Rating Methodology

TRIS RATING
A strategic partner of S&P Global

Financial Institution Rating Methodology

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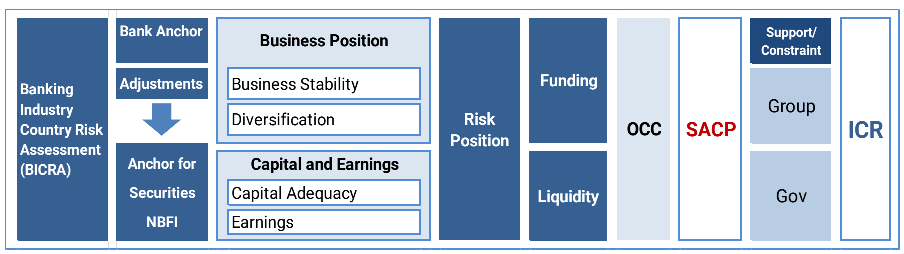
This rating methodology for financial institutions (FIs) consolidates the previously published rating methodology for banks, securities brokerage companies, and non-bank financial institutions (NBFIs). The methodology supersedes the following:

- Bank Rating Methodology, dated 20 March 2023
- Securities Company Rating Methodology, dated 9 April 2020
- Non-bank Financial Institutions Rating Methodology, dated 17 February 2020

SCOPE OF THE CRITERIA

The methodology applies to commercial banks, finance companies, depository specialized financial institutions (SFIs), securities brokerage companies, NBFIs, and other types of lending FIs that are under the same or similar regulatory supervision as banks.

RATING FRAMEWORK



TRIS Rating uses the same rating framework for banks, securities companies and non-bank financial institutions. The FI Rating Methodology focuses on the assessment of an FI's stand-alone credit profile (SACP) to derive an Issuer Credit Rating (ICR).

The rating process starts with a bank anchor, which takes into consideration the economic risk and banking industry risk of the bank's country of domicile under the Banking Industry Country and Risk Assessment (BICRA) analysis criteria.

For securities companies and NBFIs incorporated in Thailand, the starting anchor is adjusted downward by three notches and four notches, respectively, from the bank anchor. The adjustments reflect intense market competition as well as the absence of deposit funding and systemic support from regulators under stress scenarios, and the inability to access the Bank of Thailand's liquidity facilities. NBFIs are also subject to less regulatory supervision, compared to banks and securities companies.

The extent of adjustments from the bank anchor for FIs incorporated in other countries may differ, depending on the industry structure and the varying degree of regulatory supervision.

To determine the stand-alone credit profile (SACP) of an FI, we adjust the starting anchor with credit rating factors used for financial institutions. The factors include business position, capital and earnings, risk position, and funding and liquidity. Before deriving the SACP, we may examine other credit considerations (OCC) that have not been factored into the credit rating factors but that could have an impact on the overall credit profile of the issuer.

Before we finalize the ICR, we may incorporate a potential rating enhancement from extraordinary support provided by an FI's group or the government as outlined in TRIS Rating's "Group Rating Methodology" and "Rating Methodology for Government-related Entities".

ECONOMIC AND BANKING INDUSTRY RISK ASSESSMENT (BICRA)

BICRA consists of two main aspects of assessment: economic risk and banking industry risk.

Economic risk:

The economic environment of the country in which a bank operates tends to impact the financial health of the bank. The economic risk is assessed based on three sub-factors:

- **Economic resilience**

Economic resilience refers to a country's economic structure and stability, flexibility of macroeconomic policy and political risk. These are qualitative factors which are assessed based on available data. One quantitative metric that can be used is GDP per capita.

- **Economic imbalance**

Economic imbalance evaluation considers system credit expansion, property and capital markets and current account. The typical economic imbalances detected in an economy include excessive credit expansion, overheating property markets, signs of stock market speculation, consistent current account deficits, or high levels of external debt.

- **Credit risk in the economy**

Credit risk in the economy refers to the private-sector debt level and leverage of an economy which is indicated by the level of private-sector debt or household debt relative to GDP. The assessment also includes observations on credit underwriting and lending standards, payment system, and legal environment such as legal claims over collateral.

