



A subsidiary of CARE Ratings Limited

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# CareEdge Global Financial Institutions Rating Methodology

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## A. Introduction

CareEdge Global IFSC Limited's (CareEdge Global) Rating Methodology for assessing Financial Institutions details the framework, approach, and factors for assessment.

## B. Scope

This methodology applies to all banking and non-banking financial institutions globally. It includes all types of banks (multinational, domestic, public sector etc.) and non-banks across various segments (retail, commercial, housing finance etc.).

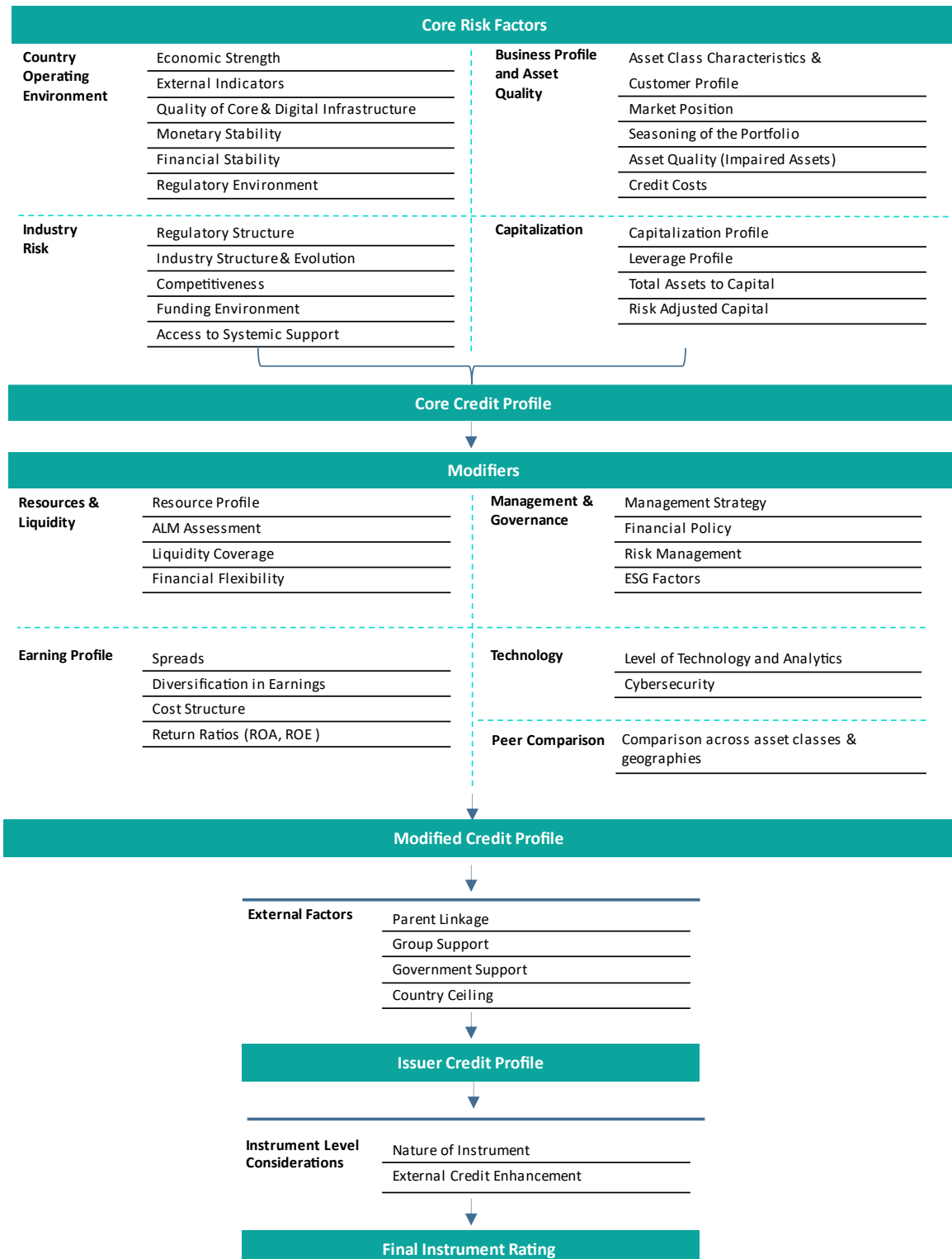
## C. Overall Framework

The assessment begins with an evaluation of Core Risk Factors to determine the Core Credit Profile (CCP). Necessary adjustments are subsequently applied to the CCP in the form of Modifiers to arrive at the Modified Credit Profile (MCP). Any External Factors that may be relevant are analysed to derive the Issuer Credit Profile. Finally, Instrument Level Considerations determine the Final Instrument Rating.

The factors used to determine the CCP are called Core Risk Factors. They include the Country Operating Environment, Industry Risk, Business Profile and Asset Quality and Capitalisation. Similarly, Modifiers used to arrive at the MCP include Resources & Liquidity, Earnings Profile, Management & Governance, Technology and Peer Assessment. Each of the Core Risk Factors, Modifiers, External Factors, and Instrument Level Considerations undergoes evaluation through an array of sub-factors.

The following chart depicts the Financial Institutions Evaluation Framework used by CareEdge Global:

### Financial Institutions Evaluation Framework



## **D. Core Credit Profile**

The factors for the assessment of the Core Credit Profile are detailed below.

### **1. Country Operating Environment**

The Country Operating Environment (COpE) is used while assessing all non-sovereign ratings to evaluate the relative strength of the operating environment of a specific country that a non-sovereign operates. COpE encompasses all aspects that a non-sovereign encounter because of operating in a specific country(s). The evaluation is based on the following six broad aspects:

- a. Economic Strength
- b. External Indicators
- c. Quality of Core & Digital Infrastructure
- d. Monetary Stability
- e. Financial Stability
- f. Regulatory Environment

Each of these six aspects are detailed below:

#### **a. Economic Strength**

The economic Strength of a country is an assessment of its size, income level, growth potential and ability to withstand various shocks. The resilience of an economy relies on stable and strong economic growth which determines both competitiveness and employment opportunities. This, in turn, augments citizens' standard of living and contributes to the sovereign's revenue generation ability. For a virtuous cycle of growth, productive investments are critical. Furthermore, a well-diversified economy provides flexibility to withstand various shocks while fostering inclusive and sustainable growth. On the other hand, over-reliance on a few sectors makes an economy vulnerable to sudden external shocks, as demonstrated in the pandemic-led disruption of some tourism and resource-dependent economies.

#### **b. External Indicators**

External Indicators include a country's access to foreign funding, trade competitiveness, and external liquidity, which have a significant bearing on the operating environment. In an interconnected global landscape, the external sector can become a source of risks emerging from global trade tensions, financial contagion, and geopolitical conflicts.

