



# Broker Entity Rating Criteria Methodology

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## Summary

PACRA's Broker Entity rating represents its opinion on the relative credit risk associated with a broker. PACRA arrives at this opinion by evaluating the broker's business and financial risks, its competitive strengths, along with an assessment of its management quality and the operating environment. Given the inherent volatility of the industry, the assessment of the financial risk profile of a broker also focuses on ascertaining the sustainability of its business operations in stressful times. While several parameters are used, the relative importance of each of these qualitative and quantitative criteria can vary across entities, depending on its potential to change the overall risk profile.

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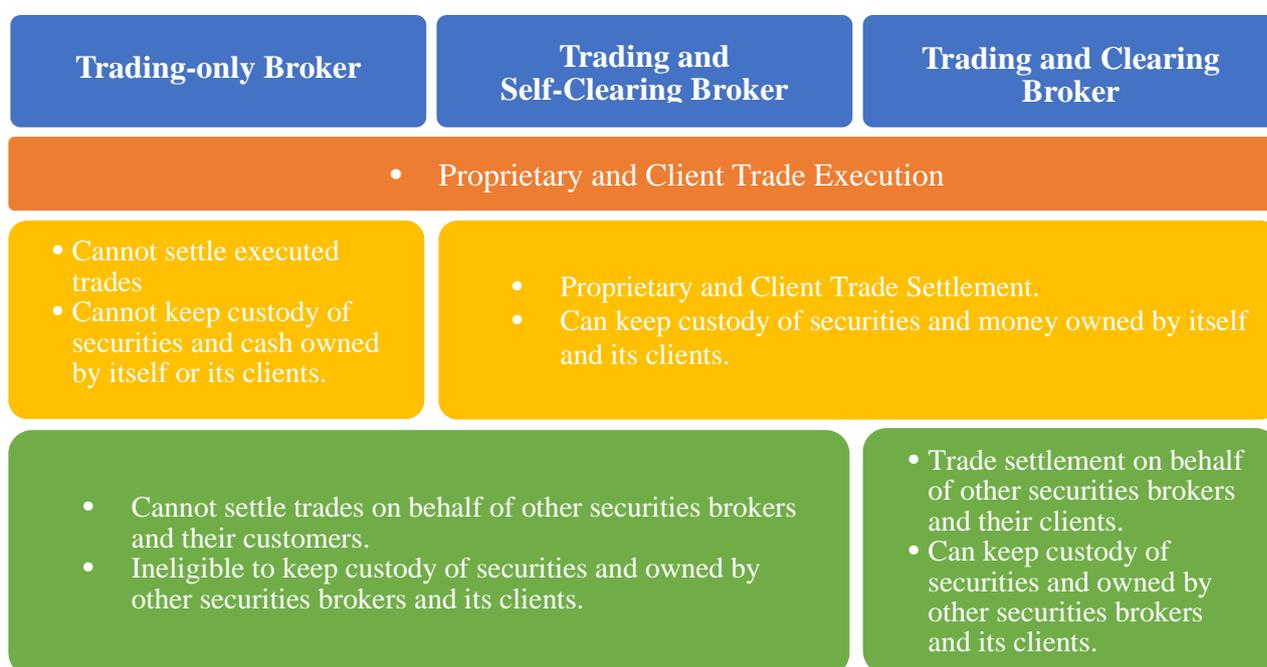
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### 1. Introduction

**1.1 Scope:** This credit rating methodology applies to securities brokers. Securities brokers are regulated by Securities and Exchange Commission of Pakistan (SECP) under the Brokers and Agents Registration Rules, 2001. SECP initially issued the Securities’ Brokers (Licensing and Operations) Regulations in June 2016. In order to undertake brokerage business, firms must: (1) hold a Trading Rights Entitlement Certificate (TREC) from the Pakistan Stock Exchange (PSX), (2) be a participant in the Central Depository System (CDS) of Central Depository Company (CDC), (3) be a clearing member of National Clearing Company of Pakistan Limited (NCCPL), and (4) must possess a securities license from SECP. Separate regulations apply to distinct categories of brokers, these include requirements for minimum capital, net worth, and minimum net capital balance. The three categories of securities brokers specified by SECP are Trading-only, Trading and Self-Clearing, and Trading and Clearing brokers.

