Corporate Scorecard

Ratings Methodology – Financial Institutions Rating Criteria

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1 OVERVIEW

This document provides an overview of Corporate Scorecard's criteria for assessing the creditworthiness of financial institutions ('FI'). The document outlines the process, principles and methodology applied in Corporate Scorecard's engagements.

2 SCOPE

Corporate Scorecard's financial institution rating methodology is an analytical framework for assigning the different types of ratings (credit and issue) which reflect a financial institution's capacity and willingness to honour its commitments in a timely manner. Corporate Scorecard's top-down approach is supplemented by rigorous, bottom-up, evidence-based analysis. Inputs to Corporate Scorecard's rating methodology include a variety of non-financial and financial data from diverse sources.
Corporate Scorecard's financial institutions rating methodology does not cover insurance companies which are covered under its own methodology.

Corporate Scorecard's rating incorporates an FI's standalone financial risk profile and the likelihood that it may receive external support from a parent group and/or extraordinary support from the sovereign. Corporate Scorecard assesses both the ability and propensity of the potential support provider to extend such support in a timely manner.

3 KEY RATING TERMINOLOGIES

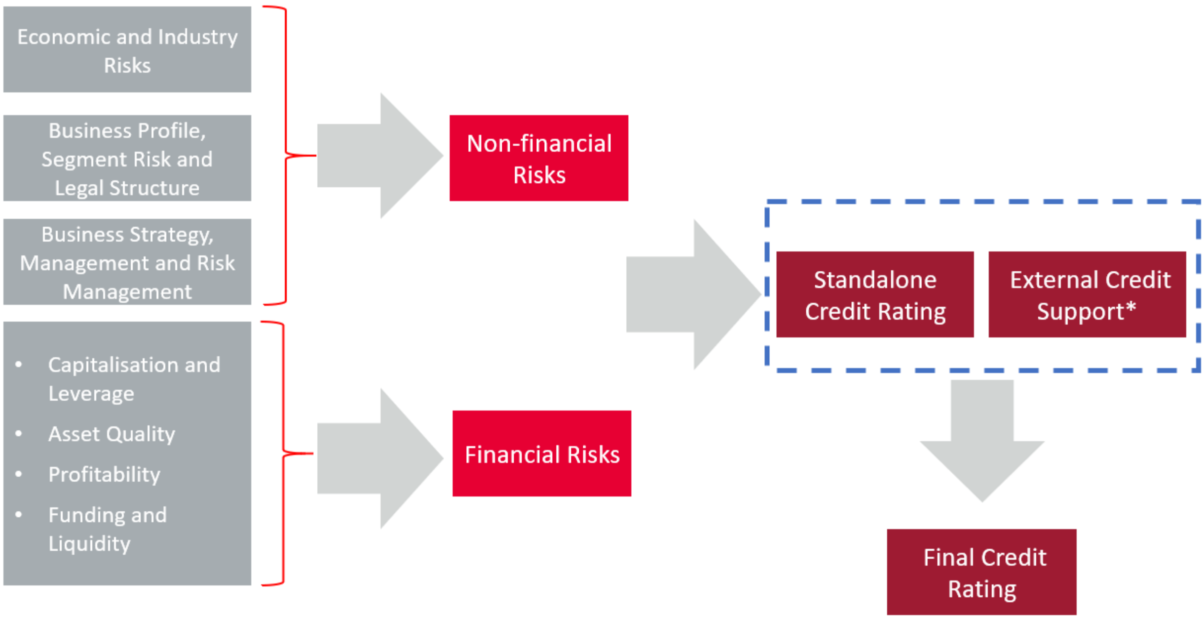
For key rating terminologies including definitions, qualifications and outlook, refer to the ratings service guide hosted on the Corporate Scorecard's website.

4 CREDIT RATING METHODOLOGY

Corporate Scorecard's assigned credit ratings are arrived at by analysing the stand-alone and combined impact of key drivers of systemic (industry fundamentals) and non-systemic risks (an FI's business risk and financial risk profile). Corporate Scorecard evaluates an FI's exposure to systemic and non-systemic risks on both, gross and net basis – taking any mitigating factors into account, to assess the impact of these risks on an FI's credit rating.