Banking industry risk:

Banking industry risk is assessed based on three sub-factors:

- **Institutional framework**

A country's institutional framework is assessed based on three aspects: 1) whether its banking laws and regulations are in line with international standards; 2) the strength and effectiveness of supervision by the regulators; and 3) its track record of crisis management during past stress periods and crisis preventive measures.

- **Competitive dynamics**

This refers to the intensity of competition within the industry. Barriers to entry are key factors that influence the competitive landscape of a country's banking industry. The stages of industry development, product sophistication, and consumer behavior also have influences on the competitive landscape. A highly competitive and fragmented market typically leads to margin compression, declining profitability, cost rationalization, and eventually consolidation among industry players.

- **System-wide funding**

The assessment focuses on the stability of funding in a banking system. Customer deposits are typically the core funding source with the highest degree of stability. Wholesale funding in the form of borrowings or issuances of debt securities as well as offshore borrowings are seen as less stable and susceptible to changes in market sentiment and external market disruptions.

FI CREDIT RATING FACTORS

Business Position

We assess an FI's business position by comparing its standings to its direct peers in the same or similar sub-segments where its core businesses are operated. We form a holistic view by considering two key aspects: business stability and diversification.

Business stability

We evaluate business stability in terms of business volumes and revenues through the economic or market cycles and changes in customer demand. Business stability takes into account the following sub-factors.

- **Business mix**

A business mix that contributes stable revenues and earnings is viewed positively. We also consider any potential risk that could impact business strategy or cause operational disruption, e.g., technology, changes in consumer preferences or regulations.

- **Market position**

Sizeable market share across business lines tends to promote revenue stability, but this has to be achieved without compromising pricing power. Thus, a gradual increase in market share and the ability to maintain market share that translate into sustained revenue growth is viewed more positively. Conversely, we take a cautious view when an FI pursues accelerated growth in market share due to changes in strategy, e.g., aggressive pricing or a shift in target customers, or imprudent expansion.

At the same time, eroding market share needs to be further explored as it may reflect weakened franchise or a shift in strategy. This could be assessed negatively if the declining trend, particularly in core businesses, is expected to continue. For a bank, we assess market share in loans and deposits. For NBFIs, loan portfolio size may or may not have an influence on business position assessment. While a large market share could help stabilize revenue streams, it does not always lead to strong market position assessment. For securities companies, we focus on revenue market share rather than the trading volume of the brokerage business.

- **Revenue stability**

We analyze FIs' revenue structure compared with peers. For revenue to sustain through the economic cycle, a large portion should be recurring from established relationships with core customers or dealers (in the case of lending businesses that depend on relationships with dealers, e.g., auto leasing). For a bank and an NBFI, interest income that stays resilient and healthy recurring fee income are examples of stable revenues. For a securities company, recurring fee income is preferred over trading or market-sensitive income.

- **Customer base**

Having long-term relationships with customer bases that generate a sizeable portion of revenues would be positive. FIs that have long-standing relationships with customers which make up their core customer bases tend to be less susceptible to costly competition for customer retention.

Diversification

Our focus on diversification is on the revenue contributions of business lines, customer base, and geographies. An FI that has strengths in a variety of products as well as a balanced customer mix and revenue structure is less vulnerable to adverse market or economic conditions and pricing competition.

- **Business line diversification**

This can be neutral, positive, or negative to an FI's business position. We analyze revenue contributions from each business line, compared to peers. Diversification is generally positive as it mitigates the impact on overall revenues from changes in market conditions or customer preferences. That said, expanding into new products lines that expose an FI to higher risk than its core businesses without proper risk management policies in place may be viewed negatively. At the same time, we may view favorably an FI with concentration in core business lines in which it has a competitive edge as it may support a strong market position and revenue stability without significant risk.

The business of an NBFI is generally considered diversified given its retail-based customers with small-ticket loan sizes on average. Hence, an NBFI with concentration in a few products or customer segments with larger ticket-size loans could be viewed negatively. Meanwhile, ability to diversify into non-lending products or services with revenue generation being sustained could be positive. For a securities company, ability to scale up a variety of financial services other than the brokerage business could help stabilize revenue during market downturns.

