



The Pakistan Credit Rating Agency Limited

## Rating Report

### NRSP Microfinance Bank Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Oct-2020	A	A1	Stable	Maintain	YES
27-Apr-2020	A	A1	Negative	Maintain	YES
28-Oct-2019	A	A1	Negative	Maintain	-
29-Apr-2019	A	A1	Negative	Maintain	-
06-Nov-2018	A	A1	Stable	Maintain	-
30-Apr-2018	A	A1	Stable	Maintain	-
31-Oct-2017	A	A1	Stable	Maintain	-
29-Apr-2017	A	A1	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings incorporate the bank's placement in the Microfinance Sector, as witnessed from its ~9% share in the gross loan portfolio (GLP) and ~10% share in the deposits of the industry. The design of the lending book keeps the concentration high wherein a considerable portion is dedicated to crop-linked loans, particularly to sugarcane crops; this, coupled with volatile system indicators, has significantly impacted the bank's credit quality in the last few years. This resulted in a considerable rise in infection ratio and a sizable quantum of write-offs in order to cleanse the loan book which has been achieved to a large extent. The management is eyeing no significant increase in NPLs in the medium term. Volumetric rise in lending book resulted in higher revenue earned. During 6MCY20, the bank witnessed good growth in profitability (Pre-Tax 9MCY20 profit: PKR 710mln, 9MCY19 loss: PKR 753mln). This along with presence of healthy investment book provides comfort. Considering the constrained market conditions due to COVID-19 pandemic outbreak and the bank's internal factors, the management's strategic focus inclines towards consolidating the bank's position in the short horizon, including exercising a cautious lending approach and building gradual product diversity. The Bank's CAR witnessed slight uptick (Sep-20: 15.71%, Dec-19: 15.4%). The management is actively pursuing actions to address strengthening of CAR which are at an advanced stage. Stable outlook incorporates enhanced pre-provision profitability, quantum of highly liquid investment book and plan of strengthening CAR over short horizon. The ratings are placed under "Watch" particularly to reflect on the challenges arising from COVID-19 outbreak and subdued economic activity. Though SBP's Relief Packages have come handy to the sector in protecting the credit quality of the players, the out-turn of the situation, and its relative impact on the risk profiles of industry players, is yet to unfold in the days to come. The ratings, however, take comfort from the association of NRSP Microfinance Bank with the National Rural Support Programme, the major shareholder, and with the three foreign development organizations - IFC, Acumen, and KfW. The major sponsor has expressed explicit intention to support the bank in case there is a need for capital injection.

The ratings are dependent upon the bank's ability to aptly combat the emerging risks under the current scenario in order to keep its business and financial risk profile intact. Meanwhile, any further contraction in net liquidity book or erosion in CAR would have a negative impact on the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	NRSP Microfinance Bank Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   FI (Jun-20), Methodology   Correlation Between Long-Term And Short-Term Rating Scale (Jun-20), Criteria   Rating Modifier (Jun-20)
<b>Related Research</b>	Sector Study   Microfinance (Sep-20)
<b>Rating Analysts</b>	Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504



## Profile

**Structure** NRSP Microfinance Bank Limited ('the bank') was incorporated as a public unlisted company in October 2008 under Section 32 of the Companies Ordinance, 1984 (now the Companies Act, 2017). The bank commenced nationwide operations in March 2011.

**Background** The bank builds on the experience of its parent institution - National Rural Support Programme (NRSP) which in 2008, spun-off its Micro Enterprise Development Programme (MEDP) into a separate bank – NRSP Microfinance Bank with an already established portfolio of ~165,000 clients.

**Operations** The bank currently operates with its head office in Bahawalpur, a key district in Southern Punjab, which places it closer to its target market. A wide range of financial services is offered by the bank including micro-lending, micro-insurance, Islamic banking products and deposits to the financially excluded individuals living in both urban and rural areas of Pakistan.

## Ownership

**Ownership Structure** The bank is a subsidiary of National Rural Support Program (NRSP) with its shareholding of ~52%. Other shareholders include International Finance Corporation (IFC), Acumen and Kreditanstalt für Wiederaufbau (KfW) – a German based Company, each having ~16% shareholding in the bank.

**Stability** Stability Continued sponsor support accompanied by stable ownership pattern, since inception, bodes well for the bank.

**Business Acumen** NRSP – a nonprofit organization – established in 1991, is an autonomous body limited by government guarantee. It is the largest Rural Support Program in the country in terms of outreach, staff and development activities. Other sponsors including; KfW - owned by the Government of Germany, IFC - a member of the World Bank Group and Acumen - incorporated in 2001, share the common purpose to develop under privileged societies of developing economies and encourage financial inclusion.

**Financial Strength** Good financial position of sponsors strengthens the financial muscle of the bank.

## Governance

**Board Structure** The overall control of the bank vests in a nine member board of directors (BOD), including the CEO. The Chairman of the Board is Mr. Rashid Bajwa and Mr. Zahoor Hussain Khan is the CEO/President of the bank. Two independent directors are part of the Board.

