PEFINDO's approach to Investment Management Quality Rating

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Executive Summary

In a rapidly evolving capital market, investment managers' role has become increasingly crucial. Despite regulations designed to protect investor interests, the increasing number of investment cases preying on investors' limited understanding of investment risks highlights the investors' significant need for more comprehensive information regarding mutual fund risks. Additionally, investors must understand the profile and track record of investment managers.

PEFINDO Investment Management Quality Rating (MI Rating) reflects an investment manager's capability in managing its investment portfolio, particularly in the investment manager's investment framework, investment process, risk management practices, investment performances, also company's performance and client servicing. However, it is essential to note that MI ratings are not credit ratings. They do not assess the creditworthiness of the manager or the likelihood of debt repayment. Therefore, the MI rating is not comparable to general obligation or debt issuance ratings.

MI Rating can help investors make informed decisions by providing an overall assessment of an investment manager, not only focusing on the portfolio performance, but also other aspects rarely assessed, such as investment framework and risk management practices. While it does not necessarily replace the need for investors to learn about investment risks, PEFINDO's MI Rating provides an independent third-party assessment regarding the investment manager, serving as a valuable tool for investors to make decisions. This article elaborates on the investment manager industry landscape and how PEFINDO assesses an Investment Manager's capability and quality concerning fund management activities.

Investment Manager Landscape in Indonesia

Asset management industry has grown significantly to become an essential part of the nation's financial ecosystem. The industry has a robust growth, with a Compound Annual Growth Rate (CAGR) of 10.2% over the past decade. As of September 30, 2023, the total assets under management (AUM) in Indonesia reached IDR822.7 trillion or equal to 15.5% of Indonesia's GDP during the same period.

Several factors have contributed to the growth of AUM in the industry. Indonesia's consistent economic growth, projected at 5.0% in 2023, has led to an increase in wealth and disposable income, thus enabling more individuals to invest. This is compounded by the rapidly expanding middle class in Indonesia, with more individuals having disposable income to invest, contributing to the growth of AUM. Technological advancements, particularly the rise of digital platforms provided by the investment manager or fintech and bank as intermediary, also made it easier for people to invest, particularly on the open-end fund (mutual fund). These platforms have lowered the barriers to entry, allowing more people to participate in the investment process. These factors, combined with the demographic trends and growing middle class, have created a favorable environment for the growth of the asset management sector in Indonesia.

The Investment Manager (*Manajer Investasi* or MI, a company engaged in asset management business) shares a typical characteristic of the financial sector, consisting of many domestic and international players but controlled by only a few big ones. As of September 2023, 95 Mis were operating in Indonesia. However, the ten largest MIs commanded around 55.4% of the industry's assets under management (AUM). The big players are usually foreign companies and local companies affiliated with a large group. We expect this trend to remain in the future, as the big companies have advantages over the size of capital, business network, and a captive market.

Tabel 1. Top 10 Investment Managers in Indonesia as of September 2023
Mutual Fund only

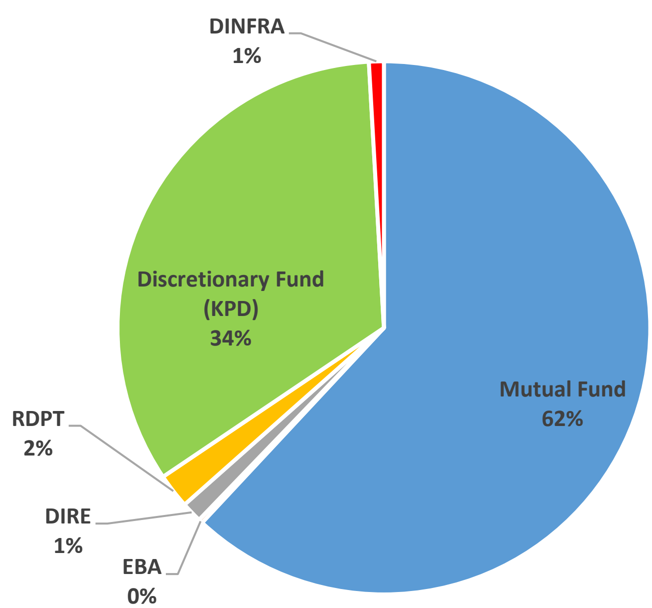
Rank	Fund Manager	Total AUM IDR bn	Market Share
1	Manulife Aset Manajemen Indonesia	45,820.3	9.0%
2	Bahana TCW Investment Management	45,530.2	8.9%
3	Trimegah Asset Management	32,415,7	6.4%
4	Syailendra Capital	31,295,2	6.1%
5	BNI Asset Management	29,575.3	5.8%
6	BRI Manajemen Investasi	28,602.8	5.6%
7	Batavia Prosperindo Aset Manajemen	28,146.1	5.5%
8	Sucorinvest Asset Management	27,111.0	5.3%
9	Mandiri Manajemen Investasi	26,105.4	5.1%
10	BNP Paribas Asset Management Indonesia	25,865.9	5.1%