Hence, external indicators such as a comfortable current account position, healthy capital inflows, sustainable external debt, adequate liquidity become increasingly important cushions to function as offsets.

### **c. Quality of Core & Digital Infrastructure**

Availability of quality infrastructure, both physical and digital, is crucial for an economy resulting in growth through supply as well as demand-side channels. Investments in energy, transportation networks, telecommunications etc. directly impact growth since infrastructure availability is an essential input for the production of goods and services. It acts as a catalyst for driving the growth of allied sectors like housing, construction development projects such as roads, power projects etc. Further, a developed infrastructure set-up reduces the cost of production and facilitates the physical mobility of people and products, thereby increasing competitiveness.

While the development of core infrastructure propels physical production, a sound digital infrastructure is necessary for the growth of an economy's services sector. This has become pronounced in recent times, wherein advancements in digital technology have become a determining factor in the economy's growth. Investments in digital infrastructure such as internet availability, modern banking solutions, data centres, artificial intelligence etc. also play a crucial role in attracting foreign investments.

### **d. Monetary Stability**

Credible monetary policy helps in attaining low and stable inflation, which fosters business confidence and contributes to financial stability. Conversely, prolonged episodes of high inflation undermine monetary policy credibility, erode purchasing power and discourage investment. In this regard, a flexible exchange rate regime allows the Central Bank to conduct independent monetary policy and manage inflation efficiently. Another important aspect is the variety of monetary policy tools at the disposal of the Central Bank and the flexibility to use them while responding to unforeseen domestic and external shocks.

### **e. Financial Stability**

To evaluate the financial stability of the country, we assess stability in asset prices, well-functioning financial institutions, and efficient interest rate transmission. A stable and deep financial system contributes to economic productivity through the efficient

allocation of economic resources and eliminates financial stress. It also enhances the government and private sector's ability to raise funds domestically.

Healthy asset quality and adequate capital buffers are the key elements for a strong financial system. The worsening asset quality of the banking system undermines the stability and soundness of the financial system. This adversely impacts credit availability in an economy weighing on the performance of the real economy. The systemic banking stress could also stress government finances through the buildup of public debt required for potential bank bailouts.

#### **f. Regulatory Environment**

The strength of a country's institutions and effective policymaking contribute to overall economic stability. Strong institutions also make an economy less vulnerable to various shocks (economic, financial, and political) as they enable the formulation and implementation of effective policies targeted at mitigating the impact of these shocks. In addition, good regulatory policies aid government effectiveness by improving the quality of public services and enhancing the credibility of the government's commitment toward economic progress and ease of doing business.

**Legal and contract enforceability:** Contract enforceability and dispute resolution frameworks reflect the strength of a country's legal system, aided by an independent judiciary. A strong legal system facilitates (i) enforcement of rights under contracts, on time and (ii) full recovery. The rule of law ensures unbiased enforcement of contracts and demonstrates the extent of citizens' respect and confidence in the rules of society.

## **2. Industry Risk**

The industry risk is evaluated to understand the profile of the sector in which the entity is operating, which may affect its financial and operational performance. This evaluation also helps to determine its ability to sustain its performance and future cash flow generation, which is the primary source of repayment of its borrowings.

We assess the industry risk using five broad aspects:

- a. Regulatory Structure
- b. Industry Structure & Evolution
- c. Competitiveness
- d. Funding Environment
- e. Access to Systemic Funding

Each of these five aspects are detailed below:

## **a. Regulatory Structure**

The regulatory framework for financial institutions in any country is a complex and dynamic system comprising laws, agencies, and authorities, each entrusted with distinct roles to ensure financial stability, protect consumer interests, and mitigate systemic risks. These frameworks are designed to evolve alongside innovations in financial markets and address emerging challenges effectively. At the core of this system is the central bank, which holds primary responsibility for implementing monetary policy, maintaining financial stability, and managing payment systems. It plays a crucial role in regulating and supervising banks and other financial entities, acting as a lender of last resort during crises, managing foreign exchange reserves and currency stability, and granting licenses to institutions such as commercial banks and payment system operators. The quality, effectiveness, and track record of bank regulation and supervision are fundamental to the stability and robustness of the financial sector. Effective oversight ensures institutions operate prudently, manage risks effectively, and contribute to overall economic stability.

The effectiveness of the regulatory framework is also assessed through examining its proactiveness, stability, alignment with global standards, degree of conservatism and caution, and its track record. Furthermore, factors such as government or political influence, governance, transparency, and the central bank's vibrancy and dynamism are essential to understanding its adaptability and efficiency. A comprehensive evaluation of these aspects, along with the role of central banks and governments in providing stable funding options, highlights the resilience and competitiveness of the financial ecosystem. Such a robust framework fosters confidence, ensures systemic stability, and supports sustainable growth by balancing innovation with risk management in an increasingly interconnected global financial environment."

## **b. Industry Structure & Evolution**

The structure of the financial services industry in any economy is intricate and constantly evolving, encompassing a diverse range of segments. Traditional players such as banks, investment firms, and insurers remain pivotal, but the rise of fintech's, digital innovators, and evolving regulatory frameworks has introduced significant dynamism to the landscape.

The evolution of the industry is influenced by technological advancements, shifting market needs, economic cycles, and global financial trends. Key factors shaping the



structure of the financial sector include the extent of penetration of financial services, the relative role between banks and non-banks and the degree of concentration in the market. The adequacy and sophistication of products to meet client needs in terms of their complexity and risk profile along with product diversity and the availability of risk management tools, also play a crucial role in defining the sector's adaptability and inclusiveness.

Additionally, the ownership structure, in terms of sovereign or private and the extent of government influence in owning and running banks, impacts the efficiency and competitiveness of the industry. The interlinkage between various participants in the financial system contributes to its interconnectedness, which can either enhance resilience or amplify systemic risks during adverse economic cycles.

The stability of monetary policies, the resilience of financial institutions, and the robustness of regulatory and governance frameworks collectively determine the efficiency of the financial system, its ability to manage risks effectively, and its contribution to economic growth. Analyzing these aspects provides critical insights into the growth potential of financial institutions, their capacity to innovate and serve diverse needs, and the risks they may encounter in a rapidly evolving financial ecosystem.

