RATING METHODOLOGIES

Capital Market Institutions (CMI)

2025

1. TASSNIEF'S Capital Market Institutions Rating Methodology

1.1. Summary: A Simplified Sequential Approach

The rating methodology describes Tassnief's approach to assessing the entity ratings of Capital Market Institutions (CMIs) in the Kingdom of Saudi Arabia. The methodology gives an overview of key analytical factors and the weightage of each. A separate criteria and scorecard are also in place which are used by the rating analyst to arrive at the scorecard ratings during the rating process. The credit rating methodology has been developed for lenders of CMIs. Tassnief has in place a separate asset manager quality rating methodology which has been developed for investors in funds managed by asset management companies.

The CMI entity rating provides an assessment of an CMI's risk with four broad dimensions for arriving at the standalone ratings: (A) Business Risk (B) Financial Risk (C) Industry Risk (D) Qualitative Risk, with several sub-factors. During the ratings process, each area is evaluated, and all assessments are combined to determine the standalone rating. The evaluation criteria comprise a combination of both quantitative and qualitative factors.

- **Business Risk:** The business risk assessment factors in the CMI's market position, Assets Under Management (AUM), stability, growth and business diversity in terms of different business segments, AUMs and product offerings. The main purpose of this evaluation is to assess the stability and predictability of the CMI's revenues, earnings and cash flows, to determine sufficiency against current and expected obligations.

- **Financial Risk:** Financial risk analysis includes an evaluation of the company's current and future profitability, liquidity and capitalization indicators. This includes trends, level of revenues, operating & overall profitability, capital adequacy and liquidity buffers. The size of a company's proprietary book or principal investment segment, the level of income diversification from the same and inherent risk exposure and mitigants from the same, are also key rating considerations.

- **Industry Risk:** The assessment also includes an evaluation of the industry risk, covering the factors that impacts credit worthiness of all asset managers. These factors include strength of macroeconomic indicators, regulatory and legal environment, level of competitive intensity, barriers to entry, impact of technological disruptions, resilience to external shocks and extreme events.

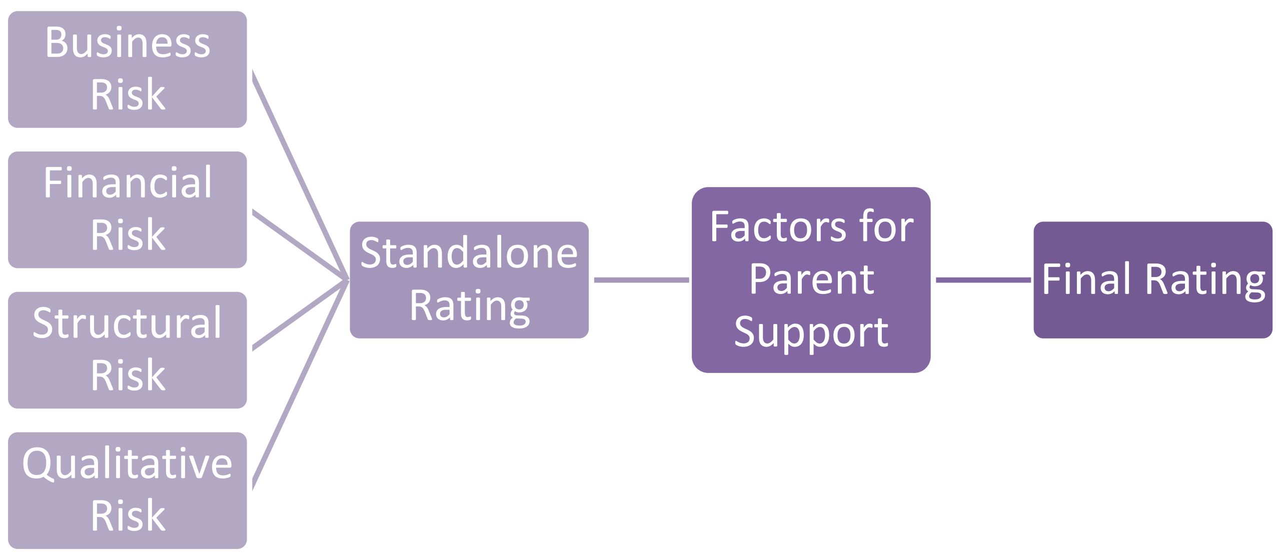
- **Qualitative Risk:** Qualitative risk factors assessment includes a review of the company's governance framework, risk management policies, regulatory compliance, internal controls, ESG considerations and quality of financial disclosures.

