

BANKS AND NON-BANK FINANCIAL INSTITUTIONS CRITERIA

Scope of the criteria

This criteria is applicable for the rating of banks and similar financial service companies. The criteria is applicable in according both national scale and international scale ratings. For enhanced understanding, the criteria should be read in conjunction with the definition of ratings released by Prudential Ratings which provides better understanding of some of the terms used herein. The definition of bank in this criteria is extended to include commercial banks, trust banks, building societies, prudentially managed finance service companies, deposit taking micro-finance institutions and other similar financial institutions. Incorporating both qualitative and quantitative analysis, the criteria's rating and Prudential Ratings rating process is laid out in an intuitive way outlining analysis of a rated entity's operating environment, its financial profile and an analysis of the entity's support framework to the extent that it is factored in the ratings.

Summary of the criteria

Prudential Ratings criteria broadly takes a three-stage analytical approach, which is an assessment of the bank's operating environment, its financial profile and support factors. These three broad stages build up the issuer's credit rating profile. The operating environment analysis is the culmination of the Country risk and Industry risk assessment. The financial profile is built from four factors, that is, the Business profile, Capital and Earnings, Funding and Leverage and Risk. Lastly, the Support Factor is an analysis of the bank's Shareholder Support and/or Government Support. The diagram below shows the flow and the interrelationship of these subfactors.

Country Risk Analysis

Prudential Ratings is of the view that the general wealth of a country, together with its socio-political environment, are key considerations in formulating the credit risk profiles of corporate issuers in that country. Broadly, there is a positive correlation between the performance of corporates within a country, and that country's economic performance as measured by GDP growth. In considering the economic performance of a country and its wealth levels, Prudential Ratings normally uses GDP



growth rates and GDP per capita measures, both considered together with the measures of income equality and distribution of wealth, such as Gini Coefficient. It is noted that in other jurisdictions, accurate measures of the income distribution may not be readily available. In such instances observable patterns of income distribution can be subjectively considered, such as general access to social amenities, state of public infrastructure, etc.

While the socio-political assessment may be difficult to quantify, Prudential Ratings considers political and social stability as being broadly credit positive. Stability of tenure of key political office bearers, strength and independence of key institutions and the general social stability will be assessed based on Prudential Ratings' judgment.

In assessing the country risk, publicly available and generally accepted sources shall be used, such as the World Bank Governance Indicators, National Statistics Publications, and World Bank Ease of doing business publications. Where an entity operates in different jurisdictions, the country risk assessments of the different jurisdictions shall be considered, and their impact on the overall credit risk profile shall be weighted based on each jurisdiction's relative contribution to the rated entity.

Industry Risk Assessment

Industry Risk Assessment is an analysis of the systemic risk that affects all institutions in a particular operating environment. For this purpose of this criteria, Prudential Ratings determines a bank's industry risk primarily on the basis of where it is domiciled and primarily regulated. However, in the event that a bank has operation in several jurisdictions its industry risk score may differ to local peers. Prudential Ratings analysis will determine the ultimate industry risk assessment factor for such an institution on a weighted industry risk assessment basis. Prudential Ratings may choose to weight the industry assessment on the basis of Loan book or Total Risk Weighted Assets distribution. For example, a bank with a 50% of Total Risk Weighted Assets in Country A ('with a Weak Industry Risk Assessment') and another 50% in Country B ('with a Strong Industry Risk Assessment') can have an eventual 'Adequate Risk Assessment'. The industry risk assessment for each country is analysed in the following factors:



Industry Framework: A large, highly developed and concentrated banking sector may result in a positive adjustment to the operating environment score as these market features will usually help banks to grow their franchises, achieve economies of scale and protect margins. Elements typically demonstrated by such industries include a relatively strong regulatory and legal framework, characterised by developed legislation and regulations, adoption of regulatory best practice like Basel principles on capital and funding, an effective and independent banking regulatory body, sound accounting standards, appropriate protection of creditor rights and developed corporate governance standards, is considered positively for the industry risk assessment. A small, developing or highly fragmented banking sector may be negative for the operating environment score, as may limited central bank liquidity support mechanisms, limited broader institutional frameworks and underdeveloped domestic capital markets including low barriers to entry, unstable earnings and incomes over time, among others.