### **c. Competitiveness**

Assessing the competitiveness of the financial sector in any economy requires the evaluation of key factors that influence its efficiency, innovation, and adaptability to changing conditions. Competitiveness in this context refers to the ability of financial institutions to sustain and enhance their position within the industry, both domestically and globally, while meeting market demands effectively. Several factors shape the competitive environment of a country's financial sector, including market concentration, the risk appetite of institutions, the sector's structure, and its risk-adjusted financial performance. Additionally, distortions in the market, such as regulatory arbitrage or unequal access to capital, play a significant role in shaping the competitive landscape. The efficiency of financial institutions and their ability to price risks accurately are crucial indicators of competitiveness. The interplay between the financial sector and other markets, such as the bond market, is another critical dimension. Institutions may either compete with or complement the bond market, depending on the depth and sophistication of the financial system. Furthermore, regulatory policies, customer expectations, technological evolution, and capital flows are key drivers influencing the sector's competitiveness.

In many economies, the financial sector is dominated by a few large players, which can lead to reduced competition but also offers advantages such as economies of scale and enhanced system stability. However, such concentration often creates high entry barriers, hindering the establishment of fresh players. The entry of fintech firms and other digital innovators is reshaping this dynamic, challenging traditional players and introducing new competitive pressures.

Assessing competitiveness involves examining how institutions compete within this framework, their efficiency, the impact of new entrants, and the broader economic and regulatory environment. A thorough evaluation provides valuable insights into the sector's ability to innovate, adapt, and contribute to sustainable economic growth while managing risks in an increasingly complex and interconnected financial ecosystem.

#### **d. Funding Environment**

The funding environment in any economy is a critical determinant of financial system stability and the overall health of economic activities. It encompasses the various mechanisms through which financial institutions and markets source capital to meet lending, investment, and operational needs. A robust and diversified funding environment supports economic growth, reduces vulnerabilities, and enhances the resilience of the financial sector. One key aspect is the systemwide funding stability, which reflects the availability and consistency of funds across the economy. A stable funding base, particularly through deposits, serves as a cornerstone of financial stability, minimizing the risks of liquidity mismatches and funding disruptions. The stability of deposits is influenced by factors such as depositor confidence, regulatory safeguards like deposit insurance, and macroeconomic conditions.

Access to debt capital markets is another critical element of the funding environment. A well-functioning debt market provides financial institutions with alternative sources of funding, reducing reliance on traditional deposits and enhancing the system's overall resilience. The diversity of funding sources, including wholesale funding, retail deposits, and market-based instruments, ensures greater flexibility and risk distribution within the financial system. In conclusion, a healthy funding environment is characterized by systemwide stability, a reliable deposit base, diverse funding options, and robust market access, all underpinned by the confidence that authorities can provide effective liquidity support when needed. A comprehensive assessment of these elements is essential to gauge the resilience of an economy's financial system and its ability to navigate both opportunities and challenges in a dynamic global landscape.

### **e. Access to Systemic Funding**

Access to systemic funding refers to the capacity of financial institutions to secure necessary funding during periods of heightened demands or stress. Such access, typically facilitated by central banks, government interventions, or financial mechanisms, is a crucial role in preventing widespread panic, sustaining economic activity, and averting systemic collapse.

The ability of authorities to provide funding or liquidity support during periods of stress is pivotal to maintaining confidence in the financial system and ensuring broader economic stability. Central banks and regulatory authorities often act as lenders of last resort, supplying liquidity to prevent systemic crises and stabilize financial institutions during market disruptions. The effectiveness of such interventions depends on the strength of the regulatory framework, the adequacy of reserves, and the willingness of policymakers to act decisively.

Institutions with public policy roles or strategic long-term government ownership often enjoy substantial government support aimed at reinforcing their financial health and resilience. This support—through financial injections, regulatory accommodations, or strategic interventions—not only enables these institutions to meet societal objectives but also underscores the government’s commitment to maintaining a stable financial sector essential for economic development. Systemically Important Financial Institutions (SIFIs) occupy a unique position in this landscape due to their size, interconnectedness, and critical role in providing essential financial services. These SIFIs are also subjected to enhanced oversight, including stricter capital adequacy requirements, robust liquidity management frameworks, and regular stress testing.

In conclusion, the critical role of systemic funding mechanisms is essential for ensuring the continuity of financial institutions and maintaining confidence in the financial systems during periods of stress.

### 3. Business Profile and Asset Quality

The assessment of the business profile and asset quality of a financial institution involves the evaluation of the past and expected future business performance with an emphasis on the assessment of quality of its portfolio which will have a major impact on its ability to generate the cash flows required for debt servicing. The business profile and asset quality are assessed using five broad aspects:

- a. Asset Class Characteristics & Customer Profile
- b. Market Position
- c. Seasoning of the Portfolio
- d. Asset Quality (Impaired Assets)
- e. Credit Costs

#### a. Asset Class Characteristics & Customer Profile

Evaluating a financial institution's business model involves analyzing several critical factors to assess its operational strength and market position within the financial sector. A key element is the composition of its lending portfolio, specifically the balance between retail and wholesale segments. This distinction reveals the institution's focus—whether on individual consumers or large corporate entities—and provides insights into its risk profile, revenue sources, and growth potential. Retail lending typically involves smaller, more frequent transactions with individual clients, while wholesale lending centres on larger, often more complex deals with corporate customers. Institutions that offer a broad array of products and services across diverse customer segments and geographic regions are less vulnerable to economic downturns affecting specific markets or customer groups. This diversification helps smooth out income fluctuations and buffers against sector-specific risks. Spreading loans across different sectors, borrower types, and regions also lowers the risk of default concentrations. Understanding the characteristics and creditworthiness of institution's borrower segments is essential which includes evaluating the diversity, stability, and risk profiles of borrowers across retail and wholesale categories. High-quality borrower segments are indicative of lower credit risk and stronger repayment potential.

The stability of a financial institution's business model is underpinned by several factors that collectively determine its resilience to economic volatility. Institutions with a well-diversified revenue mix, including recurring fee income and sustainable net interest income, tend to exhibit greater stability. Fee income from services such as wealth

management, advisory, and transaction fees often provides a steady stream of cash flows, in contrast to more volatile income sources like trading activities or one-time gains. A balanced and predictable revenue structure is crucial for long-term operational resilience and financial health.

## **b. Market Position**

Evaluating whether the financial institution holds a significant position within the domestic banking and financial industry is essential as the institutions that are major players tend to have greater market influence, larger customer bases, and potentially stronger financial stability and are better equipped to endure economic fluctuations. Their market position often correlates with the level of support they receive from sector regulators, which can also include access to liquidity support. This diversification reduces reliance on any single sector or customer type, thereby enhancing overall resilience. Larger entities often benefit from economies of scale, which contribute to operational efficiencies and greater financial stability. Their extensive branch networks and broad customer reach provide a solid foundation for consistent revenue generation and risk management capabilities that smaller institutions may struggle to match. The composition of a financial institution's loan portfolio and its deposit base significantly influences stability as entities with substantial retail loan portfolios, catering to individual consumers, and stable deposit relationships tend to maintain more predictable net interest income.

