



Criteria for Financial Ratios – Financial Sector

Executive Summary

ACER Credit Rating Private Limited (ACER), a SEBI-registered credit rating agency, is committed to delivering independent and transparent opinions on issuer and credit ratings. ACER credit insights aim to empower investors, lenders, and businesses with opinions on ratings. With a clear vision to support India's economic growth story, ACER upholds the highest ethical and analytical standards, combining deep domain expertise, advanced analytics, and rigorous processes to ensure every rating is objective and insightful.

The Company reserves the right to amend this policy from time to time in accordance with the applicable regulations, circulars, and directives issued by the Securities and Exchange. Board of India. This rating criteria will be reviewed annually.

Financial risk analysis constitutes a core pillar of the credit evaluation framework for financial sector entities, reflecting the unique balance-sheet-intensive nature of their operations and the centrality of risk management practices. Ratings assigned by ACER represent an informed and forward-looking opinion on relative creditworthiness and are derived from an integrated assessment of financial risk, business profile, governance standards, and the operating and regulatory environment applicable to financial institutions.

ACER primarily relies on audited standalone financial statements for banks, non-banking financial companies (NBFCs), housing finance companies (HFCs), insurance companies, and other regulated financial entities, with trend analysis typically covering a 3–5 years period. Consolidated financial statements are also examined where group structures, subsidiaries, special purpose vehicles, or off-balance-sheet exposures have a material bearing on the entity's risk profile. Depending upon the complexity of the organisational structure, group support/parent support taken into account relevant financial ratios will also be considered. Periodic financial disclosures, including quarterly results, regulatory filings, and supervisory data, are reviewed to assess recent performance, emerging risks, and compliance with prudential norms. Forward-looking analysis incorporates management projections, business plans, and stress-testing outcomes to evaluate the sustainability of capital, profitability, and liquidity under varying operating conditions.

For analytical clarity, financial risk indicators for financial sector entities are broadly categorised into capital adequacy, asset quality, earnings and profitability, liquidity and funding, leverage, and market risk indicators. The relative importance of each category varies by sub-sector, regulatory regime, and business model, for instance, lending institutions, insurers, and market intermediaries, while sector-specific ratios and regulatory benchmarks are applied to capture distinct risk characteristics.



While financial ratios and prudential metrics provide a structured and comparable basis for assessing financial strength, their interpretation is subject to limitations arising from regulatory forbearance, accounting practices, portfolio seasoning effects, and the potential lag in recognition of stress. Accordingly, ACER applies significant analytical judgment and places financial metrics within the broader context of governance quality, risk management discipline, franchise strength, regulatory oversight, and systemic linkages. No single metric is viewed in isolation or as determinative of the overall credit assessment.

Overall, financial risk analysis for financial sector entities provides a disciplined, transparent, and regulator-aligned framework for evaluating credit risk, supporting ACER objective of delivering credible, consistent, and forward-looking credit opinions to market participants and regulators.

This criteria adheres to the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999, and the latest SEBI Master Circular from time to time. and will be reviewed annually and necessary changes will be made as per need basis.

This policy applies to:

- Commercial Banks (Public & Private)
- Non-Banking Financial Companies (NBFCs)
- Housing Finance Companies (HFCs)
- All India Financial Institutions (AIFIs)
- Any other Financial Institutions

The policy aims to:

- **Assess Standalone Credit Strength:** Evaluate the issuer's inherent creditworthiness by analysing its capacity to manage underlying business and financial risks, independent of external support.
- **Detect Emerging Stress:** Apply ratio-based analysis to gauge potential future provisioning needs and identify asset segments that may transition to non-performing status over the medium term.
- **Ensure Consistent Analytical Adjustments:** Establish well-defined principles for normalising reported financials—such as the computation of Tangible Net Worth or the treatment of hybrid instruments—to better capture the entity's underlying economic and financial position.

Core Principles Governing Financial Ratio Analysis

- ACER adopts a principle-based and judgment-driven approach to the analysis of financial ratios for financial sector entities. Financial ratios are used as analytical tools to understand risk, sustainability, and resilience, and are not applied as mechanical thresholds or standalone determinants of credit ratings.
- The assessment emphasises trend analysis, peer comparison, and sustainability of financial performance rather than point-in-time metrics. Greater importance is placed on

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the direction and stability of key ratios over time and their alignment with the entity's business model and risk profile. Financial ratios are seen as a combined metric rather than in isolation.