**Members' Profile** The directors are experienced professionals having exposure in various sectors, including the microfinance industry.

**Board Effectiveness** The Board of directors is branched into three sub-committees namely (i) Audit (ii) Remuneration & Compensation and (iii) Operational Risk and Policy. These committees ensure effective oversight of the bank's affairs and strengthens the Board's governance role.

**Transparency** M/S A.F. Ferguson & Co. are the external auditors of the bank. The auditor has expressed an unqualified opinion on the financial statements of CY19.

## Management

**Organizational Structure** The bank has divided its organization structure in ten departments with each department head reporting directly to the CEO, while the head of the internal audit department reports to the Audit Committee.

**Management Team** Mr. Zahoor Hussain Khan – the President and CEO – carries over 23 years of experience in banking and finance and has been associated with the group for long. The CEO is assisted by an experienced management team.

**Effectiveness** To ensure effectiveness of the operations, the bank has three management committees in place, namely; i) Operations and Risk Management Committee (ORMC), ii) Asset Liability Committee (ALCO) and iii) IT Steering Committee.

**MIS** Detailed MIS reports are generated to support the senior management in timely and effective decision making. MIS includes reports pertaining to disbursements, repayments, recoveries, deposits, and compliance.

**Risk Management Framework** The bank has instituted policies for assessing credit worthiness of loan applicants, which is paramount to its business model. Recently, the bank has particularly steered its focus towards consolidating its position through adopting more stringent and efficient risk control mechanisms.

**Technology Infrastructure** The bank uses Oracle Flexcube as its core banking software; implemented since 2012. Back to back support contract from Oracle is directly in place to ensure smooth system run.

## Business Risk

**Industry Dynamics** Pakistan's Microfinance Industry comprises 39 microfinance providers including 12 Microfinance Banks, 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes and 4 other projects. MFIs dominate the industry with a share in lending portfolio of ~72%. As at End-6MCY20, the Industry Gross Loan Portfolio (GLP) clocked in at PKR~299,948mln (End-CY19: PKR ~305,753mln). Amid economic uncertainty, a slump in growth within the industry is noted. The recent flooding in various parts of Sindh, is expected to have an impact on the credit health of entities, which have a sizable lending mix in the area. The outbreak of the pandemic Covid-19, has added further uncertainty in the industry, since the consumers are part of a segment, which is deemed to be highly financially vulnerable.

**Relative Position** The bank catered to ~5% of the borrowers in microfinance industry (including MFIs, RSPs and other projects) as at End-6MCY20, grabbing a ~9% share of the market in terms of Gross Loan Portfolio (GLP). Moreover, it has a market share of ~10% on the deposits side.

**Revenue** Interest/Mark up income of the bank increased to PKR~4,198mln during 6MCY20 (6MCY19: PKR~3,303mln). The asset yield clocked in at ~22% (6MCY19:~20%).

**Profitability** Net mark-up/interest income clocked in at PKR~2,307mln during 6MCY20 (6MCY19: PKR~1,754mln). The bank's net profitability rose sharply to PKR~338mln (6MCY19: PKR~439mln). This was majorly due to a significant fall in provision charge during the period (6MCY20: PKR~678mln, 6MCY19: PKR~1,022mln), on account of infected credit health.

**Sustainability** Recently, the microfinance industry has notably absorbed the effect of macroeconomic instabilities in its portfolio in the shape of slumped growth and elevated Portfolio At Risk (PAR). The bank, in terms of effect absorption, has been on the higher end, due to its product mix concentration and other factors. Moreover, the effect of Covid-19 will put pressure on the growth prospects, liquidity and future infection of the loan book, of all industry players. In the short horizon, the bank therefore, plans on devising strategies to regain its credit quality and capital adequacy, to reiterate its stability in the market.

## Financial Risk

**Credit Risk** The bank's loan book is primarily concentrated in non-collateralized loans. As at End-6MCY20, the GLP rose to PKR~29,450mln (End-CY19: PKR~27,910mln) with a growth of ~3%. Advances continued to be dominated by Agri Input Loans (~54%), followed by MicroEnterprise Loans (~21%) and Livestock Loans (~19%). The bank's infection ratio rose to ~4.1% (End-CY19: ~1.6%), mostly on account of non-payments by sugarcane farmers. Continued curtailment of NPLs is essential to the profitability of the bank going forward.

**Market Risk** Short term investments during 6MCY20 increased to PKR~3,416mln (End-CY19: PKR~1,440mln). This was majorly due to the rise in investments in Government Securities.

**Funding** The bank's funding is majorly fueled through deposits, which primarily consists of time deposits (~68%). Out of the total deposit base of the bank amounting to PKR~33,327mln (End-CY19: PKR~26,651mln), Islamic banking deposits constitute ~12%. The bank's advances to deposits ratio (ADR) improved to ~86% (End-CY19: ~103%), representing increased room for growth.

