RATING METHODOLOGY

FINANCIAL INSTITUTIONS

OVERVIEW

The ratings we assign to financial institutions convey our opinion of the institution's long-term relative creditworthiness. We anchor our rating methodology largely to banking entities in Malaysia which include commercial banks, Islamic banks, investment banks and development financial institutions. For non-bank financial institutions, we believe the rating factors outlined in our methodology broadly retain relevance in assessing the credit strength of these entities, which we then integrate with an evaluation of industry risk and competitive position while accommodating differences in business and funding models.

This rating methodology addresses two distinct scenarios that would lead to an event of default or a higher risk of default. The first manifests as a gradual decline in financial performance metrics or observable change which impact the institution's long-term commercial viability. The second scenario is more acute, often coming as a surprise in the form of sudden institutional failure due to insolvency or illiquidity as seen in instances of bank failure globally since the Global Financial Crisis.

We emphasise a forward-looking evaluation of an institution's ability to financially withstand shocks stemming from their balance sheet risks and business activities, revolving around five main rating factors: (i) Asset Risk; (ii) Funding and Liquidity; (iii) Profitability; (iv) Capital Adequacy; and (v) Management and Other Qualitative Factors.

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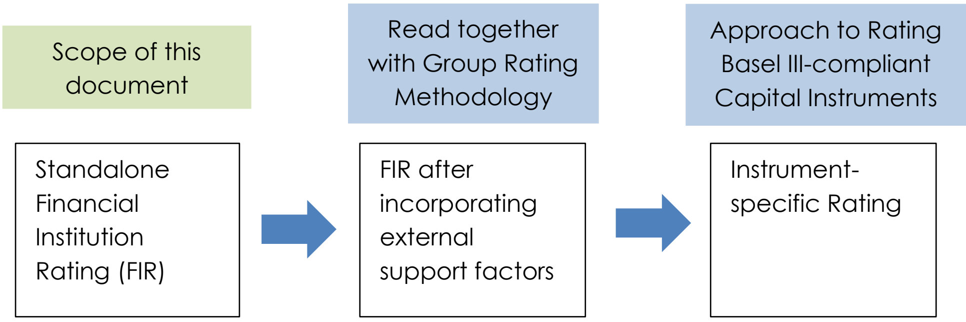
This document is effective April 2025 supersedes the previous "Financial Institutions Rating Criteria" methodology document.

APPROACH TO RATING FINANCIAL INSTITUTIONS

Our rating approach begins with assessing an institution against a scorecard to arrive at a standalone financial institution rating. The scorecard considers both quantitative and qualitative factors, incorporating macroeconomic conditions where appropriate. We then determine the expected level of support from the company's parent or shareholders, following standards set out in our "Group Rating Methodology" document, to arrive at a final rating incorporating external support factors. Finally, at the debt instrument level, we apply additional notching to reflect subordination and other characteristics relevant to credit risk that are specified in the issuance's terms and conditions; further details on such instruments for banks can be found in our "Approach to Rating Basel III-compliant Capital Instruments" document.

Exhibit 1: Approach to assigning ratings to financial institutions



Standalone FIR – Scorecard

To arrive at a standalone rating, we score an institution across five primary rating factors, with each divisible into a set of sub-rating factors. These rating factors construct our assessment of the institution's financial performance and risk profile, and categorically represent the quantitative and qualitative components of our scorecard. We may apply further adjustment to the aggregate scorecard score to incorporate additional considerations (e.g. peer comparison, etc) to the extent we deem those sufficiently significant to justify an upward or downward adjustment to arrive at a final FIR score.

Exhibit 2: Rating factors and standard scorecard weights

Quantitative				**Qualitative**
Asset Risk **(25%)**	Funding and Liquidity **(25%)**	Profitability **(10%)**	Capital Adequacy **(20%)**	Management and Other Qualitative Factors **(20%)**

We place great emphasis on having a forward-looking perspective in rating financial institutions. In this regard, we assign greater weight to asset risk as well as funding and liquidity, as we believe these have greater predictive value in determining an institution's creditworthiness. We begin our scoring of an institution against each rating factor by referencing an anchor indicator, which we deem most representative of an institution's strength in the corresponding rating factor. The initial score suggested by the anchor indicator is then further informed by granular assessments from our rating sub-factors. The scores we assign for each rating factor map back to individual rating levels (AA, A, BBB, etc).