- **Geographic diversification**

For FIs with domestic branch networks or expansion outside of Thailand, we examine revenue breakdown by geographic distribution. This is crucial for traditional business lines that still require face-to-face services. These may include, for instance, auto title loans provided by NBFIs or retail banking in Thailand. Thus, diversified geographic coverage via extensive branch networks is generally viewed favorably. In addition, with the growing trend in digitalization, adding a digital platform to an FI's traditional service channels would also be positive for its business position as it should help expand revenues and customer base as well as optimize costs in the long run.

- **Customer diversification**

For an FI to be viewed positively, core revenues or a large portion of its revenues should not derive from a small group of customers. For a securities company, we consider a mix of customers that use its brokerage and other investment services. We also evaluate data on the top-20 exposure. For a bank or an NBFI, this could be credit exposure, while for a securities company it could be volume of brokerage business or margin lending.

Capital and Earnings

Capital essentially indicates an FI's ability to absorb losses. The assessment focuses on its capital level and ability to replenish capital through earnings generation and other sources. Capital and earnings assessment involves three major steps:

1) Measurement of capital position against regulatory requirements

For a bank or securities company, the capital level assessment starts with measurement of capital adequacy against regulatory requirements. At this level, we determine whether the current capital level is at risk of breaching the regulatory requirement, subject to regulatory forbearance, or in breach, as there could be a cap on its SACP.

For a bank, we measure the capital ratio against the regulatory requirement in the country of domicile. The capital ratio may include core equity Tier 1 (CET1) ratio, Tier 1 ratio, or other solvency standard monitored by the regulators. For Thai banks, we focus on CET1 ratio. For a securities company in Thailand, we use net capital ratio (NCR) as a benchmark. For an NBFI, there is generally no specific capital level to measure against given the lesser degree of regulatory supervision.

2) Capital assessment based on our projected average capital or leverage ratio.

For Thai banks, we use our projected CET1 ratio. In the country where CET1 ratio is not available at all or on a timely basis, leverage ratio measured by equity-to-asset ratio may be used. We use an average ratio of the current year and the next two years. For a financial group, we use consolidated CET1.

For securities companies and NBFIs, we calculate the risk-adjusted capital ratio (RAC) by applying risk weights to different types of assets. The capital assessment at this stage is based on the weighted average RAC over five years with greater focus on the projected years. For certain NBFIs, we may use the debt-to-equity (D/E) ratio to assess the leverage level where risk weights for assets are not applicable. Typically, these are NBFIs whose core businesses are not lending activities.

3) Capital and earnings adjustments

Once we calculate the initial capital ratio in step 2, the capital assessment may be adjusted by quality of capital and/or quality of earnings. For Thai banks and securities companies, the quality of capital is generally high, given minimal or no hybrid capital in their capital structure.

The quality of earnings can be measured based on earnings capacity and earnings buffer. Earnings capacity, which is measured by the ratio of earnings before tax to average risk-weighted assets (EBT/ARWA), is used for securities companies and NBFIs. Earnings buffer is measured by the ratio of pre-provision operating income, adjusted for one-off items, less normalized credit losses, divided by risk-weighted assets. The ratio is used for banks and securities companies to evaluate the ability to generate core operating income to cover normalized credit losses. This can be positive or negative, but is generally positive for banks and most securities companies. When it is negative, it may lower the capital and earnings assessment in cases where the RAC ratio is already at the low end of the capital scale.

Risk Position

In assessing an FI's risk position, we take a holistic approach to evaluate its risk position relative to its peers. The key indicators used depend on the type of FI, although in general the focus is on risk appetite, loss experience, concentrations, complexity, and other types of risk specific to the FI.

Risk appetite. The emphasis is on growth and changes in exposure. Higher growth in core businesses and high-risk activities relative to the industry or notable changes in risk exposure may indicate an aggressive risk appetite. Nonetheless, high growth or changes in exposure may not always link to a riskier position as it depends on the FI's ability to manage risk. For NBFIs, lending and underwriting policies are reviewed and compared among peers or with banking standards in the same country to gauge risk policy and appetite.

Loss experience. An FI's recent and historical loss experience relative to peers can be an indicator of the effectiveness of its risk management and impacts its risk position. For banks or NBFIs, loss experience can be indicated by various data, including formation of non-performing loans (NPLs), NPL ratio, expected credit loss (ECL) provisions to average loans (or credit costs), trend in loan loss provisions by loan staging, debt restructuring efforts, NPL write-offs and recovery.

