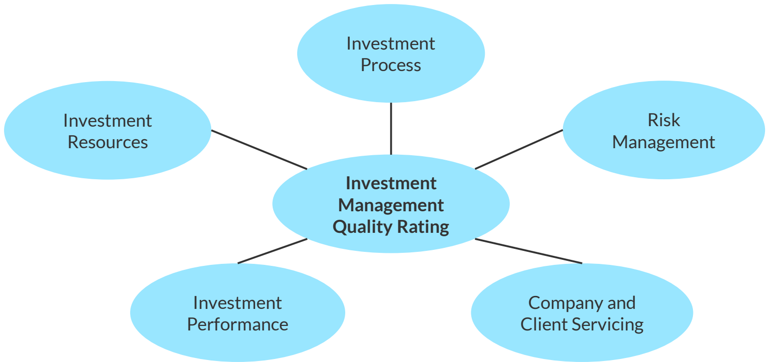
When completing the scorecard, a numerical correspondence table is used to assign numerical scores that translate to a given rating level for each pillar. The weighted scores across the five pillars are used to arrive at a numerical rating level score. This rating score is compared by a committee to the Scorecard Rating Level Bands and used in determining the final rating. The committee will also consider other information when available, such as peer managers, strategies, and funds and adjust scores relative to peers as part of the committee process.

The criteria are largely qualitative, although some analytical areas primarily will be driven by quantitative metrics. For example, the investment performance pillar is mostly influenced by quantitative measures of historical performance.

### IMQ Ratings Analytical Framework

The same pillars and scorecard are used for traditional active, passive, and alternative illiquid strategies. However, the analysis will take into consideration factors that are unique or distinctive for a particular strategy. For example, the staffing skills and investment processes for private equity, real estate and other non-traditional strategies are very different than for traditional liquid strategies (see Appendix C: Qualitative Considerations for Private Equity Strategies).

### IMQ Ratings Analytical Framework




Source: Fitch Ratings.

### Rating Numerical Correspondence

| Rating Level | Numerical Scoring |
|---|---|
| Excellent | 5 |
| Strong | 4 |
| Proficient | 3 |
| Adequate | 2 |
| Weak | 1 |

### Scorecard Rating Level Bands

| Weighted Score | Rating |
|---|---|
| >4.25 | Excellent |
| 3.50–4.25 | Strong |
| 2.50–3.50 | Proficient |
| 1.75–2.50 | Adequate |
| <1.75 | Weak |

## Investment Process: 25% Weighting

A robust, well-defined investment process is critical for delivering consistent returns relative to a well-defined set of investment objectives.

**Investment Objectives — Clarity and Consistency**

A robust investment process starts with transparent, appropriate and clearly defined investment objectives that are consistently executed over time. The IMQ rating focuses on:

- the clarity of investment objectives and investment universe (including, among others, the definition of investment horizon, risk limits, investment philosophy, and benchmarks or targets);
- the consistency of investment performance and sources of return and risk relative to the investment objective (including a review of performance attribution reporting and other relevant documentation);
- the terms of the investment offerings relative to market standards, i.e. redemptions, use of leverage, derivatives, and illiquid securities.

The score assigned in this category is driven by the degree of clarity in investment objectives, the degree of consistency between the sources of risk and return and the investment objective over time, and the terms of the investment offering relative to market standards. Fitch completes this assessment by reviewing a fund's investment objectives and terms or, at firm-level, indicative investment objectives for the firm's main strategies and performance attribution reporting or other related documents to understand the extent of any style drift.

Fitch assigns a score of Excellent in this category when investment objectives, which include an articulated investment philosophy, are very clear, highly consistent with the realized performance (i.e. show minimal style drift), and the investment terms are consistent with best practices. Fitch assigns progressively lower scores as the clarity of investment objectives decline, style drift becomes more evident, or as investment terms become less well aligned with the strategy. If multiple scoring areas show some weakness, then the overall category score will be lower. Fitch assigns a score of Weak where it identifies poorly explained or confusing investment objectives such as "black-box" investment strategies, performance that deviates materially from the stated approach, or investment terms significantly misaligned with the strategy in question.

### Research Process

### Research Process Attributes

| Rating | Description |
|---|---|
| Excellent | Exemplary research process demonstrating great capacity, analytical rigor, extremely high level of discipline and repeatability (i.e. based on well-defined and consistently applied methodologies), and documentation of research findings and analysis. Exemplary fit between the research process and the investment universe. |
| Strong | Strong research process demonstrating a high level of capacity, analytical rigor, discipline and repeatability (i.e. based on well-developed and proven methodologies), and documentation of research findings and analysis. Strong fit between the research process and the investment universe. |
| Proficient | Good research process demonstrating a good level of capacity, analytical rigor, discipline and repeatability (i.e. based on well-developed and proven methodologies), and documentation of research findings and analysis. Reasonable fit between the research process and the investment universe. |
| Adequate | Some areas of weakness or inconsistency in the research process, e.g. limited documentation of research outputs or variable research methodologies. |
| Weak | Significant research process weakness, e.g. failure to document research recommendations. |

Source: Fitch Ratings.