Economic performance: In jurisdictions with a demonstrated and expected relatively high underlying rate of economic growth, emanating from, competitive advantages, convergence with more developed markets or favourable demographics, Prudential Ratings may make a positive adjustment to the industry risk assessment. The rationale being an economic expansion usually supports banks' asset quality and facilitates revenue growth. Prudential Ratings will make a negative adjustment where it believes the economic growth to be unsustainable, expected to suffer a period of negative growth or where unemployment is observed or expected to increase.

Rate of Credit Growth: Prudential Ratings may make a negative adjustment to the industry risk score where it is determined that the rate of credit growth in an economy is growing faster than the rate of economic growth as it poses risk of future deterioration of asset quality and general economic well-being. In its assessment of industry indebtedness levels, Prudential Ratings considers other sources of lending like non-bank credit, international borrowing among others and debt service requirements for corporate institutions.

Score	Description
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Strong	The rated entity operates in a large, highly developed and concentrated banking sector with a strong legal and regulatory framework, very good levels of sustainable economic and credit growth.
Adequate	The rated entity operates in a moderate, developing and/or moderately concentrated banking sector with an adequate legal and regulatory framework, good levels of economic and credit growth.
Weak	The rated entity operates in a smaller, somewhat underdeveloped and/or fragmented banking sector showing weak/inadequate legal and regulatory framework with low levels of economic and/or high/unsustainable credit growth.

Business Profile

The business profile assessment aims to reflect the risks the rated entity could face and its ability to retain and acquire new market share and earnings via an analysis of its long-term competitive strengths and weaknesses. A bank's business profile is normally conditioned by the operating environment, however specific features of the bank's business operations can add to or mitigate its industry risk score. The assessment of this factor is broken down into 3 sub factors: (a) Business Stability (b) Business Diversification (c) Management and Governance. On the culmination of the subfactor assessments, Prudential Ratings will assign a score of 'Strong'; 'Moderate' or 'Weak' on the overall assessment of the Business Profile.

(a) Business Stability

Business stability relates to the robustness and resilience of the business's market position in the face of economic and market fluctuations. A strong and competitive franchise puts a business in a good position to generate and defend core earnings. The criteria use metrics of revenue stability, market share, and the customer base to compare a bank's business stability with that of domestic and similar global peers. While Prudential Rating Co appreciates the importance of revenue diversification, for banks and related institutions, business lines with a higher proportion of recurring fee income and net interest income are regarded as more stable. Fees from off balance sheet financing activities, trading income and other market sensitive income are generally considered less stable. Business stability is enhanced if it is evident that the rated entity exhibits more of the following characteristics:

- Participating in an industry that has significant barriers to entry.



- The rated entity' customer base is demonstrably sticky. That is, a higher proportion of the bank's customer base is a result of regulation or mandates that matches the institution's profile and/or long-standing relationship that have stood economic fluctuations.
- The rated entity's clientele is not highly price sensitive.
- Revenues are less sensitive to perception of creditworthiness.
- The bank is determined as a domestic systemically important bank in the operating environment.
- The bank has a demonstrable and defensible niche service advantage.

Prudential Ratings will assign a score of 'Strong'; 'Adequate' or 'Weak' on the overall assessment of the Rated entity Stability.

(b) Business Diversification

A diversified business model supports the assessment of a rated entity's business profile. Good business diversification results in stable and predictable revenues that are better to withstand economic cyclicity or sustained down turns. Business diversification is measured by the contributions of different business lines and geographies to a bank's revenues, compared to peers locally and/or globally. Our criteria considers business diversification in the form of revenue source, geographical footprint of then banks services and channels of service delivery (for example a cost effective mix of physical branches, mobile and internet banking platforms can place a bank in a significantly stronger position to peers in the same operating environment concentrated to a single service delivery channel). The assessment of the business diversification is considered in the context of the operating environment.