The below figure summarises Corporate Scorecard's framework for arriving at credit ratings.

Figure 1: Overview of the Rating Process



*External credit support refers to Parent support and/or Sovereign support

Corporate Scorecard's rating process starts with an assessment of an FI's exposure to industry risk factors (top-down approach). Corporate Scorecard determines an FI's exposure to non-systemic risk factors by analysing non-financial and financial business risks (bottom-up approach). Corporate Scorecard combines the results of its top-down and bottom-up approaches to arrive at the standalone credit rating. Lastly, the standalone rating is modified for availability of any external support.

The table below summarises various factors and sub-factors which may be evaluated to determine impact of key risk drivers:

Risk	Factors	Sub – Factor
Economic and Industry Risks	Sovereign Risks, Legal and Regulatory Framework	• Legislations and regulations • Effectiveness of regulatory bodies • Financial market development
	Economic Performance, Growth and Stability	• Economic growth • Size and diversity of the economy • Volatility • Geopolitical Risks
	Level of Competition and Market Structure	• Size of the market • Market penetration • Entry barriers
Business Profile, Segment Risk and Legal Structure	Business Profile	• Market Share and Scale • Brand and Reputation • Diversity of Operations
	Segment Risk	• Cyclicality • Segment specific market risks
	Structure	• Transparency • Complexity • Limitations
Business Strategy, Management and Risk Management	Business Strategy and Management	• Management track record • Adaptive framework
	Corporate Governance	• Financial reporting and audit quality • Remuneration structure • Related party transactions
	Risk Management	• Monitoring of limits • Operational controls
	Risk Appetite and Underwriting Standards	• Portfolio diversification and security • Delegated approval authorities
Financial Risk	Capitalisation and Leverage	• Regulatory capital requirements • Ability to raise capital • Quality of capital
	Asset Quality	• Adequacy of provisioning • Diversification
	Profitability	• Net interest margins • Efficiency
	Funding and Liquidity	• Maturity profile • Asset liability mismatch • Funding mix

External Credit Support	Parent Subsidiary Linkage (PSL) Framework	• Legal linkage • Operation linkage • Strategic linkage • Financial linkage • Strength of the parent
	Sovereign Support	• Ability and willingness of the Sovereign • Systemic important of the FI

The following sections summarise the credit rating process. The arrangement of the following paragraphs is only to facilitate cohesion and may not necessarily reflect the actual rating process.

4.1 Economic and Industry Risks

Corporate Scorecard identifies key risks associated with the economy and industry which the FI operates in. Economic risk is mainly associated with macroeconomic conditions such as geopolitical risks, foreign currency exchange rates, interest rates, GDP growth, employment indicators, government regulation, political stability, financial market development, and is a key determinant of the cap or floor to an FI's credit rating. Industry risk relates to the threat of a loss in revenue or market share due to regulatory changes, structural changes to the industry landscape (e.g. disruptive business models, technological or product advancements), a change in the competitive landscape and market dynamics, or any other factors.

Some factors contributing to Operating Environment assessment include:

4.1.1 Sovereign Risks, Legal and Regulatory Framework

Government regulations significantly influence the financial markets and operating environment for businesses domiciled and/or having material operations in their jurisdiction. Corporate Scorecard analyses the extent of geopolitical risks in the country of the FI's operations. This includes analysis of the political climate, the sovereign's relations with its neighbouring economies, the economic interdependencies and relations with key partners.

A developed legislative and regulatory framework, an effective regulatory body, sound accounting and corporate governance standards, and appropriate regulations for reasonable protection to creditors are essential for a stable operating environment. A large financial sector with developed institutional investors market supports the financial institutions and an FI's access to capital, funding and liquidity. Corporate Scorecard evaluates the support or constraints the regulatory environment imposes on an industry.

4.1.2 Economic Performance, Growth and Stability

Healthy economic growth, its sustainability and low volatility in variables such as interest rates, exchange rates and asset prices are viewed favourably for an operating environment assessment. Corporate Scorecard also reviews other indicators of macro-economic performance such as the current position of the economy in the credit cycle, system lending growth and its mix; consumer confidence; household borrowing levels; terms of trade and asset prices (commodity prices, house prices, equity prices, bond yields). Prolonged weakness in the general economy, asset bubbles, wide fluctuations in capital flows, a negative trend in lending practices are some of the drivers of increased risk to the financial sector. The health and rate of growth of the economy can also serve as a reference point to assess if the FI is following an aggressive growth strategy relative to the system growth.

