



Rating Criteria for Non-Banking Finance Companies and Financial Institutions

Executive Summary

ACER is India's newest SEBI-registered credit rating agency, committed to delivering independent and transparent credit ratings. Our purpose is to empower investors, lenders, and businesses with ratings they can trust-enabling informed decisions and fostering confidence in India's financial markets. 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, consistent, and insightful. At ACER, we are not just rating credit, we are fueling India's journey towards a stronger and more resilient economy.

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.

The Financial Institution represents a critical component of India's financial ecosystem, serving as essential intermediaries that bridge the gap between traditional banking institutions and underserved market segments. NBFCs have emerged as vital players in last-mile credit delivery, addressing diverse financing needs through innovative financial solutions, specialized product offerings, and technology-driven approaches to credit assessment and delivery.

This comprehensive rating criteria establishes a systematic framework for evaluating the creditworthiness of NBFCs and other financial institutions operating across diverse business segments, including retail finance, wholesale lending, microfinance, housing finance, infrastructure finance, and other specialized financial services. The criteria is designed to deliver robust, forward-looking credit opinions that accurately reflect an organisation's ability to meet its financial obligations while adapting to the dynamic regulatory and economic environment.

The assessment framework is structured around four interconnected pillars that collectively capture the multidimensional nature of a Financial Institution's credit risk: Business Parameters, Ratio Analysis, Management Quality, and Environmental, Social, Governance and Legal Parameters. This holistic approach ensures comprehensive evaluation of all material credit risks and mitigating factors, leading to consistent and reliable rating opinions that support informed decision-making across the financial ecosystem.

Rating Framework: Four-Pillar Assessment Approach



Pillar A: Business Parameters

This pillar evaluates the fundamental business characteristics that determine an organisation's competitive positioning, market resilience, and growth sustainability. The assessment encompasses multiple dimensions that collectively reflect the institution's ability to generate stable earnings and maintain market position across economic cycles.

Scale and Market Presence

- **Total Business Size** reflects the NBFC's or other financial institution market presence and operational scale, measured in absolute terms of total business volume. A larger business size contributes to operational resilience and provides greater financial flexibility, while a smaller footprint may indicate limited operational reach and potential vulnerability. Scale also influences bargaining power with lenders, investors, and counterparties, affecting funding costs and strategic options.
- **Reliability of Financial Forecasts** evaluates the accuracy and realism of management's projections against historical performance and industry trends, with consistent achievement indicating sound planning and execution capabilities.

Market Position and Diversification

- **Market Share Growth Potential** evaluates competitive strength based on historical trends and market positioning. Higher growth potential indicates effective competitive positioning and the ability to capture emerging opportunities, while stagnant or declining trends suggest structural competitive challenges.
- **Geographic and Product Diversification** assess exposure distribution across regions and product offerings. Broad geographic presence mitigates local economic risks and regulatory concentration, while diversified product portfolios provide earnings stability and reduce dependence on single market segments.
- **Branch Network Coverage** for NBFCs demonstrates physical outreach capabilities for loan origination, customer relationship management, and collection activities. Extensive branch networks support operational reach and customer access, particularly crucial for retail-focused NBFCs, while limited networks may constrain growth potential and market penetration.
- **Listing Status and Market Capitalization** provide insights into market visibility, access to public capital markets, and overall financial standing. Listed entities with substantial market capitalization typically enjoy better funding access and stakeholder confidence compared to unlisted entities with a limited capital base.
- **Portfolio Concentration Risk** evaluates diversification across various economic sectors for non-specialist NBFCs. Well-diversified portfolios with lower concentration in top sectors reduce susceptibility to industry-specific downturns and enhance earnings stability.