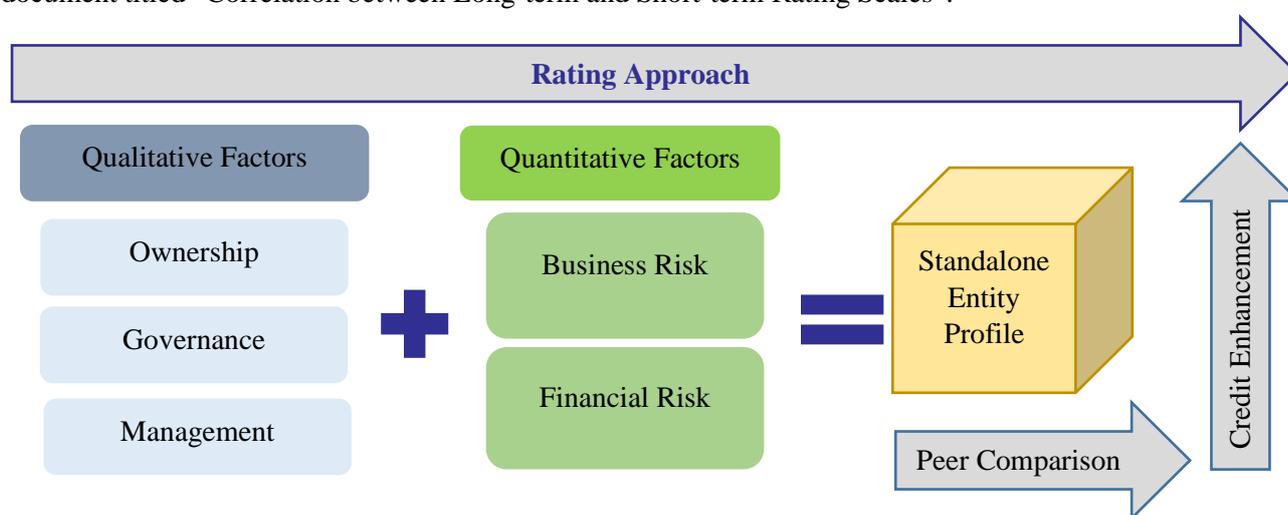


**1.1.1** Securities brokers provide multiple services, including brokerage (equity, fixed income, and commodity) and dealing in listed and unlisted equities. They also provide (or help provide) leverage products such as Margin Trading Systems, Margin Financing, and Securities Lending and Borrowing. Additionally, some brokers also provide advisory services and may also engage in underwriting. To offer underwriting services, a broker must be registered with SECP as an underwriter under the Underwriter Rules (2015).

**1.2 Rating Framework:** PACRA assesses brokers on a range of quantitative and qualitative factors, specifically Organizational Profile, Ownership, Governance, Management, Business Risk, and Financial Risk. No single factor has an overriding importance, and all factors are reviewed in conjunction. Quantitative factors often do not portray a holistic view of an entity, hence PACRA employs a balance of both quantitative and qualitative factors in its analysis. This balance is maintained to ensure comparability of other ratings over time. The quantitative factors assist in achieving objectivity in the rating process, while the qualitative factors provide insight on a brokerage's ownership, governance, and management capabilities, which determine their capacity to sustain and enhance the quantitative aspects. Together, these factors establish a comprehensive understanding of a brokerage's performance and potential for growth.

**1.2.1** The main objectives of this rating methodology are to understand the business model of a broker (and its inherent risks), evaluate the management’s strategy, assess the local macroeconomic environment, and analyze the developments in the securities industry. Another key consideration under the broker entity rating methodology is the relative positioning of the broker in comparison to its industry peers and competitors.

**1.2.2** PACRA’s rating process does not include an audit of a broker’s financial statements. However, it does examine the existing control environment to establish the accuracy of the broker’s financial statements and their reflection of the financial performance and integrity of the balance sheet. PACRA also makes necessary adjustments for comparability between the financial data of different brokers and establishes a "peer group" of comparable brokers to conduct sufficient analysis of brokers. The overall assessment culminates in the assignment of a long-term and short-term credit rating to a broker. Information on the distinction between the long-term and short-term ratings and the relationship between them may be found in PACRA’s Criteria document titled “Correlation between Long-term and Short-term Rating Scales”.