Prudential Ratings will assign a score of 'Strong'; 'Adequate' or 'Weak' on the overall assessment of the Business Diversification.

(c) Management and Governance

The assessment of a bank's management and governance is qualitative. This subfactor aims to assess management's operational and strategic competence, risk management and effectiveness of its corporate governance model to meet its



business and financial objectives. This qualification on the basis of this subfactor is informed by a study of the bank's history, present and future as determined based on strategic direction, budgets and any other material substantiating. Management and governance assessment is determined to a large extent in accordance to the dictates of the operating environment regulation, and where its lacking, to international best practice. A bank's management and governance is considered negatively in the following context:

- Management has had a history of infractions/ non-compliance with local regulation.
- Where management's qualifications is deemed lacking/insufficient for the tasks at hand.
- The organisational structure is determined to be overly complex or insufficient for the rated entity's scale of operations.
- Business strategy has been demonstrably out of sync with the realities of the operating environment, for example a history of sustained losses or operational inefficiencies (sustained high cost to income ratio compared to peers) does not board well for this assessment. Lack of continuity and consistency of strategy or inflexibility of it.
- High risk model atypical of banking practice; for example, a bank with an aggressively high asset-liability mismatch, invests in sophisticated alternative instruments, forex, land among others.
- Ineffectiveness of the board's supervisory functions.
- High and unplanned turnovers in senior management positions.
- Existence of key person risk and proven inadequacies of succession strategy.
- weaknesses in financial reporting (quality, frequency and/or timeliness) compared to international best practice, or where internal or external audit processes appear less robust relative to the operating environment.
- The existence of significant related party transactions, exacerbated in the event transactions are not executed at market rates.

Prudential Ratings will assign a score of 'Adequate' or 'Weak' on the overall assessment of the Management and Governance.

Score	Description
Adequate	Management and governance is appropriately skilled management and governance structures for the size and complexity of the organization, for the execution of the bank's objective.
Weak	Management has a shown management and governance deficiency such as breach of laws or regulation, do not abide by corporate governance best practice, high management turnover, prevalence of key man risk, lack of succession planning, inadequate board oversight and overly complicated board structures.

On the rated entity's business profile, Prudential Ratings may accord as 'Very Strong'; 'Strong'; 'Adequate'; or 'Weak'.

Score	Description
Very strong	Dominant market position and pricing power, very strong franchise and very high share of market deposits or loans, above average geographical diversification and/or control of significant control of distribution lines.
Strong	Strong franchise with high share of market position of assets or deposits, above average geographical or business line diversification or some control of distribution lines, better than average revenue and earnings stability.
Adequate	The bank's business profile is broadly in line with market averages in terms of business diversification, revenue stability, geographical distribution.
Weak	Smaller in comparison to peer average market share of deposits or assets, limited business lines, comparatively weaker revenue stability, geographical spread or influence on distribution channels.
Very weak	Significantly smaller compared to peer average market share by deposits or assets, very limited or monoline business with no significant on distribution channels, very limited geographical spread, poor revenue stability, with threatened going concern.



Prudential Ratings regards credit risk as the main risk factor that a bank is exposed to, notwithstanding other sources of the same.

(a) Credit Risk

In assessing credit risk, we look at how an institution's underwriting practices are linked to its credit risk appetite, as well as the robustness of the techniques used in monitoring and managing its credit portfolio. To an extent, a bank's credit risk position is determined by its operating environment which is factored in the sector risk assessment. However, this segment provides a further look through to the idiosyncratic nature of the rated entity in relation to peers in the market and others globally comparably. In the assessment of a bank's credit risk, Prudential Ratings premises the initial focus on the non-performing loans as a proportion of gross loans with pursuant modifiers. The bank's NPL ratio is assessed against the market average of the same, intuitively better performance against the market is considered in good light. Further look through is given to events that could bias this metric such as loan write offs, restructuring, growth of the loan book, loan classification among others. The NPL ratios are therefore considered in conjunction with credit loss ratios over the respective period. The study of quantitative metrics, behaviour of credit in the market together with the rated entity's operational characteristics form the basis for a forward-looking credit opinion on the bank. Other factors that feeds this view are discussed below:

Risk appetite and underwriting procedures: A comparatively low risk appetite approach backed by prudent loan underwriting procedures is considered positively. The assessment is made against peers participating in the same operating environment or in globally comparable ones. Prudential Ratings may adjust the credit risk assessment downwards where it views the bank as having a relatively high-risk appetite or weak underwriting standards which in the agency's view may be more likely to result in asset-quality deterioration or volatility.

