



Non-Banking Financial Institutions (NBFIs) Rating Criteria Methodology

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Summary

LRA's methodology documents lay out the umbrella frameworks guiding its credit ratings. This document provides an overview of LRA's approach to assigning credit ratings to Non-Banking Financial Institutions (NBFIs). LRA arrives at this opinion by conducting a detailed evaluation of several qualitative and quantitative factors, namely: i) Profile, ii) Ownership, iii) Governance, iv) Management, v) Business Risk, and vi) Financial Risk. The relative importance of each of these qualitative and quantitative criteria can vary across NBFIs depending on their potential to change the overall risk profile. While standalone credit quality is addressed, LRA incorporates the relative positioning of an NBFI to arrive at the final credit rating.

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1. Introduction

1.1 Scope: In Sri Lanka, the Non-Banking Financial Institution (NBFI) sector encompasses Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs), regulated by the Finance Business Act, No. 42 of 2011, and the Finance Leasing Act, No. 56 of 2016.

- LFCs offer a range of products such as leasing, vehicle loans, SME and Microfinance loans, and gold loans, primarily funded through public deposits.
- SLCs focus exclusively on leasing services and do not accept deposits, instead relying on equity and debt instruments for funding.

NBFIs play a crucial role in providing financial services to customer segments that struggle to secure funding from traditional banks due to stringent requirements and documentation issues, thereby promoting financial inclusion.

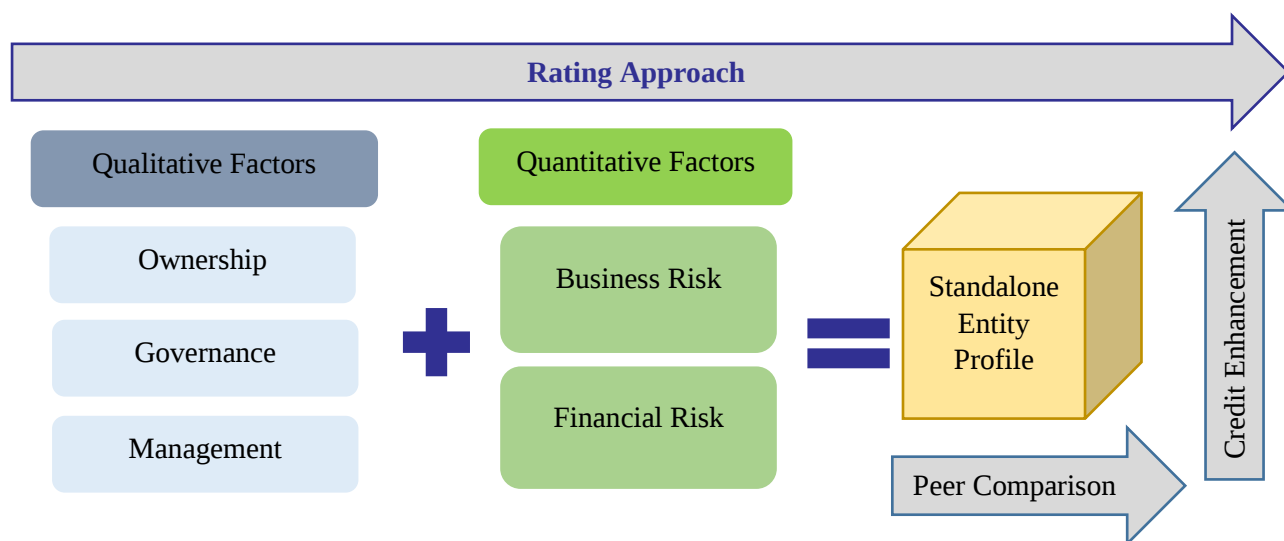
This methodology applies to finance & leasing companies. Modarabas, which share similar risk factors with other NBFIs, are also covered by this approach.

