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Rating Methodology Securities Companies

Updated January 2022



FiinGroup



Financial Information • Business Information • Market Research • Credit Ratings

Executive Summary

This publication has been developed by FiinRatings and substantially revised by S&P Global Ratings' experts. This publication presents FiinRatings' methodology for assigning issuer credit ratings (ICRs) on securities companies in Vietnam and is intended as a general guidance to help companies, investors and other market participants to understand how FiinRatings looks at quantitative and qualitative factors in explaining rating outcomes.

- The criteria organize the analytical process according to a common framework and articulate the steps in developing the stand-alone credit profile (SACP) and issuer credit rating (ICR) for securities in accordance with international standards.
- FiinRatings uses a principle-based approach for assigning and monitoring ratings nationally, which is in accordance with international standards. These broad principles apply generally to ratings of all types of corporates and asset classes. However, for certain types of issuers and issues, FiinRatings complements these principles with specific methodologies and assumptions.
- FiinRatings assigns credit ratings to both issuers and issues and strives to maintain comparability of ratings across sectors and over time. That is, FiinRatings intends for each rating symbol to connote the same general level of creditworthiness for issuers and issues in different sectors and at different times nationally.
- FiinRatings' approach to rating securities companies involves a comprehensive assessment of several parameters. Some core parameters are considered to have a high influence on the credit quality of a securities company, while others are considered supplementary parameters. FiinRatings takes a forward-looking view on the performance of securities companies on these parameters while evaluating its rating.
- If you have any question or concern, please contact our Customer Support Team at <https://fiingroup.vn/ContactUs>, or email fiinratings@fiingroup.vn.

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1. Scope of the Criteria



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ISSUER AND ISSUE RATING

Issuer Credit Ratings

A FiinRatings issuer credit rating is a forward-looking opinion about an obligor's overall creditworthiness. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, as it does not take into account the nature of and provisions of the obligation, its standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the counterparty credit ratings, corporate credit ratings and sovereign credit ratings are all forms of issuer credit ratings.

Issue Ratings

A FiinRatings issue credit rating is a forward-looking opinion about the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium-term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation as well as the currency in which the obligation is denominated. The opinion reflects FiinRatings' view of the obligor's capacity and willingness to meet its financial commitments as they come due, and may assess terms, such as collateral security and subordination, which could affect ultimate payment in the event of default.

THE RATED UNIVERSE

Securities company in Vietnam refers to enterprise licensed by State Securities Commission to perform one or several services or business activities prescribed in clause 1 of Article 72, clauses 1, 2, 3, 4 and 5 of Article 86 in the Law on Securities dated November 26, 2019.

Securities firms includes firms whose principal activities typically include

- Securities broking (charging a fee to act as intermediary between buyers and sellers) and margin lending; and/or
- Underwriting and issuance agency services; and/or
- Securities sales and trading or proprietary trading; and/or
- Financial and investment advisory services

Securities companies commit their own capital to act as principals in dealings with other market participants, and/or tend to be balance sheet intensive and confidence sensitive. Their funding structure tends to include a significant amount of confidence-sensitive, short-term funding, such as securities sold under agreements to repurchase.