For securities companies, we concentrate on trading losses from investment portfolios or certain non-brokerage business lines as well as credit losses on margin lending. Degree of losses compared to peers in the same sub-segment or business line measured during the same period provide a good indicator of an FI's risk position.

Concentrations. We assess risk concentrations by reviewing an FI's exposure to customers, products, business lines, industries, and sectors, or other aspects that could potentially lead to a higher loss experience compared to peers. An FI with materially high-risk concentration of any type is viewed as having a weak risk position. Top-20 exposure may be used as an indicator.

Complexity. Complexity itself is not necessarily a negative factor. The focus is on an FI's ability to manage risks associated with the complexity of products, business lines, and organizational structure. For banks in Thailand, complexity could arise from their diversification efforts towards non-traditional banking products and channels, although their expansion thus far has been at a measured pace. For securities companies, engagement in the derivatives business, structured capital market products, or investments in non-traditional asset classes are examples of increased complexity.

Other material risks. We also assess other risks, including interest rate risk, operational risk or risk associated with non-FI businesses. For a bank or an NBFI, the focus is on asset-liability management (ALM), mainly maturity and repricing gaps. Currency risk may be highlighted for an FI that expands into overseas markets where assets and funding are in different currencies. For securities companies, apart from credit risk from counterparties and margin lending, market risk is also a focus area as it is generally higher than credit risk due to the nature of the activities that involve investments in risky assets, either for own proprietary trading or for hedging of financial products offered to customers.

Funding and Liquidity

Funding. Our assessment of funding position is based on both quantitative and qualitative measures. The focus is on the stability and diversity of funding sources. The strength of a bank's funding position is assessed based on the composition of its funding structure. A bank that sources funding mainly from retail depositors, especially from retail current accounts and savings accounts (CASA) is considered to have a strong funding position as these are viewed as sticky deposits. If the bank's proportion of CASA is lower than major peers, we would expect that at least its funding maturity profile should be appropriate for its asset maturity profile. Conversely, a bank that relies heavily on short-term wholesale funding, particularly confidence-sensitive types, is viewed to have a relatively weak funding position.

The metrics that we use to monitor banks' funding profiles include loan-to-deposit ratio, deposits to funding base, CASA deposits to total deposits (CASA ratio), deposit costs, and reported Net Stable Funding Ratio (NSFR) per Basel III capital regime, if available. The cost of deposits is analyzed to assess whether the strength in deposits is built on aggressive pricing strategies which may not be sustained.

For NBFIs and securities companies, diverse sources and amounts of funding that are readily available on a long-term basis are viewed more favorably than funding that needs to be secured by collateral (fixed assets or loan portfolio). Long-term and sizeable funding backup from a parent or group can support funding position assessment. Also, a funding structure that comprises mainly long-term funding is viewed more positively as it minimizes refinancing risk in a stress scenario.

For quantitative measurement, we use the Gross Stable Funding Ratio (GSFR) for securities companies and the Stable Funding Ratio (SFR) for NBFIs. Both ratios measure funding stability by comparing available stable funding to stable funding needs. We also consider various qualitative factors for securities companies and NBFIs as a supplement to the quantitative funding assessment.

Liquidity. Liquidity assessment is one of the most important factors in our credit rating process as we view that poor liquidity management could lead to defaults on financial obligations even if capital remains strong. The assessment focuses on an FI's ability to withstand liquidity outflows over the coming 12-month period under a stress scenario. Similar to funding, we evaluate liquidity both quantitatively and qualitatively. Ongoing liquidity backup from a parent or group also lends support to an FI's liquidity assessment.

Quantitative measurements for banks focus on the ratios that compare liquid assets to various balance sheet items, such as total assets, short-term funding, or customer deposits. We also compare the reported Liquidity Coverage Ratio (LCR) with the industry average and observe the trend. For securities companies and NBFIs, the Liquidity Coverage Measure (LCM) ratio is used to measure available liquidity against liquidity needs.

These quantitative measures are always considered in parallel with qualitative factors. This is because the quantitative measurements rely on a point-of-time financial position reported on the balance sheet, which may be misleading and untimely. We also analyze monthly repayment schedules over the next 12-month period to ensure the FI has sufficient liquidity sources to cover liquidity needs.