A large, well-diversified domestic economy generally results in lower macro-economic volatility in comparison to a small economy dependent on few sectors, particularly if the sectors are highly cyclical.

Corporate Scorecard's analysis of the cyclicality, size and diversification of an economy, and the sensitivity of an economy to market risks helps it ascertain the relative stability of an FI's operations and earnings.

4.1.3 Level of Competition and Market Structure

Industry concentration is mainly a function of entry barriers and the size of the market. Typically, a tightly regulated, small market with few large operators will tend to exhibit higher concentration and stability of earnings, than a less regulated and fragmented market. The market-share concentration in an industry typically determines the strength and stability of a typical operator's margins. Corporate Scorecard reviews the trend and composition of margins and their consistency with the market structure. Corporate Scorecard also evaluates the market's maturity, including penetration of banking products and product differentiation.

4.2 Business Profile, Segment Risk and Structure

Corporate Scorecard identifies non-systematic business risks with an FI's business model and its legal form, or constitution.

4.2.1 Business Profile

Corporate Scorecard assesses an FI's business profile to determine its competitive position using, among other factors, its market share and scale, brand and reputation, diversity of operations and segment mix.

Market Share and Scale: A financial institution's market share and scale is usually reflective of its competitive position within the industry. Market share could be ascertained from the proportion of an economy's demand for core banking products – loans and deposits, met by the FI. Scale of operations is generally reflective of market share and pricing power, while product/technological leadership and breadth of service offering may be a key driver of the same. Larger FIs like Domestic Systemically Important Banks (D-SIBs) generally have a higher capacity to absorb system related (undiversifiable) losses, making them more resilient to financial crises. In addition, Corporate Scorecard also reviews an FI's distribution network which includes the use of brokers, branches or any other distribution networks.

Brand and Reputation: An FI's product leadership, pricing power, scale of operations and track record of robust earnings contribute positively to its brand and reputation. Adverse public opinion of an FI's business practices, evidence of financial misconduct and deficient risk management and compliance procedures may have a negative impact the brand and reputation, consequently impacting market share and earnings.

Diversity of Operations: Diversity of operations across products, customers and geographic segments may provide strong, intrinsic resilience to earnings. Global banks with an international footprint typically rate well in this category. In addition, strong product level and geographic diversification can also act as a key competitive advantage over local/ regional banks and drive high client retention.

4.2.2 Segment Risk

Banking services may broadly be segmented into:

- investment banking (assuming market risk including proprietary trading and debt and equity underwriting),
- private banking, commercial banking and retail banking, and
- wealth management and insurance.

The above segments have exposure to different risk factors, and as such, share less than perfect correlation in occurrence of a loss over reporting periods. FIs reliant on segments exposed to higher risk – market risks, cyclicality or other risk factors – for a high proportion of income are viewed less favourably than competitors that rely for their earnings on low risk segments.

4.2.3 Structure

Legal structure and its complexity may also impact the assessment of an FI's business risk. Corporate Scorecard examines the legal structure, its restrictions on an FI, and its suitability to the business objectives. Structures that limit scalability and/or impose restrictions on access to capital and liquidity, among other factors, may typically constrain a rating. For instance, a mutual owned operator may benefit from a lack of return on capital objective, but its ability to source additional equity funding may be limited and may necessitate a higher buffer to regulatory capital requirements, than what may be considered sufficient for a corporate.

Corporate Scorecard examines the following factors, among others, in relation to an FI's structure:

Opacity: Structural complexity may limit transparency to asset ownership, sources of cash generation, tax liability, contingent liabilities and legal recourse. Lack of transparency may emanate from layers of intermediate entities, cross ownerships, structure unsuitable for scale and complexity of operations, and may influence a rating outcome.

Double Leverage: Double leverage refers to existence of debt at multiple levels in a Group, facilitated by complex ownership structures. For instance, in addition to an FI's own financial obligations, the parent may have financed the equity capital by raising external borrowings. This debt funded equity is viewed as a weaker source of capital and may necessitate a fixed dividend payout by the FI, to meet the parent's debt servicing obligations.