RATING FACTORS

Rating Factor 1: Asset Risk (25%)

Our evaluation of asset risk seeks to capture the risk of financial losses that an institution may experience arising from its business activities, which are largely reflected in its balance sheet exposures. These losses are typically linked to credit, market and operational risks. Asset risk as a rating factor helps us apply a forward-looking perspective in assessing risks that may impact an institution's creditworthiness, which may not be apparent in top-line financial performance numbers alone, especially in good times. Our assessment of asset risk focuses on an institution's assets but also takes liabilities into account to the extent they interact with assets to affect measures of risk sensitivity or produce a risk netting effect.

Anchor Indicator: Gross Impaired Loans (GIL) Ratio
The primary role of banks, in general, is to facilitate financial intermediation between those with funds (depositors) and those in need of funds (borrowers). In this regard, we broadly expect loans or financing to form the bulk of an institution's total assets and, correspondingly, represent the main source of risk. Credit risk is the main risk associated with loans and financing, and borrowers who have exhibited clearer signs of default are captured in the impaired loans figure. We believe that an institution's level of gross impaired loans relative to its gross loans, measured by the GIL ratio, is the most intuitive indicator to function as a starting reference point to underpin our evaluation of asset risk.

Rating Sub-factors

(i) Loan/financing growth
A healthy amount of loan growth is viewed positively to the extent it supports an institution's profitability, but we are cognisant of the diluting and potentially distortive effect it can have on asset quality ratios such as the GIL ratio. Where an institution exhibits high loan growth exceeding the industry average or its past loan growth, we investigate the main drivers to determine its sustainability. If the information we gather suggests that aggressive loan growth stems from relaxed credit underwriting standards or an increase in the institution's risk appetite, this typically would result in a negative adjustment to the institution's asset risk score to reflect a likely shift to higher risk levels moving forward. As part of our investigative process, in addition to enquiring into changes to the institution's risk appetite and credit controls, we may compare the institution's assets from

lending activities against its credit-related risk-weighted assets (RWA) for perspective against historical trends.

(ii) Provisioning for credit losses

This sub-factor examines the extent an institution has recognised credit losses and reflected these in the provisioning levels recorded on its balance sheet. A high level of provisioning relative to the institution's level of impaired loans would suggest the institution's future earnings and shareholders' equity will be insulated from further deterioration even if those loans default in full with zero recoverability, given that the losses had been recognised prior. We look at the multiplier of the institution's provisioning level over its gross impaired loans, commonly known as the loan loss coverage (LLC) ratio. Additionally, we calculate an adjusted LLC ratio which includes regulatory reserves set aside by banks to comply with Bank Negara Malaysia's (BNM) Financial Reporting policy document. We generally improve the asset risk score for an institution showing very strong buffers with an adjusted LLC ratio exceeding 200%, while a ratio of less than 100% may result in adjustment leading to a worse score.

(iii) Leading indicators of credit performance

The GIL ratio is, by nature, a lagging indicator as it largely reflects defaults that have already materialised, although this is considered an improvement following MFRS 9 accounting standards that expands on classification triggers, in comparison to non-performing loans (NPL) which is solely time-based (i.e. arrears). To be more anticipative of future performance, we supplement the GIL ratio with an analysis of the institution's loans or financing that have shown signs of weakening creditworthiness, such as those that have exhibited repayment delinquency (2 to 3 months in arrears) as well as those that have met the institution's judgmental triggers for closer monitoring. In this regard, the assessment may lead us to adjust our scoring for asset risk after considering the institution's historical trends as well as its position relative to other institutions.

Along a similar vein, we are conscious of potential evergreening of non-performing loans resulting from rescheduling and restructuring (R&R) practices, which may lead to an understated GIL ratio. We look for signs of aggressive R&R practices by institutions that we rate, obtaining information where possible on the degree to which an institution grants R&R to borrowers exhibiting missed payments that suggest emerging cash flow problems, as opposed to borrowers seeking to pre-emptively take actions to better manage their cash flow.

Prevailing macroeconomic conditions are considered when we look at an institution's sectoral credit exposures, where we may take a view on the potential for deteriorating conditions to affect the credit performance of certain sectors (i.e. vulnerable) and their subsequent impact to the health of the overall credit portfolio. We may adjust the asset risk score based on the significance of an institution's exposure to vulnerable sectors.