Operational Resilience

- **Operating History** reflects institutional experience through economic and credit cycles. Longer operating history indicates seasoned management expertise and proven performance track records, while limited history suggests emerging operations with less proven capabilities.
- **Collection Efficiency** measures the effectiveness of loan recovery processes and borrower repayment discipline. High collection efficiency indicates robust operational controls and strong credit administration capabilities, critical for maintaining asset quality and profitability.
- **Credit Portfolio Quality Trend** for Last Years Assesses the historical trend of Gross NPA (GNPA) over time. Consistent decline or stability indicates strong asset quality, while a deteriorating trend signals increasing credit risk.
- **PCR Trend for Last Years** Monitors the trend in Provision Coverage Ratio (PCR), indicating changes in provisioning policies and the NBFC's approach to loss absorption. Stable or improving coverage reflects conservative recognition of potential losses and financial prudence.
- **Liability Growth** other than TNW for last year measures the expansion strategy and potential reliance on external borrowings by calculating the year-on-year growth in liabilities excluding net worth. Consistent, stable growth is preferred, while a declining trend indicates increased risk.
- **Large Exposure Management Top Single Largest Borrowers** Exposure Evaluates the concentration of credit risk to a limited number of individual entities. Lower exposure highlights prudence and reduced vulnerability stemming from significant single borrower risks.
- **Interest Rate Sensitivity** Qualitatively assesses the FI's exposure to adverse interest rate movements. It evaluates the effectiveness of asset-liability management (ALM) and hedging strategies on profitability and the balance sheet

Regulatory and Stress Adaptation

- **Regulatory Environment Adaptation** evaluates the Financial Institution's ability to respond effectively to regulatory changes. Proactive compliance demonstrates operational readiness and low regulatory risk, while lagging compliance indicates potential operational challenges and growth constraints.
- **Stress Test Performance** measures institutional capacity to withstand adverse economic scenarios. Comfortable stress test performance indicates strong financial resilience and robust risk management capabilities, while poor performance highlights vulnerabilities requiring attention.

Trend Analysis and Forecasting with Peer-to-Peer Comparison

- **Revenue growth trend analysis** over the past three years assesses the consistency, scale, and sustainability of the company's top-line expansion. Strong, consistent growth



indicates robust market positioning and effectiveness in capturing demand, while fluctuating trends may highlight vulnerability to market conditions or operational challenges.

- **Growth trend analysis in profit margins**, including gross, operating, and net margins over the last three years, evaluates the company's ability to maintain cost discipline and operational efficiency. Stable or improving margins demonstrate operational resilience, while declining margins may signal rising costs or competitive pressures.
- **Profitability resilience under different economic scenarios** (base, optimistic, pessimistic) measures the company's ability to sustain earnings across varying market conditions. Strong resilience indicates effective risk management, flexible cost structures, and stability in earnings under adverse conditions.
- **Leverage ratios comparison**, including Debt/EBITDA, measures the company's financial risk relative to peers. Lower ratios indicate prudent capital structure and stronger debt-servicing capacity, while higher ratios suggest potential vulnerability under stress.
- **Leverage ratios comparison**, including Debt/Adjusted Tangible Net Worth, evaluates the company's solvency relative to peer companies. Higher ratios indicate greater reliance on debt funding, while lower ratios demonstrate stronger equity backing and financial stability.
- **Liquidity ratios comparison** against peer companies assesses the company's short-term financial flexibility. Strong liquidity relative to peers demonstrates the ability to meet obligations, while weaker liquidity may indicate refinancing or operational risk.
- **Cash flow ratios**, including Operating Cash Flow to Sales (OCF/Sales), compared across the sector, indicate the efficiency of converting revenue into cash. Higher ratios show robust cash generation and financial flexibility, while lower ratios may signal reliance on external funding or working capital constraints.

Pillar B: Ratio Analysis

This pillar provides a comprehensive analysis of an NBFC's and other Financial Institutions financial health through a systematic examination of capital strength, asset quality, profitability, sustainability, and liquidity management capabilities.

Capital Adequacy Assessment

- **Capital Adequacy Ratio (CRAR)** indicates capital strength relative to risk-weighted assets, with higher ratios demonstrating stronger solvency and ability to absorb unexpected losses. This metric provides confidence in the Financial Institution's capacity to withstand financial stress and support continued operations.
- **Tier 1 Capital Ratio** measures the quality of core equity and reserves, with higher ratios reflecting robust capital that can effectively absorb losses and ensure long-term financial stability.