Investment research underpins a robust investment process. Fitch assesses research capabilities relative to the investment strategy. For instance, an equity manager managing concentrated portfolios of "best ideas" with clearly demonstrable depth of analysis of individual stocks would score highly. Alternatively, an equity platform that is managed as a benchmarked portfolio and has extensive coverage — through quantitative modelling, for example — of the stocks included in the relevant index, could also score highly. In all cases, Fitch considers the following factors core to a high-quality research process:

- consistency of research capabilities with investment universe;
- discipline and repeatability of the process;
- documentation and effective communication of research; and
- quality of output.

### Investment Decision-Making, Portfolio Construction and Execution

Together with investment research, portfolio construction, including the efficient execution of buy and sell decisions, is critical to investment performance. Fitch analyzes the investment decision-making and portfolio construction process by looking at the following aspects:

- incorporation of research outputs;
- portfolio construction and risk budgeting;
- well-articulated and disciplined buy and sell decisions; and
- well-resourced trade execution capabilities.

## Investment Decision-Making and Portfolio Construction Attributes

| Rating | Description |
|---|---|
| Excellent | Very robust investment decision-making process demonstrating research-based investment recommendations, very strong decision-challenging mechanisms such as investment committees, sophisticated and extremely well-resourced trading capabilities and very effective portfolio implementation and re-balancing. |
| Strong | Robust investment decision-making process demonstrating research-based investment recommendations, strong decision-challenging mechanisms such as investment committees, sophisticated and well-resourced trading capabilities and effective portfolio implementation and re-balancing. |
| Proficient | Sound investment decision-making process demonstrating reasoned investment recommendations, some decision-challenging mechanisms such as investment committees, well-functioning and -resourced trading capabilities and good portfolio implementation and re-balancing. |
| Adequate | Adequate investment decision-making process demonstrating some areas of relative strength and others of relative weakness. For example, limited investment decision challenge (e.g. star manager culture), or low levels of trading sophistication relative to the investment universe. Adequately resourced trading capabilities and good portfolio implementation |
| Weak | Clear evidence of poor investment decision making, i.e. clear divergences between portfolio management and research and/or an absence of material trading capability. |

Source: Fitch Ratings.

### Performance Tracking

Performance tracking and attribution analysis are important for measuring the outcome of the investment process, as well as the consistency of its application against the investment universe in accordance with the stated investment objectives. Performance tracking and attribution analysis allows for the continuous monitoring of the drivers of performance and can help identify style drift while informing decision-making and portfolio construction. Moreover, detailed performance tracking serves as a critical feedback mechanism that helps identify weaknesses in the investment process, which could in turn lead to adjustments that improve the investment process over time.

### Performance Tracking

| Rating | Description |
|---|---|
| Excellent | Best in class measures of performance. Formal and ongoing use of robust and sophisticated metrics, models and analysis that are highly consistent with the asset class, and fully detail and explain the sources of investment performance and risk. Benchmarks are approved by an investment committee and periodically recalibrated. Formal communication of results during investment committees and through frequent reports to the investment team and management. |
| Strong | Robust measures of performance. Formal and frequent use of metrics, models and analysis that are consistent with the asset class and clearly explain the sources of performance and risk. Benchmarks are approved by an investment committee. Formal communication of key results during investment committees and through frequent reports to the investment team and management. |
| Proficient | Good measures of performance with some room for improvement. Formal use of metrics, models and analysis that are consistent with the asset class in a frequency consistent with the asset class, that explain the sources of performance and risk. Benchmarks are clearly defined, but are not necessarily approved by a committee. Formal communication of results through reports to the investment team and management. |
| Adequate | Adequate measures of performance with some weaknesses. Use of basic metrics that are consistent with the underlying asset class, though with a lower frequency than optimal for the asset class. In general, PMs are in charge of performance metrics calculation, but there is a review by a second person. |
| Weak | Weak or non-existent measures of performance. Performance measures and/or their calculation frequency are inconsistent with the underlying asset class. Performance monitoring relies solely on the PM. |

Source: Fitch Ratings.