- Financial ratios are evaluated in a forward-looking manner, incorporating management projections, expected changes in operating conditions, and regulatory developments. Sensitivity and stress considerations are applied to assess the entity's ability to withstand adverse scenarios.
- The interpretation of ratios is contextual and model-specific, recognizing differences in leverage, margins, asset quality, and liquidity profiles across banks, NBFCs, and other financial institutions. Cross-entity comparisons are undertaken only where analytically appropriate.
- Financial ratio analysis is integrated with qualitative assessments relating to governance, risk management, funding flexibility, and regulatory compliance.

Classification of Financial Ratios

To establish a uniform, transparent, and analytically rigorous framework for assessing the financial risk profile of financial sector entities, using sector-appropriate ratios that reflect:

1. Capital Adequacy and Management
2. Asset Quality
3. Resource Profile (Funding)
4. Earnings and Profitability
5. Liquidity
6. Growth Ratio

The relevance and weight of each category vary by broader sector and business model.

Certain ratio calculations are as per regulatory norms. This Policy includes following Financial Ratio but are Not Limited to:

Capital Adequacy and Management

Capital adequacy represents a financial institution's ability to absorb losses, support growth, and maintain stability under stress. ACER considers capitalization to be a core pillar of financial risk assessment, particularly given the leveraged nature of financial sector balance sheets and the inherent cyclicity of credit risk.

Key Ratios (Illustrative examples)

- Capital Adequacy Ratio (CAR / CRAR)
- Tier I Capital Ratio
- Common Equity Tier I (where applicable)
- AUM/Adjusted Net Worth

Capital Adequacy Ratio (CAR / CRAR)



Measures the adequacy of total regulatory capital relative to risk-weighted assets. It reflects the institution's overall loss-absorption capacity and compliance with regulatory capital requirements. It is calculated as the sum of Tier I and Tier II capital divided by risk-weighted assets. Adequate headroom over minimum thresholds enhances resilience against credit and market stress. A higher CAR indicates an ability to undertake additional business and a capacity to withstand stress

Tier I Capital Ratio

Represents the proportion of core capital available to absorb losses on a going-concern basis. A higher Tier I ratio indicates stronger capital quality and greater ability to withstand financial stress without external support. Tier I Capital Ratio, computed as Tier I capital divided by risk-weighted assets. Tier I capital is the primary source of funds for a bank. Under Basel III, the minimum regulatory requirement is 7.0%.

Common Equity Tier I (CET I) Ratio (where applicable)

Captures the highest quality of capital, comprising common equity and retained earnings. This ratio is a key indicator of capital permanence and loss-absorption strength, particularly under stressed conditions. Common Equity Tier I Ratio is calculated as common equity Tier I capital divided by risk-weighted assets. A high CET1 ratio indicates a superior capital cushion to survive adverse economic downturns without affecting regular business functions. Under Basel III, the minimum CET1 is 5.5%.

1. Asset Quality

Asset Quality is the cornerstone of an institution's operational efficiency and a direct reflection of its credit appraisal and risk management practices. Weakness in asset quality leads to higher credit costs, which dilute yields, erode earnings, and can eventually impact growth prospects and solvency.

Key Ratios (Illustrative examples)

- Gross NPA Ratio
- Net NPA Ratio
- Provision Coverage Ratio (PCR)
- Slippage Ratio
- Credit Cost Ratio

Gross NPA Ratio

Gross NPA Ratio is calculated as gross non-performing assets divided by gross advances and measures the proportion of the loan portfolio that has turned non-performing before provisioning. A lower and stable Gross NPA ratio indicates sound underwriting standards and



portfolio quality, while rising levels signal stress in the loan book and elevate pressure on earnings and capital. Trends and incremental movements are given greater importance than absolute levels.