Asset Concentration: High concentration exposures in respect to single borrowers/counterparties, geographical location, economic sectors or asset classes may increase vulnerability to idiosyncratic and/or cyclical asset performance fluctuations.



Collateral Coverage and Reserves: Higher ratios of collateral cover and loan loss reserves act as buffer against potential credit losses. A rated entity's history of loan losses and industry trends come in handy when assessing adequacy of the collateral and reserves. Other elements of this assessment are with regards to the valuation of collateral, liquidity of the collateral asset, legislation regarding foreclosure and asset liquidation are considered. Conversely, inadequate reserving and collateral coverage result in negative adjustment to the credit risk assessment.

Growth: High loan growth relative to peers as captured by the loan book growth metrics may lead to initial operational and system stress or a significant increase in impaired loans as the portfolio matures. Additionally, high loan book growth rates may reduce the NPL ratio due to the lag effect on the numerator, while a sudden contraction of the same may inflate it. Prudential Ratings may view modest loan book growth compared to peers as conservative and therefore positive for the risk assessment.

In addition to the Credit Risk as discussed above, Prudential considers the following components of risk under this factor:

(b) Market risk

Prudential Ratings may adjust negatively the risk assessment where it believes there are material risks of losses arising from trading risk and structural interest rate risk, non-loan assets such as interbank exposures, derivative fair values, securitisations. The assessment of market risk also incorporates foreign currency risk where it is applicable. Sufficient cover of foreign currency liabilities is expected, in the case of its insufficiency Prudential Ratings considers this as a rating's negative.

(c) Operational Risk

This is the risk of direct or indirect losses emanating from the shortcomings of internal processes and procedures, people and systems. Prudential Ratings will perform an analytical overview of systems, processes and procedures to come to an adjustment of the risk assessment factor. Deficiencies in internal processes and procedures, people and systems warrant a negative adjustment.

(d) Other Risks



The criteria takes into account legal or from off-balance-sheet exposures such as guarantees and commitments. The coverage extends to reputational risks which could impact the bank's profile in financial or other terms, bearing in mind the susceptibility of banks to these which may spark deposit runs, among other risks. Prudential Ratings incorporates risks borne by subsidiaries, including nonbanking subsidiaries in ratings assessment of a bank within a group structure.

Prudential Ratings will assign a score of 'Strong'; 'Adequate' or 'Weak' on the overall Risk assessment.

Score	Description
Very strong	The rated entity exhibits very minimal credit risk, with a broadly spread loan book, and very strong reserving and through the cycle losses; minimal operational risks; market and regulatory risks. The rated entity exhibits robust operational, IT and risk mitigation systems in place; minimal market
Strong	The rated entity exhibits below market average credit risk, diversification of loan book, strong reserving and low credit losses through the cycle; operational, market and regulatory risks.
Adequate	The rated entity exhibits credit characteristics broadly in line with market averages in regards to through the cycle credit losses, risk concentrations; operational, market and regulatory risks.
Weak	The rated entity exhibits above average credit characteristics in terms of NPLs, credit losses, concentrations; operational, market and regulatory risks.
Very weak	The rated entity exhibits significantly weaker credit characteristics in terms of concentrations, credit losses and in relation to its credit profile; operational, market and regulatory risks.

