



SECURITIES FIRMS

Rating Methodology

JCR-VIS Credit Rating Co. Ltd.'s (JCR-VIS) rating objective for a securities firm is to assess likelihood of the company not being able to make timely payment of its obligations. Ratings being prospective in nature, JCR-VIS integrates analysis of an entity's recent financial and operating performance with an assessment of the firm's strategic plan. The focus is on evaluating the quality of a firm's balance sheet, the appropriateness of its liquidity and capital funding policies, and the effectiveness of its risk management strategies with regard to asset/liability management, exposure limits on clients, etc.

JCR-VIS reviews the quality of the firm's financial fundamentals, its franchise, evaluating its ability to attract adequate funding and generate profitable returns through market cycles. This review is central to the rating process and is supported by consistent monitoring of industry dynamics and competitive forces.

Industry dynamics and regulatory framework

Securities firms are involved in a highly competitive industry in

which trading activity can be greatly impacted by interest rates and economic cycles. The industry can also be significantly affected by event risk, particularly resulting from regulatory or political developments. Such factors can lead to greater volatility in earnings and profitability relative to other industry sectors. Generally, securities firms serve the basic function of distributing and trading financial instruments for customers, financing customer positions, and providing advisory and underwriting services. The importance of these functions to a given economy, the size of the customer base, and the availability of substitute products or alternative suppliers will affect the approach to a rating.

All securities firms have to be members of at least one of the stock exchanges (Karachi, Lahore and Islamabad), though some are members of all three. The stock exchanges are regulated by the Securities and Exchange Commission of Pakistan (SECP) and they in turn have their own rules to regulate their members and the listed companies. The

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often-changing regulatory framework must be understood. In the recent years, the SECP and the stock exchanges have imposed greater restrictions on trading in an effort to protect market participants. JCR-VIS reviews regulations that promote money and capital markets through regulation of stock-trading commissions or other transaction costs and taxes, and examination of policies & procedures. These rules and regulations provide creditors protection through minimum capital, exposure limits and margin requirements. In addition to these, the company's efforts at prudent risk control in accordance with its business lines are also analyzed.

Strategy / Franchise Strength

While developing an understanding of the management's business strategy, JCR-VIS evaluates its competitive positioning and niche, and the viability of the company to operate in that niche and at the same time grow its business volumes. A lot depends on the company's ability to adapt

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to the changing needs of its clientele and offer innovative services & products which are consistent with the changing dynamics of the industry and market. Services could include convenience of online customer account status or other pertinent information, and ancillary products could include research reports and other publications, which add value to client trades. Market share and trends on busi-

ness & client growth are effective tools to gauge the company's franchise value.

JCR-VIS also reviews the responsiveness of the company towards globalization and increasing trend towards foreign investing. The company's ability to handle inward foreign investments in capital markets in a cost-effective manner is a valuable diversification in revenue sources. The benefits to the company would be higher margins through enhanced volumes compared to other firms. Depending on the firm's business, JCR-VIS examines the size of marketing force, customer profile, customer retention & growth, and average turnover in trading activity.

Management

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A view on the corporate structure is developed. This area also reviews managerial involvement in risk control, its ability to innovate, focus of management on core competencies and the management's flexibility in responding to competition. Importance given to planning & implementation processes, and the decision-making hierarchy also provide insight into the level of controls in place in the company and the confidence in the management team itself. Per employee revenues and costs would help determine management efficiency and economical utilization of resources. In the end, management expertise

is reflected in the financial performance of the company.

Risk Administration & Controls

Broad parameters of risk include price and interest rate risk, credit / counter party risk and operational risk. A company's vulnerability to these risk factors may

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be measured by the volatility in rev-

enues and pre-tax income. Earnings of a securities firm are exposed to the fluctuating market conditions. Securities firms' main sources of income include brokerage from client trading in money and capital markets, gains on proprietary trading, consulting and advisory fee, underwriting income and financing carryover transactions (COT). Circuit breaker mechanism in implementation in the three stock exchanges, to some extent, help limit losses from price fluctuations. In addition, these firms usually manage their risk, sourcing portion of revenues through more stable channels like fixed income investments. JCR-VIS reviews the company's asset liability management procedures and any long term mismatches in its funding structures. Diversifying client base and developing a strong retail clientele is also vital to manage client turnover. Risks for smaller companies may be higher due to their inability to participate in the broader market or manage a large client base.