Source: Bareksa and OJK, processed by PEFINDO

AUM by Product Classes

In Indonesia, AUM is typically classified into six products: Mutual Fund, Discretionary Fund (*Kontrak Pengelolaan Dana*/KPD), *Reksadana Penyertaan Terbatas* (RDPT), *Dana Investasi Real Estate* (DIRE), *Dana Investasi Infrastruktur* (DINFRA), and Asset Backed Securities (EBA).

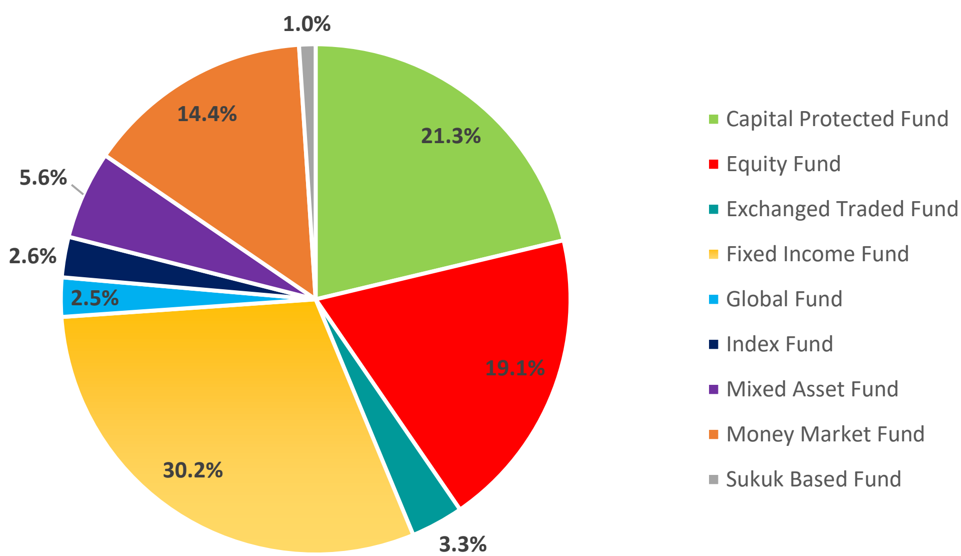
Graph 1. AUM Based on Product Type as of September 30, 2023



Source: OJK, processed by PEFINDO

Mutual funds are the most popular investment choice, accounting for 62% of the Industry's AUM. For investors with less time and expertise in managing their portfolio actively, mutual funds offer the service of a professional investment manager, including the benefit of portfolio diversification. Nevertheless, mutual funds still carry risks such as market risk (decreasing unit value), liquidity risk, and default risk. As of September 30, 2023, based on the asset class, mutual funds fall into some categories: Fixed Income Funds (30.2%), Capital Protected Funds (21.3%), Equity Funds (19.1%), Money Market Funds (14.4%), Mixed Asset Fund (5.6%), ETF (3.3%), Index Fund (2.6%), Global Fund (2.5%), and Sukuk Based Fund (1.0%). Each category has its investment focus and risk-return trade-off.

Graph 2. Mutual Fund Based on Asset Class as of September 30, 2023



Source: OJK, processed by PEFINDO

Indonesian investors predominantly invest in Fixed Income Funds and Capital Protected Funds due to their lower risk appetite and stability of capital. Fixed-Income Funds primarily invest in bonds and treasury bills, offering a steady income stream. These funds are preferred by investors who want stability of capital, prefer low level of risk investments, and are looking for higher returns than conventional bank deposits. Capital Protected Funds aim to preserve the initial capital invested, making them attractive to conservative investors. These funds aim to mitigate risks arising out of economic downturns by focusing predominantly on fixed-income securities and debt.