**Liquidity** Liquidity profile improved during the period as the bank's liquid assets-to-deposits and borrowings ratio rose to ~31% at End-6MCY20 (End-CY19: ~22%).

**Capital Adequacy** Capital adequacy ratio (CAR) of the bank has reached precarious levels as at End-9MCY20 ~15.71% (End-CY19: ~15.4%). Cautious management action and injection of capital is necessitated in order to keep the CAR above the regulatory benchmark.



<b>BALANCE SHEET</b>	<b>30-Jun-20</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>
	<b>6M</b>	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>
<b>Earning Assets</b>				
Finances	28,256	27,610	23,432	21,100
Investments	3,416	1,440	3,322	2,551
Deposits with Banks	6,362	3,946	6,128	5,192
	<b>38,034</b>	<b>32,996</b>	<b>32,882</b>	<b>28,843</b>
<b>Non Earning Assets</b>				
Non-Earning Cash	1,634	1,504	1,214	1,674
Net Non-Performing Finances	378	52	180	(159)
Fixed Assets & Others	6,637	5,452	4,075	3,231
	<b>8,649</b>	<b>7,009</b>	<b>5,468</b>	<b>4,746</b>
<b>TOTAL ASSETS</b>	<b>46,684</b>	<b>40,005</b>	<b>38,351</b>	<b>33,590</b>
<b>Funding</b>				
<b>Deposits</b>	<b>33,327</b>	<b>26,651</b>	<b>26,263</b>	<b>23,671</b>
Branch Banking	33,327	26,651	26,263	23,671
Branchless Banking	-	-	-	-
Borrowings	3,978	4,484	5,278	4,053
	<b>37,306</b>	<b>31,134</b>	<b>31,541</b>	<b>27,725</b>
<b>Non Interest Bearing Liabilities</b>	<b>4,354</b>	<b>4,183</b>	<b>2,201</b>	<b>1,851</b>
<b>TOTAL LIABILITIES</b>	<b>41,659</b>	<b>35,318</b>	<b>33,743</b>	<b>29,576</b>
<b>EQUITY (including revaluation surplus)</b>	<b>5,017</b>	<b>4,684</b>	<b>4,598</b>	<b>4,012</b>
<b>Deferred Grants</b>	<b>8</b>	<b>3</b>	<b>10</b>	<b>2</b>
<b>Total Liabilities &amp; Equity</b>	<b>46,684</b>	<b>40,005</b>	<b>38,351</b>	<b>33,590</b>
<b>INCOME STATEMENT</b>	<b>30-Jun-20</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>
Interest / Mark up Earned	4,198	7,524	6,332	4,976
Interest / Mark up Expensed	(1,891)	(3,402)	(2,226)	(2,039)
<b>Net Interest / Markup revenue</b>	<b>2,307</b>	<b>4,122</b>	<b>4,105</b>	<b>2,937</b>
Other Operating Income	474	1,165	833	871
<b>Total Revenue</b>	<b>2,781</b>	<b>5,287</b>	<b>4,938</b>	<b>3,808</b>
Other Income	-	-	-	-
Non-Interest / Non-Mark up Expensed	(1,628)	(3,355)	(2,885)	(2,315)
Pre-provision operating profit	1,153	1,932	2,053	1,493
Provisions	(683)	(1,845)	(1,155)	(388)
Pre-tax profit	470	87	899	1,106
Taxes	(133)	(3)	(308)	(284)
<b>Net Income</b>	<b>338</b>	<b>84</b>	<b>591</b>	<b>821</b>
<b>Ratio Analysis</b>	<b>30-Jun-20</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>
<b>Performance</b>				
ROE	13%	2%	14%	23%
Cost-to-Total Net Revenue	59%	63%	58%	61%
Provision Expense / Pre Provision Profit	59%	95%	56%	26%
<b>Capital Adequacy</b>				
Equity/Total Assets	11%	12%	12%	12%
Capital Adequacy Ratio as per SBP	15.4%	15.4%	16.6%	18.4%
<b>Loan Loss Coverage</b>				
Non-Performing Advances /Gross Advances	4.1%	1.6%	2.7%	0.3%
Loan Loss Provisions / Non-Performing Advances	68%	88%	72%	331%
<b>Funding &amp; Liquidity</b>				
Liquid Assets / Deposits and Borrowings	31%	22%	34%	34%
Advances / Deposits	86%	103%	89%	88%
CASA deposits / Total Customer Deposits	32%	32%	26%	38%
<b>Intermediation Efficiency</b>				
Asset Yield	22%	23%	21%	19%
Cost of Funds	10%	11%	8%	8%
Spread	12%	12%	13%	11%
<b>Outreach</b>				
Branches	154	154	143	105

**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+	
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-	
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	
CC	<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.
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 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 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):

<p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
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### **Rating Team Statements**

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

### **2) Conflict of Interest**

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

### **Conduct of Business**

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

### **Independence & Conflict of interest**

- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

### **Monitoring and review**

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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