JCR-VIS reviews the risk management guidelines, which have been developed by the com-

pany and the extent of any deviation from these guidelines. These would also include the level of exposure taken on any client and the client assessment procedures being followed. Margin requirements from clients can mitigate the counter party exposure of the securities firm. The stock exchanges also guarantee commitments in COT in some of the key, liquid stocks which mitigates counter party risks while trading in these shares.

The securities firm also needs to manage and comply with the frequently changing regulatory requirements. In addition, these firms should have in place strong internal controls to mitigate operational risks. These would include errors in trading and investment, frauds and embezzlements. Since at any point, large number of transactions are being handled, losses from operational negligence could be substantial and may have long term consequences on the reputation of the company. Assessment also includes evaluation of any risk, which may be peculiar to the company.

Risk management should be a continuous process in the company. JCR-VIS evaluates the level of risk and the risk measurement & management tools being used and the extent of transparency. These tools should

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be robust enough to adapt to the changing needs of the company and the market. The management information system

(MIS) should enable the company to carry out scenario and stress tests, identify concentration areas and signal non-compliance. Technology is one of the forces that have driven change in the capital markets. JCR-VIS reviews the pace of adoption of technology at securities firms and the degree of competitive advantage it may create, the prospect for new entrants resulting from technological change, such as Internet brokers, and the need for technological capital spending as a barrier to entry.

Performance

Both trend analysis and industry comparison is conducted to determine the relative financial performance of the company. Revenue and cost structures are broken down into the separate business / product lines and contribution from different categories of customers. The quality of the company's own investment portfolio,

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return from proprietary trading, and income from client dealing and any other stable sources of income are taken into consideration. Across time and industry comparison determine how well a securities firm has been able to manage its risk relative to other players. Regular new listings indicate economic growth, and may generate additional sustainable income, which in turn help support ratings. Performance measures would include the pre-tax return on funds employed, volatility in revenues, efficiency and any over/under-performance

relative to the broader market and the reason for such results. Performance is also evaluated relative to projections and reasons for deviations are explored further.

JCR-VIS assesses the financial flexibility of the company. The ability of the company to rationalize costs in

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times of sluggish market conditions and spread fixed costs over a larger volume is critical. Costs per transaction would help indicate the flexibility in pricing available to the company. Larger companies would fair well in their ability to develop economies of scale.

Capitalization and Liquidity

The stock exchanges have established capital requirements for their members and have also imposed allowable trade limits in relation to the member's capital. Whereas this sets the minimum level of capitalization, an in depth study of its adequacy is developed relative to the level of risk involved in the company's business lines. While credit, liquidity, concentration and market risks may be apparent from the company's financial statements, judgment is required as to the level of operational risks, litigation and reputational risks involved in the business being undertaken. Composition of funding sources, maturity profile, diversity is also taken into consideration, while future funding needs and sources are also identified. Analysis of liquidity would include the company's ability to liquidate its investment portfolio in a short span, raise borrowings / un-utilized credit lines and cover repayment of liabilities. **JCR-VIS**



Faheem Ahmad

President & CEO, JCR-VIS
Founder, VIS Group

Faheem Ahmad has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copyrighted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of shareholders in group companies include the largest publication house in Pakistan and major financial institutions.

He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters degrees in Engineering and Business Administration from USA. His research work has been published in various international journals.



Jamal Abbas Zaidi

Executive Vice President

Jamal Abbas Zaidi has more than three decades of rich experience in financial and general management at the local and international level. Prior to joining JCR-VIS, he was the CEO of a leasing modaraba and a senior executive of the then largest leasing company having IFC and ADB equity. Internationally he worked for World Bank at a multi-million dollar project in Nigeria. He has held key positions in the industrial and financial sectors and has contributed many papers in international and local conferences and workshops. He is also the Vice-Chairman and Director of Islamic International Rating Agency, Bahrain.

He is a Fellow member of the Institute of Cost and Management Accountants of Pakistan.



Nazia Saleem

Senior Financial Analyst

Nazia Saleem currently leads ratings of insurance and non-banking financial companies. Prior to joining JCR-VIS, she worked as an equity analyst at a reputable brokerage firm. She holds a Masters degree in Business Administration from the Institute of Business Administration, Karachi. She has also cleared CFA level III examination in 2003.

Jahangir Kothari Parade (Lady Lloyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

JCR-VIS Credit Rating Company Limited

Affiliate of Japan Credit Rating Agency, Ltd.
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JV Partner in CRISL, Bangladesh
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