## Investment Resources: 25% Weighting

Fitch elects to differentiate investment resources as a separate and distinct pillar from investment process. Investment manager's key assets are people and technology. The ability to execute a given strategy and minimize risk requires appropriately resourced research and investment teams, supported by robust front-office workflows and technology as well as support from the middle-office, back-office, and third-party service providers.

### Staffing

Fitch reviews the depth and breadth of resources to determine their fit with the demands of the investment process. In a people-driven business such as investment management, a key determinant of performance is the quality, depth, experience and organization of staff relative to requirements. Large numbers of staff are not a prerequisite for higher scores: more important is having the right staff for the process. For example, a fundamental stock-picking strategy needs a strong and diverse pool of research analysts to cover the investment universe. Conversely, a quantitative strategy places greater emphasis on engineers and data scientists to support the models and tools employed in its investment process. The main areas of analysis are:

- functional organization;
- key roles and responsibilities;
- segregation of responsibilities;
- key person dependencies, including key man risk;
- individual and collective experience and tenure of C-suite and key investment and risk staff;
- staff turnover of C-suite and key investment and risk staff (including reasons for turnover) and replacement capability; and
- workload indicators of capacity and scalability of investment, research and risk staff.

## Investment Resources Attributes

| Rating | Description |
|---|---|
| Excellent | Exemplary and well-organized team with very clear and complete separation of functions demonstrating no key person dependence. Industry leading levels of individual and collective industry experience and company tenure. Complemented by a balance of profiles. Very low levels of staff turnover accompanied by structures allowing for very timely and efficient replacement hiring. Very high fit between number of staff and investment objectives. |
| Strong | Well-organized team with clear separation of functions demonstrating minimal key person dependence. High levels of individual and collective industry experience and company tenure complemented by a balance of profiles. Low levels of staff turnover, particularly at senior levels, accompanied by structures allowing timely and efficient replacement hiring. High fit between number of staff and investment objectives. |
| Proficient | Broad separation of functions, albeit with some overlap and increasing key person dependence. Average levels of individual and collective industry experience and company tenure. Modest staff turnover at more senior levels with, potentially with longer time taken to make replacement hires. Resources broadly aligned with objectives |
| Adequate | Key person dependence more material, with individuals involved in several functional areas, resulting in a less clear separation of duties and responsibilities. Experience and tenure lower than average reflecting higher staff turnover at multiple levels and difficulties in attracting replacement hires. Leads to weaker staffing of some functions. |
| Weak | Severe key person dependency, very low levels of tenure and experience, material and sustained staff turnover and/or inadequate staffing levels. |

Source: Fitch Ratings.

### Front Office Technology and Workflows

Fitch assesses front-office workflows and technology to understand how well they support the investment and risk management processes, taking into consideration the investment manager's particular needs and strategies. The focus is on how front-office workflows and technology support the investment professionals and allow them to remain focused on their primary objective — effective portfolio management. Areas of consideration include:

- automation of front office workflows;
- IT functionality, scalability and coverage;
- access to and use of key internal and external data;
- automation and level of technology integration; and
- technology resources, maintenance and off-site backup.

Fitch will assign a score of Excellent to front-office workflows with a very high degrees of automation (thus allowing fund managers to focus on their core activities), highly sophisticated tools (such as quantitative models), which are fully integrated to portfolio management, and trading systems allowing a very high level of scalability and very robust reporting capability. Furthermore, Fitch would not expect to see material weakness in maintenance protocols and resources, disaster recovery processes or off-site backup at higher scoring levels.

If, in Fitch's opinion, there are weaknesses, then it will assign progressively lower scores, particularly in the case of weaknesses in multiple scoring areas. Fitch will assign a score of Weak to front-office workflows with weak functionality and/or integration into the investment and risk management processes and where substantial manual intervention required. This may be evident in reporting weakness. Technology platforms which lack basic maintenance and support will also be scored Weak.

### Middle-/Back-Office Support and Third-Party Service Providers

Middle- and back-office operations, as well as third-party service providers, support the delivery of the investment process and, therefore, form part of Fitch's IMQ rating analysis by an assessment of:

- staffing levels;

- functional separation from front office;
- systems integration, i.e. straight through processing (STP);
- segregation of assets;
- portfolio valuation independence and oversight; and
- third-party service provider selection and oversight.

Fitch will assign a score of Excellent to managers when: they have functionally segregated middle and back offices that are well staffed relative to the firm's size and AUM; middle- and back- office systems are fully integrated with front-office activities through a very high use of straight-through processing technology (including in the case of outsourced activities); the manager fully meets or exceeds industry and regulatory standards for asset segregation and portfolio valuation/oversight; third-party service providers are unaffiliated, well known and reputable with robust manager oversight, or in the case of in-house affiliates, there is clear functional and organizational separation with 'arm's length' dealings.

