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Key Credit Factors For Asset Managers

Criteria Officers:
Nik Khakee, Criteria Officer, North American Financial Institutions, New York (1) 212-438-2473; nik.khakee@standardandpoors.com
Emmanuel Dubois-Pelerin, Criteria Officer, Global Financial Services, Paris (33) 1-4420-6673; emmanuel.dubois-pelerin@standardandpoors.com
Michelle M Brennan, Criteria Officer, European Financial Services, London (44) 20-7176-7205; michelle.brennan@standardandpoors.com

Primary Credit Analysts:
Sebnem Caglayan, CFA, New York (1) 212-438-4054; sebnem.caglayan@standardandpoors.com
Dhruv Roy, London (44) 20-7176-6709; dhruv.roy@standardandpoors.com

Chief Credit Officer, Americas:
Lucy A Collett, New York (1) 212-438-6627; lucy.collett@standardandpoors.com

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Key Credit Factors For Asset Managers

*(**Editor's Note:** We republished this criteria article on Dec. 19, 2014, to add "Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers," published May 7, 2013, to the list of related criteria. This article outlines our methodology for deriving short-term ratings, which we apply to financial services companies.)*

1. Standard & Poor's Ratings Services has revised its global methodology for rating asset managers, a subset of financial services companies. This article follows our request for comment (RFC), "Request For Comment: Key Credit Factors For Asset Managers," published Sept. 11, 2014, on RatingsDirect. For a summary of the changes made relative to the RFC, see "RFC Process Summary: Standard & Poor's Summarizes The Request For Comment Process For The Nonbank Financial Services Companies And U.S. Business Development Companies Criteria," published Dec. 9, 2014. These criteria should help market participants better understand our approach to analyzing the key credit factors (KCFs) for asset managers. This KCF should be read in conjunction with our corporate ratings criteria (see "Corporate Methodology," published Nov. 19, 2013). This article also is related to "Principles Of Credit Ratings," published Feb. 16, 2011.

2. These criteria supersede "Rating Asset Management Companies," published March 18, 2004, "Equity Credit For Hybrid Securities Issued By Asset Managers," Nov. 13, 2006, and the parts of "Rating Private Equity Companies' Debt And Counterparty Obligations," March 11, 2008, and "Counterparty And Debt Rating Methodology For Alternative Investment Organizations: Hedge Funds," Sept. 12, 2006, that relate to alternative asset managers.

SCOPE OF THE CRITERIA

3. This methodology applies to traditional and alternative asset managers. We define asset managers as companies that derive a majority of their revenues from management and performance fees for managing third-party money or assets on behalf of retail or institutional investors. These assets are commonly referred to as assets under management (AUM). We define traditional asset managers as companies that typically manage mutual funds that invest in stocks, bonds, or money market instruments on behalf of retail and institutional investors. We define alternative asset managers as companies that typically manage private equity funds, hedge funds, debt (credit) funds, or fund of funds (private equity or hedge fund) mostly for wealthy individuals or institutional investors.

4. For traditional asset managers, total revenue primarily consists of management fees, which are generally charged as a percentage of AUM. For alternative asset managers, in addition to earning management fees, one of the primary business objectives is to earn performance fees (in certain situations referred to as "incentive fees" or "carried interest," see Glossary), which may be earned if an asset manager's investment performance exceeds certain predetermined thresholds (hurdle rates).

5. Asset managers also generate unrealized or realized gains on principal investments as well as investment income (or loss). These principal gains (or losses) and investment gains (or losses) can also include dividend income from direct investments made in their funds alongside third-party investors.

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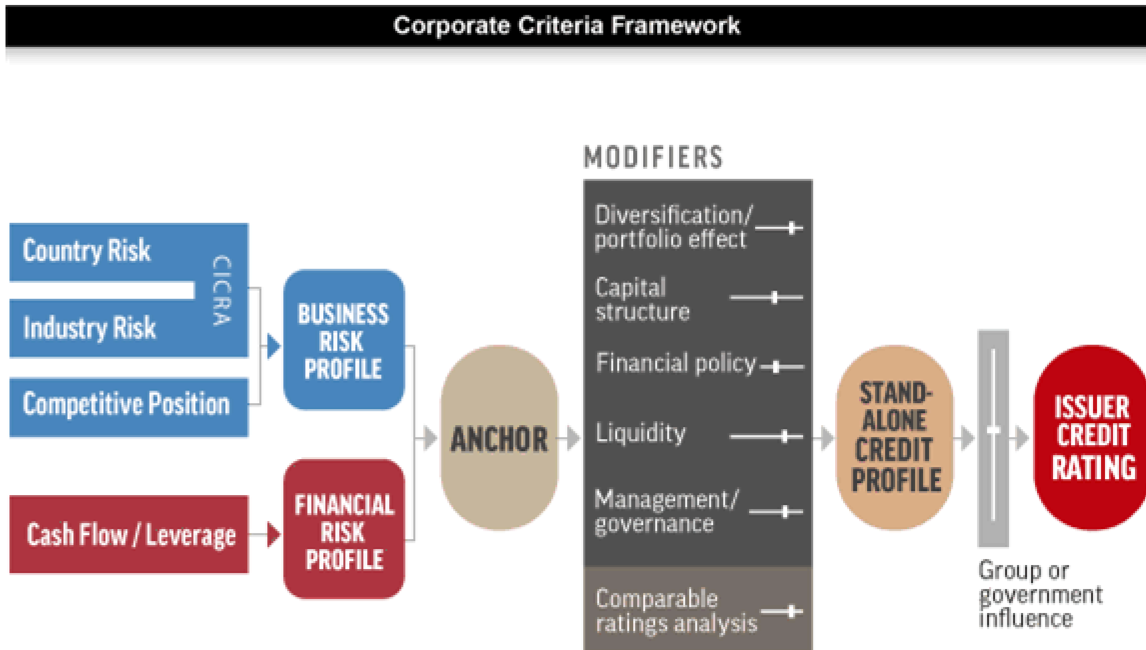
SUMMARY OF THE CRITERIA

6. Under these criteria, the foundation for determining the stand-alone credit profile (SACP) on an asset manager, which we use to derive the rating, is our "Corporate Methodology," published Nov. 19, 2013 (see chart). We also apply all the criteria listed in the "Related Criteria" section at the end of this article. This KCF describes how we apply those criteria in their entirety, except as otherwise stated herein to address the unique characteristics of the asset manager industry.

7. In determining the SACP on an asset manager, we assess its business risk and financial risk profiles. The business risk profile reflects the amount of financial risk that an asset manager can bear at a given SACP level and is the foundation for an asset manager's expected economic success. The business risk profile comprises the risk and return potential for an asset manager in the markets in which it participates, the competitive climate within those markets (its industry risk), the country risks within those markets, and the competitive advantages and disadvantages the asset manager has within those markets (its competitive position). We combine our assessments of industry risk, country risk, and competitive position to determine the business risk profile.