Net NPA Ratio

Net NPA Ratio is calculated as net non-performing assets (gross NPAs minus provisions) divided by net advances and reflects the residual credit risk remaining on the balance sheet after accounting for provisions. A lower Net NPA ratio indicates favourable provisioning buffers and better loss-absorption capacity, whereas elevated levels suggest potential vulnerability of capital in the event of further deterioration. Net NPA is viewed in conjunction with capital adequacy.

Provision Coverage Ratio (PCR)

Provision Coverage Ratio is calculated as total provisions held against NPAs divided by gross NPAs and measures the extent to which impaired assets are already provided for. Higher PCR provides downside protection to capital and earnings, particularly during periods of stress. Weak PCR may constrain ratings even if reported NPAs are moderate, as it implies higher future credit cost risk.

Slippage Ratio

Slippage Ratio is calculated as fresh NPAs added during a period divided by standard advances at the beginning of the period and captures the rate of new asset quality deterioration. This is a crucial forward-looking indicator that measures incremental stress added to the portfolio during the period. Lower and stable slippage ratios indicate controlled credit costs and effective underwriting, while elevated or volatile slippages are viewed as early warning signals of stress and may precede deterioration in headline NPA ratios.

2. Resource Profile (Funding)

Resource Profile assessment is critical as it determines an institution's ability to mobilize stable funds at competitive rates, which is key to maintaining operational stability. Our analytical approach differentiates between banks, which are primarily deposit-funded, and Financial Institutions (FIs) or NBFCs, which rely more on wholesale funding.

The primary goal is to assess the stability of funds (ability to retain funds during stress) and the cost of funds (impact on margins). A heavy reliance on short-term wholesale funding to finance long-term assets is a critical risk factor.

Key Ratios (Illustrative examples)

- CASA Ratio
- CASA to Liabilities Ratio
- Top 20 Depositors / Top 20 Borrower



- Credit to Deposit (CD) Ratio

CASA Ratio

CASA Ratio is calculated as current account and savings account deposits divided by total deposits and measures the proportion of low-cost and relatively stable funding in the deposit base. CASA deposits represent a cheap source of funding for the banking system. A high CASA ratio is viewed positively because it reduces the overall cost of borrowings, which in turn contributes to a higher Net Interest Margin (NIM) and better overall profitability.

CASA to Liabilities Ratio

CASA to Liabilities Ratio is calculated as CASA deposits divided by total liabilities, and reflects the contribution of stable, low-cost deposits to the overall liability structure. A higher ratio enhances overall funding stability and resilience during periods of stress, while a lower ratio indicates greater dependence on market or wholesale funding, increasing sensitivity to liquidity conditions.

Top 20 Depositors / Top 20 Borrowers

This concentration ratio is calculated as aggregate balances of the top 20 depositors (or top 20 lenders) divided by total deposits or total borrowings, and measures concentration risk in funding sources. Lower concentration reflects a granular and diversified funding profile, which is viewed positively. High dependence on a limited number of depositors or lenders heightens rollover and confidence risk and may constrain ratings, particularly under stressed conditions.

Credit to Deposit (CD) Ratio

Credit to Deposit Ratio is calculated as total advances divided by total deposits and indicates the extent to which deposits are deployed into lending activities. We analyse this ratio in conjunction with balance sheet patterns to understand underlying liquidity issues. An increasing trend often reflects that credit growth is outpacing deposit growth, which forces the bank to consume its on-balance sheet liquidity (such as excess SLR investments) to fund new loans.

3. Earnings and Profitability

Earnings and profitability reflect a financial institution's ability to generate sustainable income, absorb credit costs, and support internal capital generation. Stable and adequate profitability provides a key buffer against asset quality stress and funding volatility. Earnings serve as the first line of defence against credit losses; therefore, this policy focuses on core operating profitability and the ability to augment the capital base through retained earnings.



Key Ratios (Illustrative examples)

- Return on Total Assets (ROTA)
- Return on Net Worth (RONW)
- Net Interest Margin (NIM)
- Cost to Income

Return on Total Assets (RoTA)

ROTA is considered the ultimate indicator of a bank or financial institution's overall profitability. It indicates the returns generated on the total asset base and encompasses the institution's efficiency in managing pricing, operations, asset quality, and fund-raising. ROTA measures the operating efficiency of an entity by calculating the profit generated per unit of total assets deployed. From the ACER perspective, ROTA is critical because it factors in the impacts of non-interest income, fixed costs (such as employee expenses), and asset quality. A higher ROTA demonstrates a strong ability to absorb credit losses and reduces dependence on shareholders for growth capital.