If, in Fitch's opinion, there are weaknesses in any of these areas, then it will assign progressively lower scores, particularly in the case of weaknesses in multiple scoring areas. For example, a score of Weak will be assigned in cases of middle-/back-office functions that are highly manual with poor technological integration, assets are not segregated through the use of independent, reputable custodians, auditors not known or reputable or the valuation practices lack independence, i.e. functional separation from front office or use of independent pricing services.

## Risk Management: 25% Weighting

Fitch considers a well-developed, integrated, influential and independent risk management process highly important in delivering consistent risk-adjusted returns and limiting downside risk.

### Risk Control Framework

Fitch's analysis of risk control focuses on the overall risk management environment and the balance it strikes between independence from and integration with the front office. Fitch analyzes the following core areas:

- risk control framework and controls;
- level of influence, independence and redundancy; and
- policies and procedures.

### Risk Control Attributes

| Rating | Description |
|---|---|
| Excellent | Very strong risk control framework characterized by multiple layers of efficient control points (e.g. three lines of defense) governed by well thought-out, frequently updated and readily available policies and procedures. Processes demonstrate very high levels of independence from (and integration with) the business, supported by the presence of a fully independent chief risk officer (CRO) or functional equivalent. |
| Strong | Strong risk control framework characterized by various layers of control points governed by well thought-out, frequently updated and readily available procedures. Process demonstrates high levels of both independence from and integration with the business. Independent CRO or functional equivalent. |
| Proficient | Proficient risk control framework involving a basic set of control points reliant on human intervention. Procedures are well developed but may be less accessible OR less readily available than at higher scoring levels governed by well thought-out, frequently updated and readily available procedures. Process demonstrates adequate levels of independence from and integration with the business. |
| Adequate | Some areas of weakness in the risk control structure, e.g. limited number of control points missing (e.g. no pre-trade compliance testing) or aged procedures. Risk may not be sufficiently independent from or integrated with the front office. |
| Weak | Material risk control weakness in any area. |

Source: Fitch Ratings.

### Risk Monitoring, Measurement and Stress Testing

How an investment manager measures and reports risk is critical to maintaining investment performance. Stress testing is an increasingly important part of risk management, typically effected to gauge the potential effects of systematic or idiosyncratic negative events on portfolios. Fitch analyzes how the investment manager manages the three main risk categories: credit, market, and liquidity risk. Not all of these risks are necessarily relevant in all cases. For example, liquidity risk only indirectly affects term-funded or closed-end investment strategies through its effect on market pricing and supply more broadly, whereas it can be highly material to an open-ended fund investing in less liquid securities.

The core factors in Fitch's assessment are:

- quality and timeliness of risk management;
- processes for establishing and reviewing risk limits; and
- stress testing capability.

### Risk Monitoring Attributes

| Rating | Description |
|---|---|
| Excellent | Very strong risk management process demonstrating very timely, highly sophisticated and detailed risk reporting and analysis. Highly robust processes for establishing and adjusting risk limits. Highly sophisticated stress testing capability. |
| Strong | Strong risk management process implemented through timely, sophisticated and detailed risk reporting. Robust processes for establishing and adjusting risk limits. Sophisticated stress testing capability. |
| Proficient | Sufficient risk management process, with average quality risk reporting, analysis and frequency resulting in the establishment of some risk limits. Sound stress testing capability. |
| Adequate | Overall, risk reporting and analysis and frequency is adequate relative to the investment strategy. Some examples, at times, of weakness in risk limit calibration or frequency of updates. Rudimentary stress testing capability. |
| Weak | Weak risk function with poor risk reporting and analysis and/or frequency. Flawed limit setting. Absent or inadequate stress testing. |

Source: Fitch Ratings.

### Compliance

Compliance covers investment and personal compliance areas, specifically focusing on:

- processes for ensuring compliance with regulatory, contractual portfolio and internal limits and policies;
- fair trade allocation policies and procedures; and
- personal trading policies.

In this category, Fitch assesses the degree to which processes support compliance with regulatory, internal and contractual limits and policies, the extent to which fair trade allocation is considered and how personal trading restrictions are overseen.

Fitch will assign a score of Excellent when compliance and trade allocation policies and procedures are highly robust and well developed, and pre-and post-trade compliance testing are fully automated. Furthermore, Fitch would not expect there to have been any material compliance incidents in recent history, i.e. insider trading. Fitch assigns progressively lower scores where compliance testing processes are less comprehensive, less automated, or less frequent, or policies and procedures are less well-developed. Similarly, Fitch will assign lower scores where there have been more frequent or more material personal trading breaches in the recent past. For example, where there have been material compliance issue(s) resulting in significant regulatory sanctions Fitch will assign a score of Weak.