8. The financial risk profile is the outcome of decisions that management makes in the context of its business risk profile and its financial risk tolerances. This includes decisions about the manner in which management seeks funding for the company and how it constructs its balance sheet. It also reflects the relationship of the cash flows the organization can achieve, given its business risk profile, to its financial obligations. We use cash flow/leverage analysis to determine an asset manager's financial risk profile assessment.

9. We then combine an issuer's business risk profile assessment and its financial risk profile assessment to determine its anchor (see table 3 of the corporate methodology). When two anchor outcomes are listed in table 3 of the corporate methodology, for a given combination of the business risk profile and financial risk profile assessments, we apply paragraph 30 of the corporate methodology. Additional rating factors can modify the anchor. These are: diversification/portfolio effect, capital structure, financial policy, liquidity, and management and governance. Comparable ratings analysis is the last analytical factor to determine the final SACP on an asset manager.



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IMPACT ON OUTSTANDING RATINGS

10. Please see "RFC Process Summary: Standard & Poor's Summarizes The Request For Comment Process For The Nonbank Financial Services Companies And U.S. Business Development Companies Criteria," published Dec. 9, 2014.

EFFECTIVE DATE AND TRANSITION

11. These criteria are effective immediately, except in markets that require prior notification to, and/or registration by, the local regulator. In these markets, the criteria will become effective when so notified by Standard & Poor's and/or registered by the regulator. We intend to complete our review of our asset manager ratings within the next six months.

METHODOLOGY

Part I: Business Risk Analysis

12. To assess an entity's business risk profile, we first determine the Corporate Industry and Country Risk Assessment (CICRA) and the competitive position, and then combine them per our corporate methodology. To arrive at the CICRA, we combine the industry risk assessment and the country risk assessment and apply table 1 of the corporate

methodology.

A. Industry Risk

13. Within the framework of our criteria for assessing industry risk (see "Methodology: Industry Risk," published Nov. 19, 2013), we view asset managers as an "intermediate risk" industry (which equates to an assessment of 3). The industry risk assessment is based on our analysis of cyclicality and competitive risk and growth. For asset managers, our assessments of both cyclicality and competitive risk and growth are "intermediate risk" (3).

1. Cyclicality

14. The asset manager cyclicality assessment is 3 (see table 2 in "Methodology: Industry Risk").

15. To arrive at this assessment, we apply "Methodology: Industry Risk," but with some modifications due to data limitations. The Compustat historical database, the primary data source Standard & Poor's used for determining industry cyclicality across many other sectors, does not cover the asset manager industry. To determine the cyclicality of revenues and profits, we use 2002-2012 financial data for 34 rated asset managers that we believe represent the global industry well. We focus our cyclicality assessment on the 2007–2009 recession. We do not factor in previous recessions, primarily because of the lack of financial data.

16. We use the decline in the S&P 500 index of U.S. large cap stocks as a proxy for the 2007-2009 cyclical downturn. The S&P 500 index is one of the most widely used benchmarks of market performance in the asset management industry. Although it covers only U.S. equities, given the increasing correlation between the S&P 500 and other global indices, especially in recent downturns, we believe cyclical movements in the S&P 500 should broadly reflect the global equity markets as well.

17. To the extent possible, we adjust the financial data for significant mergers and acquisitions that took place.

18. For our analysis, we use the 2008 decline (over the prior year) in AUM, instead of revenues, as the first variable in determining the cyclicality assessment. This is because traditional asset managers primarily derive their revenues from management fees, which are typically calculated as a percentage of AUM. AUM declines during market downturns can result from either falling market values or net sales, or both. Revenue declines for asset managers can have a lagged effect, depending on firm-specific factors such as customer mix (retail versus institutional) and asset class mix (equities versus fixed income, for example). The weighted average percentage decline in AUM during 2008 for the sample of 34 rated asset managers was 16.7%.

19. We measured the profitability decline by calculating the drop in EBITDA margin in 2008 (relative to the prior year) for the sample of 34 asset managers. The weighted average EBITDA margin decline was 7.2%.

2. Competitive risk and growth

20. We assess asset managers' competitive risk and growth as "intermediate risk" (3) applying table 4 of "Methodology: Industry Risk." To analyze competitive risk and growth, we assess four subfactors as low, medium, or high risk using table 3 in "Methodology: Industry Risk." These subfactors are:

- Effectiveness of barriers to entry;

- Level and trend of industry profit margins;
- Risk of secular change and substitution of products, services, and technologies; and
- Risk in growth trends.

a) Effectiveness of barriers to entry

21. Barriers to entry, in our opinion, are moderate in the asset managers industry, and so we assess them as "medium risk." There are no meaningful barriers to starting an asset management firm. However, there are significant barriers to becoming a large-scale asset manager and competing with established industry participants. These barriers include:

- Regulation: The burden of maintaining compliance with the increasingly complex requirements of regulatory regimes, especially for asset managers operating on a global scale, necessitates additional back-office personnel and robust risk management.
- Cost advantages: Larger asset managers enjoy significant economies of scale with respect to distribution costs, technology infrastructure, compliance, and other operating expenses.
- Distribution capabilities: Established industry participants have relationships with consultants and other "gatekeepers," which enable them to reach broad investor bases. These relationships take time to develop, and new entrants cannot easily replicate them.
- Risk management: Investors are increasingly demanding greater transparency, more robust risk management, and better governance from asset managers, which are more difficult for new entrants to provide.
- Product innovation and branding: Incumbent players are better able to invest in product innovation and branding, which can be key drivers of AUM growth. Further, firms with established track records are in a better position to attract both AUM and industry talent.
- Proven investment performance and track record: Investors most likely invest their money with asset managers that have proven investment outperformance (compared with benchmarks and major indices) and longer track records.

b) Level and trend of industry profit margins

22. For asset managers, the level and trend of industry profit margins is "low risk," in our assessment. The industry can generate strong profitability and operating cash flows. Based on our calculations for a representative sample of our rated asset managers, average annual EBITDA margins between 2007 and 2013 were relatively high and stable. The peak EBITDA margin during this period was 42% in 2010, and the low was 37% in 2008. In 2013, it was approximately 39%. Given the severity of the 2008-2009 market downturn, the relative stability of EBITDA margins indicates the resilience of industry profitability. The "low risk" assessment is supported by:

- The competitive dynamics of the industry. Although competition in the industry can be intense given the large number of companies, the primary basis of competition is not price, but rather product differentiation (based on investment objectives and investment performance). Therefore, asset management firms are, to a large extent, able to maintain their pricing power during downturns, making margins resilient to falling AUM.
- The low capital intensity of the industry translates to a relatively high degree of cost flexibility (such as with respect to staff compensation and distribution costs). During periods of declining AUM, firms are able to reduce overhead costs significantly without long-term damage to the franchise. During the 2008-2009 downturn, we observed that many asset managers rapidly cut variable costs, such as incentive compensation.

c) Risk of secular change and substitution of products, services, and technologies

23. The assessment of secular change by products, services, and technologies is "medium risk" for asset managers. This assessment reflects two main considerations.