Kontrak Pengelolaan Dana (KPD), or Discretionary Fund, the second largest asset management product after Mutual Fund at 34% of the total AUM, is a significant part of the investment landscape in Indonesia since it caters to a specific investment objective of the investor. In a discretionary fund, the fund manager makes its investment decisions based on the investor's objectives and risk profile. The investor can be the individual, insurance company, or pension fund company. The regulations in KPD are also more flexible than those of mutual funds, considering that KPD investors are categorized as professional investors. Still, there are regulations that must be fulfilled, some of which are a minimum managed fund amount of IDR10 billion, the use of a custodian bank to house the instrument, and reporting of contracts to OJK.

Regulatory Framework for Investment Management

The regulatory framework governing the asset management industry in Indonesia has undergone some changes to accommodate growth and safeguard investor interests. The Indonesian Financial Services Authority (OJK) plays a pivotal role in establishing and enforcing regulations to ensure the industry's stability and transparency, with regulations as follows:

- POJK 24/04/2014: Guidelines for Implementing Investment Manager Functions
- POJK 23/04/2016: Mutual Funds in the Form of Collective Investment Contracts
- POJK 10/04/2018: Implementation of Investment Manager Governance
- POJK 17/04/2022: Investment Manager Code of Conduct

The most recent one is the POJK 17/04/2022, replacing POJK 43/POJK.04/2015 concerning the Investment Manager Code of Conduct, providing more details on the code of conduct for investment managers, particularly on risk management and stress test practices. This POJK emphasizes the best practices of liquidity risk management in investment management, which are recommended in the IOSCO Recommendations for Liquidity Risk Management for Collective Investment Schemes (FR01/2018). The IOSCO recommendations are designed to ensure liquidity sufficiency, including in stressed market conditions. These recommendations also contained the principles of liquidity risk management for collective investment schemes to serve as a practical guide for authorities and industry practitioners.

This regulation also enhances some guidelines related to working papers, gift acceptance, investment management activities, IT risk management (periodic audit), and fund fact sheet standardization. We view that the POJK 17/04/2022 represents a significant step forward in enhancing the governance of investment managers, improving liquidity risk management, and ultimately safeguarding the interests of investors.

PEFINDO's Approach to Assessing Investment Manager

PEFINDO's MI Rating Methodology aims to provide comprehensive information about investment risks associated with mutual fund products for investors to make better decisions. In addition, the methodology also reviews the profile and track record of the investment manager.

PEFINDO MI Rating reflects the investment manager's overall capability to manage the investment portfolio, measuring how effectively and efficiently an investment manager in its investment and operation activities. However, it is important to note that MI ratings are not credit ratings. They do not assess the creditworthiness of the manager or the likelihood of a debt repayment (MI is not allowed to issue debt). Therefore, they are not comparable to general obligation or debt issuance ratings.

Rating Scope

MI Rating Methodology is applicable to every investment manager (MI) operating in Indonesia. As the MI Rating assesses an MI's overall ability to manage investment funds, not focusing on the specific mutual fund products, the methodology application is not limited to the size or type of mutual funds in an MI's portfolio. Similar to regular corporate rating or general obligation rating, MI must have a sufficient track record of operation, generate revenue, and obtain an operating permit from OJK.

Rating and Definitions

The rating assesses several primary factors, consisting of in-depth reviews of several sub-factors. Each sub-factor has a certain weight, which will calculated to determine the final score value in the rating methodology. Furthermore, based on the total score value and the scorecard standards, we will evaluate the Investment Manager rating category, indicating MI's capability to manage the funds.

We categorize MI Rating into five categories, from superior to weak. The MI rating's assessment focuses on an MI's ability to manage its investment portfolio rather than the ability to fulfill its financial obligations. The MI's overall assessment is performed qualitatively and quantitatively, based on information obtained from clients directly and public information.

Table 1. MI Rating Categories and Definitions

Score	Rating Categories	Definition
>80	**Superior** ($_{id}$MIR-1)	The investment manager has **superior** fund management capability and quality.
66-80	**Very Strong** ($_{id}$MIR-2)	The investment manager has **very strong** fund management capability and quality.
51-65	**Strong** ($_{id}$MIR-3)	The investment manager has **strong** fund management capability and quality.
41-50	**Adequate** ($_{id}$MIR-4)	The investment manager has **adequate** fund management capability and quality.
0-40	**Weak** ($_{id}$MIR-5)	The investment manager has **weak** fund management capability and quality.

Summing up the scores proportionally will determine the characteristics of MI management between the categories Superior ($_{id}$MIR-1), Very Strong ($_{id}$MIR-2), Strong ($_{id}$MIR-3), Adequate ($_{id}$MIR-4), and Weak ($_{id}$MIR-5).