(iv) Credit concentration

We see concentration risk as a concern due to its role in potentially producing outcomes that can deviate significantly from what statistical averages, which are often based on large well-diversified datasets that hold true in the long run, would suggest in the context of credit loss experience. A well-diversified credit portfolio characteristically exhibits low concentration to single or groups of counterparties, loan type and sectoral exposures. We primarily incorporate concentration risk in our scoring of asset risk by examining an institution's exposure to the top 20 single or group of borrowers. A credit portfolio heavily skewed toward characteristically highly diversified retail loans would also be considered favourably where sufficient to be a differentiating factor in comparison to peers.

(v) Credit repayment risk profile

An institution's loan portfolio may consist of various types of credit facilities with differing repayment terms and levels of credit support. We may consider the extent an institution's overall credit exposures are inherently exposed to lower or higher levels of credit risk. For example, credit facilities associated with trade finance generally carry lower risk given their short-term nature with the purpose of bridging borrowers' cash flow between the purchase of goods up until their conversion into manufactured products and onward sale. High levels of collateralisation in the credit portfolio tend to be viewed favourably, whereas facilities with bullet repayment terms are believed to carry higher credit risk, translating to an uplift or moderation to the asset risk score where an institution's corresponding exposures are significant relative to its peers that we rate.

(vi) Nature of assets/business

We recognise the need, in some instances, for alternative indicators to supplement or replace the GIL ratio in anchoring an institution's asset risk score. These instances may manifest in loans or financing constituting a small percentage of an institution's assets, reflecting business models that differ from traditional banking such as in the case of investment banks which may carry only legacy loan exposures.

The percentage of contribution from loans and securities to an institution's assets are both examined in our analysis. Where we deem an institution's securities book the primary contributor to an institution's asset risk, we focus our assessment on the presence of credit concentration in addition to the credit quality of securities held. A moderation in adjustment from other rating sub-factors may be employed in calculating the asset risk score if we judge appropriate to reflect both loan and securities book perspectives.

(vii) Risk sensitivity

This rating sub-factor expands our assessment of asset risk to also include market risk, particularly from the perspective of movements in interest rates and foreign exchange (FX) rates. For interest rate risk, we are chiefly interested in measures of risk linked to an institution's interest rate risk in the banking book (IRRBB), which are Earnings-at-Risk (EaR) and Economic Value of Equity (EVE). EaR informs us how an institution's earnings will be impacted over the next one year if interest rates were to move today by a given percentage, caused by the gap between the repricing of assets and liabilities. EVE measures the expected impact to shareholders' equity, particularly from changes in the fair value of securities. We may make a negative adjustment to the asset risk score if we believe EaR and EVE are at elevated levels relative to an institution's earnings and capital as well as in comparison to its peers. We inform our assessment of these IRRBB measures with analysis of an institution's fixed to floating loans profile, securities book maturity profile as well as average tenor of fixed deposits.

Sensitivity to FX rates is also of interest, particularly for institutions with structural FX exposures linked to operating subsidiaries overseas. We look at an institution's ability to manage its exposures arising from trading activities, structural balance sheet exposures and business activities.

Rating Factor 2: Funding and Liquidity (25%)

The strength of an institution's funding and liquidity occupies special attention in how we rate financial institutions. We take heed of lessons learned from past global bank failures, where heavy deposit withdrawals or a bank run scenario led to those banks' inability to meet its obligations to providers of funds. These bank failures came as surprises involving large and well-known institutions, that might otherwise have remained commercially viable or been able to recover had they not run into liquidity issues.

An institution's choice of funding structure not only determines its resilience in stress scenarios involving heavy withdrawal of funds (i.e. liquidity strength) but is also interconnected with its commercial profitability. Reliance on relatively expensive sources of funding tends to reduce margins earned and consequently provides less room for those margins to absorb increases in credit default losses. Besides shareholders' funds, an institution's funding is typically sourced from a combination of customer deposits, wholesale or interbank borrowing, and bond issuance. Our assessment of an institution on this rating factor focuses on the stability of funding sources and the availability of liquid securities to meet funding withdrawals under stress scenarios.

Anchor Indicator: Customer Deposits/Total Liabilities* (%)

* Excludes liability items not representing funding sources

We favour customer deposits as a source of funding for their characteristic of traditionally being lower cost as well as potential for showing high levels of diversification. Our computation of the anchor indicator removes non-funding related liability items. A higher funding and liquidity score would typically be assigned to an institution with a high percentage of its total liabilities constituting customer deposits, adjusted for our rating sub-factors.