24. First, allocation of assets to capital market investments (as opposed to bank savings) will be increasingly important given aging populations and increasing life expectancy in developed economies. Our assessment is premised, in part, on our belief that the search for long-term real returns will likely continue to raise demand for products and solutions offered by asset managers.

25. Second, against this backdrop, we also consider savings products that banks offer (especially as interest rates rise) and annuity products that insurance companies offer as alternatives to asset management companies, and they pose a medium level of substitution risk. In our opinion, there is some limited substitution risk from outside the traditional asset management industry.

d) Risk in growth trends

26. We view asset management as an established industry with sustainable revenue growth. As a result, the assessment of risk in growth trends is "low risk."

27. We use global AUM growth as a proxy for revenue growth. Global AUM increased to $68.7 trillion in 2013 from $32.8 trillion in 2002, representing a nominal compound annual growth rate of 7%, according to Boston Consulting Group data. Given that this was despite a 17% year-over-year decline in 2008, we believe the industry can sustain this growth rate. We believe that asset managers will be able to maintain a growth rate in excess of forecasted medium-term world real GDP growth.

B. Country Risk

28. To determine an asset manager's country risk exposure, we apply section "C. Country Risk" of the corporate methodology and "Country Risk Assessment Methodology And Assumptions,'" published Nov. 19, 2013. These criteria rank countries on a scale from very low risk (1) to very high risk (6), based on four risk subfactors:

- Economic risk,
- Institutional and governance effectiveness risk,
- Financial system risk, and
- Payment culture and rule of law risk.

29. We generally determine exposure to country risk using invested AUM by country or region. To the extent invested AUM by country or region are not available, or we believe invested AUM by country or region are less relevant for an asset manager, we may focus on AUM by domicile of investor, or revenue or EBITDA by country as a metric to determine country risk exposures. We do not assess country risk exposure through a measure of total assets because most asset managers do not derive revenue from direct investment, and so their total on-balance-sheet assets are typically a poor indicator of exposure by country.

C. Competitive Position

30. As per our corporate criteria, we assess an asset manager's competitive position on a six-point scale: excellent (1), strong (2), satisfactory (3), fair (4), weak (5), or vulnerable (6). The analysis includes a review of:

- Competitive advantage;
- Scale, scope, and diversity;
- Operating efficiency; and
- Profitability.

31. We assess the first three factors on a five-point scale: strong (1), strong/adequate (2), adequate (3), adequate/weak (4), or weak (5). We then ascribe a specific weight to each factor to determine the preliminary competitive position. The level and volatility of profitability are assessed and combined using table 15 of the corporate methodology. We then combine that outcome with the preliminary competitive position assessment using table 16 of the corporate methodology. The applicable weightings depend on the company's competitive position group profile (CPGP). For asset managers, the CPGP is "services and product focus" (see table 11 in the corporate methodology), and so the weightings of the factors are:

- Competitive advantage (45%);
- Scale, scope, and diversity (30%); and
- Operating efficiency (25%).

1. Competitive advantage

32. In assessing the competitive advantage of an asset manager, we consider:

- Business strategy (see paragraph 35),
- Market position (see paragraph 36-41),
- Investment performance (see paragraph 42-44), and
- Net AUM flows (see paragraph 45).

33. An asset manager with a "strong" or "strong/adequate" competitive advantage assessment typically has two or more of the following, or one of the following that is particularly significant:

- Successful business strategy capable of supporting good market share in the geographies it operates in and investment strategies it provides to its investors. The growth strategy is mostly based on organic growth rather than aggressive growth fueled by acquisitions.
- Strong market position marked by sizable AUM sourced through global operations. Brand equity and reputation have been created through superior track record of asset management.
- Strong market position, as indicated by a sizable sales force and high, stable, or growing sales emanating from an increasing variety of distribution channels.
- Investment performance that consistently outperforms its benchmarks and/or peers.
- Growing AUM with positive net AUM flows year over year on a sustained basis.

34. An asset manager with a "weak" or "adequate/weak" competitive advantage assessment is typically characterized by two or more of the following, or one of the following that is particularly significant:

- Poor business strategy with declining market share or product offerings that don't meet investor appetite, and/or aggressive acquisition strategy.
- Less than $15 billion in AUM and relatively short track record of asset management, small sales force in which AUM are raised only through a handful of distribution channels with low market penetration, and/or low level of repeat clients.
- Weak investment performance that consistently underperforms its benchmark and/or peers.

- Declining AUM with negative asset flows (redemptions exceed new investment) over an extended period of time in most of the asset classes or key or largest funds or strategies of the asset manager without reinvestment in similarly profitable alternative funds of the asset manager.

a) Business strategy

35. In reviewing business strategy, we consider an asset manager's relative success, or lack thereof, at establishing leadership positions in the markets in which it competes and at protecting or growing market shares in a profitable manner. We consider an asset manager's introduction of new products or strategies to meet investor demand or in response to macroeconomic conditions. (An example would be an asset manager providing floating rate or short duration products when interest rates are rising.) We also review an asset manager's acquisition strategy to assess how it may increase or decrease competitive advantage. Some asset managers supplement organic growth with growth through acquisitions, especially those trying to enter into new products or new markets. Over time, a successful acquisition strategy can enhance competitive advantage, especially in highly fragmented markets where scale can provide an advantage.

b) Market position

36. In reviewing market position, we consider the absolute level of AUM, market share in different geographies and products, brand reputation, track record of managing AUM, and distribution capability.

37. ***Level of AUM.*** A high level of AUM does not necessarily support creditworthiness, and low AUM does not necessarily weigh on creditworthiness. Nevertheless, low AUM are typically associated with small firms that could face a number of risk factors, such as key man risk, reliance on a handful of funds, weaker distribution, and risk of AUM falling significantly and thus lowering revenue. These factors could weaken creditworthiness. We typically define a small traditional asset manager as less than $50 billion in AUM, midsize as $50 billion to $250 billion, large as $250 billion to $500 billion, and global as more than $500 billion, especially if AUM are geographically diverse. The AUM scale and ranges could be much smaller for alternative asset managers. The permanence of AUM, stemming from the multiple year lock-ups of many alternative asset managers' AUM, in our view, offsets some of the weaknesses of the lower level of AUM. Large absolute size can help to reassure clients that other investors are prepared to entrust their capital to the asset manager, and can reflect scale, which may benefit operations and reduce key man risk because there is likely to be another portfolio manager available to step in. We also look at growth in AUM over the past five years. Steady growth in AUM over a period of time that already incorporates market movements indicates that a franchise is being steadily built up and is resilient.