Sponsor support notching is applied on the standalone rating to arrive at the final rating. The sponsor support notching depends on the following factors:

- Financial profile of the parent entity
- Shareholding of the parent entity
- Linkages between the parent and subsidiary
- Past track record of support
- Difference in the credit rating of the parent entity and standalone profile of the subsidiary

Graphically, *figure 1* below summarizes the simplified sequential approach of Tassnief when it comes to rating Capital Market Institutions.

Figure 1. Summary of TASSNIEF'S sequential approach for capital market institution ratings



1.2. Standalone Rating of Capital Market Institutions (SR.A)

1.2.1. Definition and General Principles

The Standalone Rating of a Capital Market Institution (SR.A) reflects its intrinsic financial strength, which does not depend on any Parental External Support Factor. The SR.A stands as TASSNIEF'S opinion on a Capital Market Institution's capacity to face, alone, the drawbacks of the economic cycle, as well as internal and external shocks prone to affect it. The SR.A is the starting point of any credit analysis applicable to Capital Market Institutions. TASSNIEF will publish the SR.A of all the Capital Market Institutions that TASSNIEF will be asked to rate.

TASSNIEF determines the SR.A based on 14 **Standalone Rating Factors for Capital Market Institutions** (SRF.A), within 4 broader categories: (i) the **Business** SRF.A; (ii) the **Financial** SRF.A; (iii) the **Industry** SRF.A and (iv) the **Qualitative** SRF.A.

Each SRF.A (from SRF.C1 to SRF.C14) is subject to a **Weight** (W_n, n=1 to 14). The SR.A is the weighted sum of the 14 scores.

1.2.2. Weighting the Standalone Rating Factors for Capital Market Institutions (SRF.A)

The list and weighting of the 14 SRF.A in their four categories are reported on the table below:

SRF.A	Categories	Nature of risk factors	Acronyms	Weights (categories)
SRF.A1	BUSINESS SRF	Market share	MS	35%
SRF.A2		AUM profile	AP	
SRF.A3		Business diversity	BD	
SRF.A4	FINANCIAL SRF	Profitability	PR	35%
SRF.A5		Financial flexibility	FF	
SRF.A6		Liquidity	LQ	
SRF.A7	INDUSTRY SRF	Macroeconomic environment	ME	15%
SRF.A8		Operating environment	OE	
SRF.A9	QUALITATIVE SRF	Governance and management	GM	15%
SRF.A10		Risk management	RM	
SRF.A11		Regulatory compliance	RC	
SRF.A12		Internal controls	IC	
SRF.A13		ESG considerations	EC	
SRF.A14		Quality of financial disclosures	QF	

Mechanically, the sum of weighted scores leads to the Total Weighted Score (TWS). This TWS does not necessarily reflect the opinion of TASSNIEF'S Rating Committee as to the financial strength of the CMI. TASSNIEF's Rating Committee will exercise judgment which may allow deliberated deviation.

1.2.3. Definition of Standalone Rating Factors for Capital Market Institutions

The 14 Standalone Rating Factors for Capital Market Institutions (SRF.A) that TASSNIEF uses are summarized below:

(i) Business SRF.A: 35% weight

The business risk assessment has three sub-factors namely market position, business diversity, AUM & revenue profile. The rating of each sub-factor is based on a weighted average of the ratings of indicators for that sub-factor.