Funding and Liquidity

Prudential Ratings regards funding and liquidity as tied to the hip and ought to be considered as two sides of the same coin. Funding implies the way an institution is able to finance its operating activities. The profile of a bank's sources of financing is referred to as the funding structure. Prudential Ratings will perform a look through of each



institution's funding structure against peers in the same operating environment or globally comparable to perform a ranking as to the suitability and sustainability of a bank's funds against its own uses and against peers. To avoid a breach in repayment of its funding obligations and others, a bank ought to manage well the inherent asset-liability mismatch risk that banks naturally onboard due to the nature of their operations. A profitable banking institution that fail to manage its liquidity appropriately could still default. Following the reasoning above, liquidity is absolute, in that it ought to satisfy a bank's payment obligations, as and when they fall due. Banks with higher liquidity metrics on hand therefore ranks better than peers with lesser in this regard. However, conservancy in terms of liquidity to the extent of redundancy could negatively impact other factor like earnings, this determination is made on a case by case basis.

(a) Funding Structure

In modern day finance, a bank has to its disposal several sources of funding. Prudential Ratings considers diversified funding structure a positive attribute. However, further look through and prominence is given to the funding structure in accordance to the sustainability and suitability of funding.

Capital and reserves: Prudential Ratings considers shareholder contributions and internally generated funding sources like retained earnings as the most stable. A bank with high capital and reserve metrics is likely to score higher on this assessment, *ceteris paribus*.

Customer deposits: for most conventional banking models, customer deposits pose the biggest funding source. Banks are able to create a wider array of assets with this funding source which immediately induces an asset-liability risk. However, customer deposits themselves can be classified into several categories according to their attributes. Retail deposits are considered to be the most stable funding source, mainly due to their granular nature, followed by corporate deposits and public sector deposits. Financial corporates deposits take lower prominence in ranking to other corporate deposits due to their volatile nature. High sectoral, or single name deposit concentrations are considered negatively.



Market funding: Market derived funding is generally considered to be lesser stable and, in most cases, costlier than the other funding sources discussed above. Prudential Ratings appreciates the varied nature of securities obtained from the market. However, a general pattern of prominence can be given to the specific types of common market derived funding. Local currency, long term funding is ranked better other sources of funding on the basis of their risk profile. Longer term funding is considered positively on a cost, and liquidity strain basis. Foreign currency is less favourable as it induces foreign currency risk, whose management could result in delving in costlier options and adding counterparty risks and a layer of complexity.

Market derived funding in some cases come with covenants, which as a result induce covenant risk to the rated entity. Penalties for breach of covenants are funding specific, in some cases a covenant breach causes acceleration of payments, constitute an event of default or cause cross defaults. Distance to covenants becomes important and severe down notching can be applied where risk is perceived or observed.

Central Bank Funding: an observed pattern of reliance on the lender of last resorts is negative. Also, prohibited access to central bank funding or the interbank market as contingency funding is regarded as a funding structure weakness. This factor can also be discussed under liquidity.

(b) Liquidity

Liquidity is judged in the context of funding structure. A volatile funding structure can be offset with higher liquidity on hand. Ratio analysis of liquidity and funding helps to shed light on the quantitative analysis of this factor. The qualitative factors of liquidity are considered as below:

Liquid assets coverage ratio: The liquid asset coverage of short-term financial obligations and wholesale funding is a key metric. An insufficient coverage of these liabilities could bring down a bank's rating significantly. In the assessment of liquidity, Prudential Ratings considers the regulatory and asset specific encumbrance, loan book maturity profile and liquidity contingency measures available at the bank's disposal. The loans to deposits ratio is key in determining a bank's liquidity profile. Prudential Ratings deems an ideal ratio of loans to deposits is in the range of c.70%.



However, this metric is operating environment sensitive and is also compared against peers. Off balance sheet liabilities or facilities could possibly mitigate or aggravate risks depending on the nature of the exposures. Significant undrawn off-balance sheet credit facilities can be added to loans to give a better picture of a bank's leverage position.

Regulatory Liquidity Coverage: In jurisdiction where the regulator specifies a minimum liquidity ratio, Prudential Ratings places prominence to the attainment of such. In instances where a bank is expected to maintain such a ratio at all times, Prudential Ratings may discount such proportion from consideration of liquidity for other uses. The extent of Prudential Ratings' actions is informed by the penalties enacted by the regulator for breaches.