Cases of severe or repeated regulatory sanctions may lead Fitch to cap the rating at a lower level than indicated by its rating scorecard.

### Alignment of Interest

Over the longer term, a well-aligned incentive structure can contribute meaningfully to a robust investment process and reinforce effective risk management. Fitch analyzes the incentive structure to determine the extent to which it supports alignment of interest with investors and discourages excess risk-taking.

Fitch will assign a score of Excellent where, in its opinion, it identifies a very clear performance-based compensation policy, which strongly reinforces core risk management objectives and is well calibrated to an appropriate time horizon or the strategy in question.

For example, a compensation policy with a strong variable component directly linked to longer-term risk-adjusted returns over short-term nominal returns will be viewed favorably. As the incentive structure weakens Fitch will assign progressively lower scores. Fitch will assign a score of Weak where it identifies compensation structures that show material misalignment.

## Company and Client Servicing: 15% Weighting

### Company

An investment manager's financial resilience, experience and strategic commitment can influence its ability and willingness to make necessary investments in people and technology in support of the investment decision-making platform. The main areas of focus for the IMQ rating are:

- market presence and franchise;
- financial stability — ownership; revenue/EBITDA/fixed-cost coverage trends; product, strategy and client diversity; and
- investment experience.

If the investment manager itself or its majority owner/parent are rated, then Fitch will not conduct a stand-alone assessment of the investment manager's financial stability but will instead look to the rating. Higher ratings will equate to higher scores.

### Company Attributes

| Rating | Description |
|---|---|
| Excellent | Exceptionally strong reputation and market presence complemented by very high financial stability, underpinned by a very highly diverse investor base and product mix with stable or growing assets under management (AUM). Exceptionally long market experience encompassing multiple market cycles. |
| Strong | Strong reputation and market presence complemented by high financial stability, underpinned by a highly diverse investor base and product mix with stable or growing AUM. Very long market experience encompassing multiple market cycles. |
| Proficient | Good reputation complemented by reasonable financial stability, albeit showing some potential financial weakness such as overreliance on one or more market segments or investors/investor groups, outflows from core strategies or increased financial leverage (e.g. from a leveraged buyout). Long market experience encompassing at least one market cycle. |
| Adequate | A newly founded investment manager with a short track record or low (but growing) AUM, resulting in lower financial stability that potentially affects the manager's investment capabilities. Alternatively, an established investment manager, which is suffering deterioration in financial stability driven, for example, by sustained and material outflows. |
| Weak | Material weaknesses in terms of financial stability that materially affects investment capabilities, little market presence, reputational issues and/or minimal relevant investment experience. |

Source: Fitch Ratings.

### Client Servicing

Robust, transparent client servicing and reporting helps investors make timely decisions about whether the manager is meeting the stated goals and acting appropriately as an agent on behalf of the investor. Therefore, Fitch assesses the degree to which investors can access timely and transparent reporting of risk-adjusted performance trends, performance drivers and market events. Fitch will assign a score of Excellent where reporting is very timely, highly accessible, e.g. via multiple channels, and provides transparent summary and detailed information. Conversely a Weak score would apply where there is material weakness in reporting timeliness and accuracy or a failure to meet basic investor needs.

## Investment Performance: 10% Weighting

While IMQ ratings are forward-looking relative assessments of an investment manager's investment capabilities and the strength of its operational platform, Fitch believes that past investment performance (controlled for risk) can provide investors with insights into how successfully and consistently the investment and risk management processes have been executed over time, against stated investment objectives. In particular, Fitch believes that significant performance weakness relative to peers or benchmarks can be indicative of a weakness in a manager's operational set up or the execution of its processes. On the contrary, performance that is in-line or better than peers or benchmarks can serve as confirmation that the investment process is being executed well while not being predictive of future performance in efficient markets. Consequently, Fitch applies an asymmetric treatment to its analysis investment performance for IMQ ratings whereby the investment performance analysis will have a neutral impact on the overall rating for managers that perform in line with, or better than, peers or benchmarks. However, when a manager significantly underperforms, the Investment Performance pillar could be rated Weak, which would negatively pressure the overall IMQ rating. For the purposes of this analysis, Fitch considers a bottom quintile performance over a three-year horizon and/or performance materially lagging a representative index as a threshold against which a manager's performance can be judged to be weak.

Fitch's criteria call for a minimum of three years of monthly performance data. In the absence of at least three years of performance data, Fitch will consider using a proxy track record from a similar fund, mandate or other source, including track records generated at precursor funds or firms where the process is substantially identical and has transferred to the new fund or firm in a short period of time by substantially the same team. In the absence of at least three years of performance data, Fitch may still rate the fund; however, Fitch may elect to cap other rating pillars, or the overall IMQ rating until a sufficient track record has been realized.