Structural Subordination: A complex group structure may result in a de-prioritisation of some creditors' claims to the FI's cash flows. For instance, when the FI being rated is only a holding company, whose primary source of cash flow is dividends received from operating subsidiaries, creditors of the FI shall rank lower than creditors of the subsidiaries.

Cash Traps: Cash traps refer to restrictions, including contractual (such as dividend stoppers) and regulatory, preventing a parent from being able to readily provide support to an FI.

4.3 Business Strategy, Management and Risk Management

Corporate Scorecard evaluates the management quality, which can either increase or reduce the corporate's exposure to non-systematic risks.

4.3.1 Business Strategy and Management

Management qualifications, track record, diversity, size and participation directly and indirectly impact execution of an FI's business strategy. High attrition/turnover may adversely impact smooth business operations and execution of medium to long-term business objectives. An FI's clearly articulated strategic vision and evidence of a management team that is in alignment with that strategy, supports the business risk profile. Corporate Scorecard also analyses the flexibility of the FI's strategy and its ability to respond to changes in its external environment.

4.3.2 Corporate Governance

Corporate Scorecard considers if the FI's corporate governance practices are adequate to minimise agency risk – a risk that management actions are not in the interest of the FI's creditors, depositors or any other stakeholders. The quality of financial reporting, external and internal audit processes, management's and directors' remuneration structure and other policies are also considered. The presence of multiple and/or material related party transactions, linkage of management compensation to only short-term business objectives are some instances which may adversely impact an FI's performance on the corporate governance parameter and may also necessitate a further analysis.

4.3.3 Risk Management

A financial institution requires strong and effective risk management tools to adhere to its stated risk appetite and underwriting standards. These controls include the reporting and monitoring of limits pertaining to product or credit concentrations, geography, market risks, policies for escalating breaches to controls, and operational controls (e.g. separation of duties and consistency in the alignment of employee incentive structures). Corporate Scorecard also looks at the portfolio risk management practices of the FI including monitoring, control and review of limits. Risk controls may also include custom scorecards, internal ratings or third-party data sources such as national credit bureaus. In addition, Corporate Scorecard also assesses if the FI has put in place sufficient risk controls to manage reputational, litigation and cyber risks.

4.3.4 Risk Appetite and Underwriting Standards

Corporate Scorecard assesses an FI's risk appetite and its impact on the quality of its loan book. Some indicators analysed include loan-to-value ratios, exposure to unsecured lending and imposition of individual and sector portfolio limits, and delegated approval authorities under an FI's underwriting standards. Balance-sheet expansion or contraction is compared against underlying economic scenario, peers, sector and industry averages to assess the adherence of an FI's operations to its risk appetite and the build-up of any potential risks. For instance, rapid loan growth can make understanding of the true asset quality difficult, as loan growth may be a result of increased risk appetite while the loan-book may not have had time to mature and impact the impaired loans balance in the future.

4.4 Financial Risk

Corporate Scorecard uses quantitative measures to benchmark and measure the financial risk profile of the FI against its peers. The benchmarking exercise enables Corporate Scorecard to identify anomalies and outliers, which warrant a closer examination to identify the likely source and sustainability of such advantages/disadvantages over industry peers and impact on the FI's credit profile.

The quantitative measures are grouped into four main categories - capitalisation and leverage, asset quality, earnings and efficiency, and funding and liquidity.

4.4.1 Capitalisation and Leverage

Healthy capitalisation provides a financial institution the ability to withstand any operational and/or impairment losses. Some of the key factors considered in determination of an FI's capitalisation and leverage profile are:

- Adherence to **regulatory capital adequacy requirements** – higher the cushion over the minimum capital requirement, greater the capacity to absorb losses.
- Capital relative to scale of operations – higher the better.
- **Ability to raise capital** – whether the FI is able to access the capital markets or approach its key investor base, to support a high growth strategy or meet sudden changes in the regulations. This is viewed in conjunction with the FI's ability to generate capital through internal accruals (earnings).
- **Quality of capital** – the proportion of Tier I capital, which is superior to Tier II capital.