- **Capital Conservation Buffer** represents surplus equity held above regulatory minimums, acting as a cushion during stress periods and demonstrating prudent capital planning and financial discipline.
- **Common Equity Tier 1 (CET1)** represents the purest form of capital, consisting of common shares and retained earnings, with higher ratios indicating strong loss-absorbing capacity and ability to support growth initiatives.
- **Leverage Ratio** compares owned funds to outside liabilities, with lower leverage indicating a stronger financial foundation and enhanced ability to withstand funding shocks while maintaining balance sheet stability.
 - A. **Short-Term Debt / Total Interest-Bearing Liabilities** – Shows reliance on short-term borrowings. Higher values indicate increased refinancing and rollover risk. Reflects potential vulnerability in liquidity management.
 - B. **Undrawn Credit Facility / Outstanding CP** – Measures liquidity backup available against commercial paper obligations. Higher coverage provides greater comfort for meeting obligations. Ensures readiness for unforeseen funding requirements.

Asset Quality Analysis

- **Gross and Net NPA Ratios** measure the percentage of loans classified as non-performing, with lower ratios indicating stronger portfolio quality and effective credit risk management.
- **Provision Coverage Ratio** assesses the portion of NPAs covered by provisions, with higher ratios reflecting conservative recognition of potential losses and financial prudence in risk absorption.
- **NPA Recovery and Write-off Ratios** evaluate the effectiveness of collection efforts and final loss recognition, indicating management's ability to recover distressed assets and maintain portfolio quality.
- **Credit Cost** measures provisioning expense as a percentage of average loans, directly impacting profitability and reflecting ongoing credit risk management effectiveness.
- **Slippage Ratio** tracks the proportion of standard loans turning non-performing, serving as an early indicator of emerging credit challenges and portfolio deterioration.
- **Total Stressed Assets / Gross Loans (%)** – Includes NPAs and restructured assets. Higher values indicate more portfolio stress. Highlights potential vulnerabilities not captured in standard NPA measures.
- **Credit Risk RWA (%)** – Credit risk-weighted assets as a percentage of total RWA. A higher proportion reflects greater credit exposure risk. Demonstrates the intensity of risk in the loan book.
- **AUM Growth (%)** – Growth in Assets Under Management. Higher growth reflects the successful expansion of the loan portfolio. Indicates scalability and business momentum.
- **Securitized Loans** – Loans sold or transferred through securitization. Provides risk transfer and liquidity generation. Reduces the concentration of assets on the balance sheet.



Profitability and Efficiency Metrics

- **Return on Assets (ROA)** and **Return on Equity (ROE)** measure management's effectiveness in generating returns from assets and equity capital, indicating overall business profitability and resource efficiency.
- **Net Interest Margin (NIM)** represents the difference between interest income and expenses over average earning assets, demonstrating core lending profitability and effectiveness in managing lending and borrowing spreads.
- **Cost-to-Income Ratio** compares operating expenses to operating income, with lower ratios indicating higher operational efficiency and better cost control capabilities.
- **Cost of Funding** – Weighted average cost of borrowings. Lower cost enhances margin sustainability. Reflects efficiency in sourcing and managing funds.
- **Interest Income Growth** measures the annual expansion of core lending business, demonstrating the ability to scale revenue-generating operations while maintaining asset quality.
- **Fee-Based Growth (%)** – Growth in non-interest income sources such as processing fees. Provides income diversification. Reduces dependence on interest rate spreads.

Liquidity and ALM Assessment

- **Liquidity Coverage Ratio (LCR)** compares liquid assets to short-term obligations, ensuring the ability to meet immediate cash requirements during stress scenarios.
- **Net Stable Funding Ratio (NSFR)** evaluates stable funding relative to required funding over one year, demonstrating long-term funding sustainability and resilience against liquidity mismatches.

Pillar C: Management Quality

Management quality significantly influences long-term credit strength and operational success through strategic direction, governance frameworks, and execution capabilities.

Leadership Quality and Experience

- **Management Experience** in financial services, particularly during various economic cycles, provides a crucial context for evaluating decision-making capabilities during stress scenarios. Long-tenured leadership teams often demonstrate superior institutional memory and stakeholder relationship management.
- **Leadership Stability** supports long-term strategic planning and execution while reducing risks associated with management transitions. Assessment also considers succession planning and organizational depth to ensure continuity.



Governance Structure and Board Effectiveness

- **Board Composition Analysis** evaluates the balance between independent and promoter directors, ensuring adequate oversight and strategic guidance. Effective governance includes appropriate committee structures, regular performance evaluation, and clear accountability mechanisms.
- **Board Size and Independence** assess the breadth of expertise and oversight capacity within governance structures, with appropriate independence levels ensuring effective oversight of management decisions.