38. ***Market shares in different geographies or products.*** We also assess market shares by key markets, regions, or products, based on level of AUM, when available. We look for trends in market share and consider the attractiveness of the key markets and regions in which the asset manager operates. Asset management is a fragmented industry. But a resilient market share suggests that AUM are sticky (redemptions are less likely to occur) and that significant AUM outflows may be manageable.

39. ***Brand reputation.*** In reviewing brand reputation, we consider an asset manager's brand strength, or lack thereof. We view a brand as strong if it is a recognizable and established brand that is not reliant on the reputation of a handful of individuals and is attractive to a variety of investors. In turn, a strong brand is suggested by an asset manager's ability to attract, retain, and, when necessary, replace talented portfolio managers. A clear price premium suggests strong brand reputation. Companies successfully leveraging existing brand names into new service categories also show strong brand equity and reputation.

40. ***Track record of managing AUM.*** We consider an asset manager's track record over its years of operations. We could take a negative view if a firm has been managing significant AUM for fewer than three years. We also consider an asset manager's demonstrated ability to overcome adversity. Adversity could be the result of marketwide reputational damage, such as from losses incurred due to redemptions associated with the U.S. market timing scandal, or firm-specific reputational damage due to operational error or employee fraud. This is especially relevant for institutional managers whose success depends, in part, on being placed on consultants' "approved" lists. For these institutional managers, if they are removed from approved lists because of poor performance or reputational damage, it may take several years to be placed back on such lists. Brand strength is typically confirmed by market share gains, consistent asset inflows, a talented portfolio management team, above-average profitability, and premium pricing.

41. ***Distribution capability.*** In reviewing distribution capability and service quality, we typically consider an asset manager's investor base by geography, by type (retail versus institutional), the diversity and reliability of distribution outlets and the asset manager's share of those outlets, the size of its sales force (including sales staff that manage existing client relationships), and the proportion of repeat clients investing in its newly formed funds, which is a good indicator of service quality. Good investment performance will be of little use if a firm cannot translate this into strong gross sales. A strong distributor may also be able to mask (for a while) an underperforming portfolio manager or investment team. Market conditions and investor preferences are both cyclical and volatile, and without strong distribution capability, very few funds would maintain year-over-year strong asset inflows, in our view.

c) Investment performance

42. The investment performance of an asset manager is usually analyzed in one of two ways: its investment performance compared with major indices or various benchmarks (including peer group) and its investment performance ranked according to nationally and internationally recognized sources of fund management performance data. Ultimately, the fortunes of an asset manager rest on its investment performance. Many managers can have a lucky run rather than genuine talent, and so we look at investment performance over different timeframes. Strong, long-term, and consistently above-average investment performance is more supportive of credit quality than one-time outperformance.

43. We view investment performance as positive if either 70% or more of AUM is in the top two quartiles on three-year and five-year time horizons, or if 70% or more of AUM outperforms benchmarks or indices on three-year and five-year time horizons. We look at one-year investment performance only on a qualitative basis to assess the recent trend because we believe one year does not represent a long enough track record. We consider overall investment performance as negative to competitive advantage when 30% or more of AUM is in the bottom quartile on either the three-year or the five-year time horizons, or if 40% of AUM or more underperforms benchmarks or indices on either the three-year or the five-year time horizons. Otherwise, performance is neutral to competitive advantage. Some of the alternative strategies may not have a benchmark, in which case the performance is evaluated on an absolute and risk-adjusted basis, over three-year, five-year, and since-inception time horizons, using metrics such as internal rate of return (IRR) compared with peers in the same investment strategies.

44. We also focus on the investment performance of key or the largest funds/strategies an asset manager offers, in addition to its aggregate investment performance. These bellwether funds often determine brand and reputation, and we view the three-year and five-year performance relative to a benchmark or peer group to be an important indicator of investment performance. If seven or more of an asset manager's 10 largest (measured by AUM) funds/strategies outperform benchmarks or indices on the three-year and five-year time horizons, we view that as positive, whereas if

four or more of the 10 largest funds/strategies are underperforming benchmarks or indices on either the three-year or the five-year time horizons, we view that as negative to investment performance. Otherwise, investment performance is neutral or determined by paragraphs 42-43.

d) Net AUM flows

45. Net AUM flows are very important to the competitive advantage assessment because they are a tangible metric of the effectiveness of a manager's business strategy, market position, and investment performance. We generally focus on trends over a number of years (typically the past five years) across a variety of asset classes, geographies, distributional channels, and funds. We look at gross sales too, relative to industry gross sale trends. We consider net AUM flows to strengthen an asset manager's competitive advantage when the manager experiences positive net sales (new investment exceeds redemptions) on one-, three-, and five-year time horizons on an aggregate basis and by asset class and by channel. We define "negative" AUM flows as net redemptions (outflows exceed new investment) on an aggregate basis on a three-year time frame, except potentially during a year of very adverse industry conditions--such as 2008. In such a case, we could alternatively base our assessment on which asset managers achieve a quicker recovery or turnaround relative to peers. Otherwise, net AUM flows are neutral to competitive advantage. For alternative managers, we would not view fund distributions as negatively as we would redemptions because fund distributions are typically a reflection of realization activity, whereas redemptions are often a reflection of an investor's decision to withdraw capital. However, we expect a significant portion of the fund distributions to be reinvested into new funds.

2. Scale, scope, and diversity

46. In assessing an asset manager's scale, scope, and diversity, we consider:

- AUM by asset class,
- AUM by distribution channel/investor base,
- AUM by geography,
- Variety of funds/strategies, and
- Revenue diversification by business line.

47. We look at AUM concentration and diversity in multiple ways (see paragraphs 52-57). When successful and continuing, diversification supports scale, scope, and diversity, and we view that as benefiting overall competitive position. Sometimes asset managers diversify into asset types or geographies in which they have no or little prior knowledge or expertise. In our view, this weakens overall competitive position. For example, an asset manager may weaken its overall competitive position upon entering into new products or businesses (alternative assets such as hedge funds or fund of funds) or countries where it has limited expertise and lacks critical mass to be a robust competitor. Diversification supports scale, scope, and diversity only when actively pursued and with the expertise and adequate staffing and infrastructure to enter new products and markets.