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2. Rating Methodology

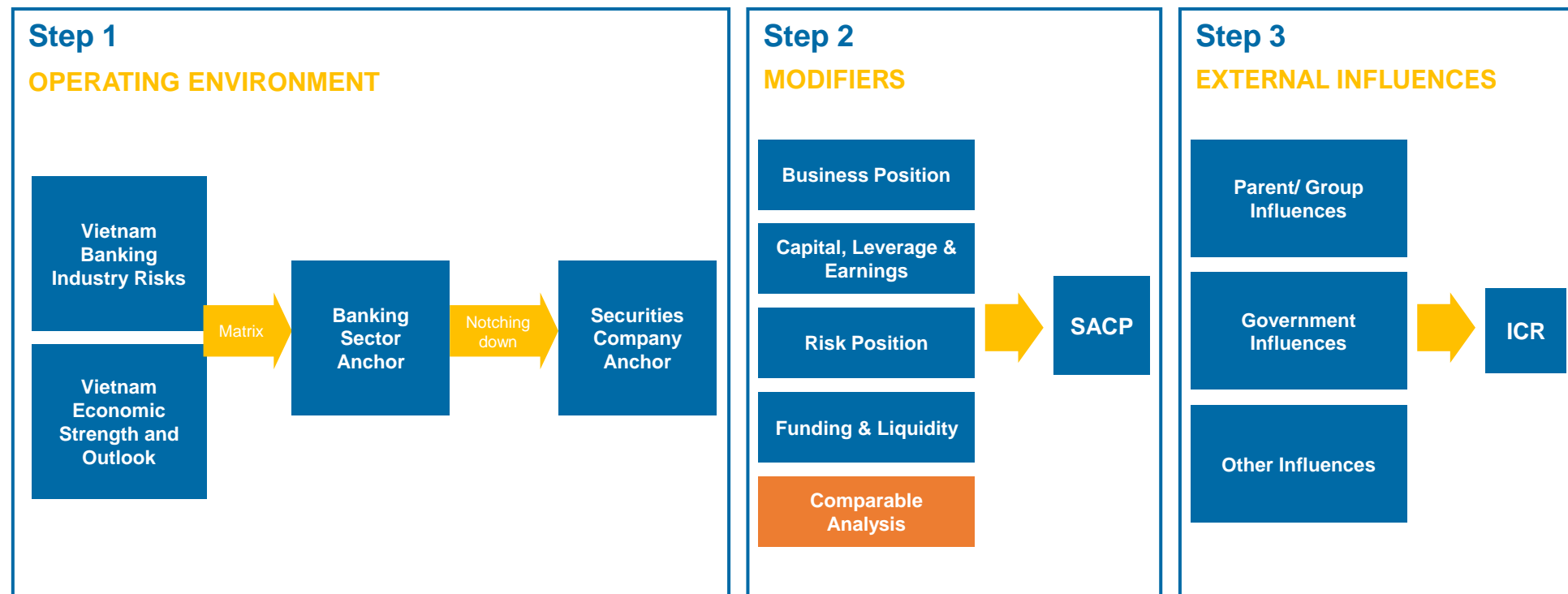
- Issuer Rating



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FiinRatings, together with close support of S&P Global Ratings' experts, has developed its rating criteria to factor in the recent market developments of the securities sector in Vietnam market.

Rating Framework for Securities Companies



Source: FiinRatings

Note:

- The Anchor: the economic and industry risks that the company faces
- The Stand-Alone Credit Profile ("SACP"): an issuer's creditworthiness in the absence of intervention
- The Issuer Credit Rating ("ICR"): an issuer's overall creditworthiness given the consideration of any relevant information

Step 1: Building the Anchor: *Securities Companies*

The first step to determine the anchor of securities companies, which is adjusted by notching down from the anchor of Banking industry.

SECURITIES COMPANIES ANCHOR

Notching downwards from Banks' Anchor

- *Higher risk, especially market risk for proprietary trading activities*
- *Competition: High competition risk within securities companies, especially in the brokerage services*
- *Lack access to SBV, which increases liquidity and funding risk in comparison with banks*

Vietnam Banking Sector's Anchor						
Banking Industry risk	Economic strength and growth potential					
	Very strong	Strong	Satisfactory	Fair	Weak	Very weak
Very low risk	AAA/AA+	AA+/AA	AA/AA-	AA-/A+		
Low risk	AA/AA-	AA-/A+	A+/A	A/A-	A-/BBB+	
High risk	A+/A	A/A-	A-/BBB+	BBB+/BBB	BBB/BBB-	BBB-/BB+
Very high risk		BBB+/BBB	BBB/BBB-	BBB-/BB+	BB+/BB	BB/BB-
Extremely high risk			BB+/BB	BB/BB-	BB-/B+	B+/B

Economic Factors

Economic Resilience Economic structure & stability, Macro policy flexibility

Banking Industry Factors

Institutional framework	Banking Regulation and supervision; Regulatory track record
Competitive dynamics	Banking Industry Risk Appetite; Industry stability; Presence of market distortions
Systemwide funding	Cross-border / External funding sources; Domestic Capital Market; Funding risks; Government role

Step 2: Assessment of Modifiers: *Overall Adjustments to the Anchor*

FiinRatings adds to or subtracts notches from securities companies' anchor for entity-specific factors to determine the SACP.