LRA caters to Licensed Microfinance Companies (LMFCs) and Microfinance Non-Governmental Organizations (Microfinance NGO) and Collective Investment Schemes with their own methodologies as the Microfinance Institution Rating methodology and the Stability Rating methodology respectively.

1.1.1 The services that an NBFI can offer are accepting deposits, granting lease facilities, hire purchase, term loans, personal loans, micro loans, pawning etc. A finance company which provides many products has a greater ability to diversify its operations. However, the added related risks must be managed accordingly.

1.2 Rating Framework: LRA bases its analysis of NBFIs on a number of quantitative and qualitative factors. Overall factors are categorized under six key areas: i) Profile, ii) Ownership, iii) Governance, iv) Management, v) Business Risk, and vi) Financial Risk. No single factor has an overriding importance or is considered in isolation, and all factors are reviewed in conjunction. Quantitative factors help in achieving objectivity in the rating process while the qualitative side helps in establishing the sustainability of the relevant factors in the foreseeable future. Neither all factors can be quantified, nor do quantitative values portray the whole story. LRA, therefore, seeks to employ a best combination of both to ensure comparability between ratings over time.

1.2.1 While LRA's rating process does not include an audit of an NBFI's financial statements, it does examine the control environment to establish extent to which the financial statements accurately reflect an NBFI's financial performance and balance sheet integrity. LRA makes adjustments where necessary to make an NBFI's financial data comparable to those of its peers. In order to carry out adequate analysis of a particular NBFI, it is helpful to establish a "peer group" of comparable NBFIs. Only long-term ratings are assigned in Sri Lanka.



2. Profile

2.1 Background: LRA reviews the background of an NBFI to understand its evolution from where it started to where it currently stands. LRA analyzes how and through what means the NBFI has achieved the desired expansion. LRA looks at the progress of the NBFI from its historical past which helps determine the ability of the NBFI to successfully realize its strategy. The significant factor here for LRA is to assess whether the NBFI has achieved the desired expansion through organic growth or acquisitions. Meanwhile, the source of funding for desired growth is also critical.

2.2 Operations: The assessment of operations of an NBFI depends on the exposure of business segments and the stage the business is in. Here LRA reviews the diversity, geographic spread of operations, product offering, asset mix, borrower profile, size of the franchise/portfolio, and track record of operations. Size may be an important factor if it confers major advantages in terms of operating efficiency and competitive position. Unlike their banking brethren, NBFIs are often subject to less formal regulations.

3. Qualitative Factors

3.1 Qualitative assessment helps in establishing the sustainability of the credit rating in the foreseeable future. Qualitative considerations here refer to rating factors which do not pertain to an entity's business or financial risk. Rather, they focus more on internal processes, people, and systems; thus, it is essential to incorporate a forward-looking perspective into rating opinions. This section is meant to provide a brief overview of how LRA generally factors qualitative considerations into its assessment, insofar as they can impact an issuer's ability to meet financial obligations.

3.2 Incorporating the potential impact of qualitative considerations into the rating opinion can be challenging because it is generally inferred or estimated based on information which may not be standardized and is difficult to quantify. This often requires some degree of subjectivity and analyst judgement, supplemented by LRA's own experience, and the experience of the underlying entity or other entities with similar risks. Three factors underlying LRA's qualitative analysis at entity level include: Ownership, Governance and Management. The scope of analysis for each category is briefly described below.

3.3 Ownership: This section provides an overview of the risks pertaining to the structure and stability of the entity's ownership structure, owners' experience and prowess in the entity's industry, and willingness and ability to extend extraordinary financial support in distressful circumstances. In case of newly established or small financial institutions where capitalization requirements are yet to be met, LRA critically analyses the willingness and ability of the sponsors to support the institution to comply with the applicable regulatory requirements within required timeframes.

3.4 Governance: This section provides an overview of the risks pertaining to the Board of Director's role in establishing a robust oversight and control framework to ensure appropriate management oversight, alignment between shareholder and management objectives, transparency in reporting and disclosures, and adherence to applicable regulatory requirements.