When assigning IMQ ratings at the level of the investment manager, Fitch will assess composite indicators of performance, which in most cases would comprise historic performance of flagship funds/mandates or composites under the investment manager's main strategies. As a secondary or complementary approach, Fitch may also use aggregate measures of performance such as the percentage of AUM achieving a given performance threshold, particularly when the strategies encompassed within the scope of the rating are substantially similar and would generate similar performance (for example, money-market funds and short-term bond funds).

Strategies with the greatest AUM and most representative of the firm's product offerings (for example, a firm's asset weighted performance) will have the most influence on Fitch's overall rating assessment. This reflects our view that at the investment manager level, aggregate indicators of performance are more relevant to an assessment of the manager's overall investment capability than potentially idiosyncratic individual fund or mandate performance.

### Traditional Liquid and Passive Strategies

For active traditional, liquid strategies Fitch assesses risk-adjusted return profiles, drawdown management and consistency of performance with the investment objectives. In most cases, this will be the three-year information ratio level and trend over time for benchmarked strategies, or the Sharpe ratio for non-benchmarked strategies. Fitch bases its drawdown analysis on the fund's return profile over time compared with the index (for benchmarked strategies), peers or Fitch-assigned benchmarks (for non-benchmarked strategies, or where there is not a sufficient peer group) as well-stated investment objectives. Fitch assesses the magnitude of drawdowns for the investment strategies analyzed relative to the drawdowns experienced by the relevant benchmark over the considered time horizon.

When assessing passive funds or strategies, Fitch focuses on tracking error. Strategies and funds that demonstrate a poor tracking error could result in a negative adjustment in Fitch's rating analysis. Tracking error is analyzed relative to the relevant index and based on how closely the manager's tracking error is to zero, indicating perfect index replication.

### Nontraditional, Illiquid Strategies

In the case of nontraditional illiquid strategies, Fitch focuses on return measures such as Multiples of Invested Capital (MoIC) and Internal Rate of Return (IRR), while also taking into consideration the inherent cyclicality and potentially long investment horizons. In addition to MoIC or IRR, Fitch may also use alternative measures of performance, where such measures are appropriate for the asset class, such as vacancies or tenant defaults in the case of real estate assets. For strategies involving less liquid assets, Fitch sees less informational value in interim downward unrealized price adjustments; additionally, the time horizon used, as it may differ depending on the asset class or investment strategy being assessed in order to take into account different return attributes. For example, for real estate funds, where the return profile can be realized steadily over time, Fitch will use as a minimum three-year time horizon for the performance analysis, whereas for investment strategies with longer lifecycles, Fitch's time horizon is longer.

For investment strategies that have long lifecycles, such as private equity, Fitch will utilize vintage performance analysis, relative to peers, of similarly styled funds that the investment manager has managed in the past as well as focusing the performance track record of more recent funds. Fitch uses peer group IRR's and MoIC vintage performance data as reported by reputable external data providers (such as Preqin or Cambridge Associates), when available. In its analysis of the vintage performance data, Fitch places greater emphasis on funds that have three or more year's cumulative returns with a greater weight to older vintage funds that have demonstrated success in harvesting portfolios. Fitch will evaluate the performance of these funds relative to similar funds from the same respective vintage years in terms of quartile performance using IRR and MoIC.

Private equity managers that post bottom quartile rankings over longer periods of time will viewed as weak performers. Likewise, Fitch may elect to apply the downward rating adjustment until a sufficient track record has been realized in the case of managers with shorter track records.

### Fees and Share Class

For traditional, actively managed strategies, Fitch analyzes risk-adjusted returns by looking at gross returns (or its closest approximation via the lowest fee share class where information is available) as the purest measure of investment performance. While management fees can materially alter the net return to investors, this is outside the scope of the rating for traditional, active strategies.

For passive funds and strategies, Fitch's analysis of tracking error is net of investment management fees, to reflect that there is a cost/benefit trade-off between the amount of tracking error and the costs incurred to achieve perfect index replication. For non-traditional, less liquid strategies such as private equity, returns are measured gross and net of fees and expenses to provide a comprehensive perspective.

## IMQ Rating Scorecard

The standard weighting scheme for the five pillars in the IMQ rating scorecard (see Appendix B) underpin the rating process, serving as the primary means for a committee to derive the IMQ rating. A rating committee may assign a lower IMQ rating from what is calculated using the standard pillar weightings in the scorecard in cases where the manager's capabilities are materially weak in one or more key areas. In this case, one or more factors can act as constraints to a rating pillar or to the final rating through the application of a rating cap overlay, as reflected at the bottom of the scorecard.