Foreign Currency Liquidity Risk: Where a bank is exposed to foreign currency risk, Prudential Ratings expects the bank to be sufficiently covered in the specific currency.

Groupwide Liquidity: In a group structure, where a bank's liquidity can be drawn down to satisfy other subsidiaries' liquidity requirement, Prudential Ratings may consider this a negative; and may consider the opposite positively.

Prudential Ratings will assign a score of 'Strong'; 'Adequate' or 'Weak' on the overall Funding and Liquidity assessment.

Score	Description
Very strong	The rated entity demonstrates very stable long term funding sources, in nominal terms, cost of these funding sources, diversification by sources, geographic distribution of sources, strength of funding providers. The rated entity has very robust liquidity management policy, very strong coverage of both local currency and foreign currency short term obligations and/or very good contingent liquidity facilities in place, also in relation to peers.
Strong	The rated entity demonstrates above market average strength in funding structure, in terms of stability of sources, nature, geographical distribution of sources and nominal values of the funding. Robust liquidity management policies, strong coverage of both local and foreign currency short term obligations and/or good liquidity facilities in place, in relation to peers.

Adequate	The rated entity demonstrates funding structure broadly in line with market averages in terms of nominal value, strength, diversity of sources. The liquidity management policies are also in line with the market averages, adequate coverage of short-term obligations.
Weak	Weak funding structure, showing concentration in funding sources, counterparty exposures, geographic sources and . The bank shows some stress in its coverage of short-term obligations.
Very weak	Very weak funding structure, funding significantly threat to capital, geographic sources. Very close or in default of short-term obligations.

Capital and Earnings

The assessment of a bank's capital and earnings aims to ascertain its ability to withstand unreserved and unexpected financial shocks. The logic goes that a bank with high capital and reserves and/or ability to internally generate capital is in better stead to withstand losses than one which isn't. Prudential Ratings' assessment of a bank's capital and earnings is taken in the steps outlined below:

Regulatory Capital requirements: With the evolution of global finance and experience from market crashes, regulators around the world have adopted frameworks detailing minimum capital and reserving banks within their jurisdiction ought to keep in bid to improve stability of their financial systems. In some jurisdictions, inability to keep the regulatory capital minimums could lead to regulatory forbearance. Therefore, Prudential Ratings considers a bank's capital holding in line with these stipulations by the regulator. The further the distance from these regulatory minimums a bank is the more positive its assessment is considered. Further thought is given to consideration in line with a bank's risk and size, to which a bank holding capital to the point of redundancy could be a slight negative for its management and strategy discussed above, this consideration is expected to be applied rarely. In jurisdictions where regulatory forbearance is enforced, banks failing to meet the minimum capitalisation regulatory requirements have their ratings hard capped at sub-investment grade level. The same applies for non-bank financial institutions with the same predicament with the regulator or covenants of significant financing lines. The rating is significantly



lowered where failure to meet the regulatory minimums is deemed a threat to the going concern of the institution.

Risk Adjusted Capital: The Risk Adjusted Capital is a key metric is determined sufficiency of a bank's capital holdings. The risk adjusted capital is calculated as the Total Capital divided by Total Risk Weighted Assets. The quality of a bank's risk adjusted capital is informed by its operating environment and a further look through via peer analysis. The calculation of a bank's risk weighted assets is informed by jurisdictional guidelines. However, Prudential Ratings may apply moderation in accordance with Basel guidelines that it considers more appropriate. Prudential Ratings considers only loss bearing capital components in its Total Capital Ratio. The Total Capital reflects core capital that is share capital, share premium, distributable and loss bearing reserves, loss bearing minority interests and retained profits plus loss bearing hybrid instruments minus intangibles, and deferred tax assets.

Prudential Ratings applies the following adjustments to Initial Capital Assessment:

Valuation: Prudential Ratings may apply haircuts to performing loans, foreclosed assets, revaluation reserves or any other assets where we considered them overvalued.