SRF.A1: Market Share (MS)

CMI's market share based on AUMs is a key rating factor. The market share in terms of revenues from asset management services is considered in relation to aggregate revenues from asset management activities of CMIs. This enables Tassnief to evaluate the strength of the CMI's franchise value and business model, in order to incorporate the impact of variation in management fees among CMIs.

Absolute level of AUMs in asset management is reviewed because scale provides resilience in market downturns, as well as operational leverage.

The aggregate revenue of the CMI is incorporated as higher the revenue, the better the business scale, diversification potential and loss absorption capacity.

Apart from asset management, Tassnief also reviews the market position of the CMI in associated areas including securities brokerage and investment banking.

For the brokerage segment, brokerage revenue in relation to total industry brokerage revenue is assessed. Dominance in revenue based market share, is indicative of strong client relationships, and sustainable competitive advantages.

The market share in brokerage based on volume is the percentage of total market trading volumes executed through the CMI. A high volumetric market share indicates market liquidity provision, operational efficiency and systemic importance.

The volumetric market shares of brokerage are also reviewed for institutional and retail segments. Institutional market share is assessed because institutional clients do larger trades and therefore contribute greater income on average and have stable relationships with the CMI. Retail market share is assessed because retail diversification reduces concentration risk.

The volumetric market share of brokerage are assessed for local and foreign segments. A high local market share indicates strong brand recognition and good regulatory relationships. International presence is assessed through foreign market share, which shows greater revenue diversification, reduced market concentration, and better sophistication in operations.

The market share in investment banking is determined by comparing the investment banking revenue of the CMI with the aggregate revenues of CMIs operating domestically. The investment banking market share reflects franchise value, quality of deal flow, and ability to generate higher margin income.

Additional factors

The market share in securities brokerage is also considered based on the value of shares traded, relative to the total value of shares traded in the domestic stock market. This allows for a more extensive view of the company's brokerage business.

To the extent that better fund performance is likely to translate to AUM resilience and growth, fund performance in terms of rankings against peer funds is a key factor. Here, institutional clients are as likely to focus on a disciplined and structured investment approach of the CMI, as they are to focus on the fund performance itself.

SRF.A2: AUM Profile (AP)

The AUM retention rate is calculated by subtracting the long-term redemptions and net distributions from the long-term AUMs at the beginning of the period. This gives us the net long-term AUM. Then, the annual AUM retention rate is calculated by dividing the net long-term AUM by the long-term AUM at the beginning of the period. Weighted average is determined by the equally weighting the average of the most period and average of three recent periods. This gives Tassnief a perspective into the strength of an CMIs franchise by understanding the relative stickiness of the AUMs. It allows for establishing the CMI's business resilience and its ability to withstand economic cycles.

Tassnief compares the AUM sales relative to redemptions in a given time period to determine the AUM replacement rate. Weighted average is determined by the equally weighting the average of the most period and average of three recent periods. This allows Tassnief to evaluate the ability of the CMI to regain AUMs that have reduced due to the redemptions.

Other factors

The rate of rise or decline in AUMs is compared to the industry. Tassnief also determines the percentage of starting AUMs that remained after accounting for client withdrawals and distributions.

Profile of AUMs, in terms of retail and corporate AUMs, is also reviewed. A CMI that has a sizeable retail investor base with the segment significantly contributing to the AUM mix is considered positively, given that retail AUMs tend to be stickier and more granular in nature.

SRF.A3: Business Diversity (BD)

The CMA provides five main licenses to CMIs in KSA, comprising Dealing, Managing, Arranging, Advising and Custody. The higher the number of licenses, the more diverse the range of activities that a CMI is allowed to undertake. This is taken as a key indicator of business diversity, which translates to resilience in economic downturns.

The CMI's revenue diversification in terms of revenue from asset management, securities brokerage and investment banking is checked to ascertain the segment diversity.