3.5 Management: This section provides an overview of the risks pertaining to the management team's proficiency in executing strategy, maintaining strong information systems and utilizing them for efficient decision making, and ensuring adherence to the entity's ethical and quality standards.

3.5.1 Risk Management Framework/Control Environment: This includes an analysis of the NBFI's appetite for risk and the systems in place to manage these risks. LRA examines the independence and effectiveness of the risk management function, the procedures and limits that have been implemented, the limits setting authority, and the degree to which these procedures are adhered to. LRA endeavors to assess an NBFI's senior management's understanding of, and involvement in, risk management issues and examine the reporting lines in place. In recent years, there has been a noticeable upgradation in the risk management systems of the NBFI in the face of increasing guidance and supervision from the Department of Supervision of Non-Banking Financial Institutions.

Credit Risk

- Asset quality Indicators: Primary tool to assess the level of risk being taken.
- These indicators are viewed in the context of returns achieved
- Credit risk management is assessed to determine how the risk return equation evolve in different phases of financial institutions business cycle.

Market Risk

- Asset and liabilities management strategy is reviewed.
- Board and management policy limits, typically expressed as earnings at risk, are evaluated along with reports from management systems.
- Market risk on its own may not be a rating driver. However, poor market risk management or aggressive market risk-taking without mitigants would likely pressurize an institution's ratings.

Operational Risk

- Operational Risk analysis include,
- Financial institution's definition of such risk,
- The quality of its organizational structure,
- Operational risk culture,
- Approach to the identification and assessment of key risks
- Data collection efforts, and
- Overall approach to operational risk quantification and management.

Reputational and other Risks

- May emanate from operational problems or failure in any risk management systems
- Results in withdrawal of deposits in case of strain on reputation.
- Difficult to evaluate but could adversely affect an institution's rating in cases where it is significant.
- Any regulatory non-compliance may lead to potential legal ramifications as well.

4. Business Risk

4.1 Industry Dynamics: The process for anchoring a credit rating of an NBFIs builds on LRA's understanding of the industry dynamics of specific segments that the NBFIs is operating in. This understanding, which follows an in-depth research approach, is documented as a sector study. The analysis captures the placement of the local industry in the international context to see the points of identity and distinction. In points of identity, the risks and challenges identified for the international players are re-evaluated for the local players, with a view to see whether the local players have established effective mitigants against those risks and taken due measures to meet the challenges. At the same time, LRA identify the risks and challenges specific to the local context of the industry. While conducting the analysis, LRA takes a view on the industry alone, independent of the market players. This exercise helps to form a view on the industry's significance in the economic environment of the country, the regulatory environment, and the likely support, if needed.

4.1.1 LRA explores the possible risks and opportunities for an NBFIs that result from social, demographic, regulatory, and technological changes, including any interplay those forces have among each other. Case in point, regulatory impositions in regard to digital financial services offered by NBFIs. Moreover, it considers the effects of geographical diversification and trends in industry expansion or consolidation required to maintain a competitive position. The analysis includes the role of the supervisory authority, its supervision of regulated entities, reporting requirements, and regulations relating to specific types of institutions and to specific financial products.

4.1.2 Economic Risk: LRA analyzes basic economic indicators of the country including size and composition of economy, performance of important sectors, gross domestic product (GDP) growth, inflation, saving & investment trends, and potential demand for credit. An important part of the economic analysis is the positioning of the industry and impact assessment of economic risk factors on the industry.

4.1.3 Regulatory Environment: A well-regulated and supervised system is pivotal for credibility and stability of NBFIs even when the operating environment may become unfavorable. LRA's evaluation of the regulatory system involves evaluation of criterion related to capital and other countercyclical measures to absorb risk and the extent of regulatory supervision and changes in response to the macro environment and prospective regulatory changes.