Some of the indicators of the strength of an FI's capital:

Ratio	Calculation
Common Equity Tier 1 ("CET")	Common Equity / Risk Weighted Assets

Tier 1 Capital Ratio	Tier 1 Capital / Risk Weighted Assets
Total Capital Ratio	Tier 1 Ratio + Tier 2 Ratio
Leverage	Total Assets / Total Equity
Prudential Buffers	Capital Conservation Buffer + Countercyclical Capital Buffer

4.4.2 Asset Quality

The credit risk on an FI's loan portfolio directly impacts its asset quality. An FI's write-off charge and/or **adequacy of provisioning** measured over the years, and benchmarked against peers, is an indicator of its risk controls, underwriting standards and risk appetite.

Some of the indicators of the quality of an FI's loan portfolio:

Ratio	Calculation
Charge-offs	Loans written off / Gross Loans
Loans accruing but past due	Accruing loans past due 90 days / Gross Loans
Impaired Loans	Impaired Loans / Gross Loans
Individual Loan Provisioning	Individual Loan Provision / Impaired Loans
Total Loan Provisioning	(Individual Loan Provision + Collective Provision) /Gross Loans
Total Provisioning	Individual asset impairment provision / impaired assets

In addition to the above factors, Corporate Scorecard may conduct a further deep-dive analysis on an FI's asset quality, on a case-to-case basis. This examination, may include the following parameters, among others:

- **Diversification** – analysis of risks emanating from high concentration of the FI's loan book to a specific geography, few customers or customer segments.
- **Credit profile of customers** – In case of very high client concentration risk, analysis of the FI's largest counterparties' financial capacity may also materially impact the FI's credit rating.

4.4.3 Profitability

Healthy and sustained profitability, combined with consistent retention of earnings, supports an FI's capacity to service external debt and withstand adverse asset related shocks through generation of internally accrued capital. Profitability is dependent upon the following factors:

- **Net interest margins** – measure of difference between the interest income generated on the assets and the interest paid on borrowings. Typically, net interest margins are affected by volatility in interest rates and interest rate duration gap between an FI's customer loans and borrowings and the ability of the FI to access funding at competitive rates.

- **Diversity of income** – across various customer segments/industry groups and across various products ensures relative stability of income. Also, non-interest income such as fee income/service charges for guarantees, cash management facilities, etc. which provides cushion during times of pressure on net interest margins further supports the stability of margins and margins.
- **Efficiency** – measured as ratio of operating costs to income. Banks with higher efficiencies have a lower cost-to-income ratio.
- Charge-offs/provisioning.

Some of the indicators of an FI's profitability:

Ratio	Calculation
Net Interest Margin	(Interest Income / (Loans – Special Provision)) – (Interest Expense / Deposits)
Efficiency Ratio	Non-Interest Expense / Operating Income
Return on Assets	Net Profit After Tax / Average Assets
Return on Risk Weighted Assets	Net Profit After Tax / Risk Weighted Assets
Return on Equity	Net Profit After Tax / Average Equity
Loans to Assets	Loans / Assets

4.4.4 Funding and Liquidity

Increase in **customer deposits** is one of the key funding sources for an FI's asset growth. A D-SIB or a large bank can also support its funding requirements by accessing **equity/debt capital markets, raising wholesale deposits and other sources of wholesale funding**. In this context, non-bank financial institutions are at a natural disadvantage, given restrictions (whether regulatory or self-inflicted) on raising wholesale deposits and external borrowings.

When considering the funding profile Corporate Scorecard examines:

- term debt burden and maturity profile of the debt;
- **asset-liability mismatch** both on a market value and on a cash flow basis;
- wholesale to retail **funding mix** as well as the currency mix of its borrowings; and
- **size, diversity and geographical spread** of the depositor base. A bigger and more diversified depositor base ensures better stability than otherwise.

However, with an increase in deposits, management of liquidity risk also grows in importance. Liquidity depends on the quality and quantity of liquid assets available to an FI and its asset liability maturity mismatch and other factors.