Main Factors

PEFINDO set four main factors as the criteria for assessing MI's capabilities, covering the entire process from the initial investment process regarding product creation, investment portfolio monitoring to the performance of the portfolio compared with benchmarks and peers, and the MI's quality of services to customers to maintain its competitive advantage. The four main factors and their respective weights are Investment Framework (40%), Implementation of Risk Management (30%), Track Record of Portfolio Performance (15%), Company Performance and Service to Clients (15%). Each factor and its sub-factors are then analyzed based on the available data and considerations.

Table 2. Main Factors and the Score Weight

PEFINDO Investment Management Quality Rating (MI Rating)			
Investment Framework (40%)	**Risk Management (30%)**	**Portfolio Performance (15%)**	**Company Performance and Client Servicing (15%)**

We give the most significant weight to the Investment Framework given that the investment process is the most fundamental and integral of the activities performed by an MI. However, apart from the process, we are also trying to increase awareness of the risk factors inherent in an MI, by giving a significant weight to the Risk Management factor at 30%. In this methodology, the risk management implementation is divided into two parts: risk management for investment portfolios and risk management for companies, including the governance and compliance aspects, and externally and internally established guidelines and regulations.

Factor 1. Investment Framework (40%)

This aspect asses the MI's ability to make appropriate and structured investment decisions, including the readiness of the required resources to execute the various investment processes. The investment framework, divided into several sub-factors, is the most fundamental factor in this methodology. It has the most significant weight (40%), as it highly influences the risk management implementation, and over time, the mutual fund portfolio performance and MI's reputation. This assessment comprises four sub-factors: Investment Process; Research and Analysis; Investment Team Profile and Quality; and Infrastructure and Operations.

Investment Process (10%)

Investment process assesses the investment decision-making process, including investment philosophy, which provides guidelines for investment objectives and sets the target to be achieved within a certain period. MI must maintain consistency between portfolio performance and company philosophy.

About the investment process, we will assess the investment plans and preparations used as the basis to make decisions, the role of the investment committee, the segregation of authority and responsibility within the investment team, and an analysis of the investment strategies implemented during that period. Analyzing the strategies may capture how the MI adjusts when facing macroeconomic changes in the industry and how the investment portfolio performs against predetermined projections.

In the instrument selection process to form the basis of the mutual funds, we also assess the analytical process done by the MI, including macroeconomic and industry analysis, issuer analysis, and purchases and sales execution timing. It is necessary to understand the assumptions and the measuring tools the MI uses to evaluate the portfolio performance. We also ask for supporting documents such as portfolio planning documents, attribution analysis, and records of periodic procedure updates.

Research and Analysis (10%)

This assessment covers research and analysis activities executed by equity and credit analysts, including if there is a specification or separation of functions between the two types of analysts, the existence of such research and analysis functions, or if there is a double function of research and analysis attached to the fund manager position. Analyst capacity may also determine how in-depth research activities can be carried out internally and in collaboration with external parties. Besides, analyst capacity may also indicate how active the MI is in its trading activities, whereas an active MI tends to prefer to develop vital research and analysis capabilities internally. In contrast, a passive MI may prefer maintaining only a sufficient team of analysts or diverting these functions to third parties.

The depth of the research and analysis process is also reflected in the usage of key ratios in measuring the level of risk, along with the use of assumptions and scenarios developed for stress testing. We will also assess the methods used to evaluate the value of instruments, such as stocks and bonds, and the consistency of application of those methods. In addition, document maintenance is also essential to record the progress of the analysis. We may request a copy of the research report and working papers to provide more detailed information in assessing the research and analysis process.

Infrastructure and Operational (10%)

It is an assessment of MI's technology infrastructure in terms of capacity, coverage, and level of automation of main activity processes. It is important for MI to have a high-quality IT system to maintain suitable operational activities. From assisting in the implementation of the investment process, to sending and executing orders, publishing analytical reports, and managing investment portfolios, IT systems play an important role in monitoring the required compliance level and smoothing the data reconciliation process.

Another consideration is the level of automation of the MI's IT system to evaluate whether the system still requires manual intervention in its operations. An integrated and fully automated system functions better and provides more detailed information regarding client preference data, such as cost information, research, marketing, investment banking transactions/fund placement, and global support, improving the quality of service provided. Conversely, if the IT system is not fully integrated and still requires manual intervention, it will be an additional burden for the back office to provide this information and will hamper the overall investment process.