Tassnief also reviews the concentration of AUMs across corporate and retail client segments. Balancing retail and corporate AUMs enhances investor base stability and reduces concentration risk from large institutional mandates.

The performance and diversity of distribution channels are evaluated by looking at the number of distribution channels being used. Utilizing multiple distribution channels broadens client access and diversifies fund inflows, mitigating reliance on any single source.

The AUM diversity in terms of asset class is checked by looking at the AUM contribution of the single largest asset class. Diversifying AUMs across various asset classes lowers overall risk and improves return consistency by reducing sensitivity to specific market movements.

For securities brokerage, the share of retail compared to corporate clients is checked. A mix of retail and corporate brokerage clients provides more stable, diversified revenue streams compared to relying solely on institutional activity.

Tassnief also checks the number of local and foreign brokerage clients. Operating in both local and foreign brokerage markets expands client opportunities and hedges against risks specific to a single domestic economy.

Other factors

Key factors for assessing business diversity also include how spread out the investor base is (granularity) and how loyal those investors are (stickiness). Granularity refers to the proportion of everyday individual investors versus larger corporate investors. The level of investor concentration, meaning how much of the fund is held by a small number of investors, helps understand the stability or 'stickiness' of the investor base.

Besides brokerage revenues, diversity of revenues is also assessed in terms of other sub-segments, including asset custody, securities lending and margin financing.

Product/service diversity is also assessed. A diverse range of products and services helps firms sustain fee income and retain assets by enabling clients to switch investments rather than withdraw funds when specific strategies fall out of market favour.

For investment banking segment, diversity in income from debt and equity transactions, mergers and acquisitions, securitization etc. is considered positively.

(ii) Financial SRF.A: 35% weight

The financial risk assessment entails an analysis of the CMI's performance compared to predefined benchmarks. It covers both, a review of the financial indicators in absolute terms, as well as a comparison on relative basis against industry averages and peers. The assessment also takes into context the business risk profile of the CMI, particularly its ability to generate stable cash flows and how it can affect the financial profile.

SRF.A4: Profitability (PR)

Assessment of revenue and profitability is important because it indicates the CMI's ability to service outstanding obligations through cash flows. Historical trends and projections are analysed to form a view on the performance over the rating horizon. A track record of stable revenue growth improves an CMI's access to favourable capital markets, enabling better debt management and potential deleveraging across market cycles.

A key indicator reviewed for assessing profitability is operating profit (in absolute terms) and operating margin which is the operating profit in relation to revenue. A positive operating profit reflects sufficiency of recurring revenues to meet operating expenses. Some of the key drivers are AUMs (by impacting revenues and benefits of scale), fee structure and product/service mix on the revenue side. On the expenses side, the key components are compensation (salaries, bonuses for fund managers, and support staff salaries), technology and operational infrastructure, sales and marketing, regulatory and compliance. A larger CMI with high AUMs is able to distribute fixed costs across revenue in a better way and therefore benefits from economies of scale. Performance fees may in part be driven by the fund performance compared to benchmarks and therefore is less predictable.

The net profit in absolute terms and the profit before tax in relation to the revenue is also reviewed. The evaluation is done to account for the impact of proprietary investment and financing decisions (mainly leverage/debt levels impacting finance cost). This is crucial for understanding impact of capital structure on earnings and the CMI's capacity to build equity through retained earnings.

SRF.A5: Financial Flexibility (FF)

The financial policy of the CMI is evaluated to understand its financial flexibility. To evaluate an CMI's future risk, Tassnief examines its existing and forecasted debt obligations relative to the cash flows it generates annually. The operating profit is used as a proxy for cash flows. Emphasis is placed on the level of operating profit and its relation to the outstanding debt level, i.e. debt to operating profit.

The equity size is also considered in absolute terms to assess the CMI’s loss absorption capacity and capacity for investment and growth.

A key indicator is the debt to equity ratio, which is viewed in combination with the reasons for which debt is undertaken. Higher leverage is generally more risky and therefore viewed with caution. However, it could also translate to enhancement of shareholder value, if debt is undertaken for judicious reasons.