## 2. Profile

**2.1 Background:** PACRA reviews the background of the broker to understand its evolution from inception to where its current position. PACRA analyzes the methods employed by the broker to achieve its desired expansion. PACRA looks at the progress of the broker from its historical performance, which helps in determining the ability of the broker to successfully execute its strategies. A significant factor here for PACRA is to assess whether the broker has achieved its expansion through organic growth or acquisitions. Additionally, the source of funding utilized for achieving the growth is also examined critically.

**2.2 Operations:** The assessment of a broker’s operations depend on the stage of business it is in and its exposure to different business segments. Understanding the operations helps PACRA identify potential business risks a broker could face, its ability to safeguard existing its businesses from these risks, and its ability to attract and generate new business. PACRA reviews the diversity and geographic scope of operations, the strength and quality of the broker’s business model, franchises, licenses, standard operating procedures, policies, protocols, and product offerings. The size of a broker may be an important factor if it provides significant advantages in terms of operational efficiency and competitive position. Moreover, PACRA evaluates the customer experience in dealing with the brokerage firm, taking into account factors such as the quality of the mobile application and trading platform, information accuracy, and efficiency in order execution.

### 3. Qualitative Factors

**3.1** The qualitative assessment helps establish the sustainability of the rating in the foreseeable future. Qualitative considerations refer to rating factors that do not pertain to an entity’s business or financial risk. They focus on internal processes, people, and systems, and are thus essential to incorporate in a forward-looking rating approach. This section provides a brief overview of how PACRA factors in qualitative considerations to its assessment, insofar as they can impact an issuer’s ability to meet financial obligations. PACRA’s detailed approach undertaken to conduct qualitative analysis is documented in its methodology titled “Qualitative Considerations”.

**3.2** Incorporating the potential impact of qualitative considerations into the rating opinion can be challenging as they are inferred or estimated based on information which may be unstandardized or difficult to quantify. This requires some degree of subjectivity and analyst judgement, supplemented by PACRA’s own experience and the experience of the underlying entity (or other entities with similar risks). The three factors underlying PACRA’s qualitative analysis at the entity level include: Ownership, Governance, and Management. The scope of analysis for each category is briefly described below.

**3.3 Ownership:** The analysis of ownership is driven by the risks pertaining to the structure and stability of the entity’s ownership, the key owners’ experience and prowess in the securities industry, and the owners’ willingness and ability to extend extraordinary financial support in distressful circumstances.

**3.4 Governance:** This section analyzes the risks pertaining to a broker’s Board of Directors’ 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:** PACRA’s analysis of management examines the risks pertaining to the proficiency of the management team of a broker in executing strategy, maintaining strong information systems & utilizing them for decision making, and ensuring adherence to the entity’s ethical and quality standards. Key factors looked into by PACRA are organizational structure, the profile and business acumen of the management team, the management effectiveness, and the control environment in place. PACRA’s management analysis emphasizes an entity’s present protocols to maintain robust information systems, key-person risk and turnover, and formulate strategic plans.

**3.5.1** PACRA examines the independence and effectiveness of the risk management function, the procedures and limits that have been implemented, the limits setting authorities, and the degree to which these procedures and limits are adhered to. PACRA assesses a broker’s senior management’s understanding of and involvement in risk management and examines the reporting lines in place. In recent years, there has been a noticeable improvement in the risk management systems of brokers as a result of increasing guidance and supervision from State Bank of Pakistan (SBP) and SECP.

### Credit Risk

- Risk emanates from the inability of clients to pay for the securities purchased on their behalf.
- PACRA analyses the mechanism put in place by the broker to minimize credit risk.
- Assessment of credit worthiness of client is crucial.

### Market Risk

- Arises from adverse movements in investment values.
- Management’s policy as to the proprietary book play a vital role in the overall assessment of the broker’s market risk appetite
- Poor market risk management or aggressive market risk-taking without mitigants would likely pressure a broker's ratings.

### Liquidity Risk

- Occurs due to insufficient funds to meet obligations.
- PACRA analyses liquid investments against the broker's funding base.
- Brokers with well defined policies of maintaining adequate liquidity are considered superior.