## **c. Seasoning of the Portfolio**

Assessing the seasoning of a portfolio plays a vital role in evaluating its asset quality, as it sheds light on how well the portfolio has matured and its performance over an extended period. A seasoned portfolio tends to display more predictable behavior, offering greater clarity on credit risk, repayment patterns and overall stability. This analysis is particularly useful for gauging the likelihood of defaults and understanding how loans perform post-disbursement, especially during early delinquency stages. Newly originated loans (unseasoned) carry higher risk due to their limited performance track record and lack of exposure to different economic cycles.

Portfolios that have endured adverse conditions over their life cycle, such as economic downturns or financial crises, offer valuable insights into their resilience. They also help assess the impact of underwriting practices, economic environments, and borrower quality across different periods, providing a comprehensive view of portfolio performance.

#### **d. Asset Quality (Impaired Assets)**

Healthy asset quality and adequate capital buffers are the key elements for a strong financial system. However, the weak asset quality of the financial institutions reflected in terms of the high proportion of non-performing loans to gross loans undermines the stability and soundness of the financial system and adversely impacts credit availability in an economy.

While analysing the asset quality of an entity, the credit risk management framework is evaluated along with assessing the trend in slippages, loan losses and write-off/provisions and the track-record of recoveries which are examined closely. Additionally, the proportion of delinquent or stressed assets which are yet to be classified as non-performing are also evaluated. An increase in the quantum of non-performing assets entails higher credit costs as well as reversal of interest earned on NPAs, which impacts the profitability of the financial institution leading to a decline in capitalisation profile and reducing its loss absorption capability. The overall asset quality is assessed by the proportion of NPAs that the entity has vis-à-vis its advances. Furthermore, the net worth cover that it has to absorb losses from these NPAs is also examined. The portfolio diversification, level of concentration to certain groups / individual borrowers and exposure to troubled industries/areas are evaluated to arrive at the level of weak assets. Additionally, sector-wise exposures of the institutions are evaluated to assess the existing and potential levels of stress. While corporate loans have the risk of higher ticket size and slippage in a few accounts may increase the NPAs for the institutions, retail loans are more granular and have a lower risk of large-scale slippages. The analysis of the wholesale book entails an assessment of top exposures and sectoral distribution along with a track record of recovery from and provision coverage on bad loans. While analysing the non-wholesale, assessment of movement in NPAs, secured or unsecured nature of loans, track record of recovery, etc. are analysed. The potential stress on the book is assessed by evaluating the restructured assets as well as the quantum of identified weak/stressed assets in total exposure to arrive at the potential NPAs in conjunction with the provision made and the possible impact of the unprovided exposure on the profitability of the financial institution.

#### **e. Credit Costs**

Credit cost represents the total expense a lender incurs in managing credit risk within its portfolio, serving as a reflection of underwriting quality and portfolio seasoning. It is a vital metric for assessing the health of the loan book and its impact on profitability. Effective understanding and managing credit costs is crucial for financial institutions to

sustain profitability, ensure long-term growth, and enhance resilience against economic shocks, as higher credit costs directly diminish profit margins.

Credit costs significantly influence capital adequacy, provisioning requirements, and loan pricing, as institutions must account for risks associated with their portfolios. Regulatory mandates, such as provisioning norms set by regulatory authorities, play a key role in determining credit cost calculations. Loans extended to high-risk segments typically incur higher credit costs, while secured loans have lower credit costs compared to unsecured loans.

Additionally, diversification across asset classes, geographies, and sectors affects the overall risk profile, influencing credit costs. A well-diversified portfolio can help mitigate risks and optimize credit costs, ensuring a balanced and resilient financial framework.

#### **4. Capitalization**

Capitalization plays a fundamental role in credit assessment as it reflects the financial institution's ability to absorb losses, maintain stability, and support growth. Assessing capitalization provides insights into the institution's financial strength, risk-bearing capacity, and overall creditworthiness.

The following four aspects are analysed for assessing the capitalization profile:

- a. Capitalization Profile
- b. Leverage Profile
- c. Total Assets to Capital
- d. Risk Adjusted Capital

Each of the four aspects are presented below:

##### **a. Capitalization Profile**

The Capital Adequacy Ratio (CAR) measures the extent to which a financial institution's capital is available to absorb unexpected losses, with a higher CAR indicating the institution's capacity to undertake additional business. Evaluating an entity's adherence to regulatory capital adequacy norms, alongside its ability to withstand potential capital erosion from provisions for NPAs, provides critical insight into the robustness of its capital profile. A strong CAR not only ensures compliance with regulatory requirements but also enhances a financial institution's ability to extend credit, supporting business growth.

Capital adequacy is a vital indicator of a financial institution's financial health, reflecting its ability to absorb potential losses and sustain business expansion. Under Basel III regulations, institutions are required to maintain minimum capital levels that align with their specific risk profiles and operational scopes. Adhering to these regulatory thresholds is critical, as non-compliance can trigger corrective actions from regulators, limiting operational flexibility.

The CAR is central to this evaluation, representing the ratio of a bank's capital to its risk-weighted assets. Assessments emphasize the adequacy of core equity capital while also considering the use of supplementary instruments as although core equity is essential, the ability to raise non-core capital diversifies funding sources reducing reliance on equity alone. Additionally, the institution's historical performance in capital raising provides valuable insight into its financial flexibility and market confidence.

Stress-testing scenarios further evaluate resilience by examining the institution's capacity to navigate adverse economic conditions. These tests account for asset growth trajectories, risk management practices, and the institution's ability to sustain operations under challenging circumstances.

In conclusion, maintaining a strong capital base is fundamental to a financial institution's stability and growth. Comprehensive assessments of regulatory compliance, capital structure strength, and strategic flexibility are essential to safeguarding financial stability and enabling institutions to adapt to dynamic market environments effectively.

## **b. Leverage Profile**

The leverage profile of a financial institution reflects its reliance on borrowed funds to finance assets and operations, serving as a critical indicator of financial stability, risk tolerance, and capacity to manage obligations. This measure highlights the level of financial leverage and the associated financial risk. While higher leverage can enhance returns for equity shareholders, it also elevates risks for debt holders, particularly during periods of uncertainty or fluctuations in asset quality and earnings.

## **c. Total Assets to Capital**

Evaluating the total assets-to-capital ratio for a financial institution offers critical insights into its financial health, risk management practices, and operational efficiency. This ratio reflects the degree of financial leverage by comparing total assets to equity capital. A higher ratio may indicate a larger operational scale but also heightened vulnerability, as



it suggests greater reliance on debt or liabilities to finance assets. Additionally, a high ratio could signal aggressive growth, which, if not effectively managed, might strain capital resources and weaken risk management frameworks. Institutions with excessively high ratios are more susceptible to financial shocks or adverse market conditions.