In context of regulatory compliance, the capital adequacy ratio (CAR) is also checked to ensure it is sufficiently above the minimum required level and provides sufficient cushion to fund future growth plans.

The equity size in relation to the size of the investment portfolio or proprietary book is also reviewed. This is assessed to evaluate the amount of risk that the equity of the CMI is exposed to with regards to the market performance of the investment portfolio.

SRF.A6: Liquidity (LQ)

Liquidity is a key consideration and is evaluated through a review of the various sources of liquidity available to an CMI. The absolute amount of liquid assets are compared to the liabilities, to ensure that the CMI has sufficient liquidity to service obligations and maintain cushion to absorb market volatility. In general, the liquid assets comprise cash held in the form of bank deposits, investments in sovereign instruments and listed securities such as stocks. A strong ratio indicates a good buffer to handle routine payments and unexpected cash needs, which is positive for credit quality.

The assessment also covers the CMI's reliance on, and remaining capacity under, its committed bank lines of credit. Low utilization suggests the CMI has ample backup liquidity available from its banks if internal cash flows are temporarily insufficient, which is indicative of financial flexibility.

In addition, the firm’s access to capital is evaluated by reviewing all financing facilities. Higher diversity of funding sources, allows the CMI to withstand liquidity shocks in a better way.

(iii) Industry SRF.A: 15% weight

The rating analysis covers the operating environment of the CMI. This mainly covers an assessment of the macroeconomic profile of KSA and the Saudi CMI sector. The assessment also includes an evaluation of the industry risk that covers the factors impacting credit worthiness of asset managers. These factors include strength of macroeconomic indicators, regulatory and legal environment, level of competitive intensity, barriers to entry, impact of technological disruptions, resilience to external shocks and extreme events.

<u>SRF.A7: Macroeconomic Environment (ME)</u>
The macroeconomic profile of KSA includes several advantageous factors that are embedded in the country's credit profile. These strengths include a large economy, a high GDP per capita, substantial hydrocarbon reserves with low extraction costs, a strong ability to absorb shocks due to a robust net asset position (net foreign assets represent over 50% of GDP), sizeable foreign currency reserves and high debt affordability (meaning that interest expenses are low relative to revenues) with easy access to funding. Going forward, real GDP growth is forecasted at around 2.5% while fiscal deficit is expected to remain manageable. Debt affordability is expected to remain high while debt to GDP is expected to remain around 30% despite significant investment being undertaken by public sector entities. Key assessment factors that are part of the macroeconomic assessment include size of the economy, GDP growth, fiscal buffers, external position, cushion in terms of reserves and debt affordability.

<u>SRF.A8: Operating Environment (OE)</u>
The assessment of operating environment mainly covers the rate of AUM growth in the CMI industry. Key drivers for future growth in terms of policy initiatives are also incorporated. It also covers the distribution of AUMs across the CMIs, to assess the market structure of the industry and level of competitive intensity. The distribution of AUMs in terms of asset class is also revised to assess the demand trends of the CMI industry. Key assessment factors that are part of the operating environment evaluation also include industry revenue cyclicality, growth prospects and diversification in business profile.

(iv) Qualitative SRF.A: 15% weight

Qualitative factors assessed include the CMI's governance, risk management, regulatory compliance, auditor relationship and financial policies.

<u>SRF.A9: Governance and Management (GM)</u>
Tassnief assesses the extent of independence and governance practices followed by the CMI. The analysis covers board composition, number of independent directors, their profile and experience in relevant fields. Oversight quality is assessed through review of minutes of board

meetings. The ownership structure is analysed to assess the ability of owners to support the business. Key person risk in management is assessed through presence of succession planning framework. Profile of senior management in terms of relevant experience and past track record are also assessed.