48. An asset manager with a "strong" or "strong/adequate" scale, scope, and diversity assessment is typically characterized by two or more of the following, or one of the following that is particularly significant:

- Robust and active diversification of AUM by asset class, distribution channel, geography, investor base, and strategies/funds offered.
- Absence of reliance on a particular customer, product, or fund, or on a group of a few customers, products, or funds.

- Ability to expand its scale or diversify its AUM in the next 12-18 months.
- If scale, scope, and diversity is not already "strong" or "strong/adequate," one or more business lines, in addition to asset management, that in aggregate contribute more than 10% to total revenue in areas where management has adequate experience and skill sets can make it so when combined with one or more of the strengths listed above.

49. An asset manager with a "weak" or "adequate/weak" scale, scope, and diversity assessment is typically characterized by two or more of the following, or one of the following that is particularly significant:

- Concentrated AUM with respect to asset class, geography, investor base, and/or number of strategies/funds offered.
- Reliance on a particular customer or market or on a group of customers or end-markets.
- Diversification into business lines where management does not possess the required expertise.
- Inability to expand its scale or diversify its AUM in the next 12-18 months.

a) AUM by asset class

50. In reviewing AUM by asset class, we look at the proportion of invested AUM in equity, fixed income, money market, or alternative assets (private equity, credit, or hedge fund) for a traditional asset manager. AUM by asset class supports scale, scope, and diversity when, for example, 40% is invested in fixed income and 40% is invested in equity assets, with the remaining 20% invested in balanced funds. Similarly, a positive assessment for an alternative asset manager would be 40% in private equity; 40% in debt (credit or hedge fund) assets, including both public and private debt; and 20% in alternative asset classes, including real estate and infrastructure. Any concentration in a single asset class of more than 80% weighs on scale, scope, and diversity, in our opinion. Additionally, further diversification by investment style within each asset class, considering the volatility of the product, supports the assessment. For example, a well-diversified product mix within an asset class can be achieved in any of the following ways:

- Well-balanced equity AUM between growth and value stocks;
- Well-balanced fixed-income AUM among governments, corporate bonds, and structured finance; or
- For credit-focused asset managers, AUM well-diversified across distressed, mezzanine, and senior debt.

51. We believe diversification can protect an asset manager against extreme market turns and allow companies to capture flows across different asset classes as investor preferences shift over cycles.

b) AUM by distribution channel/investor base

52. This subfactor addresses the proportion of AUM distributed through retail and institutional clients, AUM by top 10 retail distribution intermediaries (national and regional brokerage firms, banks, and financial intermediaries), AUM by top 10 institutional clients (corporate and municipal pension plans, endowments and foundations, and other corporate and public moneys), and revenue contribution of the top three and top 10 clients (mostly institutional clients). Generally, an investor base comprising a combination of retail and institutional investor bases diversifies revenue streams and supports scale, scope, and diversity more than a firm with only one investor base. Diversity within the institutional investor base is also favorable because institutional investors' aggregate risk appetite or risk allocation to different investment styles may change over time.

53. Asset managers that focus largely or solely on management and sales of retail mutual funds could have narrow scale, scope, and diversity because of their focus on mutual fund investors. For them, well-diversified distribution supports positive scale, scope, and diversity. For asset managers that focus on mutual funds that are sold through external sales

forces, it is key to have a well-established and well-diversified network of sales people at national and regional brokerage firms, banks, insurance companies, and financial planning firms. Some of these mutual fund-focused asset managers may have very heavy concentrations with just a few institutions, and this could pose risks because of overreliance on a handful of distributors.

54. The following situations support an asset manager's scale, scope, and diversity: each of retail and institutional assets accounting for approximately 50% of AUM (this does not apply to alternative asset managers, which typically have more than 90% of their clients as institutional investors), the top three distribution retail intermediaries or the top three institutional clients representing less than 20% of AUM, or the top three clients representing less than 20% of revenues. An asset manager with a diverse institutional investor base can more easily weather shifts in risk appetite or risk allocation. Weighing on scale, scope, and diversity would be retail or institutional assets representing more than 90% of AUM (this does not apply to alternative asset managers, which typically have more than 90% of their clients as institutional investors), the top three distributional channels or the top three institutional clients representing more than 50% of AUM, or the top three clients representing more than 50% of revenues.

c) AUM by geography

55. An asset manager that has invested AUM in different geographies is more diverse and better protected against country-specific economic forces, in our view. For instance, if the U.S. stock market plummets, instead of redeeming out of the asset manager in whole, investors may choose to reallocate fund investments to less volatile markets outside of the U.S. but in funds that are still managed by the same asset manager. The asset manager's previous experience in a new market or partnering with local participants in new markets and geographies supports scale, scope, and diversity. As an example, a stronger asset manager could have 30% of AUM residing in the U.S. and 30% in Europe (with the remaining AUM allocated elsewhere). A weaker asset manager could have more than 90% of its AUM invested in one particular country.

d) Variety of funds/strategies

56. Asset managers that have a large variety of funds/strategies demonstrate stronger scale, scope, and diversity when the asset managers with the larger number of funds/strategies have no concentrations in any one investment style or product. We consider an asset manager with more than 30% of its AUM or 30% of its revenue representing one fund or strategy as weighing negatively on scale, scope, and diversity. Also, if the top three funds/strategies represent more than 50% of AUM or of revenue derived from asset management fees (as opposed to investment income or revenue derived from other business lines, which also contribute to revenue), that would be a negative to scale, scope, and diversity. We also consider the life cycle of the funds, especially for the alternative asset managers that have finite life of funds. A weaker assessment would occur when most of the alternative asset manager's funds are coming close to the end of funds' lives (typically alternative asset manager funds have finite lives of 10-12 years) and we expect a significant portion of its AUM to trail off over the coming one to three years. AUM diversified in a number of funds is supportive of scale, scope, and diversity.

e) Revenue diversification by business line

57. Although asset managers may already have strong diversification just by managing AUM, businesses outside of asset management contributing more than 10% to revenue (overall revenue, including other segments such as asset management fees and investment income) strengthen the scale, scope, and diversity assessment only if we believe

management has adequate expertise in the additional business lines and intends to maintain or grow its presence in these additional business lines. (This is as opposed to temporary diversification due to an asset manager acquiring an additional business line through a merger or acquisition that the asset manager intends to dispose of, rather than retain.) Examples of business lines that can add to scale, scope, and diversity include a brokerage or securities firm business, assets under administration (AUA) business (see Glossary), or fees derived from advisory (such as merger and acquisition advisory) services.

3. Operating efficiency

58. In assessing the operating efficiency of an asset manager, we consider:

- Expense structure,
- Economies of scale, and
- Technology.