Return on Tangible Net Worth (RoTNW)

Also known as Return on Equity (ROE), this ratio reflects the returns generated for equity shareholders. It is a final indicator of profitability that is influenced by both the profitability of assets and the financial leverage of the entity.

Return on Tangible Net Worth is calculated as profit after tax divided by average tangible net worth, and reflects the return generated for equity holders. Adequate RONW indicates earnings strength relative to capital employed and supports capital accretion. Extremely high RoTNW driven by excessive leverage is viewed cautiously, while low RoTNW may signal structural profitability challenges.

Net Interest Margin (NIM)

NIM focuses on the overall spread earned by the entity on its total assets. It is the core measure of the profitability of the lending business before considering operational costs and provisions. Net Interest Margin is calculated as net interest income divided by average earning assets. Stable and adequate NIM indicates pricing power and efficient asset-liability management. Compression in NIM, particularly if persistent, may pressure profitability and reduce the institution's ability to absorb credit costs.

Cost to Income Ratio

This ratio is a primary measure of operating efficiency. It determines how much an institution spends on operating expenses (primarily employee and administrative costs) to generate a single unit of revenue. Cost to Income Ratio is calculated as operating expenses divided by net total income. Lower cost-to-income ratios reflect better cost control and operating leverage,



supporting profitability. Elevated or rising ratios indicate efficiency pressures and may weaken earnings resilience, especially in low-margin environments.

4. Liquidity

Liquidity is a critical supplementary parameter in assessing a financial institution's ability to meet short-term obligations and withstand stress, complementing core factors such as asset quality and capitalization. It evaluates not only the adequacy of liquidity buffers but also the stability, structure, and cost of funding that supports the loan book. ACER analysis extends beyond headline ratios to examine the institution's liquidity policy, Asset-Liability Maturity (ALM) profile, and resource stability, with a focus on regulatory resilience for banks and cash-flow coverage and maturity mismatch management for FIs/NBFCs. Given the inherent maturity transformation in financial intermediation, liquidity ratios are used to gauge the ability to meet near-term obligations without operational disruption or reliance on extraordinary funding, making liquidity a key risk factor, particularly under stressed market conditions.

Key Ratios (Illustrative examples)

- Liquidity Coverage Ratio (LCR)
- Net Stable Funding Ratio (NSFR)
- Asset-Liability Management (ALM)

Liquidity Coverage Ratio (LCR)

The LCR is a measure of a bank's short-term resilience to potential liquidity disruptions. It ensures that an institution maintains an adequate stock of unencumbered High-Quality Liquid Assets (HQLA) that can be converted into cash to meet its liquidity needs for a 30-day acute stress scenario. Liquidity Coverage Ratio is calculated as high-quality liquid assets (HQLA) divided by net cash outflows over the next 30 days and measures the institution's ability to withstand short-term liquidity stress. ACER analyses the cushion over the regulatory minimum (typically 100%) to determine the bank's ability to survive a sudden "run" or financial crisis. If the LCR is close to the regulatory minimum, ACER may sensitise the calculations based on the bank's asset-liability maturity (ALM) management.

Net Stable Funding Ratio (NSFR)

LCR focuses on short-term stress; the NSFR measures long-term resilience. It requires institutions to fund their activities with reliable and stable sources of funding on an ongoing basis over a one-year horizon.

Net Stable Funding Ratio is calculated as available stable funding divided by required stable funding and assesses the stability of funding over a one-year horizon. A higher NSFR reflects sound structural funding and reduced reliance on short-term borrowings. Persistent shortfalls



or limited headroom over regulatory thresholds are viewed negatively, particularly during periods of market stress.

Asset-Liability Management (ALM)

ALM is a qualitative and quantitative process used to manage the structural mismatches between the maturity profiles of an institution's assets and liabilities. The primary tool used is the Structural Liquidity Statement (SLS), which identifies cumulative mismatches across various time buckets. ALM is assessed through cumulative maturity mismatches between cash inflows and outflows across defined time buckets, typically expressed as percentage of total outflows. Limited negative mismatches in short-term buckets indicate balanced liquidity management, while significant or persistent mismatches heighten refinancing risk and may act as a rating constraint irrespective of otherwise stable financial metrics.