Other factors to be considered

Priority debt. For NBFIs, we also determine the level of priority debt to total consolidated debt. Priority debt includes total consolidated secured debt and unsecured debt obligations of subsidiaries. If the level of an issuer's priority debt is higher than 50% of its total debt, and most of the group's operating assets are held at the subsidiary level, we consider the issuer's senior unsecured creditors to be disadvantaged and may rate the issue one notch below the ICR. However, even if the level of priority debt is higher than 50%, we may assign senior unsecured obligations at the same level as its ICR if certain mitigations are present (refer to Issue Rating Criteria).

Holding company. The ICR of holding companies of financial groups that are under prudential regulation is generally one to two notches below the group credit profile (GCP) due to structural subordination.

OTHER CREDIT CONSIDERATIONS (OCC)

Apart from the key credit considerations discussed above, there could be other considerations that should be captured in assessing the issuer's credit profile. For instance, if there is strong evidence to suggest a serious governance issue, it could be reflected as a negative rating adjustment under "Other Credit Considerations". An FI's financial flexibility stemming from its sizeable, diversified investments in various uncorrelated businesses or industries may provide a rationale for a positive rating adjustment.

OWNERSHIP AND GROUP SUPPORT

Once we derive the stand-alone credit profile (SACP), the final step in the rating process is to assess whether there is a possibility of a rating uplift due to extraordinary group support in the case the FI is a member of a group (please refer to TRIS Rating's Group Rating Methodology) or receives financial support from the government in the case the FI is a government-related entity or GRE (please refer to TRIS Rating's Rating Methodology for Government-related Entities).

KEY FINANCIAL RATIOS

Ratio	Definition
Total Revenues	Net interest income + Net fee income + Other non-interest income
Return on Average Asset (ROAA) %	Net income / Average assets
Return on Average Equity (ROAE) %	Net income / Average shareholders' equity
Earning Asset Yield (%)	Total interest income / Average earning assets
Funding cost (%)	Total interest expenses / Average funding
Net Interest Margin % (For banks)	Net interest income / Average earning assets
Interest spread (%)	Earning asset yield - Funding cost
Earning Assets (For banks)	Cash + Interbank and money market items (asset) + Net investments + Gross loans (including deferred revenue)
Funding Base (For banks)	Deposits + Interbank and money market items (liabilities) + Borrowings and debt issued
Liquid Assets	Cash + Interbank and money market items + Net investments
Credit Cost (%)	Expected Credit Loss (ECL) provisions / Average gross loans
NPL Coverage (%)	Loan loss reserves / Gross non-performing loans
Cost to Income (%)	Total operating expenses / Total revenues
Risk-Adjusted Capital Ratio (RAC) (%)	Total shareholders' equity net of intangibles / Risk-weighted assets
Leverage ratio (E/A) (X) (For banks / securities companies)	Shareholders' equity / Total assets
Debt to Equity Ratio (D/E) (X) (For NBFIs)	Total liabilities / Shareholders' equity
Earnings before Tax / Average Risk-weighted Assets (EBT/ARWA) %	Earnings before tax / Average risk-weighted assets
Gross Stable Funding Ratio (GSFR) (%) = Available stable funding / Gross stable funding needs (For securities companies)	(Total equity net of intangibles + Long-term interbank and debt funding) / (Sum of balance sheet items x % required long-term funding)
Stable Funding Ratio (SFR) (%) (For general NBFIs)	(Long-term debt excluding current portion + Shareholders' equity) / (Non-current receivables + Long-term investments + Fixed assets)
Stable Funding Ratio (SFR) (%) (For NBFIs providing revolving loans)	(Long-term debt excluding current portion + Shareholders' equity) / (Total receivables + Long-term investments + Fixed assets)
Liquidity Coverage Measure (LCM) (X) = Broad liquid assets net of haircut / Balance sheet liquidity needs (For securities companies)	Sum of liquid assets net of haircuts / Sum of balance sheet items net of haircuts
Liquidity Coverage Measure (LCM) (X) (For general NBFIs)	(Cash + Short-term investments + Current receivables) / (Short-term borrowings + Current long-term debt)
Liquidity Coverage Measure (LCM) (X) (for NBFIs providing revolving loans)	(Cash + Short-term investments) / (Short-term borrowings + Current long-term debt)

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