59. An asset manager with a "strong" or "strong/adequate" operating efficiency assessment is typically characterized by two or more of the following, or one of the following that is particularly significant:

- Superior cost position to permit above-average profitability, even if demand declines because of investor appetite or if the AUM decline as a result of market movements.
- Highly variable expense base (typically above 60%) with an ability to adjust staff levels or compensation to changes in demand or AUM.
- Solid investment in technology and infrastructure that has helped revenue and profit growth prospects.
- Adequate infrastructure to handle a larger AUM base.

60. An asset manager with a "weak" or "adequate/weak" operating efficiency assessment is typically characterized by two or more of the following, or one of the following that is particularly significant:

- High fixed cost base (typically above 40%) and limited ability to manage fixed costs.
- Inferior cost position relative to peers', possibly caused by business model.
- Lack of investment in technology and infrastructure that leads to less efficient operations.
- Poor infrastructure to handle a larger AUM base.

61. In reviewing expense structure, we consider an asset manager's ability to reduce expenses when AUM and revenue are expected to decline. This ability reflects the proportion of variable expenses, which we assess through two key ratios: operating expenses to operating revenues (overhead ratio) and variable expenses to operating expenses (variable expense ratio). Compensation is typically the major expense item for asset managers. We consider how much of the compensation expense and total expenses of an asset manager is variable and tied to its revenues.

62. In economies of scale, we assess an asset manager's ability to manage substantial additional AUM with its existing infrastructure as well as its historical spending on that infrastructure to keep it appropriate and in line with business operations.

63. Technology can play an important role in achieving superior operating efficiency for an asset manager. Technology that supports a stronger operating efficiency assessment includes one or more of the following:

- Automated trading platforms,

- Ability to handle multiple investment strategies and product offerings for their investors,
- Interfaces with easy and user-friendly access for retail investors,
- Ability to provide detailed information on invested AUM for the investors (such as investment performance by underlying fund and underlying strategy), and
- Quantitative models that consistently achieve alpha (risk-adjusted return in excess of the compensation for the risk borne) in their suggested investment strategy.

64. Our analysis of operating efficiency does not consider manufacturing processes and working capital management (such as inventory turnover) because these subfactors are more relevant for industrial companies.

4. Profitability

65. Profitability can confirm or modify the preliminary competitive position assessment. Profitability consists of two subfactors: the level of profitability and the volatility of profitability. We combine the two subfactors into the final profitability assessment using a matrix. We assess profitability on the same 1-6 scale as we do the preliminary competitive position.

a) Level of profitability

66. We assess the level of profitability on a three-point scale: "above average," "average," or "below average" (see table 15 in "Corporate Methodology").

67. In assessing the level of profitability, we view an adjusted EBITDA margin (see below) as the best measure for comparing the profitability of asset managers. In the cases where we make adjustments related to realized performance fees and investment income to calculate adjusted EBITDA, similar adjustments will be made in the denominator (revenues) of the adjusted EBITDA margin calculation. For asset managers, an adjusted EBITDA margin of greater than 35% is "above average," 20%-35% is "average," and less than 20% "below average."

68. We generally calculate profitability ratios based on a three-year average: previous one year's results, our current-year forecast (incorporating any reported year-to-date results and our estimates for the remainder of the fiscal year), and our forecast for the next fiscal year. It is difficult and often impractical to forecast asset manager profitability beyond the next fiscal period because of the lack of visibility of top-line revenues. Management fees are largely driven by AUM or, in some cases, commitments from investors, which, like stock prices, cannot be forecasted with a high degree of accuracy. Similarly, performance fees are only received when the manager's investment performance exceeds a certain hurdle rate, which is also hard to predict.

69. Asset managers generally derive revenue from three sources:

- Fee-related earnings (FRE), which are, in most cases, contractual, relatively recurring, the most predictable and highest quality, in our view, and include management fees, transaction fees, advisory fees, and interest income, and may include a portion of dividend income;
- Performance fees, which are based on the performance of the funds under management and are typically subject to a hurdle rate and can be volatile (but not negative) over an economic cycle; and
- Investment income, which consists of principal gains (or losses) from investments (which may include a portion dividend income) made in funds alongside third-party (limited-party) investors.

70. For asset managers whose total realized performance fees (including all realized incentive fees and carried interest)

and realized investment income over the past five years represent more than 10% of total revenue on average (typically alternative asset managers), we calculate "adjusted EBITDA" by applying a 50% haircut to five-year average realized performance fees and realized investment income. For asset managers, typically traditional asset managers, whose total realized performance fees and realized investment income represent less than 10% of total revenue on average in the past five years, we do not apply the haircut to realized performance fees or realized investment income, described above, to calculate adjusted EBITDA. For asset managers, typically traditional asset managers, that don't bifurcate performance fees and investment income into "realized" and "unrealized," we will first assess the total of all performance fees and all investment income as a percentage of total revenues. If that percentage does not exceed 10% of revenues on average over the past five years, we would not apply the haircut. If that percentage is above 10%, on average, over the past five years, we may make assumptions (up to 100%) to determine how much of the performance fees and investment income is unrealized.

71. We adjust EBITDA to incorporate only the portion of net realized performance fees and net realized investment income that we consider sufficiently stable. We refer to both of these revenue sources--net realized performance fees and net realized investment income--as "net" because we net the expenses associated with each--fees and income received. Specifically, we add back to adjusted EBITDA the related expense (i.e., compensation expense related to the realized portion of performance fees and investment income included in this adjusted EBITDA). We apply such a haircut to this source of earnings to reflect our view that these earnings are less reliable than management fees, since performance fees are dependent upon achieving positive investment returns above a hurdle rate. We apply the 50% haircut to a five-year smoothed average because, while a five-year period may not cover a full economic cycle, we believe it appropriately addresses the potential volatility of this source of income. We believe a 50% haircut is applicable to both incentive fees and carried interest--all referred to as performance fees. We believe the level of volatility exhibited in these two sources of income has been sufficiently comparable to preclude any difference in treatment.

72. We do not incorporate unrealized net performance fees or unrealized net investment income in the calculation of adjusted EBITDA because a firm's ability to realize the cash flow benefit of these sources of revenue is less certain (as is the timing and amount the firm will actually receive) than with those qualified as realized.

73. We believe our 50% haircut to the five-year average of realized performance fees and realized investment income sufficiently accounts for the historical volatility we have observed in these realized performance fees and realized investment income. However, if we expect these realized performance fees and realized investment income to remain significantly impaired over an extended period of time (i.e., at least three to five years), we could apply a haircut of up to 100% in our adjusted EBITDA calculation.