### 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.

### Reputation and other Risk

- 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 industry analysis focuses on the dynamics of the domestic capital markets over the past periods. Fluctuations and cyclical movements in capital markets are analyzed, and future projections are looked at based on this (especially regarding the medium-term outlook). Key data is the interplay of domestic and foreign investors, the risk and investment appetite of these investors, and the future expected trends of these aspects. Trading volumes and their concentration help in identifying the health of the industry. Domestic market dynamics are compared with other regional and global markets with the objective of identifying gaps and areas where the domestic market lags and the implications these gaps and lags have on the market. Moreover, industry positioning of significant market players is evaluated, while legal injunctions (current and forthcoming) are reviewed to form a view on whether the industry would experience a major shift in the medium-term.

**4.1.1** The objective of PACRA’s business risk analysis is to establish the broker’s ability to sustain and grow its relative positioning in the industry while ensuring profitable operations. PACRA also explores the possible risks and opportunities for a broker that result from social, demographic, regulatory, and technological changes. It considers the effects of geographical diversification and trends in industry expansion, and other aspects, for instance if consolidation is 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 type of brokers and to specific financial products.

**4.1.2 Economic Risk:** Economic risk refers to the potential impact of economic factors on the overall economy. PACRA analyzes basic economic indicators of the country such as size & composition of the economy, performance of important sectors, geopolitical events, gross domestic product (GDP) growth, government influence, inflation, exchange rates, and trends in savings & investments. Other important parts of economic analysis are the positioning of the securities industry, impact assessment of economic risk factors on the industry, and the potential prospects within the industry.

Supply & demand in the securities industry heavily correlates with economic trends, thereby making brokerages heavily susceptible to economic risk. The extent and proportion of transactional income in the securities industry is fairly significant, inferring that in periods of economic distress – i.e., when investors are wary and refrain from trading activities – the survival of market players is significantly threatened. This threat especially pertains to smaller-scale brokers reliant on transactional revenue.

**4.1.3 Regulatory Environment:** A well-regulated and supervised financial system is pivotal for credibility and stability of brokers - even when the operating environment becomes unfavorable. PACRA pays close attention to the extent of vigilance by SBP and SECP, along with the extent of an entity's compliance towards regulatory frameworks. PACRA'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 broker among peers in the securities market. Institutions with stronger market standings demonstrate advantages arising from their comparatively larger scale and favorable market penetration. The stronger the relative position, the stronger the broker's ability to sustain pressures on its business volumes and profit margins. The relative standing takes support from the broker's market share and growth trend.

**4.2.1 Market Share:** Market share represents the broker's penetration in its chosen markets. Greater size is advantageous as it provides ability to acquire more business, have healthy pricing power, and better cost management. There are positive correlations between a broker's size (both absolute and relative), and its market position and brand value. Larger entities exercise greater power over the pricing, while ensuring proportional profits. Small entities struggle to obtain business and have less flexibility in the cost structure, which can lead to their profits remaining low. While absolute size is important, the relative proportion provides a clearer yardstick to analyze the comparative strength of market players. The larger a player is in comparison to the average, the stronger its ability to reflect the aforementioned characteristics, and thus PACRA believes that relative size would better capture the strength of a broker's standing in a dynamic industry (one not characterized by concentration). Some variables observed by PACRA to determine a broker's true competitive position such as volumetric market shares, relative market shares of retail and non-retail clients, and trends in these market shares over time.

**4.2.2 Growth trend:** While evaluating the size, PACRA also looks at the rate of growth of the securities' market, along with the growth in a broker's fundamental metrics such as revenues, expenses, performing and doubtful trade receivables/investments, et cetera. Growth is important as it ensures that an institution continues to have the ability to meet industry benchmarks and maintain or improve its competitive position. As the industry grows, the scale of an institution's operations are expected to grow. This would reflect in the enhanced ability of brokers to invest in human resource, upgrade the control environment, enhance the product slate, increase outreach, and improve the quality of products/services. To lag the industry's growth trend means shortages on these avenues, thereby pressurizing the broker's market position. PACRA monitors higher-than-industry growth trends to understand the quality of the incremental business, including the impact on key business segments and if it has

resulted in higher concentration due to added business. Higher growth while compromising the quality of the portfolio is perceived negatively.