#### **d. Risk Adjusted Capital**

Risk-Adjusted Capital (RAC) represents the capital maintained by a financial institution, adjusted for the risks associated with its asset portfolio. It serves as a critical measure to ensure the institution has adequate buffers to absorb losses from risk-weighted exposures, aligning its capital adequacy with its overall risk profile. Maintaining a strong RAC structure enhances an institution's ability to withstand shocks, comply with regulatory requirements, and support sustainable growth.

Institutions with strong RAC structure, even under stress scenarios, exhibit superior risk management and financial flexibility as greater exposure to market volatility necessitates higher capital buffers to mitigate potential losses. Evaluating RAC involves adjusting for credit risks based on asset quality and borrower characteristics, incorporating factors such as non-performing assets (NPAs), provisioning coverage, and borrower creditworthiness. Additionally, the RAC assessment accounts for the inherent risks of different asset classes, including credit risk, market volatility, and operational uncertainties. A strong RAC ratio reflects the institution's capacity to absorb potential losses, ensuring financial stability and regulatory compliance.

## **E. Modified Credit Profile**

### **1. Resources & Liquidity**

The resource profile and liquidity of a financial institution serve as key pillars for its credit assessment, reflecting its resilience and ability to secure and maintain stable funding to support operations and growth while effectively navigating challenges in a dynamic financial landscape.

The following four aspects are analysed for assessing the capitalization profile:

- a. Resource Profile
- b. ALM Assessment
- c. Liquidity Coverage
- d. Financial Flexibility

Each of the four aspects are presented below:

#### **a. Resource Profile**

The evaluation of a financial institution's resource profile focuses on understanding its ability to secure and maintain stable funding to support its operations and growth, even during periods of economic stress. This assessment emphasizes the stability, diversity, and cost-effectiveness of funding sources, which are critical for financial resilience and operational sustainability across varying market conditions.

Central to this evaluation is the analysis of deposits, a primary funding source for large financial institutions, particularly banks. The institution's ability to attract deposits at competitive costs reflects its market reputation and franchise strength. The composition of deposits is further analysed, with attention given to the proportion of low-cost deposits and the balance between retail deposits from individuals and wholesale deposits from corporate and institutional clients. Growth rates and the rollover stability of deposits are also key metrics, offering insights into the bank's ability to maintain a steady funding profile over time.

Beyond traditional deposits, the diversity of funding sources is equally important. Access to capital market instruments, bank financing, and funds from development finance institutions reflects the institution's financial flexibility. The ability to tap into alternative funding sources, such as long-term refinancing from specialized institutions, further enhances funding resilience. The capability to issue Tier-II Bonds, Additional Tier-I (AT-

I) Bonds, and infrastructure bonds for specific sector financing highlights strategic resource mobilization under regulatory frameworks.

In conclusion, a comprehensive assessment of an institution's funding profile extends beyond basic liquidity measures. It involves a strategic evaluation of deposit stability, funding diversification, regulatory compliance, and resource mobilization capabilities.

## **b. ALM Assessment**

Asset and Liability Management (ALM) assessment focuses on understanding how the maturity profiles of a financial institution's assets and liabilities align over a projected period in various time buckets. It indicates whether the cash inflows generated by the financial institution's assets can cover the outflows due to maturing liabilities and other obligations for specific time buckets. It considers the availability of backup credit lines and investments in highly liquid assets like government securities, which can be utilized or pledged as collateral during liquidity shortages. The evaluation also includes an assessment of wholesale funding sources, which are typically more sensitive to market conditions. This involves reviewing the tenure of these funding instruments and evaluating any provisions for early repayment, which can impact liquidity management strategies.

## **c. Liquidity Coverage**

A financial institution's liquidity strength is pivotal for its operational stability and resilience in financial markets. Inadequate liquidity can precipitate financial distress and even lead to failure, whereas robust liquidity buffers can support through challenging economic environments. A comprehensive approach is employed to evaluate both internal and external funding sources that enable a financial institution to meet its liquidity requirements effectively. Liquidity Coverage Ratio (LCR) is a key assessment tool to understand the sufficiency of the liquidity maintained by the entity, which is not only in compliance with regulatory requirements regarding the LCR, but also covers the potential net cash outflows over specific periods. Several types or variants of liquidity coverage ratios and related measures are used depending on the context and regulatory requirements with each type of liquidity coverage ratio serving a specific purpose, contributing to a comprehensive assessment of a financial institution's liquidity resilience. Institutions often use a combination of these measures to ensure robust liquidity management and regulatory compliance.

Regulatory LCR, which is mandated under the Basel III framework requires banks to maintain a minimum ratio of High-Quality Liquid Assets (HQLA) to net cash outflows over a 30-day stress period which ensures resilience against short-term liquidity disruptions. Similarly, Net Stable Funding Ratio (NSFR) complements the LCR by focusing on long-term liquidity ensuring that a financial institution has sufficient stable funding to support its assets and activities over a one-year horizon under stressed conditions.

Further, liquidity is also assessed under hypothetical adverse conditions, such as economic downturns, market disruptions, or regulatory shocks to analyse stress-Tested Liquidity Coverage Ratios which help the institutions to identify vulnerabilities and develop contingency plans.

Given the circumstances, a rigorous evaluation of liquidity risk encompasses a comprehensive analysis of ALM profiles, deposit stability, regulatory compliance with liquidity ratios, availability of external funding sources, and contingency measures. These assessments are essential for analysing a financial institution's ability to maintain liquidity resilience and operational stability across varying economic scenarios and market conditions.

#### **d. Financial Flexibility**

Financial flexibility for a financial institution refers to its ability to manage and adapt its financial resources, funding structure and liquidity position to sustain operations, meet regulatory requirements, and capitalize on growth opportunities, even during periods of economic or market stress. This flexibility is critical for a financial institution as it often operates in competitive and highly regulated environments, with a dependence on external funding and diverse asset portfolios.

Some of the key factors which are analysed to assess the financial flexibility of an entity include access to multiple funding avenues, such as bank borrowings, capital market instruments, securitization and deposits. Further, the ability of the financial institution to securitize or sell parts of the loan portfolio to free up capital for new lending or meet liquidity requirements and the ability of monetising investments in subsidiaries or non-core assets during financial stress are also seen favourably. Financial institutions, which belong to large groups or conglomerates also demonstrate better financial flexibility during testing times. Flexibility is a cornerstone of sustainable growth and operational resilience reflecting an entity's ability to manage funding challenges, regulatory

compliance, and economic uncertainties effectively while remaining agile to seize market opportunities.