The entity-specific factors are Business position; Capital, leverage, and earnings; Risk position; and Funding and liquidity. An entity-specific anchor adjustment can result in an entity's anchor being higher or lower than the anchor for the rest of the sector. The below illustration is how FiinRatings will adjust a securities company entity-specific factors from the anchor.

TYPICAL NOTCHING	TYPICAL PROFILE			
	Business Position	Capital, Leverage and Earnings	Risk Position	Funding and Liquidity
Very strong (+2)	Business position and stability are significantly stronger than peers, a securities company is significantly better to withstand adverse operating conditions than the anchor indicates.	CLE factors of a securities firm is of material strength, indicating superior capability to absorb loss and generate earnings.	A securities firm's specific risks or attributes mean that it is materially better placed to withstand economic stress than the capital and earnings assessment indicates.	No securities firms are assessed at this level due to their non-depository nature and reliance on wholesale funding.
Strong (+1)	Business position and stability are stronger than average. A securities company is less vulnerable to adverse operating conditions than the anchor indicates.	CLE assessment is positive, demonstrating an above-average capability in this regard.	A securities firm's specific risks or attributes mean that it is better placed to withstand economic stress than the capital and earnings assessment indicates.	Stronger-than-industry-average funding profile, and effective liquidity management with superior liquidity-related ratios compared with the industry average, benefiting from strong investor confidence.
Adequate (+0)	Business risk profile is consistent with the anchor and similar to peers with the same anchor.	Neutral assessment in CLE, capital and earnings metrics are typically in line with the industry average	A securities firm's specific risks or attributes mean that it is able to withstand economic stress in line with the capital and earnings assessment.	Funding structure and liquidity position consistent with the industry average, with sufficient liquidity to function normally and meet minimum regulatory requirement on liquidity ratios even when the market is stressed.
Moderate (-1)	A securities company is more vulnerable to adverse operating conditions than indicated by the anchor.	The assessment of CLE is considered marginally negative, compared to the industry average.	A securities firm's specific risks or attributes mean that it is somewhat less able to withstand economic stress than the capital and earnings assessment indicates..	Funding structure and liquidity position somewhat worse than the industry average, but still able to function normally and meet minimum regulatory liquidity requirements under normal market circumstances. However, liquidity pressure may rise significantly when the market is stressed.
Weak (-2)	A securities company is significantly more vulnerable to adverse operating conditions than indicated by the anchor.	CLE factors are considered significantly weaker than peers' average.	A securities firm's specific risks or attributes mean that it is less able to withstand economic stress than the capital and earnings assessment indicates.	Funding ability and liquidity position are significantly worse than the industry average and having persistent difficulty in maintaining stable liquidity position or meeting minimum regulatory requirements when the market is stressed.
Very weak (-3)	The anchor is not representative of the extent of business risk or vulnerability to adverse operating conditions.	CLE factors are significantly lower than the minimum regulatory requirements and without timely capital injection, the operations would become unsustainable.	A securities firm's specific risks or attributes mean that it is considerably less able to withstand economic stress than the capital and earnings assessment indicates.	Eroded market confidence in the securities firm leading to a highly unpredictable liquidity position, high chance of requiring intervention for liquidity support.

Step 2: Assessment of Modifiers: *Business Position*

Business position is the first SACP factor and assesses the strength of a firm's business operations relative to peers.

The strength of a firm's business position reflects the relative stability of its business lines and its resilience to adverse operating conditions. FiinRatings assesses the overall business position on a six-category scale, from "very strong" to "very weak" by combining business stability and business diversity. Business stability assesses the predictability of continuing business volumes in the face of potential economic and market fluctuations, meanwhile, business diversity strengthens or weakens a firm's business stability prospects. For securities companies, FiinRatings' assessment is based on the competitive position of the company in each of their major business lines: brokerage services, proprietary trading, investment and financial advisory, and underwriting and issuance agency services.

Management and governance if assessed as "fair" or "weak," may cap the overall assessment derived from the initial matrix but does not raise the overall assessment. FiinRatings' evaluation of a company's management entails understanding the goals, philosophies, and strategies that drive the company's business and financial performances.