SRF.A10: Risk Management (RM)

A review regarding the adequacy and effectiveness of risk management policies is also done to ensure that the CMI is able to deal with operational and systemic risks. This assessment evaluates the soundness of the Enterprise Risk Management (ERM) framework, the types of risks covered (including operational, market, credit, liquidity and systemic risks) and the effectiveness of internal policies in place to limit risk exposure. Key considerations include adherence to limits, such as proprietary book to equity exposure, minimum capital adequacy over and above regulatory requirements and other quantitative controls. The financial policy of the CMI with regards to its leverage and dividend payout is assessed because it can impact the financial flexibility of the firm. A balanced and stable dividend payout history gives investors the confidence in the CMI and encourages them to contribute to the firm’s future capital requirements. However, very high dividend payout can also limit the CMI’s financial flexibility for debt repayment and investments for business growth.

SRF.A11: Regulatory Compliance (RC)

CMIs in KSA are primarily regulated by the Capital Markets Authority (CMA). The CMA plays an important role in ensuring that CMIs have the ability to grow while also complying with key rules and regulations. Tassnief evaluates the policies and manuals in place for key areas such as Know Your Customers (KYC), prevention of insider trading and front-running. The CMI’s relationship with the CMA is assessed through a review of regulatory compliance reports and audits conducted. The magnitude and nature of any penalties imposed are likely to have an impact on the assigned ratings. Existing or potential conflicts of interest are also identified.

SRF.A12: Internal Controls (IC)

Tassnief reviews the robustness and effectiveness of the CMI's internal systems and procedures designed to manage risks, ensure operational stability and efficiency, maintain compliance, safeguard assets and ensure the reliability of reporting. These are all crucial elements for the firm's overall quality and long-term viability.

SRF.A13: ESG Considerations (EC)

ESG considerations for CMI entity ratings assess the firm's exposure to environmental, social, and governance risks. The considerations also evaluate how effectively its strategy and investment processes integrate these factors into both its own operations and its stewardship activities for managed assets.

SRF.A14: Quality of Financial Disclosures (QF)

The relationship with the external auditor and their view on the quality of financial disclosures is a key rating factor. Compliance with the regulatory requirements for financial disclosures is checked, along with the extent to which the data reflects the economic reality of the CMI.

1.3. Parental External Support Factors (ESF.P)

A number of Capital Market Institutions that will require Tassnief's rating services will be subsidiaries of industrial or financial groups, which in turn will be rated either publicly or privately. Subsidiary Capital Market Institutions will be entitled, in many cases, to receive parental support, which can be made available to them in several forms: operating support, liquidity support and/or capital support, in particular. Therefore, these forms of support must be reflected in the Counterparty Rating of the subsidiary.

TASSNIEF's thus includes **Parental External Support Factors** (ESF.P) in CMI ratings, when deemed necessary. For TASSNIEF, the Counterparty Rating (CR) of the subsidiary CMI will be derived from the sum of SR.A and ESF.P:

CR = SR.A + ESF.P

ESF.P mainly depends on the degree of **Strategic Importance (I-Strat)** of the subsidiary to the parent. TASSNIEF distinguishes between 3 degrees of Strategic Importance: High, Medium, or Low.

1.4. The Case of Public-Sector Entities

Public-Sector Entities (PSE), also named **Government-Related Entities** (GREs), are defined as industrial, commercial or administrative corporations with public-sector shareholders. From the perspective of TASSNIEF, there are two sorts of GREs: i) GREs that have no public service mandate; and ii) GREs that have been given a public service mandate and/or even a policy role. GREs that behave like private-sector entities will be rated under the standard CMI Rating Methodology. On the contrary, GREs with a public service mandate and/or a policy role will be rated according to a specific approach that includes some methodological adjustments.

These adjustments have no impact on the SR.A of the GRE but only on the inclusion in the CR of External Support Factors. Because the GRE is owned at least partially by the state, directly or indirectly, TASSNIEF believes that standard support rules described in section 1.3 are not directly applicable to eligible GREs. Consequently, TASSNIEF applies other, less conservative, criteria for these GREs.

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