5. Growth Ratio

Growth ratios capture the pace, direction, and quality of expansion in a financial institution's balance sheet and earnings. While growth can enhance scale, diversification, and profitability, rapid or unbalanced growth may elevate credit, liquidity, and capital risks.

Key Ratios (Illustrative examples)

- PAT Growth
- Assets Growth Rate
- Deposit Growth Rate
- CASA Growth

Profit After Tax (PAT) Growth

PAT Growth is calculated as year-on-year percentage change in profit after tax and reflects the growth in overall profitability. Sustainable and consistent PAT growth indicates improving earnings strength and internal capital generation. Volatile or sharp growth driven by one-offs, or declining PAT, may signal earnings vulnerability and is viewed cautiously.

Assets Growth Rate

This measures the institution's ability to expand its core business and capture market share. We define Assets Under Management (AUM) broadly to include the on-balance sheet loan portfolio as well as off-balance sheet items such as securitised, assigned, and co-originated portfolios. Assets Growth Rate is calculated as year-on-year percentage change in total assets and measures the pace of balance sheet expansion. Moderate and well-calibrated asset growth supported by capital, liquidity, and risk management is viewed positively. Rapid growth without commensurate strengthening of buffers may heighten asset quality and liquidity risks.



Deposit Growth Rate

Specific to banking entities, this ratio reflects the institution's resource-raising ability and is a critical determinant of a stable liquidity profile. Deposit Growth Rate is calculated as year-on-year percentage change in total deposits and reflects the institution's ability to mobilise stable funding. Strong and granular deposit growth supports funding stability and liquidity comfort, while weak or volatile growth may increase reliance on market borrowings and elevate funding risk. It requires deposit growth to be commensurate with credit growth. If assets grow significantly faster than deposits, it forces the bank to consume its on-balance sheet liquidity (like excess SLR investments), which weakens its resilience. ACER may also monitor if high growth is achieved by offering interest rates significantly above peers, as this may indicate a weak liability franchise or non-core, volatile depositors.

CASA Growth

This measures the absolute increase in Current Account and Savings Account (CASA) deposits, which are the most stable and low-cost funding sources for a bank. CASA Growth is calculated as year-on-year percentage change in current account and savings account balances, and measures growth in low-cost deposits.

Sustained CASA growth indicates franchise strength, funding stability, and cost efficiency. Declining or inconsistent CASA growth may lead to higher funding costs and margin pressure, impacting profitability. High CASA growth reduces the overall cost of borrowings and positively impacts the bank's Net Interest Margin (NIM). However, ACER may assess this in conjunction with absolute deposit levels. ACER may also scrutinise whether high balances are driven by temporary high-interest rate offerings, which can attract volatile, non-core depositors.

Conclusion

Financial ratio analysis constitutes a central and structured pillar of the credit assessment framework for financial sector entities, providing a disciplined basis to evaluate solvency, capital adequacy, asset quality, earnings resilience, liquidity, and risk absorption capacity in a consistent and transparent manner. The analysis focuses on sector-specific dimensions such as capitalisation (CRAR, Tier-I ratios), asset quality (GNPA/NNPA, restructured assets), profitability and sustainability of earnings (NIM, ROA, ROE), leverage and gearing, liquidity and funding profile (LCR, ALM mismatches), and operating efficiency.

These ratios are analysed both on a standalone and trend basis to assess the institution's ability to withstand credit, market, and liquidity stress across economic cycles. Importantly, ratio analysis is not undertaken in isolation; it is interpreted in conjunction with qualitative overlays including risk management practices, underwriting standards, regulatory compliance, franchise strength, governance, and the operating environment. Forward-looking assessments, incorporating realistic growth assumptions, capital-raising plans, and stress scenarios, further inform the analysis.



This integrated and sector-aligned approach ensures that credit opinions for financial sector entities capture not only quantitative metrics but also the robustness of business and risk profiles, thereby supporting credible, forward-looking, and well-grounded rating outcomes for stakeholders.