## Applying Fitch's IMQ Rating Analysis

Fitch can apply its IMQ rating criteria at the level of the investment manager, the level of an individual fund/mandate or where appropriate, at the investment strategy/platform level.

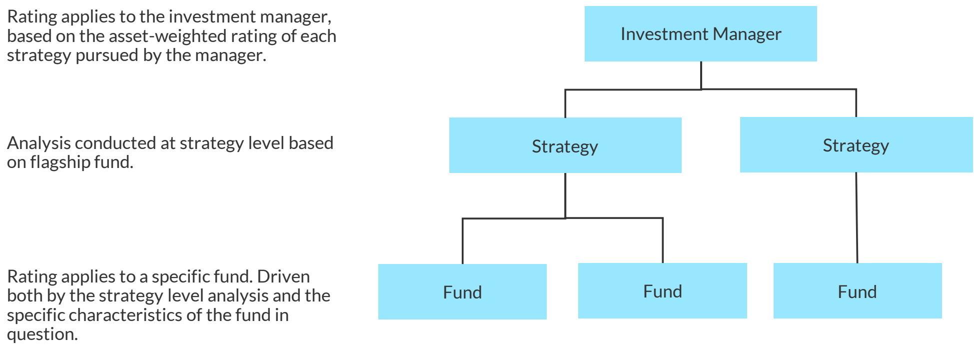
Fitch may define the scope of the rating at the manager level to exclude certain activities, such as offshore funds.

When rating a specific fund or mandate, the fund/mandate IMQ rating may take into account fund-specific performance and structural attributes that would not be a key consideration at the platform or manager level. For example, Fitch will look at the specific performance attributes of the fund or mandate in question in rating the Investment Performance pillar. Similarly, Fitch considers whether the fund structure is appropriate for the asset class, i.e. the use of open-ended, mark-to-market structures for less liquid asset classes like commercial real estate will be penalized for a structural mismatch between the asset class and the fund structure.

Where appropriate, Fitch may assign a rating at the strategy/platform level. When rating an investment strategy, the rating is specific to the qualities of the investment platform in question. The rating does not opine on a specific fund, mandate or on the credit risk profile of the investment manager directly.

Fitch defines an investment strategy as a collection of funds or mandates that invest in a broadly consistent asset class or set of asset classes in accordance with a highly consistent investment process, or investment expertise. For example, Fitch would consider an investment process focused on global equities based on fundamental, bottom-up stock selection a single strategy; whereas it would consider a top-down quantitative investment approach on the same universe a different strategy.

**Qualitative Rating Hierarchy**




Source: Fitch Ratings.

## Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or issuer-by-issuer basis and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

## Criteria Scope and Limitations

Fitch's analysis and rating decisions are based on relevant public and non-public information available to its analysts. The sources of this information are the investment manager, the fund administrator, and the public domain. This includes publicly available information on the fund such as audited and unaudited (e.g. interim) financial statements and regulatory filings.

When assigning IMQ ratings, Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its rating methodology and may obtain reasonable verification of that information from independent sources (e.g. auditors or regulators), to the extent such sources are available for a given fund or manager, or in a given jurisdiction. Investment managers may choose not to share certain information with external parties, including rating agencies, at any time. While Fitch expects that each investment manager that has agreed to participate in the rating process will promptly supply all information relevant for evaluating the ratings of the fund or manager, Fitch neither has, nor would it seek, the right to compel the disclosure of information by any agents of the fund.

IMQ ratings may not incorporate event risk. Prominent event risks include sudden, dramatic and unexpected changes in financial market prices or liquidity, adverse regulatory decisions, litigation, redemptions, fraud or other unforeseeable breakdowns in control and governance, among others.

IMQ ratings do not predict a particular investment outcome or a particular risk-adjusted return. For traditional active strategies, the risk-controlled performance analysis component of the ratings are based on gross returns (or closest approximation) and attempt to minimize the effect of any management, administrative, distribution or performance fees the investor may agree to pay.

IMQ ratings are not credit ratings nor are they intended as inputs to credit ratings.

Therefore, any attempt to compare IMQ ratings with credit ratings in their ratings levels, transition rates or other traditional performance metrics would not be appropriate.

The IMQ ratings are not and should not be construed as an investment recommendation. They should be viewed as one of many potential inputs into an investor's decision-making process.

In markets where regulators require the evaluation of certain parameters not specifically referenced here, Fitch will defer to local market regulations and highlight these distinctions in its rating action commentaries.