Investment Profile and Quality (10%)

It is an assessment of the investment team's competencies, experience, roles, and responsibilities, including exposure to key employee risk. In addition to fulfilling the standard licensing and certification as required by OJK regulations, we will also assess the depth of the investment team personnel in terms of background, expertise, length of service, training, and work experience to determine the quality of the investment team. An evaluation of the turnover ratio of the investment team, including that of the head of the investment team, will be considered, as well as existing succession planning, to assess the stability of the investment team.

A service-oriented business environment exposes an MI to key employee risks, where the resignation of a key employee will likely result in a significant business shift. Established companies usually mitigate this risk by having a strong corporate culture and ready candidates to anticipate changes at the top level. Although change is inevitable in the long term, the availability of ready candidates to replace vacant positions will likely maintain product quality, level of knowledge, continuity, and relationships within the team.

The next aspect of the assessment is how the management supervises and monitors the team's performance. The availability of a clear definition of good or poor performance, adequacy of training, as well as career development for investment team members will play a significant role in maintaining employee retention and motivation levels.

Factor 2. Risk Management Implementation (30%)

It is an assessment of overall risk management implementation practices. It is crucial for an organization and its stakeholders to have an integrated, transparent, and independent risk management implementation. Not only will this ensure a consistent company performance, but also establish ways and methods to safeguard the business continuity from undesirable and detrimental events. Accordingly, we assign the second largest weight to Risk Management Implementation after the Investment Framework (40%). This assessment is divided into two parts: one is to assess portfolio risk, and the other is to evaluate company risk.

Portfolio Risk Assessment (15%)

This assessment is related to the one done for the Investment Process but focuses on risk monitoring, measurement aspects, and stress testing. In this section, we focus on how an MI monitors and measures risks related to its portfolio planning and decision-making processes and to establish and implement measurement methods to mitigate those risks. In assessing macroeconomic, industrial, and corporate analysis, we do not re-assess the whole process again (already incorporated in the Investment Process). Instead, we focus on the accepted level of risk and tolerance for the relevant portfolio, the available measurement methods to mitigate risk and make improvements, and how the measurement method is conducted and monitored.

Another part of the assessment is the liquidity risk and stress testing capability review. Considering the sudden nature of liquidity pressure, such liquidity risk must be monitored continuously. An MI must review its portfolio to determine how quickly it can be liquidated due to an urgent need. Despite regulatory restrictions on the maximum portion of a mutual fund portfolio that can be liquidated daily, an MI's inability to fulfill its clients’ requests may significantly impact its reputation, ultimately damaging its branding and competitiveness. We will also review how such liquidity risks are monitored and documented, and what types of systems are used, to see how quickly or slowly a portfolio can be liquidated without disrupting the price stability of the instruments in the market. Meanwhile, regarding stress testing capabilities, we will evaluate the scenarios used for macro events, the measuring tools available to measure the magnitude of the impact, and how the stress testing process influences the decision-making process for a portfolio.

The final part of the portfolio risk assessment is a review of the portfolio's consistency level against specified internal requirements. Each MI may have its unique preferences for its portfolio. Without an adequate risk management system, monitoring the portfolio's consistency in meeting these specified guidelines will be difficult. These guidelines are essential, because without them, MI may be tempted to exceed the appropriate risk level to achieve short-term targets. Policies of portfolio turnover ratio, tracking error, and ESG implementation are examples of an MI’s guidelines or preferences. While these matters may not directly affect portfolio performance, an MI's adherence to its guidelines can provide insight into the investment team's commitment to maintaining a good risk awareness culture.

Company Risk Assessment (15%)

It is an assessment of the risk, governance, and compliance framework for the company as a whole. The assessment reviews the management process of various risks, such as liquidity, market, credit, operational, interest rates, investment, reputation, and others. This review also addresses governance and compliance issues, and others such as conflicts of interest, proprietary trading policies, and affiliated party transactions. The evaluation also considers the documentation completeness of the risk monitoring process.

IT system governance, including policies for managing the Company's disaster recovery centers (DRC) and business continuity planning (BCP) capabilities, is necessary to anticipate potential operational disruptions. In addition to assessing the IT systems' capability, capacity, plans, and infrastructure (done in the Investment Process section), it is also essential to evaluate the contingency plans to prepare for business disruptions. The availability of a quality back-up system is vital to ensure the stability of daily transactions despite the possibility of technical problems. While rare, natural disasters (such as earthquakes, floods, and fires) or adverse events (such as terrorist attacks and sabotage) can cause significant disruption to business activities.