74. We use adjusted EBITDA in our profitability, interest coverage, and leverage metrics.

b) Volatility of profitability

75. We assess volatility of profitability on a six-point scale, from 1 (lowest volatility) to 6 (highest volatility).

76. In accordance with our corporate methodology, we assess the volatility of profitability using the standard error of regression (SER), subject to having at least seven years of historical annual data. We typically use adjusted EBITDA but may use adjusted EBITDA margin to determine the SER for asset managers when we consider an asset manager's

adjusted EBITDA as distorted. Significant acquisitions or currency fluctuations are examples of causes of distortion. In accordance with our corporate methodology, we may--subject to certain conditions--adjust the SER by up to two categories upward (less volatile) or downward (more volatile). If we do not have sufficient historical information to determine the SER, we apply paragraphs 91 (using a peer as a proxy) or 92 (qualitative assessment) of the corporate methodology.

Part II: Financial Risk Analysis

A. Accounting And Analytical Adjustments

77. In assessing the accounting characteristics of asset managers, we apply the same methodology that we do for corporate entities (see "Corporate Methodology"). Our analysis of a company's financial statements begins with a review of its accounting elections and assumptions to determine whether the financial statements appropriately reflect an asset manager's performance and position relative to its peers, as well as corporate entities. To allow for globally consistent and comparable financial analyses, our rating analysis may include quantitative adjustments to reported results to reflect our view of underlying economic conditions and of an asset manager's ongoing business. We apply "Corporate Methodology: Ratios And Adjustments," published Nov. 19, 2013, including the adjustments to debt, funds from operations (FFO), EBITDA, and interest expense for operating leases and postretirement benefits obligations. We adjust EBITDA for asset managers according to paragraphs 71-74.

78. According to "Corporate Methodology: Ratios and Adjustments," paragraphs 231-238, we can deduct surplus cash from gross debt to calculate debt. Our standard methodology for calculating surplus cash allows the netting of available cash and liquid investments if, in our judgment, they are highly liquid and are accessible--that is, the cash and liquid investments are truly surplus and, therefore, could be used to repay debt immediately.

B. Cash Flow/Leverage

79. In assessing cash flow/leverage for asset managers, our analysis applies "Corporate Methodology," with the exception of using debt to adjusted total equity (ATE) as a core ratio when relevant (rather than FFO to debt) and using FFO to debt as a supplemental ratio. We assess cash flow/leverage on a six-point scale, ranging from (1) minimal to (6) highly leveraged, by aggregating the assessments of a variety of credit ratios, predominantly cash flow based, which complement each other by focusing on the different levels of an asset manager's cash flows in relation to its obligations.

80. We assess an asset manager's indicative financial risk metrics relative to table 17 of "Corporate Methodology."

1. Core ratios

81. For most asset managers, we determine one core ratio--debt to adjusted EBITDA--in accordance with Standard & Poor's ratios and adjustments criteria as adjusted for realized performance fees and realized investment income, as described in paragraphs 71-74. For a few of the asset managers that are in scope of this KCF, we consider debt to

adjusted total equity as the core ratio (see table 1). These particular asset managers operate hybrid models that more greatly emphasize investing their own funds' permanent capital in the form of debt or equity investments in underlying portfolio companies, generating interest and investment income (in addition to their sizable general partnership [GP] investments in underlying funds), along with managing third-party assets from which they generate management and performance fees.

82. Some asset managers also carry significant on-balance-sheet investments, which are the result of seed capital for new funds or investments in alternative asset classes that diversify the business mix away from their core business of managing third-party assets. In such cases, debt to ATE can be an important additional indicator of leverage in the context of the material on-balance-sheet risks they carry. A sole focus on cash flow leverage would result in an incomplete picture of financial risk. ATE is calculated as reported equity less goodwill, intangible assets, and unrealized portfolio appreciation or depreciation. Equity investments in all finance companies and equity in structured vehicles (CLOs and collateralized debt obligations) that the firm manages are also not included to account for the amplified leverage resulting from such investments.

83. When we think that support, in the form of a capital infusion or its equivalent, of one or more underlying managed funds is likely by the asset manager (for example, during adverse economic conditions or due to regulatory rules that impose such support), we would deduct from ATE our estimate of the capital that would be used for support.

Table 1

Assessing Debt To Adjusted Total Equity

Assessment	Debt to adjusted total equity (x)
Minimal	<0.4
Modest	0.4-0.8
Intermediate	0.8-1.5
Significant	1.5-2.0
Aggressive	2.0-3.0
Highly leveraged	>3.0

2. Supplemental ratios

84. In addition to core ratios, we also consider the following two supplemental ratios to develop a fuller understanding of a company's credit risk profile. The first ratio receives the most emphasis; the second might be relevant to a company achieving a lower tax burden over a sustained period:

- Adjusted EBITDA to interest (see table 17 of the corporate methodology)
- FFO to debt (see table 17 of the corporate methodology)

3. Time horizon ratio calculation

85. We generally calculate a company's credit ratios based on a three-year weighted average: previous one year's results, our current-year forecast (incorporating any reported year-to-date results and our estimates for the remainder of the fiscal year), and our forecast for the next fiscal year. It is difficult and often impractical to forecast beyond the next fiscal period because of the lack of visibility of top-line revenues. Management fees and performance fees are based on AUM or investment performance, which, like stock prices, cannot be forecasted with a high degree of accuracy. We place greater emphasis on forward-looking estimates, which incorporate upcoming debt maturities and expected debt

issuance/refinancing, than on historical ratios. As we forecast realized performance fees for asset managers, we would consider the net accrued performance fees on the balance sheet of an asset manager because we believe this can be a good indicator of the level of performance fees that could be realized in future periods. We generally weight the previous year, the current year, and the next fiscal-year forecast as 20%, 40%, and 40%, respectively. Specifically, we apply the aforementioned weights to the core and supplemental ratios for the respective years to get to one final ratio for each metric, which we would then use in table 17 of the corporate methodology to determine an asset manager's financial risk profile.

86. The length of the time series applied is dependent on the relative credit risk of the company and other qualitative factors, and the weighting of the time series varies according to transformational events. A transformational event is any event that could cause a material change in a company's financial profile, whether caused by changes to the company's capital base, capital structure, earnings, cash flow profile, or financial policies. Transformational events can include mergers, acquisitions, divestitures, management changes, structural changes to the industry or competitive environment, and product development and capital programs.

Part III: Rating Modifiers

87. The SACP is the anchor modified by six factors, for which we follow the corporate methodology: diversification/portfolio effect (paragraphs 126-135 of the corporate methodology), capital structure (paragraphs 136-156), financial policy (paragraphs 157-184), liquidity (paragraph 185), management and governance (paragraph 186), and comparable ratings analysis (paragraphs 187-192).

A. Diversification/Portfolio Effect

88. In assessing diversification/portfolio effect for asset managers, our analysis uses the same methodology we use for corporate entities (see "Corporate Methodology"), but since this modifier only applies to conglomerates, we don't expect it to materially affect asset managers' SACPs.