Some of the indicators of the funding and liquidity profile of a financial institution;

Ratio	Calculation

Loans to Deposits	Loans / Deposits
Liquid Assets	Liquid Assets / Assets
Liquidity Coverage	Liquid Assets / Total Net Cash Outflows Over the Next 30 Days
Net Stable Funding Ratio	Stable Funding Available / Regulatory Stable Funding Required

4.5 Arriving at the Rating

Corporate Scorecard consolidates its findings of drivers of economic and industry risks, business profile, management quality and financial risk to arrive at the credit rating of an FI on a standalone basis.

While finalising the credit rating, Corporate Scorecard relies on internally developed financial models that are informed by the evaluation of the above risk factors combined with the inputs and forecast estimates provided by the FI. These estimates are stressed or modified, as required, to reflect prevailing industry trends and Corporate Scorecard's view of various risk factors which may undermine the FI's credit rating. The above exercise also helps to identity the probable trajectory of the FI's credit rating over the short term along with associated triggers and the drivers of any likely ratings migration.

The final step is adjusting for any extraordinary sovereign support and/or any external support, implicitly or explicitly provided by the FI's parent group.

4.5.1 Sovereign Support

Governments, globally, have demonstrated their willingness to intervene and support industries and entities that are viewed as essential to the functioning of the economy. A high level of systemic importance indicates a higher probability of government intervention in the event an FI lacks internal resources to meet its financial obligations. We do note however following the Global Financial Crisis that this willingness has decreased as has (in many cases) the Government's ability to support. These factors are also considered when assessing the likelihood of Sovereign support.

Corporate Scorecard determines the probability of an extraordinary sovereign support and adjusts the FI's credit rating to reflect the same. If the FI is owned by the government, the credit rating of the FI will be closely tied to the government's credit rating. In other cases, Corporate Scorecard ascertains the extent of support depending on the relative importance of the FI to the economy, implications for the financial sector if the FI were to default, and the ability and propensity of the government to provide timely support.

4.5.2 Parent Support

The standalone rating of the FI is adjusted to reflect the credit profile of the parent. This adjustment depends on degree of operational, strategic, financial and legal linkage between the FI and the parent group, and the strength of the parent's credit profile. Refer to Annexure 6.1 detailing Corporate Scorecard's Parent Subsidiary Linkage methodology.

4.5.3 Final Rating

If the parent's rating is stronger and the linkage between a parent and the FI is assessed to be strong or moderate, the final rating of the FI may benefit and be higher than its standalone rating. On the contrary, if the linkage is weak, there may be limited, or no adjustments made to the FI's credit rating.

5 ISSUE RATINGS

An FI's credit rating after adjustments for any external support and extraordinary sovereign support serves as a starting point to compute issue ratings.
Corporate Scorecard's issue ratings are closely linked to credit ratings of the FI but may differ from the credit rating either due to seniority of the issue (subordination risks) or the collateral available (recovery prospects).

5.1 Subordination Risks

Corporate Scorecard evaluates the explicit and implicit subordination risks. The explicit subordination risk stems from the position in the capital structure, covenants, credit enhancements and bankruptcy laws. Implicit subordination arises from the group structure where risk is increased due to structural subordination.

The position of an issue in the capital structure, covenants of an issue, credit enhancement measures and bankruptcy laws of the region are evaluated to derive the seniority of the issue relative to all existing and potential future liabilities of the FI.

After determining the explicit risks, Corporate Scorecard evaluates the implicit subordination risks through an assessment of the corporate structure and identifying any structural subordination which may arise from the position of the entity within a group, or as a result of specific capital controls identified in the broader group.

5.2 Recovery Prospects

Availability of collateral can partly offset the loss to an issue subscriber in the event of a default. The expected loss to an issue subscriber is a product of the loss given default (exposure at default less collateral's recovery value) and probability of default (determined by the FI's credit rating). The reduction in expected loss to an issue subscriber due to the availability of collateral may put upward pressure on the issue rating.

Salvage Value

The salvage value is computed by grouping assets into categories derived along the lines of tangibility, liquidity and type. A distressed sale discount is applied to the prevailing market values of each of the categories and the sum of these discounted market values is the estimated salvage value expected to be realised.

The realisable value of a collateral is a function of its nature, marketability and condition, and the primary determinant of recovery prospects. Collateral may be a specifically identifiable asset or an asset class.

After forming an opinion on the subordination risks and recovery prospects, the issue rating may be notched higher or lower to reflect the reduced or additional credit risks associated with the issue.