Compliance assessment focuses on meeting regulatory requirements, whether there are any breaches or violations, and the subsequent actions to correct the problems. We will compare the Company's governance and compliance policies with the market's best practices. The management of non-public information, know-your-customer (KYC) policies and their implementation, and the availability of standard reporting documents for breaches or violations are examples of some issues discussed in this assessment.

Factor 3. Portfolio Performance (15%)

It is an assessment of an MI's portfolio performance track record, as one of the benchmarks to measure the level of success and consistency of the investment and risk management processes during a specific period against the stated investment objectives. Poor performance relative to peers or reference benchmarks may indicate deficiencies or weaknesses in the MI's operations. Conversely, the same or better performance than peers or benchmarks can suggest a well-executed investment process, although this does not guarantee future performance.

We also assess MI's track record of portfolio performance based on various asset classes owned by MI, which may provide insight into the investment management process and investment results. Our assessment uses quantitative indicators of each product's return performance and volatility risk level. In addition, we also use qualitative indicators, such as the composition of investment instruments in the portfolio. If the instruments show abnormal performance, the abnormalities will also be taken into account in our assessment. For example, if the underlying asset shares are suspended or de-listed, this will be an additional calculation factor. Likewise, if the bond rating is downgraded to be below the investment grade rating, or defaulted, we will consider such a case in our assessment.

We also evaluate portfolio performance based on the contribution of a particular mutual fund or asset class to the overall MI portfolio. Usually, this is determined by comparing the AUM value of the fund against that of the portfolio. In comparing the portfolio performance against benchmarks and peers, we will also ensure the appropriateness of the benchmarks and peers. If a general benchmark (i.e. LQ 45) is not appropriate due to no available peers given the unique nature of the portfolio, we will choose the benchmarks and peers considered to be closest to the fund's characteristics for comparison.

AUM Growth, Stability, and Diversification (7.5%)

We assess the mutual funds' AUM growth during the review period based on indicators such as annual and quarterly AUM growth rate to evaluate the growth rate and the portfolio's level of stability, including its AUM redemption trend, to compare it to similar mutual fund portfolios. We also assess the AUM composition based on fund type (product, industry) to determine the portfolio's diversification level.

Return, Volatility, and Peers Comparison (7.5%)

We assess the track record of performance and returns based on the risk and return level, comparing it to a similar mutual fund portfolio. The evaluation uses performance data such as average excess return, Sharpe ratio, and Information ratio against peers and benchmarks for the last five years in each asset class.

Factor 4. Company Performance and Client Service (15%)

This aspect focuses on MI's market presence, franchise strength, and the stability and growth of assets under management (AUM). The Company's ability to diversify its client portfolio and low dependence on a few large clients can also support the stability of the Company's performance. We also observe the stability of MI's financial performance in an increasingly competitive and regulated market. The financial profile is vital for the Company's ability to capitalize on growth opportunities and maintain its competitiveness. Our financial analysis in this assessment focuses on the level and trend of the Company's revenue and profitability. We use historical data for the last five years to assess trends and stability.

Company Business Profile (5%)

We assess MI's market share, business position and strength, and competitive advantages. Assessing its position in the industry, we consider the Company's size of AUM compared to other MIs as an indicator. We also assess MI's ability to consistently maintain or strengthen its position, employ experienced and competent professionals, attract more clients, and retain and improve its reputation. The Company's business improvement strategy is also included in the assessment. In addition, we review the Company's diversification in terms of products and services and customer types (institutional vs retail) that could provide a more stable revenue stream given the industry's volatile nature.

Company Financial Profile (5%)

We assess the historical and future sustainability of the MI's earnings and financial performance, focusing on the level and trend of the Company's revenue and profitability for the last five years. A company's earnings trends can predict its overall business sustainability, and we also compare its growth stability to that of other companies. The client service component focuses on timeliness, transparency, and accessibility of market performance and reporting. In our view, MI's good and transparent client service is important to help investors make timely decisions.

Client Service (5%)

In assessing the client service, we review the extent to which investors can access reports in a timely and accurate manner. The main aspects are regularity of report updates, availability of information delivery channels, and transparency and consistency of report formats. PEFINDO will assign a superior score when the report is timely, highly accessible via multiple channels, and provides transparent summaries and detailed information. Conversely, a weak score will be given if there is a material weakness in the timeliness and accuracy of the report or if the report fails to meet investors' basic needs.