**4.3 Revenues:** In measuring earnings quality of a broker, diversification and stability are very important factors. A broker with a diverse product slate and more than one revenue stream is considered better than a broker with a concentrated earning profile. Diversification is desirable as it enhances ability to meet present and upcoming challenges. Lack of diversification gives rise to concentration risk, reflecting vulnerability of the broker. Revenue diversification is desirable at both the customer and product/segment level. Overreliance on a handful of clients to generate revenues and profits can be potentially problematic as losing out on a client with a large contribution to a broker's revenues can lead to catastrophic constraints on the broker's financial statements. The revenue analysis of a broker also requires a clear understanding of the two lines of business in which a brokerage may engage in. One is the fee-based revenue stream, and the second is fund-based revenue stream. PACRA recognizes fee-based revenue as core business operations, and fund-based revenue as non-core (even if it is fundamental to the overall profitability of the broker). Core revenue needs to present a strong case for the continuity of the firm. Revenues are evaluated by various metrics such as client/segment revenue concentrations, comparing both core and non-core revenue with the cost of doing business or total income, analyzing revenue trends, et cetera.

**4.3.1** PACRA identifies the following types of revenues as core: brokerage, underwriting fees, advisory & consultancy fees, et cetera. Brokerage revenue, followed by underwriting fees, typically make up the larger chunk of broker revenues, while advisory fees make up a comparatively smaller share. It is worth noting that advisory fees are also yet to have a sizable presence in the domestic securities market. PACRA's evaluation of brokerage revenue involves a comprehensive assessment of each revenue stream separately, considering their various aspects, to gain a holistic understanding of the broker's performance.

PACRA analyzes the revenue generated from the sale of stocks in terms of value alongside the nature of stocks traded by the broker. Furthermore, PACRA closely observes a broker's bid-ask spread based revenue streams & contrasts them to its peers which helps in identifying a broker's ability to capitalize on market fluctuations coupled with the liquidity of stocks being traded the broker's clientele.

PACRA also evaluates the customer mix of a broker, looking at the proportion of individual, high net worth, and institutional clients. It even considers the interplay between foreign and local clients concomitant to the longevity of client relationships. These factors provide insights into the diversification and stability of the broker's client base. Moreover, PACRA views the broker's average brokerage fees in comparison to industry averages, average commissions charges, and as stated earlier; the mix of buy and sell brokerage revenue. The alternative revenue streams from underwriting, advisory, and other services are analyzed to determine their significance and contribution to the broker's total revenue, as well as their sustainability within the broker's business model.

**4.4 Cost Structure:** Cost structure is analyzed to assess the amount of operational flexibility of brokers in less favorable market conditions. PACRA considers the extent of the variable cost base of a broker, while also evaluating the broker's performance and expense ratios relative to those of its peers. This assists in understanding whether operational costs have been contained as the broker's asset bases and revenue streams grow. High expense ratios could be indicative of a significant fixed cost burden, and lower margins can indicate lesser flexibility in regards to inflation of operational costs. Overall, a low-cost base relative to peers offers brokers greater flexibility to deal with competitive pricing pressures. The key measures that PACRA looks at are the costs as a percentage of fee income, and costs as a percentage of total operating income. Non-mark-up expenses are also compared (where possible) with earning assets and the number of employees. That said, performance

measures are not assessed in isolation as variations in them can be caused by business model differences and ongoing investments in the broker's franchise.

**4.4.1 Margins:** PACRA looks at the historical trend of a broker's performance, the stability and quality of its earnings, and its capacity to generate profits. Wherever possible, PACRA analyses the earnings for each of the broker's business lines. PACRA makes adjustments to a broker's reported income statement figures, so that financial performance indicators are as comparable as possible from one broker to another. The relevant ratios for this analysis are: fee-based income to total income, and operating cost to fee-based income.

Fund-based income is an additional buffer, as are profitability and margin ratios. Fund-based income may emanate from financing activities, fixed income avenues, and proprietary trading. The depth and diversity of this fund-based income is analyzed with an objective to form a view on whether or not the income is recurring. Bad debts are also analyzed and pitched against the financing book of a broker as funding to clients may result in crystallization of credit risk. Analysis of aging is also relevant, but its impact is catered for in the financial risk analysis of the broker.