Matrix to determine Business Position						
1.2. Business diversity	1.1. Business stability					
	Very strong (VS)	Strong (S)	Adequate (A)	Moderate (M)	Weak (W)	Very weak (VW)
	Very strong/ Strong	Strong	Strong/ Adequate	Adequate/ Moderate	Moderate/ Weak	Weak/ Very weak
	Strong/ Adequate	Strong/ Adequate	Adequate	Moderate	Weak	Very weak
	Strong/ Adequate	Adequate/ Moderate	Adequate/ Moderate	Moderate	Weak	Very weak
	Adequate/ Moderate	Adequate/ Moderate	Moderate/ Weak	Moderate/ Weak	Weak	Very weak
Management and Governance						
Strong Satisfactory Fair Weak						
Management			Governance			
Positive	Neutral	Negative	Neutral		Negative	
<ol style="list-style-type: none"> 1. Strategic planning process 2. Consistency of strategy with organizational capabilities and marketplace conditions 3. Ability to track, adjust, and control execution of strategy 4. Comprehensiveness of enterprise-wide risk management standards and tolerances 5. Financial policy 6. Operational performance 7. Management's operational effectiveness 8. Management's expertise and experience 9. Management's depth and breadth 			<ol style="list-style-type: none"> 1. Board effectiveness 2. Entrepreneurial or controlling ownership 3. Management culture 4. Regulatory, tax, or legal infractions 5. Communication of message 6. Internal controls 7. Financial reporting and transparency 			

Step 2: Assessment of Modifiers: *Capital, Leverage, & Earnings*

Capital, leverage, and earnings (CLE), the second SACP factor under the methodology, assesses a firm's ability to absorb losses, which provides protection to senior creditors while the firm remains a going concern.

Matrix to determine Capital, Leverage, and Earnings Scale				
Capital and leverage assessment	Earnings assessment			
	Strong	Adequate	Moderate	Weak
Very strong	Very strong	Very strong	Very strong or strong	Strong or adequate
Strong	Strong	Strong	Strong or adequate	Adequate
Adequate	Strong or adequate	Adequate	Adequate or moderate	Adequate or moderate
Moderate	Adequate or moderate	Moderate	Moderate	Moderate or weak
Weak	Moderate or weak	Weak	Weak	Weak or very weak
Very weak	Weak or very weak	Very weak	Very weak	Very weak

Capital or Leverage represents the level of protection available to the company's creditors to absorb losses from market and other risks. Analysis of capital adequacy incorporates the absolute quantity and quality of capital, cushion over regulatory capital requirement, risk-adjusted capital levels, and management's capitalization policy. The analysis also considers the company's leveraging ability based on the business mix the company focuses on. A forward-looking view is taken on the leverage levels while evaluating capital adequacy. Besides, FiinRatings evaluates the growth outlook for the company's asset base and the ability to generate capital internally or from the capital markets.

Earnings are key to augmenting the capital required to support growth and absorb losses. The earnings profile indicates the entity's ability to price its anticipated risk. A comfortable earnings profile vis-à-vis the risk levels can help mitigate the entity's risk position. Also, stable earnings directly influence an entity's ability to attract both debt and equity. Stability and sustainability of earnings are also considered key parameters. Earnings also need to be viewed in conjunction with the asset quality of the securities company. The earnings are typically higher for entities operating in riskier asset classes, in order to cushion against potential volatilities and build up capital to absorb losses. While analyzing a company's profitability on a historical basis and in relation to peers, FiinRatings adjusts for changes/differences in accounting policies and the like. FiinRatings' analysis is forward-looking, and the relevance of past profitability performance is only a base for estimating future profitability.

The third SACP factor is **Risk Position**, which serves to refine the view of a financial institutions actual and specific risks beyond the conclusion arising from the standard assumptions in the capital and earnings analysis.

