

Rating Criteria for Banks and Financial Institutions

Brickwork (BWR) rating process involves a comprehensive quantitative and qualitative analysis of the balance sheet strength of a Bank or FI, operating performance and business profile. This includes comparisons with peers and industry standards as well as assessments of operating plans, philosophy and management.

Brickwork's analysis integrates a review of the overall economy, financial sector and the industry. BWR also analyses the increased competition while considering the evolving regulatory framework. BWR's Risk assessment is based upon the analysis of both quantitative and qualitative factors. BWR adopts the CAMEL-TP model for the rating process. Quantitative factors such as Capital Adequacy Ratio, Asset size, Asset quality, Net Worth, Liquidity, Earnings quality and Profitability of the Banks and FIs and Qualitative factors like Business risk, Management quality, People and Operating environment are analyzed. The analysis also considers the market position of the Banks & FIs and comparison with the peers. Based on these parameters, the relative strength and weakness of each entity are evaluated.

Rating Factors

An analysis of the operating environment of the Banks & FIs includes both macro and micro factors, market factors, market position and financial flexibility. The methodology would mainly focus on evaluating the financial strength of the entity based on the entity's cash generation and debt servicing abilities. The analysis is carried out based on the past audited financials and the financial projections.

BWR uses CAMEL-TP model for the rating process:



- Capital Adequacy
- Asset Quality
- Management
- Earnings Quality
- Liquidity/ Asset Liability Management
- Technology
- People

The rating also considers ownership structure of Banks & FIs.

Capital Adequacy

Capital Adequacy is a measure of the financial strength of a Bank or FI in terms of its ability to withstand operational and abnormal losses. Further, considering the regulatory requirement on the minimum capital required to be maintained by Banks & FIs, Capital Adequacy Ratio (CAR) also indicates the ability of Banks and FIs to undertake additional business. Brickwork Ratings examines the adequacy of capital, both present and future, in light of the business and growth plan of the Banks & FIs, their ability to raise additional capital considering the current Tier 1 and Tier 2 capital adequacy, the extent of government holding in case of PSU Banks & FIs and also factors the likely change in the quality of assets and the resultant provisioning/ losses and the additional capital required, if any. The size of capital provides financial flexibility for Banks & FIs. It identifies which financing options are available for the entity. The size of capital determines the ability of Banks & FIs to withstand the changing economic / competitive environment.

Asset Quality

The asset quality reflects the composition and productivity of the assets. Asset quality has a direct impact on the financial performance of a Bank or Financial institution. The asset quality is evaluated by understanding the performance of assets category wise by way of measuring the GNPA / NNPA. The experience of the Banks or Financial Institutions with respect to loan loss, provisions/ write off, loan recovery rate, ability to reduce NPAs and extent of weak assets are also factored.

Management Quality

The quality of the management will determine the success of a Bank or Financial institution. The performance of a Bank or FI is largely dependent on the vision, competence and integrity and risk appetite of the management. The analysis of the quality of management is based on the experience of the management and their track record in terms of their vision and competence in running the Banks & FIs. The analysis of the management also factors in the overall corporate governance standards in the Bank/ FI. The risk appetite in terms of the exposure to various categories of assets, adoption of technology and responsiveness to competition and growth strategy impacts the performance of a Bank/FI and this is considered during the analysis for rating.

Earnings Quality

The quality of earnings of a Bank or Financial institution determines the ability of the entity to meet debt obligations, loan book growth and reserves. BWR factors the composition between fee based and fund based activities. The quality of earning coupled with the costs impacts the profitability. Brickwork analyses track record of the profits, profit margins, growth rate of earnings and components of income and expenses of a Bank/FI.

Liquidity / Asset Liability Management

The quality of earnings is also affected by the extent of asset liability mismatch and the resultant volatility in earnings due to changes in the interest rate. A Bank or Financial institution has to be sufficiently liquid to meet payment obligations to depositors and creditors. This calls for sound Asset Liability Management by the Banks & FIs. Liquidity analysis considers the ability of the Banks & FIs to meet their obligations and is very critical for a Bank or FI to remain as a going concern. The absence of liquidity can lead to failure of a Bank or FI. Brickwork examines the mismatch in tenor of the Banks' or FI's assets and liabilities. Brickwork identifies the risk of concentration of the funds, liability structure and future cash flow projections. The extent of deposits, especially the low cost CASA, and the resultant dependence of a Bank or FI on market borrowings impacts the liquidity and also the profitability of a Bank or Financial Institution.

Technology

The technology deployed in a Bank or Financial institution affects its operational efficiency and determines its competitive position in the market. It must be comparable with the industry standards. Brickwork analyses the level of Information Technology and its integration within the departments of the Bank or Financial institution. Brickwork constantly monitors the endeavours of the Bank & FI for constant upgradation of the technology with industry standards and its competitors.

People

The people in a Bank or Financial institution are the most valuable resources and the major driving force for successes and failures. The quality of human resources employed by a Bank or FI affects its performance. BWR analyses the recruitment process and training standards of the Bank or Financial institution, which reflects the quality of the people in the organization.

Government Support

In addition to the above, Brickwork also factors in the Government support for Banks & FIs in general and the Government owned public sector Banks & FIs in particular. This is because Banks & FIs In India act as a vehicle to fulfill the economic needs, social requirements and obligations of the Government. BWR believes that Government support plays a crucial role in case of Banks & FIs and this is duly factored in by Brickwork in its analysis. Also, the extent of ownership affects the capital raising ability of a PSU Bank or Financial institution in the future.

Risk Management & Adherence to Basel Norms

BWR considers factors related to adoption of risk management practices and adherence to Basel norms.

Disclaimer:

It must be clearly understood that a Rating opinion is based on various factors/aspects which includes application of certain Rating criteria. The particular criteria applied depends on a number of factors, inter alia, sector/Industry, historical performance, cyclical trends, prevailing economic condition, group support etc. Rating opinions factor many assumptions and the application of any particular criteria or a set of criteria may be full or partial depending upon peculiarity of each case. Application of any Rating criteria should not therefore be considered as rendering finality or completeness to a Rating assessment. A reference to criteria needs to be perceived in broad terms, only as an aid to a rating decision.