Capital transferability: In group rating, the group capital metrics may understate legal and regulatory limitations to the movement of capital between subsidiaries. In these instances, Prudential Ratings may apply an adjustment to these capital metrics to the extent of such limitations. In cases where financial institution subsidiaries have a weaker standalone financial profile, a higher discount may be applied.

Loan loss reserve coverage: Where Prudential Ratings may consider a bank's loan loss reserves to be inadequate it may deduct a proportion equal to the shortfall from the bank's Total Capital.

Capital mobilisation: Where a bank demonstrates a higher/weaker ability to raise capital compared to peers, Prudential Ratings will apply a positive/negative adjustment to the initial capital assessment.

Size: A small capital base can leave an institution more vulnerable to unforeseen events, especially where there are risk concentrations, despite capital ratios being



relatively strong. Prudential Ratings may apply a downward adjustment to the initial capital assessment.

Quality of Earnings

A bank's earnings track-record is one of the key elements to consider when assessing its viability and future capital stability. Banks that demonstrate high quality, stable earnings, will generally be more robust than those with low or volatile earnings, ceteris paribus. In the assessment of earnings, Prudential Ratings considers the nominal earnings quantum and better yet the quality of earnings as calculated by Total Earnings divided by Total Risk Weighted Assets. This ratio aims to explain a bank's ability to generate recurring profits relative to the risk it assumes. This ratio is further explained in light of other consideration like diversification and drivers of earnings. Quality of earnings is also considered in the context of the operating environment and peer comparison.

Prudential Ratings can make moderations to the initial Quality of Earnings assessment on the basis of the following:

Dividend Pay-out Policy: Prudential Ratings may adjust downwards the capitalisation and earnings score where a bank has weak earnings or weak earnings retention due to an aggressive dividend pay-out policy, or the bank's expected rate of growth is high, to reflect the likely negative affect this will have on capital metrics.

Earnings Stability: Prudential Ratings may make an adjustment to a bank's earnings quality assessment on the basis of stability of earnings through a cycle, or where recent performance suggests a sustainable improvement compared to the bank's four-year average. A demonstrated or anticipated positive/negative trend could result in a positive/negative adjustment to the initial earnings quality assessment.

Concentration of earnings sources: A bank may get a negative quality of earnings adjustment where a higher proportion of its earnings are derived from non-core earnings and slightly positive adjustment conversely.

Market outperformance: A material positive/negative outperformer in term of the Total return to Total Risk Weighted Assets may get a positive/negative adjustment.



Operational inefficiency: Significant operational inefficiencies as demonstrated by a high cost to income ratio could result in a negative adjustment.

Prudential Ratings will assign a score of 'Strong'; 'Adequate' or 'Weak' on the overall Capital and Earnings assessment.

Score	Description
Very strong	The rated entity demonstrates very high capacity to withstand significant shocks to the financial profile. Demonstrated by very strong coverage of total risk weighted assets, strong earnings quality, above industry average cost management practices, peer outperforming and very conservative loan loss coverage.
Strong	The rated entity demonstrates high capacity to withstand significant shocks to the financial profile. Demonstrated by strong coverage of total risk weighted assets, strong earnings quality, above industry average cost management practices, peer outperforming and conservative loan loss coverage.
Adequate	The rated entity demonstrates capacity to withstand significant shocks to the financial profile broadly in the same range as industry average. A balance of adequate coverage of total risk weighted assets, good earnings quality, industry average cost management practices and/or, peer aligned loan loss coverage.
Weak	The rated entity demonstrates capacity to withstand significant shocks to the financial profile broadly lagging the industry average. A balance of just adequate coverage of total risk weighted assets, weak earnings quality, below industry average cost management practices and/or loan loss coverage.
Very weak	The rated entity demonstrates capacity to withstand significant shocks to the financial profile on the low tail-end of the industry average. A balance of inadequate coverage of total risk weighted assets, very weak earnings quality, very weak cost management practices and/or loan loss coverage.