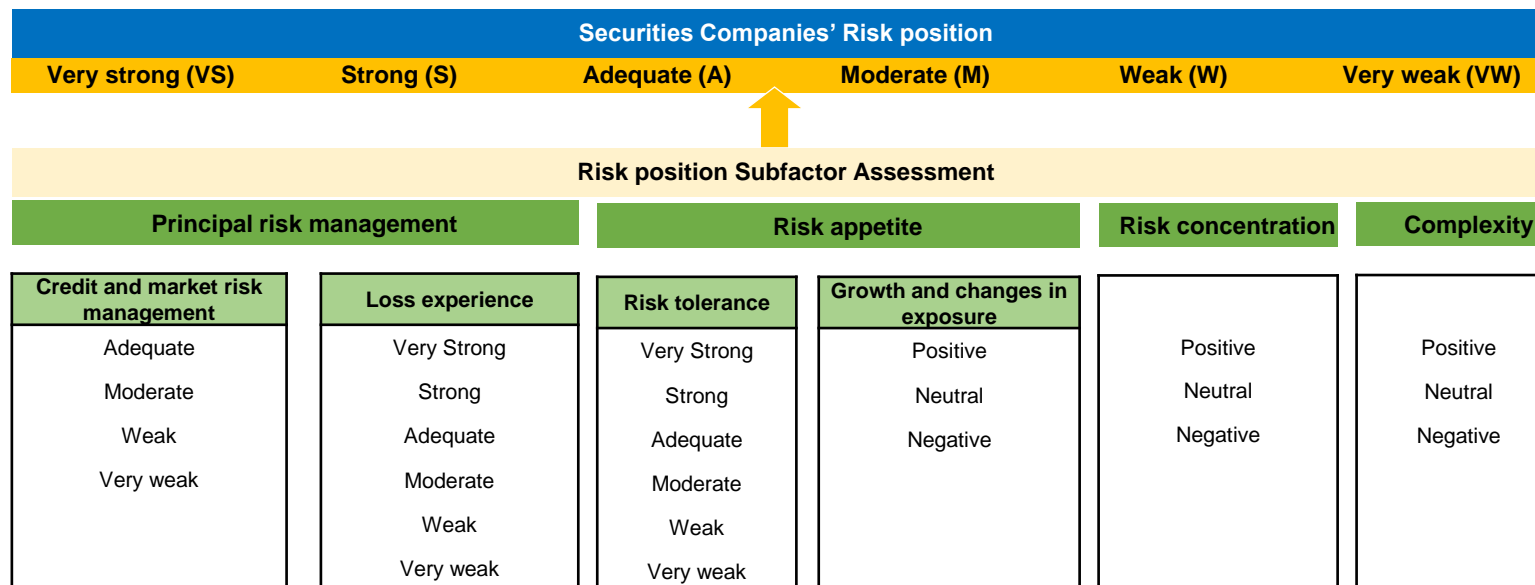
In assessing a securities firm's risk position, FiinRatings analyzes the following subfactors:

(i) Principal risk management: This subfactor addresses how well an entity manages the principal risks it faces: credit and market risks. We assess the subfactor by analyzing two indicators namely Credit and market risk management, and Loss experience. Credit and market risk management assesses a securities firm's risk oversight and control capabilities, as well as its management of reporting on principal market, credit, and counterparty credit risks. Meanwhile, loss experience can support or lower the principal risk management assessment.

(ii) Risk appetite: This subfactor is addressed by assessing two indicators: Risk tolerance (which assesses the trade-off between profitability and risk during periods of heightened market risk) and Growth and changes in exposure (supports higher or lower risk appetite but is not assigned an assessment)

(iii) Risk concentration: This subfactor focuses on the concentration of exposures to individual debtors, counterparties, and industries or sectors, or aggregations of risk across asset classes and risk types.

(iv) Complexity: An ever-increasing level of complexity in products, business lines, regions, and organizational structure may outpace a firm's capacity to manage risk. Complexity can weaken, but does not strengthen, risk position, and does so to the extent it increases or obscures risks.



Step 2: Assessment of Modifiers: *Funding and Liquidity*

The fourth SACP factor is **Funding and Liquidity**, which assesses a securities company's capacity to support business performance through effective funding while managing liquidity requirements both on an ongoing basis and in periods of stress.

Funding analysis considers the strength and stability of a security company's funding mix compared with the domestic industry average. Liquidity analysis typically considers a security company's ability to manage its liquidity needs in adverse market and economic conditions and its ability to survive over an extended period in such conditions. As securities businesses are inherently based on confidence, to the extent that the company depends on confidence-sensitive financing, it is exposed to the risk of funding disruptions. Changes to the acceptability of collateral, increasing haircuts, or material widening of a bid-ask spread can have a substantial impact on securities companies due to the frequent dependence of securities firms on credit-sensitive funding sources, which makes their ratings much more sensitive to such changes.