4.2 Relative Position: Relative position reflects the standing of the NBFIs in the related market. The stronger this standing is, the stronger is the NBFIs's ability to sustain pressures on its business volumes and profit margins. The standing takes support from three major factors, which are: i) market share, ii) growth trends, and iii) franchise/brand value.

4.2.1 Market Share: Market share represents the NBFIs's penetration in the chosen market. Market share is advantageous as it provides the ability to acquire larger business, pricing power, and better expense management. There is a positive correlation between an NBFIs's absolute and relative size, and its market position and brand value. The large entities exercise greater power over the pricing, while ensuring commensurate profits. Small entities struggle to obtain business; and with less flexibility in their cost structure, profits remain low. While absolute size is important, it is basically the relative proportion which provides a clear yardstick to analyze the comparative strength of the market players. The more distant a player is from the average on the positive side, the stronger is its ability to reflect the characteristics just mentioned. In a dynamic industry,

which is not characterized by concentration, LRA believes that relative size would better capture the strength of the NBFI's standing in the related market.

4.2.2 Growth Trend: While evaluating the size, LRA looks at the rate of growth. Growth is important as it ensures that the NBFI continues to have the ability to meet the industry's benchmarks. As the industry grows, it uplifts the scale of its operational context. This reflects in the ability of the players to invest in human resources, upgrade the control environment, enhance the product slate, increase the outreach and improve the quality of product/service. To lag the industry's growth trend means to remain short on these avenues, putting pressure on the market position.

4.2.3 Franchise/Brand Value: The strength of a franchise determines its capacity to grow while maintaining a reasonable cost-to-income ratio and profitability, thus providing resilience to earnings. LRA evaluates the franchise strength in terms of scale of operations and market share for various activities, performance and strengths relative to competition, complexity of key segments, diversification across various performance metrics such as branches, advances, liabilities, sources of other income etc., and access to special Government support or privileges - if it exists. A strong franchise is expected to result in a granular asset and liability base. LRA also considers the brand recognition and life of the NBFI for its franchise strength analysis.

4.3 Revenues: In most NBFIs, interest income is largely skewed towards income from advances. An NBFI's core revenues emanate from: i) interest or profit on advances, ii) interest or profit on fixed income investment or government securities, and iii) dividends or gains (both realized and unrealized) on investments. NBFIs vary across asset segments, namely vehicle finance, equipment finance, running finance, mortgage loans, and microfinance. LRA forms an opinion on product riskiness by evaluating prevailing operating environment, historical and recent trends, granularity, and strength of the loan security. In measuring revenue quality of an NBFI, diversification and stability are very important factors. An NBFI with a diverse product slate with more than one revenue stream is considered better than an NBFI with a concentrated earning profile. LRA sees concentration at product, customer, and geographic levels. In addition, the analysis of target markets to which an NBFI serves forms a part of the assessment. Stability is measured through historical trend analysis of the NBFI's revenues and is considered critical for sustainability of the NBFI. LRA also assesses the NBFI's ability to generate income from other sources including fees, commission, and advisory, among other services. NBFIs that rely more on generating income from risky business lines like trading activities will typically display more volatile revenue trends.

4.3.1 Diversification: Diversification is desirable since it enhances an entity's ability to meet present and upcoming challenges. Lack of diversification gives rise to concentration risk, reflecting vulnerability of the NBFI to few elements. At the same time, diversification reduced the risk of disruption in the area of revenue concentration. This does not entail that an entity specializing in a certain product/segment would necessarily be at a disadvantage. The disadvantage would only arise if the institution's business gives rise to concentration risk. At the same time, diversification into riskier segments may not improve resilience and, therefore, may not translate into superior ratings. In assessing diversification, common factors include loan mix, portfolio granularity, sectoral mix, share of domestic and overseas exposure, and borrower profile. Meanwhile, diverse geographical presence bolsters competitive position as it could offset the credit risks arising from unfavorable regional developments.