6 ANNEXURES

6.1 Parent Subsidiary Linkage (PSL) Framework

Purpose

The PSL Framework provides an overview of Corporate Scorecard's methodology for assessing the impact on the FI's credit rating, from any potential support from its ultimate parent.

Scope

The PSL Framework facilitates determination of any potential uplift on an FI's standalone credit rating as a result of support from its parent. Generally, the PSL Framework applies when the credit profile of the parent is stronger than the stand-alone credit profile of the FI.

The Framework should be read in conjunction with Corporate Scorecard's Financial Institutions Rating Methodology.

The extent of uplift to the FI's standalone credit rating would depend on the strength of linkage between the FI and the parent. Linkage is likely to be material if the parent is the dominant shareholder, asserts economic control or is able to otherwise influence the key strategic decisions of the FI.

Framework

The first step in the PSL Framework is the assessment of the standalone credit rating of an FI and the parent, using the relevant Credit Rating Criteria.

Corporate Scorecard then proceeds to assess the strength of linkage between the parent and the FI. The legal, operational, strategic and financial ties between the parent and the FI are analysed to determine the strength of the linkage. The stronger the linkage, the higher the parent's propensity to extend support.

Assessment of linkage

Corporate Scorecard analyses the legal, strategic, financial and operational linkage between the FI and the parent, by assessing the below-mentioned factors

Legal Linkage

Extent of shareholding, legally enforceable provisions, corporate status of the parent

Full ownership or majority shareholding by the parent is a key contributor to a strong legal linkage. The other instances of a strong legal linkage include the presence of a deed of cross guarantee between the parent and an FI, presence of any legally enforceable provisions, such as guarantees, or standby letter of credit provided by the parent to the FI's debt instruments.

If the parent is a listed entity, then default by the FI could result in adverse impact to the parent's reputation. Such default could also trigger cross default clauses on ISDAs and other facilities, and hence, may adversely affect the parent's ability to raise funds.

Geographical barriers and regulatory constraints may weaken the legal linkage. For instance, if the parent and the FI are domiciled in different countries, it may limit the parent's ability to gain control over the FI's funds due to tax and capital transfer barriers.

Strategic Linkage

Relative importance of the FI to the parent, shared name

Strategic linkage is measured by the FI's deemed importance to the parent, which is prima facie measured by the FI's contribution to the parent's revenue, assets, profitability or cash flows. In some cases, the strategic linkage may be strong despite the small scale of the FI's operations. For instance, the parent's focus on improvement in the FI's market competitive position through regular capital investment, or the parent's strategy to expand operations in the FI's domicile country may indicate a strong strategic linkage.

Strategic linkage is also deemed strong when the FI and the parent use a common name/ brand/ logo. Such commonality also indicates a greater intent on the parent's part to associate itself with the FI. Under these circumstances, the FI's failure to meet its financial obligations may also adversely impact the parent's reputation, thereby meaning there is a higher likelihood of financial support.

Financial Linkage

Demonstrated track record of support, economic incentive to the parent

A demonstrated track record of financial support in the form of equity infusion, extension of related party loans or standby letter of credit or letter of comfort for availing financing facilities, are all indicative of a strong financial linkage. Financial linkage is also deemed strong, when there is evidence of the parent extending regular and timely funding support, leading to the FI's low dependence on external borrowings.

While determining financial linkage, it is also necessary to ascertain the economic incentive (or disincentive) to the parent, from extending or refraining to extend financial support to the FI. If the FI is not profitable and is a drain on financial resources of the parent on a persistent basis, there is a greater likelihood that the parent company may stop extending financial support beyond a point.

Operational Linkage

Extent of management control, control over operations, centralised treasury function

Operational linkage may be considered strong if the parent and the FI have common Board of Directors, or where the parent appoints majority of the directors on the FI's Board. Corporate Scorecard also assesses the control exerted by the parent, over the FI's day to day operations and the FI's access to the parent's proprietary technology/resources. Operational linkage is also deemed strong, when the parent manages treasury operations centrally and maintains and controls common funding facilities. Further, the greater the similarity in operations and/or interdependence for product, technology, R&D, access to target markets, brand(s) etc., the stronger the operational linkage is likely to be.