## 2. Earnings Profile

The assessment of the earning profile of a financial institution involves the evaluation of its past and expected future business performance with an emphasis on the assessment of its profitability and the kind of cost structure it maintains.

The earning profile is assessed using four broad aspects:

- a. Spreads
- b. Diversification in Earnings
- c. Cost Structure
- d. Return Ratios

Each of the four aspects are presented below:

### a. Spreads

The revenue composition of a financial institution is analysed by categorizing income into fund-based and fee-based activities. This assessment evaluates the quality of earnings by examining trends in interest income and the proportion of non-interest income components. It provides insights into the diversity and stability of revenue streams, which are critical for understanding the institution's earnings resilience over time. Core earnings, representing sustainable profitability, are identified by excluding non-recurring or one-time income sources, offering a clearer view of operational profitability without the influence of exceptional items.

Each business segment contributing to core earnings undergoes a detailed risk analysis to evaluate earnings potential and growth rates, shedding light on profitability dynamics across various operational areas. Key profitability metrics, such as the yield on business assets (including loans and investments), are examined alongside the cost of funds to determine the spreads earned by the institution. The net interest margin (NIM) is a pivotal indicator, reflecting the institution's ability to generate profits from core lending and investment activities, particularly when benchmarked against industry peers and the prevailing interest rate environment.

## **b. Diversification in Earnings**

The diversification of earnings is evaluated by analyzing the structure of the financial institution's loan portfolio across various categories and types of loans extended to borrowers. This assessment provides insights into its lending practices, risk exposure, and strategic focus. Loans are broadly classified into retail and wholesale segments. Retail loans primarily include personal loans, auto loans and mortgages such as housing loans and loans against property, while wholesale loans consist of large-ticket corporate exposures. The institution's growth trajectory is compared with industry trends, along with the growth of its specific asset classes relative to overall growth in those segments. This analysis helps determine the institution's growth strategy and market positioning. Institutions with a significant share of retail assets in their total advances benefit from diversification, as these loans typically exhibit different risk profiles compared to corporate loans, thereby spreading risk across a broader borrower base.

For wholesale exposures, the concentration of loans to specific borrower groups—whether related entities or individuals—is analyzed relative to the institution's net worth. This metric assesses the level of risk concentration and evaluates the potential impact on financial health in case of adverse developments in asset quality providing a comprehensive view of the institution's earnings diversification and risk management strategies.

## **c. Cost Structure**

The cost structure of a financial institution is an essential parameter for the assessment of its operational and financial performance. It encompasses all the expenses incurred in running its business operations with the primary cost being the cost of funds as the interest paid on borrowed funds, such as loans from banks, bonds, or other market borrowings are the major cost for any financial institution. This cost depends on the funding mix in terms of short-term and long-term funding sources and prevailing interest rates with the entities having strong credit profiles or parentage often being able to secure funds at lower costs. Similarly, Operating Expenses such as employee expenses in the form of salaries, benefits and costs for training and expenses related to maintaining branch networks, offices, customer acquisitions and IT systems which include investments in digital platforms, fintech integrations, and automation tools also impact the cost structure. A well-managed cost structure helps maintain competitive pricing, ensuring profitability, and sustaining long-term growth while navigating market challenges.

#### **d. Return Ratios**

Return ratios are critical metrics used to evaluate a financial institution's profitability and operational efficiency. Two key ratios primarily analysed are Return on Assets (RoA) and Return on Equity (RoE). RoA measures how efficiently a financial institution generates profits relative to its total assets reflecting the institution's ability to utilize its asset base to create value. It accounts for both earning assets (e.g., loans, investments) and non-earning assets (e.g., fixed assets, cash reserves), providing a holistic view of asset utilisation and helps compare institutions with different asset sizes or structures. Similarly, ROE evaluates the return generated on shareholders' equity, indicating how effectively a financial institution is using its equity capital to generate profits. It reflects the return to equity investors and indicates the institution's ability to reward shareholders and helps in assessing how well a financial institution balances risk and returns to maintain sustainable growth.

A strong RoA coupled with a healthy RoE indicates both efficient asset utilization and effective equity deployment and therefore evaluating trends for both the parameters helps the stakeholders evaluate the institution's operational strategies and capital management.

The assessment of the return ratios in the context of industry benchmarks and specific institutional characteristics provides a comprehensive view of the financial performance and operational resilience of a financial institution.

### **3. Management & Governance**

The assessment of the management and governance structure of a financial institution involves the evaluation of their overall strategy, financial policies, risk appetite and compliance towards the ESG parameters.

The management and governance structure are assessed using four broad aspects:

- a. Management Strategy
- b. Financial Policy
- c. Risk Management
- d. ESG Factors

Each of the four aspects are presented below-

## **a. Management Strategy**

The entity's business plans, mission, policies to expansion, risk management, leverage profile, and future strategies to about the general industry scenario are considered. A significant factor of management evaluation involves assessing the management's ability to look into the future, and its strategies and policies to tackle emerging challenges, as well as their succession planning. As part of the evaluation of the Management Strategy, CareEdge Global assesses the effectiveness of the management strategy, its track record of achieving past commitments, and its commitment towards improving the credit profile.

The management strategy of a company is assessed by the historical track record of the effectiveness of the strategy. Effective management teams have a clear and well-defined long-term vision for the company. We assess whether this vision translates into an effective management strategy which is transparently communicated to the stakeholders. The presence of a strong strategic plan that outlines the steps to achieve the company's vision is crucial. Furthermore, the ability of management to execute strategic plans effectively is a key indicator of their competence. This involves translating strategies into actionable plans and achieving set targets. By evaluating the strategic vision, implementation track record, adaptability, and performance monitoring measures, we assess the effectiveness of the company's management strategy. The track record of achieving past commitments is a critical indicator of the management's operational effectiveness. This involves assessing whether the company has consistently met its strategic and financial goals and targets that were communicated previously to the stakeholders. A strong track record demonstrates the ability of the management to execute plans effectively and maintain credibility. This helps to build trust with stakeholders as well.

On the other hand, frequent shortfalls or missed commitments may signal potential weaknesses within the management or operational challenges, which can increase the overall management risk.

Evaluating a company's commitment towards improving its credit profile involves evaluating strategic initiatives and financial policies, such as reducing debt levels, improving its liquidity position, and maintaining strong financial ratios. Demonstrating a proactive approach to managing financial health through financial flexibility reflects positively on the management's dedication to sustaining and improving the company's credit profile. We also assess the propensity of management to undertake small or leveraged acquisitions and cash burn.