4.3.2 Non-Mark-Up Income: Non-interest income from fees, service charges, commissions, and foreign exchange income may also be an important source of revenue. LRA views earnings profiles comprised primarily

of interest income favorably given the relative stability of this income stream. However, PACRA also assesses the NBFI's ability to complement its interest income with fee income. A large fee income allows greater diversification which can improve NBFI's resilience of earnings and earning profile.

4.4 Cost Structure: Cost structure is analyzed for the amount of flexibility provided when market conditions are less favorable. In this regard, LRA considers how much of the cost base is variable. LRA also evaluates the NBFI's performance ratios relative to those of its peers to understand whether costs have been contained while assets and revenue grew. If expense ratios are high, it could be an indicator that the NBFI has a significant fixed cost burden. In this context, key measure that LRA looks at is the (Non-Mark-Up Expenses/Total Income) ratio. Whereas, Non-markup expenses comprise of i) Personnel expenses, ii) Other Non-Interest expenses (including Legal & Professional Charges and Rent, Taxes, Insurance etc.). Performance measures are not assessed in isolation as there may be variations that are caused by business model differences and the importance of ongoing investment in the NBFI's franchise. A low-cost base relative to peers offers the NBFI greater flexibility to deal with competitive pricing pressures.

4.4.1 Performance: While evaluating the NBFI's ability to convert its earnings into profits, efficiency ratios such as cost-to-total net revenue, are considered. The drag of provisioning expense is incorporated to see the level of pre-tax profitability for the current as well as future periods. Where necessary in its ratings analysis, LRA makes adjustments to the NBFI's reported income statement figures, so that financial performance indicators are comparable across similar entities. The future profitability of an NBFI is evaluated by analyzing its interest spreads (yields minus cost of funds) and its interest rate risk as both could impact profitability. LRA analyses NBFI's assets and its performance through business cycles. Either higher dependence on one asset segment, or high share of unsecured lending to borrowers with limited credit history is considered risky as any unforeseen changes in business or operating environment could impact on the earnings performance.

4.5 Event Risk: Incorporating the risk of unforeseen events into an NBFI's rating opinion is challenging - given their unpredictable nature. These events may be driven externally (e.g., M&As, regulatory changes, litigations, natural disasters, etc.) or internally (e.g., unrelated diversification, or strategic restructuring) and can lead to substantial rating changes. LRA applies its analytical judgment in assessing the likelihood of such occurrences and their potential impact, insofar as may be possible, and assesses the NBFI's track record, expertise of management team, and level of financial discipline to incorporate the same into its ratings.

4.6 Sustainability: Earning prospects are also monitored based on budgets and forecasts prepared by the NBFI. A reality check is performed while analyzing underlying assumption taken by the management as well as management's track record in providing reliable budgets and forecasts. The macroeconomic profile is used to gauge the sustainability, the sovereign's susceptibility to event risk, including political risk, the government's liquidity risk, and the risk of external events such as foreign-exchange shocks, and has a significant bearing on the vulnerabilities of its NBFIs.

Business Risk – Key Ratios**Revenues**

- Advance Yield (%)
- Deposits Cost (%)
- Core Spread (%)
- Net Mark Up Income/Total Income (%)

Earnings

- Return on Average Equity (%)
- Return on Average Assets (%)
- Non-Mark Up Expenses/Total Income (%)
- Personnel Expense/Total Income (%)

Relative Position

- Number of branches
- Total Advances/Sector's Total Advances (%)

Information Required on Business Risk

- Financial statements of the NBFI for the last three years and latest four quarters Profile of senior management
- Current capacity utilization of the plant and its trend for next three years
- Breakup of the geographic sales
- Marketing and distribution network
- Market share (%) along with marketing strategy
- Top five suppliers along with respective contribution
- Top ten largest customers, separately for each business segment, along with contribution