**4.5 Sustainability:** PACRA evaluates the strategy of the management and the viability of the designed path to reach to the brokerage's goals. Earnings prospects are monitored based on budgets and forecasts prepared by the broker's management. 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.

**4.5.1 Event Risk:** Incorporating the risk of unforeseen events into a broker's rating opinion is challenging. Events can be externally (M&A's, regulatory changes, litigations or natural disasters) or internally driven (unrelated diversification, system breakdown leading to significant operational risk or strategic restructuring), and can lead to substantial rating changes. PACRA applies its analytical judgment in assessing the likelihood of such occurrences, their potential impact, and assesses the broker's track record, the expertise of its management team, and the level of financial discipline to incorporate into its ratings.

## 5. Financial Risk

**5.1** Financial risk of a brokerage firm emanates from the types of transactions the firm executes. A broker may engage in leveraged products, receivable financing, ready futures, and proprietary trading. These transactions may (or may not) be backed by borrowings (usually short-term). In addition to borrowings, a broker may utilize client funds (normally reported under advances from and/or payables to clients) to conduct these transactions. The higher the reliance on borrowings and payables, the higher the amount of risk the broker carries. It is therefore fundamentally important to classify a broker's finances and funding avenues with clarity. This would capture the amount of risk that a firm is carrying on the balance sheet at a first glance. From here, a case may be built for an in-depth analysis of each risk.

**5.2 Credit Risk:** Credit risk is the primary risk of a brokerage firm and is a result of borrowings and client fund utilization for execution of transactions. The highest level of risk exists in case of receivables related to securities purchased on behalf of clients. This is a type of clean credit, though the firm carries respective clients' scrips in the subaccount. For these scrips, the market risk is most critical. In the event of a bearish market, the value of these scrips may stumble, causing clients to withdraw from their commitments to settle the receivables. The mechanisms put in place by brokers to limit their loss ensuing from these potential settlements is assessed through a handful of metrics - the most important being the system in place for margin calls, particularly how timely and effective the system is. This, alongside the extent of impaired receivables in the broker's balance sheet, gives a good idea about the overall credit risk borne by a broker.

**5.2.1** Credit risk also results from leveraged products. These are Margin Financing (MF) and the Margin Trading System (MTS) – products governed by oversight of NCCPL. By design, MF and MTS are not excessively risky up to a certain limit, however, they still carry a degree of counterparty credit risk, which is ultimately borne by the financing broker. This risk can originate from when investors default on margin calls and from possible deterioration of the collateral for the facility.

**5.2.2** Ready futures transactions entail purchase of securities from the current market and their sale in the future. These transactions have inherent risk mitigants against credit risk as securities are handed over only in the case of payment settlements. Nevertheless, the credit risk is still relevant in the case of a client denying to make payments in future to take up the securities.

**5.2.3** Proprietary trading is when a brokerage invests its own capital, rather than client funds or borrowings, to conduct financial transactions in pursuit of increased earnings, liquidity, and profit maximization. Proprietary trading is generally seen as a positive influence on the broker's credit worthiness as it offers a sound stream of complementary income. That said, partaking in proprietary trading means added risk for a broker. This is not a problem unless there is digression from the broker's core business activity and an extensive engagement in proprietary trading. Overburdening engagement in proprietary trading affects the level of neutrality within a brokerage's operations as it may cause conflicts of interest between clients and brokers (as there is no direct benefit of proprietary trading to clients) and signals that brokers may require significant portions of their coverages and trade liabilities for financing their "prop books" (instead of client funds) in times of distress. Thus, PACRA evaluates proprietary trading and its impact on the entity rating very closely.