## **b. Financial Policy**

The financial policies of a financial institution, particularly regarding transparency and disclosures, are critical in the financial sector. Accounting policies play a pivotal role in shaping financial statements, covering significant areas such as risk exposures, liquidity profiles, and capital adequacy metrics. These disclosures provide stakeholders with a clear and comprehensive view of the institution's financial health, operational performance, and risk management practices. Evaluating these aspects offers insights into the institution's commitment to robust financial reporting and governance practices.

The quality of accounts and disclosures refers to the accuracy, transparency, and completeness of financial reporting practices. Ensuring reliable information for stakeholders is essential for maintaining trust and providing a clear picture of the institution's financial health and risk profile. Accounting policies significantly influence how financial institutions measure, report, and disclose their financial performance and position. Adopting frameworks like the International Financial Reporting Standards (IFRS) ensures early recognition of potential losses, thereby affecting how loan portfolio quality is assessed and reported.

Additionally, adherence to regulatory standards often dictates specific accounting treatments. For instance, Basel III and other regulations require adjustments to reported financial metrics based on regulatory definitions of assets, liabilities, and capital adequacy. These standards ensure that financial institutions maintain transparency, consistency, and comparability in their financial reporting, fostering confidence among regulators, investors, and other stakeholders.

## **c. Risk Management**

A financial institution's risk management strategy is reflected in its ability to effectively handle and manage credit, market and operational risks through measurable indicators that provide insights into its risk profile. These indicators, observed over time, reveal the institution's willingness and capacity to manage risk across its operations. Understanding an institution's risk profile involves examining its stated risk objectives and how external economic and market conditions influence its risk management strategies. Monitoring current trends in risk metrics and comparing them to the institution's articulated risk goals

offers a window into its evolving risk appetite. Changes in these metrics may signify shifts in strategic priorities or responses to changing market dynamics.

One key aspect of risk management is evaluating the alignment between the institution's lending and underwriting standards and its stated risk appetite. Institutions that adhere to stringent underwriting criteria, even in competitive environments, demonstrate disciplined and proactive risk management. Similarly, an analysis of growth patterns, whether organic or through acquisitions, in comparison to industry peers provides valuable insights. A measured approach to growth—avoiding riskier opportunities pursued by competitors—often reflects a conservative strategy focused on maintaining financial stability. Proactive risk management is further evidenced by actions such as scaling back high-risk activities, tightening underwriting standards, and prioritising core customer segments and competencies. This approach emphasizes sustainable, lower-risk operations and limits speculative activities. Maintaining a historically resilient portfolio during economic downturns highlights the institution's commitment to managing risks within acceptable limits, prioritizing stability over aggressive expansion. As financial institutions grow larger, their risk management strategies must adapt to increased complexity. Growth often brings diversification across products, regions, and business lines, which can reduce reliance on specific areas. However, this diversification also introduces operational challenges, requiring more sophisticated oversight and decision-making processes to manage a diverse range of risks effectively.

A strong risk management strategy integrates disciplined growth, effective diversification, and proactive responses to emerging risks, ensuring the institution remains resilient across varying economic and market conditions.

#### **d. ESG Factors**

The evaluation of Environmental, Social, and Governance (ESG) factors in a financial institution is critical for understanding its long-term sustainability, ethical practices, and contribution to broader societal goals. ESG assessments provide stakeholders with insights into how effectively a financial institution manages non-financial risks and aligns its operations with responsible and sustainable practices.

The institution's dedication to environmental sustainability can be assessed by examining its initiatives such as financing renewable energy projects, issuing green bonds, and promoting energy-efficient technologies. Additionally, analysing its operational efforts to reduce energy consumption, minimize waste, and implement sustainable practices across

branches, offices and data centers can also help to understand its focus on sustainability. Further, evaluating the institution's policies for identifying and managing climate-related financial risks, particularly those linked to high-carbon industries, can help to understand its approach to environmental responsibility and resilience.

Further, we gauge the financial institutions' ability to influence their portfolio to reach net-zero emissions within a specified period. Financial institutions may achieve these goals through higher transition funding and deploying technology to mitigate the physical risk on its portfolio that arises out of climate funding. We assess key transition factors and metrics that are being used by the financial institution to achieve net-zero targets.

The institution's commitment to social responsibility and inclusivity can be assessed by reviewing initiatives to enhance access to banking services for underserved populations, such as microfinance programs and digital banking solutions for rural areas. Further, its policies on employee well-being, workforce diversity, and equitable practices, including representation of gender and ethnic diversity at leadership levels can also help in ascertaining its commitment to social factors. Further, examining its contributions to community development through Corporate Social Responsibility (CSR) activities, and philanthropic efforts and reviewing adherence to fair lending practices, transparent disclosures, and ethical marketing to protect customer interests and build trust are some of the factors which help in this assessment.

Governance assessment focuses on ensuring ethical and transparent practices by evaluating the board's independence, diversity, and expertise in overseeing strategy, risk management, and ESG objectives. Analyzing governance structures for effectively managing operational, financial, reputational, and ESG-related risks and reviewing the quality of ESG disclosures in financial and sustainability reports to ensure alignment with international standards such as the Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB) are critical. Further, examining the robustness of anti-corruption policies, whistleblower mechanisms, and adherence to ethical business practices to gauge the institution's commitment to integrity and accountability are some of the assessment measures for governance.

A comprehensive evaluation of ESG factors provides a holistic view of the institution's commitment to sustainable and ethical practices. Institutions that integrate ESG considerations into their strategy and operations are better equipped to mitigate risks, strengthen stakeholder trust, and seize opportunities from the global shift toward

sustainability. This assessment highlights the institution's role as a responsible corporate citizen, fostering long-term value creation.

#### **4. Technology**

For financial institutions, technology and cybersecurity are not just enablers but strategic imperatives. Institutions that invest in advanced technological solutions and robust cybersecurity frameworks can enhance efficiency, foster trust, and maintain a competitive edge while mitigating risks in an increasingly digital financial ecosystem.

The technology profile is primarily assessed using the following two broad aspects:

- a. Level of Technology and Analytics
- b. Cybersecurity

##### **a. Level of Technology and Analytics**

CareEdge Global assesses the infrastructure and technological capabilities of financial institutions as a critical aspect of their evaluation. Institutions that prioritize and invest in industry-leading technology are viewed more favourably compared to those operating with outdated or inadequate systems. Advanced IT infrastructure and cutting-edge innovative technology enables institutions to leverage innovative solutions, enhance operational efficiency, and maintain a competitive edge. This translates to lower risk, as these institutions are better positioned to adapt to market changes and ensure sustained operational effectiveness. Conversely, institutions with subpar infrastructure and outdated technology face higher risks due to potential operational inefficiencies, reduced competitiveness, and challenges in addressing technological advancements.