B. Capital Structure

89. We assess asset managers' capital structure according to the same methodology we use for corporate entities (see "Corporate Methodology"), with the exception of one additional subfactor--diversity of the capital structure. We assess capital structure as: (2) positive, (3) neutral, (4) negative, or (5) very negative. A very positive assessment (1) is not used for asset managers. In the majority of cases, we expect to assess a firm's capital structure as neutral.

90. To analyze a company's capital structure, we consider five subfactors:

- Diversity of the capital structure,
- Debt maturity profile (or schedule),
- Currency risk associated with debt,
- Interest rate risk associated with debt, and

- Investments.

91. In analyzing the diversity of the capital structure, we review the combination of debt and equity that forms an asset manager's capital and the degree of diversity within each of these two components. In analyzing diversity within debt, we review the number of different debt sources the company has, its access to different bank lines, and the number of banks providing those lines. In the analysis of equity, we consider whether the company is publicly traded and whether it has the ability to raise funds in public markets. We also look at the composition of equity (whether it includes common equity or any hybrid security, such as preferred equity). For any hybrid securities within an asset manager's capital structure, we apply "Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments," published April 1, 2013.

92. We believe that diversity of capital structure is especially important for asset managers because the somewhat higher confidence sensitivity of these firms relative to nonfinancial corporate entities may rapidly reduce funding flexibility in adverse market or economic conditions. It is favorable, in our view, for an asset manager not to rely on one or a few financial institutions to raise debt and to have access to public equity markets. We view diversity of capital structure negatively if a company is reliant on a single source (for example, one bank) to raise debt and is privately owned with limited access to additional equity.

93. In assessing debt maturity profile, currency risk, interest rate risk, and investments, our analysis uses the corporate methodology (see "Corporate Methodology").

94. Any of these subfactors can influence a firm's capital structure assessment, although some carry greater weight than others, based on a tiered approach:

- Tier one risk subfactors: Diversity of the capital structure, debt maturity profile, and currency risk associated with debt.
- Tier two risk subfactor: Interest rate risk associated with debt.

95. The initial capital structure assessment is based on the first four subfactors listed in paragraph 90 (see table 2). We may then adjust the initial assessment based on the fifth subfactor--investments--as per table 22 of the corporate methodology. (The investments assessment cannot exceed "positive.")

Table 2

Assessing Capital Structure

Preliminary capital structure assessment	Subfactor assessments
Neutral	No tier one subfactor is negative
Negative	One tier one subfactor is negative and the tier two subfactor is neutral
Very negative	Two or more tier one subfactors are negative; or only one tier one subfactor is negative but the tier two subfactor is also negative

96. In certain cases, when an asset manager has sizable investments (GP or seed investments in underlying funds, direct investments to portfolio companies, or nonstrategic financial investments) that exceed its outstanding gross funded debt (excluding operating lease or unfunded pension liability adjustment) by at least 50% on average in the last 12 months (50% excess over gross funded debt is used to reflect the liquidity discount of these investments at time of

liquidation), and we expect investments to remain at that level relative to gross funded debt over at least the next 12 months, we would assess the investments subfactor as "positive" (otherwise it will be assessed as "neutral"). A "very positive" assessment of the investment subfactor does not apply to asset managers. The positive assessment of the investments subfactor only applies to asset managers whose core ratio is debt to adjusted EBITDA (not debt to ATE) and the financial risk profile assessment is worse than (1) minimal. Furthermore, we can only assess the investments subfactor as positive if a company's financial policy, specifically related to financial discipline, supports the assessment that the potential proceeds would be used to pay down debt and all of the following apply:

- An estimated value can be ascribed to those investments;
- There is strong evidence that the investments could provide financial flexibility in the event they are monetized over an intermediate time frame;
- In the event of monetization, proceeds would be used to repay debt; and
- These proceeds would be material enough to improve existing cash flow and leverage ratios by at least one category.

97. As we analyze the investment portfolio of an asset manager, we also assess the market risk associated with those investments. Our assessment of market risk includes the manager's exposure to movements in interest rates, credit spreads, foreign exchange rates, commodity and equity prices, and any other market movements that could impair its earnings and ability to service debt. Investment portfolio market risk that produces a mismatch in cash flows, hinders profitability, or could cause a track record of losses precludes a positive assessment for investments. If the exposures are not large or hedges are in place, a positive assessment of investments is still possible despite the presence of market risk.

C. Financial Policy

98. In assessing financial policy for asset managers, our analysis uses the same methodology we use for corporate entities (see "Corporate Methodology").

D. Liquidity

99. Our liquidity analysis for asset managers applies the same methodology that we do for corporate entities (see "Corporate Methodology" and "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers").

E. Management And Governance

100. We assess management and governance for asset managers according to the same methodology we do for corporate entities (see "Corporate Methodology" and "Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers"). This excludes the sections that only apply to insurance enterprises (paragraphs 29-32).

F. Comparable Ratings Analysis

101. In assessing the comparable ratings analysis for asset managers, our analysis uses the same methodology we use for corporate entities (see "Corporate Methodology").

RELATED CRITERIA AND RESEARCH

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers , Nov. 13, 2012
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Superseded Criteria

- Equity Credit For Hybrid Securities Issued By Asset Managers, Nov. 13, 2006
- Rating Asset Management Companies, March 18, 2004

Partially Superseded Criteria

- Rating Private Equity Companies' Debt And Counterparty Obligations, March 11, 2008 (only parts that are relevant for alternative managers)
- Counterparty And Debt Rating Methodology For Alternative Investment Organizations: Hedge Funds, Sept. 12, 2006 (only parts that are relevant for alternative managers)

Related Research

- Global Asset Management 2014: Steering the Course to Growth, Boston Consulting Group

GLOSSARY

Assets under administration (AUA). Financial properties that are managed by a bank or financial institution on behalf of clients. AUA are beneficially owned by clients, and all investment decisions pertaining to these assets are also made by clients. Services offered by asset administration providers include custodial and tax-related duties.

Carried interest. Carried interest, or carry, is a share of the profits of an investment or investment fund that is paid to the investment manager in excess of the amount that the manager contributes to the partnership. As a practical matter, it is a form of performance fee that rewards the manager for enhancing performance typically in private equity strategies.

Incentive fees. Incentive fees are a form of performance fees that are typically related to funds where the underlying assets generate a coupon, such as mezzanine debt mostly found in hedge fund strategies.

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

Additional Contacts:
Ben T Bubeck, CFA, New York (1) 212-438-2176; ben.bubeck@standardandpoors.com
Tom G Connell, Toronto (1) 416-507-2501; thomas.connell@standardandpoors.com
Daniel Koelsch, FRM, Toronto (1) 416-507-2590; daniel.koelsch@standardandpoors.com

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