Prudential Ratings appreciates that when financial institutions are failing or close to it they may not necessarily default on due obligations and may have its financial profile resuscitated due to extra ordinary support. Prudential Ratings recognises a distinction in ordinary and extra ordinary support, with ordinary support being the extent of support that filters through in a financial institution's operations, competitive profile, capitalisation, funding and liquidity getting a relative boost due to being part of a bigger group or having a strong shareholder. Prudential Ratings does not provide an extra boost to a financial institution's standalone profile for ordinary support to a financial institution as we believe its existence would be reflected in the institution's competitive and financial profile. We take this position to allow merited comparison on the basis of competence of these institutions in their respective fields and jurisdictions. Prudential Ratings recognise extra-ordinary support as more of a last line of resort that is availed to financial institutions that have failed or are close to failing. Typically, this type of support is availed by the shareholders or the sovereign.

(a) Sovereign Support

As observed across the world, in some jurisdictions the financial governing authorities can set up an additional layer of support to save financial institutions from failing in order to protect the depositors and disruption of the financial systems. Typically, this type of support is accorded to financial institutions designated as systemically important to the financial well-being of those economies. This type of distinction is normally accorded on the basis of sheer size of contribution to the economy or other strategic reasons. In assessing sovereign support, Prudential Ratings qualifies the type and extent of legislation and regulation around this sovereign support recognising its varied nature across jurisdictions. Prudential Ratings goes further into assessment of the sovereign ability and willingness to support as determined by precedence and economic outlook. In the above assessment, Prudential Ratings will consider the structure of the jurisdiction's banking industry, number and size of financial institutions, the specific nature of the crisis, the sovereign's indebtedness and economic outlook, political dynamics of the said jurisdiction, the nature of resolution regime if applicable, and the history of support.

(b) Shareholder Support



Financial institutions with financially strong shareholders or part of a strong wider group benefit from the possibility of extra ordinary support to sustain their financial profiles. In distinction between shareholder support and sovereign support, Prudential Ratings considers shareholder support as more probable compared to sovereign support given the comparative direct alignment of interests and a reduced bureaucratic chain. Like in the assessment of government support above, Prudential Ratings assesses the ability and willingness to support of the shareholder. The ability of the shareholder to support is premised of the shareholders financial profile, and also the regulatory framework across the applicable jurisdictions. In some instances, regulations regarding fungibility of capital, funding and liquidity may inhibit the ability to support despite willingness and ability. In addition to the abovesaid concerns, Prudential Ratings also considers tax implications, political concerns, sizes of the respective institutions in questions, and the nature of the problem which warrants support among others. Prudential Ratings assesses willingness to support on the premise of precedence set by the parent in regards to supporting subsidiaries, political concerns where applicable, strategic role of a subsidiary in the broader group, whether the financial institution's shareholder are banking related or in a regulated industry, capacity to dispose of the said non-performing entities, performance of the subsidiary and extent of contribution to the broader group's financial profile, the implication of subsidiary default in case of shared branding, crosslinked defaults and reputational risks and the level of integration of the said subsidiary into the wider group.

(c) Guarantees

Prudential Ratings recognises guarantees for specific program issuances, or the entirety of an entity's obligations. In the case of the latter, Prudential Ratings may apply credit substitution of the rated entity by the guarantor's where the said guarantee is unconditional, irrevocable, in toto, and legally binding. The abovesaid guarantee must be timely, in respect of the rated entity's obligations and ranks the rated entity's obligations higher or pari-passu to the guarantors' senior unsecured obligations. In this case, Prudential Ratings shall substitute the rated entity credit profile with the guarantors.



Prudential Ratings caps the extent of support's impact on the rating to 2 notches above its standalone profile. Exception are applied in the case of guarantees that warrant credit substitution to the guarantor's financial profile as said above.

Score	Description
Equalisation	Demonstrated unconditional, irrevocable and timely guarantee in toto.
Strong (+2 notches)	Demonstrated and anticipated strong shareholder and/ or sovereign support. Matches most of the qualifiers stipulated above.
Adequate (+1 notch)	Reasonable confidence of shareholder and/or sovereign support. Matches just adequate qualifiers as stipulated above.