##### **b. Cybersecurity**

A financial institution with initiative-taking and robust cybersecurity framework demonstrates resilience against cyber threats, ensuring business continuity and safeguarding customer trust. Conversely, weaknesses in cybersecurity infrastructure and practices can expose the institution to operational, financial, and reputational risks, significantly affecting its overall risk profile and competitiveness. CareEdge Global assesses the robustness of an entity's cybersecurity framework, primarily by focusing on the existence and effectiveness of a formal cybersecurity policy and strategy aligned with regulatory requirements and industry best practices. Preparing for addressing cyber

incidents, including structured response plans and business continuity protocols is also critical to assess the effectiveness of the overall cybersecurity framework. Furthermore, the implementation of firewalls, intrusion detection systems, encryption protocols, and endpoint protection and measures to secure data and operations hosted on cloud platforms, including vendor risk management practices are evaluated.

## **5. Peer Comparison**

The analysis of management, business and financial risk is internal to the financial institution and used to arrive at the standalone assessment of the entity. Peer group analysis is done to assess the relative financial performance and creditworthiness of an entity by comparing it to its peers within the same country or operating in countries having similar economic risks and operating environments. This analysis involves selecting a group of institutions that share similar characteristics such as size, business model, geographic location, and market focus. The financial institution is then compared on various parameters, both financial and non-financial to its peers who may not be direct in all parameters. Key metrics and ratios are then compared across these peers to evaluate factors such as profitability, asset quality, capital adequacy, liquidity, and risk management practices.

Benchmarking against peers can identify trends, strengths, and weaknesses specific to the financial institution being evaluated, providing a clearer context for assigning a credit rating. This comparative approach helps in understanding the competitive positioning of the entity within its industry and contributes to making informed decisions regarding its financial health and stability. The positioning of the financial institution relative to its peer group refers to how the entity is perceived and positioned compared to other similar entities. Factors influencing a financial institution's positioning include financial metrics (like profitability and asset quality), customer satisfaction, market share, technological capabilities, regulatory compliance, and overall brand reputation.

## **F. Issuer Credit Profile**

### **1. External Factors**

The MCP is adjusted for parent group or sovereign support to arrive at the Issuer credit profile (ICP). In group support, the guarantor, parentage/shareholding pattern and strategic importance of the financial institution in the overall group are taken into consideration.

## **a. Parent Linkage**

The assessment of parent linkage is critical to analyse the ability and willingness of the parent entity of the financial institution to assist it, during periods of financial stress or crisis. There are several factors including legal and regulatory frameworks which play a significant role, as they outline the conditions under which support can be provided and the extent of that support. Further, past instances of support or bailouts can establish precedents that affect stakeholders' expectations and perceptions of future support. Financial resources and stability are important as support providers with strong fiscal positions and stable economic conditions have greater capacity to intervene during crises compared to those with limited fiscal space or weaker economic fundamentals. Similarly, access to liquidity is also critical, as it determines the ability to inject capital or provide emergency funding swiftly.

## **b. Group Support**

This encompasses exceptional backing provided by a larger group within which the financial institution operates. This support enhances the institution's credit profile by leveraging the group's collective resources, diversified business lines and strong financial standing. It underscores the institution's strength within a supportive network, contributing to its overall stability and capacity to navigate market challenges. The organizational framework and hierarchy within a group of companies play a crucial role in determining the flow of support. Centralized structures with clear lines of authority and consolidated financial resources may facilitate more effective support mechanisms. Conversely, decentralized structures or loosely affiliated subsidiaries may face challenges in coordinating and deploying support swiftly and effectively. The ease with which financial resources can be transferred or utilized across different entities within the group is essential. Factors such as local regulatory restrictions, currency exchange controls, and tax implications can affect the fungibility of resources. A financial institution operating in diverse jurisdictions may encounter barriers that limit its ability to mobilize funds or provide timely support to subsidiaries facing financial difficulties. Similarly, entities with operations in multiple countries must navigate varying legal, regulatory, and economic environments. These differences can impact the feasibility and speed of providing support across borders. Regulatory requirements related to capital adequacy, liquidity reserves, and financial reporting standards may further constrain the transfer of resources between entities in different jurisdictions.

**c. Government Support**

Government support for financial institutions during times of financial stress is critical for maintaining systemic stability and ensuring the resilience of the economy. Large or interconnected financial institutions have systemic importance and are critical to the functioning of the economy, and their failure could have ripple effects. Government intervention plays a crucial role in stabilizing financial institutions during periods of economic or systemic stress. This support aims to preserve financial stability, safeguard depositor interests, and prevent broader economic disruptions. Government intervention not only helps in maintaining trust in the financial system but also reduces the risk of runs on banks or other institutions. A stable financial system underpins economic growth and development, making government support vital in times of crisis.

**d. Country Ceiling**

The sovereign ceiling serves as a benchmark for rating entities within a country, reflecting the intertwined nature of sovereign and corporate credit risks. It refers to the highest possible credit rating that can be assigned to an entity within a country, typically capped at or just below the sovereign's credit rating. This concept reflects the influence of a country's economic, financial, and political stability on the creditworthiness of entities operating within its borders.

## **G. Issuer Instrument Rating**

### **1. Instrument Level Considerations**

#### **a. Nature of Instrument**

The credit rating approach outlined assigns the top rating to the most senior debt obligations, aligning them with the entity's Issuer credit profile (ICP). In contrast, other instruments, which have lower priority for repayment, may be rated one or more notches below the ICP. This lower rating reflects their higher risk due to their subordinate position in the creditor hierarchy. These rating adjustments provide a clear indication of the relative risk and priority level associated with different debt instruments issued by the entity, aiding investors, and stakeholders in their risk assessments.

#### **b. External Credit Enhancement**

External credit enhancement (ECE) refers to mechanisms or instruments provided by third parties to improve the credit profile, enabling it to secure a higher credit rating than its standalone or intrinsic creditworthiness. By reducing the perceived risk for investors, ECE enhances the institution's ability to access funding on more favourable terms. Some of the key Forms of External Credit Enhancement include Third-Party Guarantees wherein a highly rated entity (e.g., a parent company, sovereign, or multilateral agency) guarantees part or all the obligations of the financial institutions. These guarantees can cover principal, interest, or both, and are often provided by development banks or export credit agencies. Similarly, Credit Insurance in the form of Insurance policies from highly rated insurers protects against specific risks, such as default or political instability and these are normally used for cross-border transactions. Further, collateralized support in the form of highly liquid and secure assets (e.g., cash, government securities) is pledged to back the financial institution's obligations which reduces the credit risk by providing direct recoverability for lenders in case of default.



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