A relatively high proportion of securities firms' borrowings and lending is secured by liquid securities collateral. Liquidity can evaporate when repo counterparties and prime broker clients retreat as a result of negative market stress events that create actual or perceived losses, regulatory investigations, or allegations of fraud. Many firms manage this risk by maintaining adequate alternative liquidity (in the form of unencumbered assets) that can be quickly pledged in return for secured loans. Many also maintain committed bank lines. To be effective, these sources require good operational systems that permit the pledging of assets and the drawing-down of committed bank lines, regardless of market conditions. Securities firms may also use extended debt tenure to lower funding risks. In the Vietnamese scenario, however, very few securities firms have raised long-term debt. FiinRatings reviews a company's contingency liquidity plans, the feasibility of such plans, the liquidity of assets funded, and access to repo/call or securities lending markets.

Funding and Liquidity					
Funding	Liquidity				
	Strong	Adequate	Moderate	Weak	Very Weak
Very Strong	Very Strong	Strong	Strong/ Adequate	Adequate/ Moderate	Very Weak
Strong	Strong	Strong/ Adequate	Strong/ Adequate	Adequate/ Moderate	Very Weak
Adequate	Strong/ Adequate	Strong/ Adequate	Adequate/ Moderate	Moderate/ Weak	Very Weak
Moderate	Strong/ Adequate	Adequate/ Moderate	Moderate/ Weak	Weak	Very Weak
Weak	Adequate/ Moderate	Moderate/ Weak	Weak	Very Weak	Very Weak

Assessment Factors	Positive	Negative
Stable and diversified sources of funding	More stable and diversified than peers	Less stable or diversified than peers
Confidence-sensitivity of funding	Less sensitive than peers	Reliance on more price-sensitive funding resources
Access to funding from banks	Access to stable funding from central bank and inter-bank market	No stable funding from banks.
Funding that is appropriate for its asset profile	Yes	No, which may lead to asset and liability mismatch
Refinancing risk	No	Substantial refinancing risk in the foreseeable future
Liquidity coverage	Stronger than peers	Weaker than peers, may have large unusual liquidity needs in the short term that may not be covered.

Comparable ratings analysis is the last analytical factor under the methodology to determine the final SACP on an entity, and this considers the overall credit quality of the entity and its position against peers.

This analysis can lead us to raise or lower our anchor, based on our overall analysis of its credit characteristics for the factors we have considered in arriving at the SACP. This involves taking a holistic review of an entity's SACP, in which we evaluate an entity's credit characteristics in aggregate and consider any factors not already captured. A positive assessment may lead to raising our assessment and alternatively a weaker assessment may lead to lowering our assessment, relative to the anchor. The application of comparable ratings analysis reflects the need to "fine-tune" ratings outcomes, even after the use of each of the other modifiers. A positive or negative assessment is therefore likely to be common rather than exceptional. The SACP may be notched up/down by one notch or remain unchanged.

Generally, we compare an entity with all other entities in the same sector and country of domicile. More specifically, the peer group is typically securities companies that are in the same sector and have similar SACPs (i.e., the same or one notch higher or lower). However, the peer groups may include others. For example:

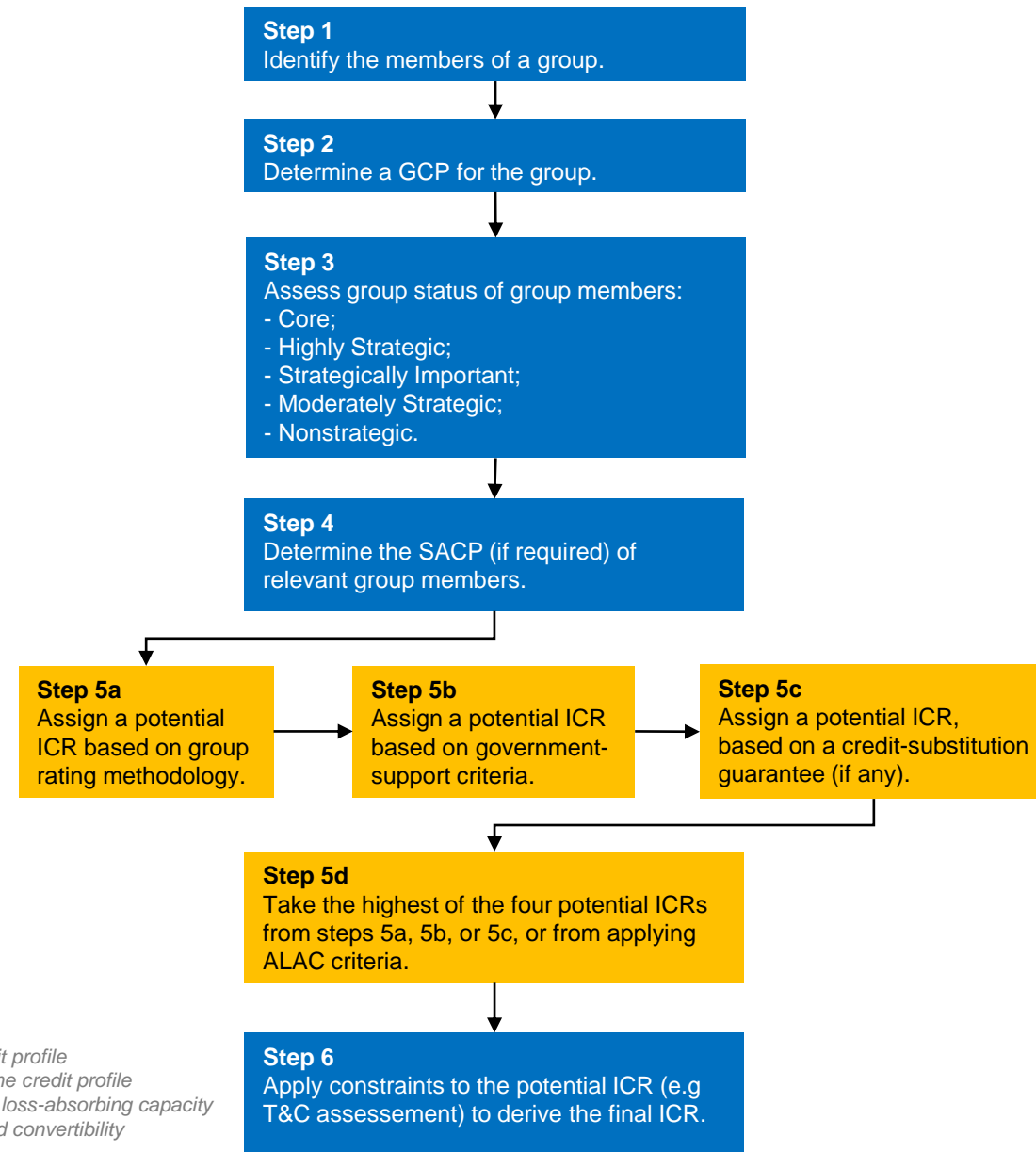
- The peer group may include securities companies in Vietnam when the SACP is close to the bank anchor.
- The peer group may include securities companies in the same sector but in different countries if there's an insufficient number of domestic peers or because regional or global peers form a better comparison.
- The peer group may include securities companies from other sectors when the entity's business overlaps with or is adjacent to other financial sectors.

Step 3: Assessment of External Influencers

After determining the SACP, FiinRatings then factor in any potential external influences on an entity to determine the ICR.

The criteria address a key area of "External support" in Framework. One of the main rating considerations is the potential for support (or negative intervention) from the parent company or group.

The criteria articulate the steps in determining an issuer credit rating (ICR) or financial strength rating (FSR) on a member of a corporate or financial services group. This involves assessing the group's overall creditworthiness, the stand-alone credit profile of group members, and the status of an entity relative to other group members and the parent company.



Content



2. Rating Methodology

- Issue Rating



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Once we have Issuer Credit Rating, we can proceed to rate an Issue.