Promoter Integrity and Competence

- **Quality of Promoters** assessment considers track records with lenders, investors, government authorities, and stakeholders, reflecting integrity, credibility, and reliability based on historical behavior and market perceptions.
- **Resourcefulness and Transparency** evaluate promoters' ability to raise funds at competitive costs within reasonable timelines, alongside clarity and openness of financial reporting practices.
- **Promoters' Vision** assesses clarity, consistency, and effectiveness in business policies, strategic initiatives, and stakeholder communication, with exemplary promoters demonstrating coherent vision and strong leadership capabilities.

Pillar D: Environmental, Social, Governance and Legal Parameters

This pillar evaluates board engagement, compliance frameworks, regulatory adherence, and legal exposures, reflecting overall institutional compliance strength and sustainability practices.

Compliance and Regulatory Adherence

- **Regulatory Compliance Culture** assesses adherence to AML, KYC, and SEBI rules, with exemplary compliance indicating disciplined processes and high integrity, while repeated lapses highlight potential operational risks.
- **Non-Executive Directors' Engagement** measures attendance ratios and tenure completion, indicating board stability and governance commitment through effective oversight mechanisms.
- **Whistleblower Policies** assess mechanisms for reporting ethical concerns and irregularities, with robust policies ensuring timely reporting, accountability, and ethical conduct across the organization.
- **Operational Risk Management** examines systems and controls to mitigate operational risks, with strong controls reducing transaction errors, fraud, and process failures while enhancing organizational resilience.



Legal and Regulatory Exposure

- **Litigation Exposure** measures exposure to legal and recovery-related claims, including NCLT and CGTMSE cases, with lower exposure demonstrating limited financial and reputational risk.
- **Regulatory Violations Record** tracks non-compliance with RBI and other regulatory prescriptions, with minor violations reflecting disciplined processes while major violations indicate operational and credibility risks.
- **Supervisory Rating** reflects the regulator's overall assessment of FI's performance and risk management, with higher ratings demonstrating strong compliance and institutional robustness.

ESG Considerations

- **Social Responsibility Initiatives** assess customer protection measures, employee welfare practices, and community engagement, reflecting institutional values and long-term sustainability considerations.
- **Corporate Social Responsibility Activities** evaluate active engagement and investment in community development initiatives, assessed proportionally to operational scale and financial capacity.
- **Cybersecurity and Data Protection** protocols are critical given large volumes of customer information managed by financial entities, with strong systems safeguarding against breaches and operational disruptions.

Criteria Integration and Rating Determination

The comprehensive assessment across all four pillars is integrated through a structured analytical framework considering both quantitative metrics and qualitative factors. The criteria recognizes that credit strength emerges from interactions between business fundamentals, financial management, leadership quality, and external environment factors.

Each pillar contributes to the overall credit assessment based on relative importance for the specific Financial Institution's business model and risk profile. The integration process ensures balanced consideration of all material factors while avoiding mechanical scoring approaches that may miss important qualitative nuances.

The forward-looking nature of assessment incorporates management's strategic plans, regulatory developments, market trends, and potential stress scenarios. This approach ensures rating opinions reflect not only current performance but also the sustainability of credit quality under various operating scenarios.



Conclusion

This comprehensive rating criteria provides a robust framework for evaluating Financial Institution's creditworthiness through systematic assessment of business fundamentals, financial health, management quality, and external factors. The criteria's holistic approach ensures consideration of all material credit factors while maintaining consistency and transparency in rating determination.

The framework recognizes the diverse nature of Financial Institution's business models while providing standardized evaluation criteria that enable meaningful peer comparisons and stakeholder understanding. As the NBFC sector continues evolving, this criterion provides flexibility to adapt to changing business practices, regulatory requirements, and market conditions while maintaining analytical rigor and rating consistency.

The ultimate objective is to provide stakeholders with reliable, forward-looking opinions on relative credit risk that support informed decision-making across the financial ecosystem. Through comprehensive analysis and expert judgment, the criteria delivers rating opinions reflecting both current credit strength and future prospects under various economic scenarios, thereby contributing to overall financial system stability and efficiency.