# Rating Criteria for Securities and Broking Firms

These criteria apply to firms engaged in the trading and underwriting of securities and those providing brokerage services in the financial services space. Specifically, primary dealers, brokerages and securities investment firms qualify under this category. Securities firms act as agents in the investment space. They provide fund-based services such as underwriting and trading in government securities and corporate debt, margin lending against these securities and fee-based services such as equity and debt broking and placement, asset management and advisory.

Securities firms primarily are exposed to market risks since they hold securities largely for short durations, although they are also exposed to credit risks during this period. They also face large operational risks, especially in their brokerage business. Their credit risk profile is assessed using the following key parameters:

## Business Risk

Business risks and process of managing the same are both complicated in securities firms. While market position is important in any financial institution, it carries a whole different meaning for securities firms. Moreover, risk management requires complex models and systems even for small entities in this business, and regulatory compliances can be onerous.

## Market Position

Brokerages depend on garnering market share to not only increase their revenues, but also be able to invest in building other businesses to increase their offerings to get a larger share of the customer wallet. A larger market share also helps them build better research and advisory capabilities needed to attract high-net-worth individuals and also a share of the large institutional funds. The market share by segment is assessed, along with the number of branches, franchisees, active clients, and so on.

## Diversity in Operations

Growth beyond a certain size, and attracting large corporates and funds requires securities firms to offer a wide variety of business segments, viz., broking, distribution, investment banking and trading, and also a good spread of products, viz., brokerage accounts, margin funding, IPO funding, distribution, book building and underwriting.

## Risk Management and Regulatory Compliance

Given the myriad of risks that securities firms face in their different lines of businesses, an evaluation of the policies, models and processes adopted by the entity are analysed. Some of the key risks that need assessment and management at securities firms are market risks in investments, measuring VaR and interest rate sensitivity, trading limits for proprietary trades, margining and haircut policies for margin lending, and operational risks in brokerage accounts. The regulatory compliances for securities firms are also complex and need comprehensive risk management tools and MIS to meet the necessary compliances. The state of preparedness of the entity to meet the above requirements is assessed.

## Financial Risk

Financial risk for securities firms is assessed based on their capital/leverage, profitability/ return metrices and liquidity for short-term requirements.

## Capitalisation

The gearing of the entity, any commitment by the management to cap the gearing over time and flexibility of the entity to raise capital; the requirement for capital is higher for entities that have larger proprietary positions.

## Earnings

The earnings of securities firms are volatile and are dependent on the performance of the markets. Diversity in businesses and product offerings is used by entities to smoothen the earnings. In addition, an assessment of the quality of earnings is done. Entities that have higher earnings from proprietary trading are vulnerable to losses during a market underperformance.

## Liquidity

Liquidity maintained through liquid assets and unutilized limits available for any short-term requirements is important for trading entities.

## Management

Management strategies on growth, business segments and products, risk appetite for proprietary trading, competency related to risk management, systems and models implemented are evaluated to assess the management's ability to run the entity.

These criteria outline the methodology to arrive at the standalone rating of a securities firm. The rating further considers any support that the entity can get from its parent or group or can be expected to provide to other entities in its group. In such cases, the standalone rating of the entity gets notched-up, and the extent of the notch-up is driven by BWR's criteria for notching-up the standalone ratings of entities based on parent/group/government support, which can be found on the BWR website.

**About Brickwork Ratings**: Brickwork Ratings (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by Reserve Bank of India [RBI], offers credit ratings of Bank Loan, Non-convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. BWR has rated over 11,400 medium and large corporates and financial institutions' instruments. BWR has also rated NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations. BWR has Canara Bank, a leading public sector bank, as one of the promoters and strategic partner. BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations.

**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.

Brickwork Ratings India Pvt. Ltd. (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by the Reserve Bank of India [RBI], offers credit ratings of Bank Loan facilities, Non-convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. [hereafter referred to as "Instruments"]. BWR also rates NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations.

BWR wishes to inform all persons who may come across Rating Rationales and Rating Reports provided by BWR that the ratings assigned by BWR are based on information obtained from the issuer of the instrument and other reliable sources, which in BWR's best judgement are considered reliable. The Rating Rationale / Rating Report & other rating communications are intended for the jurisdiction of India only. The reports should not be the sole or primary basis for any investment decision within the meaning of any law or regulation (including the laws and regulations applicable in Europe and also the USA).

BWR also wishes to inform that access or use of the said documents does not create a client relationship between the user and BWR.

The ratings assigned by BWR are only an expression of BWR's opinion on the entity / instrument and should not in any manner be construed as being a recommendation to either, purchase, hold or sell the instrument.

BWR also wishes to abundantly clarify that these ratings are not to be considered as an investment advice in any jurisdiction nor are they to be used as a basis for or as an alternative to independent financial advice and judgement obtained from the user's financial advisors. BWR shall not be liable to any losses incurred by the users of these Rating Rationales, Rating Reports or its contents. BWR reserves the right to vary, modify, suspend or withdraw the ratings at any time without assigning reasons for the same.

BWR's ratings reflect BWR's opinion on the day the ratings are published and are not reflective of factual circumstances that may have arisen on a later date. BWR is not obliged to update its opinion based on any public notification, in any form or format although BWR may disseminate its opinion and analysis when deemed fit.

Neither BWR nor its affiliates, third party providers, as well as the directors, officers, shareholders, employees or agents (collectively, "**BWR Party**") guarantee the accuracy, completeness or adequacy of the Ratings, and no BWR Party shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of the Rating Rationales or Rating Reports. Each BWR Party disclaims all express or implied warranties, including, but not limited to, any warranties of merchantability, suitability or fitness for a particular purpose or use. In no event shall any BWR Party be liable to any one for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Rating Rationales and/or Rating Reports even if advised of the possibility of such damages. However, BWR or its associates may have other commercial transactions with the company/entity. BWR and its affiliates do not act as a fiduciary.

BWR keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of the respective activity. As a result, certain business units of BWR may have information that is not available to other BWR business units. BWR has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

BWR clarifies that it may have been paid a fee by the issuers or underwriters of the instruments, facilities, securities etc., or from obligors. BWR's public ratings and analysis are made available on its web site, www.brickworkratings.com. More detailed information may be provided for a fee. BWR's rating criteria are also generally made available without charge on BWR's website.

This disclaimer forms an integral part of the Ratings Rationales / Rating Reports or other press releases, advisories, communications issued by BWR and circulation of the ratings without this disclaimer is prohibited.

BWR is bound by the Code of Conduct for Credit Rating Agencies issued by the Securities and Exchange Board of India and is governed by the applicable regulations issued by the Securities and Exchange Board of India as amended from time to time.