- **Issuer ratings:** General estimate of the creditworthiness of the Company
- **Issue ratings:** Specific rating for a financial instrument (e.g., corporate bond, unsecured debt instruments)
- **The issue ratings** = Issuer ratings +/- Issue notching factors (*Qualitative and Quantitative factors*)

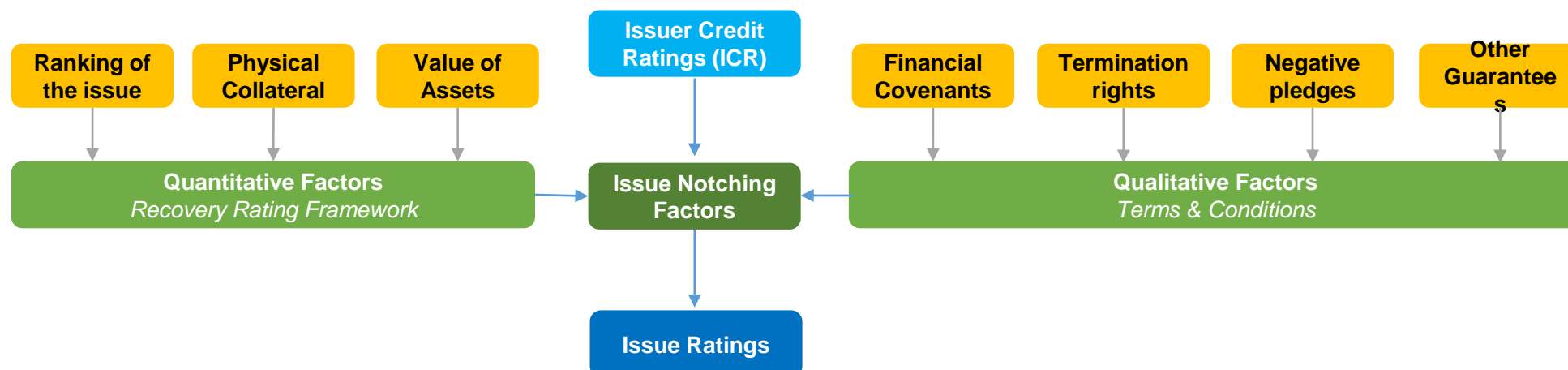
Issue Credit Ratings Framework

Issue credit ratings are based, in varying degrees, on S&P Global Ratings' analysis of the following considerations:

- The likelihood of payment--the capacity and willingness of the obligor to meet its financial commitment on a financial obligation in accordance with the terms of the obligation;
- The nature and provisions of the financial obligation, and the promise we impute; and
- The protection afforded by, and relative position of, the financial obligation in the event of a bankruptcy, reorganization, or other arrangements under the laws of bankruptcy and other laws affecting creditors' rights.

Issue ratings are an assessment of default risk but may incorporate an assessment of relative seniority or ultimate recovery in the event of default. Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation may apply when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.)

The issuer ratings could be notched up or notched down maximum 3 notches (1 category) to produce the final issuer ratings.



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3. Key metrics



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The table below illustrates the key metrics that FiinRatings uses in assessing creditworthiness of a securities company. These are not the only factors we use throughout the rating process.

Key Metrics: Quantitative Assessment Factors	Assessment Factor
1. Total Asset and Y-O-Y growth	Business Position
2. Total Revenue and Y-O-Y growth	Business Position
3. Market share in brokerage and margin lending activities	Business Position
4. Revenue from proprietary trading and its volatility measures	Business Position, Risk Position
5. Financial safety ratio	Capital or Leverage, Risk Position
6. Gearing ratios and debt coverage measures (Debt / EBITDA)	Capital or Leverage
7. Operating profit margin	Earnings
8. Return on average total assets	Earnings
9. Return on average total equity	Earnings
10. Net interest margin	Earnings
11. Cost to income ratio	Earnings
12. Total Assets to Total exposures to risk	Risk Position
13. Short-term Fundings to Long-term Fundings	Funding
14. Long-term Fundings to Long-term Assets	Funding & Liquidity
15. Liquid Assets / Short-term Fundings	Liquidity
16. Current and quick ratios	Liquidity

Source: FiinRatings

Note: The table above lists some of the key metrics that FiinRatings can use in analyzing securities companies. The above ratios may not be applicable to all securities companies and are not the sole metric used. Factors outside of the metrics listed above could be of importance to the rating, and their importance varies based on the actual situation of each company. Therefore, throughout the credit rating process, FiinRatings often incorporates more risk-oriented qualitative assessments.



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