5. Financial Risk

5.1 Credit Risk: Importance of credit risk is significantly more in case of lending institutions including finance companies and modarabas, because of the generally second tier client base of these institutions (as compared to commercial banks' borrowers). Credit risk can arise from both on- and off-balance sheet business of the NBFI. On-balance sheet credit risk can materialize from loans, investment in fixed-income securities, and inter-bank deposits. Off-balance sheet credit risk includes non-performance of the counter party on the guarantees issued by the NBFI. Out of entities covered in this section, generally investment finance companies expose themselves to off-balance sheet risk factors. LRA analyzes both risks in similar manner, however, as the quantum of risk taken on from on-balance sheet business is higher, particular emphasis is placed on it. Moreover, investments in fixed income securities of private corporates are considered part of the overall financing portfolio for the purpose of credit risk analysis. This is because of their nature, which is very much similar to the financing operations of NBFI.

5.1.1 Credit risk analysis includes review of credit portfolio at all levels. The portfolio is evaluated to calculate market share, analyze type of counter party (consumer, SME, or corporate etc.), and product mix in terms of secured and unsecured. Meanwhile, concentration level is given high importance. Concentration is assessed at all levels including sectoral exposure, borrowers, and type of products. The level of concentration is considered to have a positive correlation with the degree of risk, i.e., the higher the concentration, more risk the portfolio carries. Thus, a high level of diversification can shield NBFIs from the impact of downturn in any single

segment. Moreover, diversification into riskier segments does not necessarily provide any help to improve the risk profile of the portfolio; it may negatively impact on the ratings.

5.1.2 Asset Quality: Assessing quality of assets is an important pillar of credit risk. The portfolio is analyzed with respect to size of the exposure, mainly top 20 exposures, and sectoral division. In addition, watch-list accounts and sectors that are still performing, and non-performing accounts are reviewed to analyze the current asset quality as well as future impact of any expected delinquencies on the overall quality of the portfolio. Post-delinquency, the level of reserves maintained for provisioning requirements is considered important. Meanwhile, asset quality is assessed using both absolute and relative criteria, and where applicable, ratios are compared with the peers. The quality of fixed income securities portfolio is measured. In addition to the size of the exposures, the business dynamics of the sector relating to the counterparty and security structure of the instrument is given due credence. Similarly, other exposures are analyzed on the basis of nature, size, and credit worthiness of the counterparty. LRA also observes the quality of the collateral lodged against the NBFI's financing facilities through the lens of recoverability thereby paying due regard to arrangements which could inadvertently result in enhanced credit risk. Besides which, the nature of the collateral arrangement must fall within the realm of regulatory compliance.

5.2 Market Risk: Many of the NBFI's, in addition to regulatory investments (applicable to deposit taking entities), maintain their own investment portfolio. This may comprise investments in fixed income securities, government papers, and direct exposure to equity markets. LRA evaluates market risk with particular emphasis on the trading book of the NBFI. While potential losses lying on the balance sheet that are yet to materialize stand as a risk of drag on performance of the NBFI, any available unrealized gain on investments held for sale is considered as a cushion to unforeseen losses that may arise due to price movements.

5.3 Liquidity and Funding: NBFIs are classified into two main segments for funding and liquidity assessment: i) NBFIs that finance their assets through either deposits or borrowings from NBFIs, or a combination of both, and ii) NBFIs that meet their requirement either from internal sources (equity) and/or from shareholder loans.

5.3.1 In case of the first kind of NBFIs, LRA's analysis includes identifying any marked concentration in deposit base and/or borrowings, as well as identifying significant trends in funding sources. Composition of the deposit base is analyzed in terms of: i) tenor and pricing of deposits – the maturity profile of liabilities is seen in tandem with related asset base to analyze liquidity profile, ii) fixed rate vs floating rate – this has direct implications on business margins in case of mismatch with assets, and iii) retail vs institutional – retail deposits are considered sticky as compared to institutional deposit. While concentration level in funding base is analyzed, due importance is given to liquidity management. LRA believes higher asset turnover as compared to liabilities is good for liquidity management.