**5.3 Market Risk:** Market risk, also known as unsystematic risk, arises from fluctuations in stock prices, interest rates, commodity prices, and exchange rates. PACRA's assessment of market risk is premised on an understanding that not all types of investments are equally exposed to market risk. The impact of market risk is different from one type of investment to the other. In certain investments, the interplay of credit risk and market risk aggravates the overall amount of risk exposure. For instance, a broker's exposure in bonds also indicates its exposure to interest rate, and in turn, credit risk (as bond prices are highly vulnerable to changing interest rates). Bonds with low ratings reduce the asset quality of a broker's investment portfolio and hence are negative considerations. Furthermore, a broker's policy pertaining to proprietary trading plays a vital role in the overall assessment of its market risk appetite and its ability to manage conflict of interest. PACRA considers the extent to which a broker is invested in liquid assets (notably short-term government securities). Greater liquidity is a proxy of lesser market risk exposure and is thus a positive consideration. A broker's ratio of equity to investments is also an insightful metric for gauging market risk. This ratio assists PACRA in observing the proportion of investments financed by a brokerage's own capital, as opposed to borrowed capital (and therefore less exposure to financing costs). PACRA also observes a brokerage's tradeable investments relative to their total investments. The idea is that a greater proportion of tradeable investments out of total investments causes greater exposure to short-term market fluctuations - thereby increasing total market risk exposure.

**5.4 Liquidity Risk:** PACRA's main aim is to identify the cushions present in a broker's balance sheet against its committed liabilities. PACRA investigates brokers' ability to readily liquidate their investment portfolios to cover repayments against short-term liabilities. Evaluation of liquidity risk is a relatively straightforward computation – using metrics such as liquid investments as a percentage of the total funding base, alongside liquid capital balances to liabilities, liquid assets as percentage of trade related liabilities and short-term borrowings, et cetera. PACRA places emphasis on the ability of a broker to raise capital in times of short-term financial distress, and liquidate assets in order to cover liability repayment in times of distress.

**5.5 Capital Structure:** PACRA analyzes a broker’s ability to maintain the capital structure to formulate a view on the broker’s sustainability of operations. Funding sources currently available to a broker, their level of utilization, and the composition of those funding sources (diversity and maturity profile) are assessed to view a broker’s financial health. The metric Net Capital Balance (NCB) is used to proxy the overall health of the broker and would reflect its size and rating. Some other ratios that are assessed to observe the quality of the capital structure include financial charge service & debt payback ratios.

**5.5.1 Credit Enhancement:** Brokers carrying third party commitments to cover their monetary obligations possess an advantage in regards to their overall financial risk profiles. In such cases, key factors to assess the impact of the third party on the broker entity ratings are: the financial profile of the third party, and the extent of coverage (amount and duration) the third party provides.

### Information Required on Financial Risk

- Top 10 trade receivables and top 10 trade payables.
- Top 10 accounts classified under doubtful receivables
- Details of exposure limits for the brokerage operations and measures taken by the management to ensure implementation of these limits
- Details of instances of margin calls during recent one year
- Authority limits of treasury head and other top management as well as policy regarding total investment limit in said securities as percentage of equity
- Details of latest approved funding limits along with outstanding amount
- Internally approved list of eligible securities for margin financing (if any)
- Calculation of net capital balance under Rule 2 (D) of the SECP Rules, 1971
- Aging analysis of receivables
- Statutory reports filed with PSX and SECP

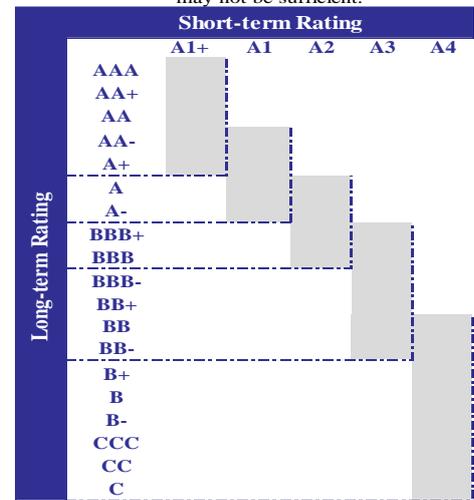


### Credit Rating

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.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> 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.
AA-	
A+	
A	<b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	<b>Good credit quality.</b> 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.
BBB	
BBB-	
BB+	<b>Moderate risk.</b> 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.
BB	
BB-	
B+	
B	<b>High credit risk.</b> 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, favorable business and economic environment.
B-	
CCC	<b>Very high credit risk.</b> Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



\*The correlation shown is indicative and, in certain cases, may not hold.

**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term 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 'Developing'.

**Rating Watch** Alerts 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) PACRA finds it impractical to surveill 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 six 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) Broker Entity Rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) Independent Power Producer Rating
- g) Microfinance Institution Rating
- h) Non-Banking Finance Companies Rating

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