# Appendix A: Investment Management Quality Rating Definitions

Fitch assigns Investment Management Quality (IMQ) ratings to investment management organizations collectively, to investment strategies and to individual funds or investment mandates. In certain jurisdictions and regulatory frameworks, these may also be referred to as asset manager ratings. The ratings are applied to active, passive and alternative investment managers and strategies. The ratings are forward-looking relative assessments of an investment manager's investment capabilities and the strength of its operational platform. The ratings are not credit ratings and are not comparable to the traditional credit ratings assigned to the debt issued by some investment managers.

## Rating Scale and Definitions

| **Excellent** |
| --- |
| The investment manager has extremely strong investment capabilities and operational characteristics. |
| **Strong** |
| The investment manager has strong investment capabilities and operational characteristics. |
| **Proficient** |
| The investment manager has good investment capabilities and operational characteristics. |
| **Adequate** |
| The investment manager has adequate investment capabilities and operational characteristics. |
| **Weak** |
| The investment manager has weak investment capabilities and operational characteristics. |

### IMQ National Scale Ratings

The agency assigns National Scale IMQ ratings to investment managers, their strategies, and their funds operating in countries where, for some rating factors, a comparison with international standards may not applicable due to certain accepted, generally less stringent, local market practices.

In such instances, those factors are evaluated solely relative to local market standards. National scale ratings are denoted by a special identifier for the country concerned, e.g. 'Strong (mor)' for Morocco and are comparable only to National IMQs assigned in the same country and should not be viewed as comparable with IMQs offered on other national scales or on the international scale. In certain local markets, Fitch may utilize different ratings scales due to regulatory requirements and/or market convention. In these cases, the ratings scale and definitions, if different than above, will be clearly disclosed and delineated on Fitch's relevant local market website.

## Appendix B: IMQ Rating Scorecard

### IMQ Rating Scorecard

| Pillars and Key Factors | Weight (%) |
|---|---|
| Investment Process | 25.00 |
| Investment Objectives – Clarity and Consistency | |
| Research Process | |
| Investment Decision-Making and Portfolio Construction | |
| Performance Tracking and Assessment | |
| **Investment Resources** | 25.00 |
| Staffing | |
| Front-Office Technology and Work Flows | |
| Middle/Back Office Support and Third-Party Service Providers | |
| **Risk Management** | 25.00 |
| Risk Control | |
| Risk Monitoring, Measurement and Stress Testing | |
| Compliance | |
| Alignment of Interests | |
| **Company and Client Servicing** | 15.00 |
| Market Presence and Franchise | |
| Financial Stability | |
| Experience | |
| Client Servicing | |
| **Investment Performance** | 10.00 |
| Historical Performance | |
| **IMQ Scorecard Result** | 100.00 |
| Standard IMQ Rating Weighted Score | |
| ↓ | |
| **Qualitative Adjustments to Scorecard Output** | |
| ↓ | |
| **Final IMQ Rating** | |

IMQ – Investment Management Quality.
Source: Fitch Ratings.

## Appendix C: Qualitative Considerations for Private Equity and Other Alternative and Illiquid Strategies

Private equity and similar alternative and illiquid (real estate, infrastructure, etc.) strategies require specialized skill sets that are fundamentally different from those required for more traditional, liquid strategies. Pre-investment research, valuing companies, real estate or infrastructure projects and implementing the investment strategies while balancing and aligning the interests of several constituents and effectively exiting investments all necessitate specialized skills and experience. Also, due to the illiquid nature of the asset class, valuation is more challenging, thus making valuation practices and policies that much more important.

For illustrative purposes, below we provide an example on some unique or additional considerations when assigning IMQ ratings to private equity managers and funds:

With respect to the clarity and consistency of the investment objective:

- performance objective;
- return hurdles;
- investment focus (sectors, start-up/development);
- investment approach (in-depth operational involvement versus purely financial);
- level of company and board participation;
- investment horizon;
- use of leverage at the fund level;
- co-investment in funds;
- fund terms, i.e. clawback provisions; and
- number of funds and timing of new capital issues.

At the earlier stages (pre-investment or sourcing stages), Fitch would look to evaluate a manager's capacity with respect to:

- management of the economic cycle;
- sourcing of new investments;
- deal sizing;
- company analysis – broad business plan, expected IRR, cash flow modelling, etc.;
- market intelligence;
- portfolio construction;
- due diligence workflows;
- approval process; and
- investment implementation.

At the post-funding stage, Fitch would look to evaluate the manager's:

- review of investments, and ongoing monitoring of company-level risk factors (actual versus budget);
- involvement with the companies;
- work-out approach and work-out history;
- exit strategy, timing and process; and
- management of cash flows – Distribution policy and constraints to LPs.