5.3.2 In the second case, where the assets are financed from equity, sufficiency of free capital available to the NBFI is assessed as discussed in the Capital Adequacy section. While in case of shareholder loans, the terms of the loan, repayment flexibility, and the NBFI's plan to meet the repayment terms are analyzed.

5.4 Capital Structure: LRA evaluates an NBFI's capitalization as a cushion to absorb unreserved losses. These include impact of foreseeable future business losses, if any, and expected level of provisioning on bad loans and non-performing investments.

5.4.1 While analyzing capital, LRA excludes the amount that is tied up in fixed assets and, where applicable, any strategic investments from available capital to assess the adequacy and sufficiency of equity of the NBF. LRA also assesses the ability of the company to generate capital from internal sources. Meanwhile, dividend payout policy is considered important to evaluate as it may have a significant bearing on potential capital formation rate. Additionally, LRA gives due consideration to compliance with regulatory requirements.

5.4.2 Credit Enhancement: The NBF that carries a third-party commitment to make good on an amount obligated to the lenders may provide additional support to its financial risk profile. In this case of determining the impact on a rating, key factors to assess are the financial profile of the third party and the extent of coverage – quantum and duration – it provides.

Financial Risk – Key Ratios

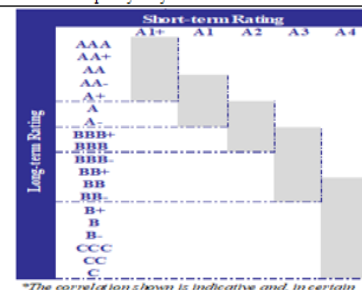
Credit Risk	• Top 20 Advances / Total Finances (%) • Non-Performing Advances / Gross Advances (%) • Non-Performing Advances / Equity (%) • Gross Finances / Funding (%)
Market Risk	• Government Securities / Investments (%) • Investments / Equity (%) • (Investments + Debt Instruments) / Total Assets (%)
Liquidity and Funding	• Liquid Assets / Funding (%) • Advances / Deposits (%) • Top 20 Deposits / Deposits (%) • Short Term Funding / Funding (%)
Capitalization	• Equity / Total Assets (%) • Total Debt / Equity (%)

Information Required on Financial Risk

- Top 20 performing private group exposure
- Statement of credit exposure by type of security
- Latest internal risk ratings of Facilities obligators
- Party wise detail of classified loan portfolio
- Latest statement of marginal/watchlist accounts
- Details of funding lines and repayment pattern

Credit rating reflects forward looking opinion on credit worthiness of underlying entity or instrument. More specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating		Short-term Rating	
Scale	Definition	Definition	
AAA	Highest credit quality: Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.	A1+	The highest capacity for timely repayment
AA+	Very high credit quality: Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic or financial.
A+		A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic or financial conditions. Liquidity may not be sufficient.
A	High credit quality: Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to change in circumstances or in economic conditions.		
A-			
BBB+			
BBB			
BBB-	Good credit quality: Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.		
BB+			
BB			
BB-			
B+	Moderate risk: Possibility of credit risk developing. There is a possibility of credit risk developing particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.		
B			
B-			
B-			
CCC	High Credit Risk: A limited margin of safety remains against credit risk. Financial commitments are currently being met, however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.		
CC			
C			
D			
	Obligations are currently in default		



Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate terms in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. "stable" outlook means a rating is not likely to change. "positive" means it may be raised. "Negative" means it may be lowered. Where the trends have conflicting elements, the outlook may be described as

Rating Watch Alert to the possibility of a rating change subsequent to or in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate. B) cessation of underlying entity. C) the debt instrument is redeemed. D) the rating remains suspended for six months. E) the entity / issuer defaults. Or / and f) LRA finds it impractical to surveil the opinion due to lack of requisite information

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance: Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every 12 months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note: This scale is applicable to the following methodology (s):

- a) Stockbroker entity rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) MicroFinance Institution Rating
- g) Non-banking Finance Companies Rating

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