Rating Sub-factors

(i) Funding stability

The profile of customer deposits can differ significantly across institutions, and while generally a more stable funding source, customer deposits further comprise certain deposit types and depositor segments that are stronger contributors to this characteristic stability. In this regard, we identify the split between current accounts and savings accounts (CASA) and other types of deposits (e.g. fixed deposits and money market deposits) as one dimension for analysis, and the proportion of retail versus non-retail deposits as another dimension. CASA is considered favourably compared to fixed deposits as the latter tends to seek institutions offering higher interest rates, thus providing an institution with high reliance on fixed deposits less flexibility in lowering its deposit rates given the need to maintain its deposit base. The potential for money market deposits to dry up in periods of stress and materialise liquidity risks also positions them less favourably. Retail deposits are considered more sticky and highly diversified compared to non-retail deposits, as the former consists of savings that are less likely to move around compared to business deposits that may have transitory balances with large movements for operational payments. Where we observe the ratio of CASA to total deposits or the ratio of retail deposits to total deposits to individually exhibit significantly higher levels compared to peers, uplifts to the funding and liquidity score may be considered, while low levels may result in a negative adjustment.

An institution's loan growth should be supported by a stable funding base given the inherent maturity mismatch between a financial institution's assets and liabilities. We address this perspective through the loans-to-deposits ratio (LDR), where an upward or downward adjustment would be made to the funding and liquidity score for institutions with LDR outside the range of 80% to 100%.

Following the principle of stable funding, we would also consider an institution's bond issuances to exhibit stability. Amounts from bond issuances and other sources we consider to be stable funding would be included in our calculation of the LDR to arrive at a higher adjusted LDR, in addition to improving the initial score from our calculation of the anchor indicator for funding and liquidity by being added to customer deposits.

(ii) Asset-liability matching

An institution with closely matched maturities in assets and liabilities is less likely to run into liquidity issues, as the gap between the receipt of funds from maturing assets and the due date of liabilities is minimised. In the context of determining an institution's ability to meet fund withdrawals, securities held are also considered closely matched to short-term funding as they can be sold to generate liquidity. We may make adjustments for institutions with closely matched assets and liabilities that would otherwise receive a weaker funding and liquidity score due to low levels of customer deposits or weaker assessment from our funding stability sub-factor. We may also examine significant currency mismatches between an institution's assets and liabilities for a view of liquidity strength in specific currencies.

(iii)Funding concentration

Similar to our views on credit concentration, we are likely to apply a negative adjustment to an institution's funding and liquidity score where we observe concentration to the top 20 single or group of depositors, and may extend this perspective more broadly to customer types and sectors. Concentration risk will also be examined where non-deposit sources of funding are significant.

(iv) Funding access

We may notch up an institution's funding and liquidity score as necessary to reflect a relative advantage afforded by its size and reputation in covering funding gaps or mitigating impact to its counterparty credit lines during periods of stress. Also taken into consideration are the institution's comparative strengths in accessing debt markets and sourcing customer deposits.

(v) Liquidity position and liquid securities

The readiness of an institution to meet fund withdrawals on an ongoing basis is supported by its available cash and securities available for liquidation. For this purpose, we look at the regulatory Liquidity Coverage Ratio (LCR) as an appropriate measure that captures withdrawals over 30 days under a stress scenario, while also looking at the regulatory Net Stable Funding Ratio (NSFR) for the longer-term perspective. We generally take note of an institution's buffers above the regulatory minimum level for LCR and NSFR. Uplifts to the funding and liquidity score from high LCR and NSFR may be considered only in the context of an institution exhibiting low funding concentration risk, with decreasing incremental returns.

We may consider the percentage of the institution's liquid securities that comprise securities classified under Financial Investments at Amortised Cost in its financial statements. A large percentage may indicate an institution would encounter issues such as the sudden recognition of significant market losses on the disposal of these securities that are not subject to mark-to-market treatment. In such instances, we may expand our assessment to enquire about the potential mark-to-market impact and risk sensitivity of these securities.

Rating Factor 3: Profitability (10%)

Profitability occupies one of our rating factors for its role in strengthening an institution's capital position via the flow of profit to shareholders' equity. We recognise that a profitable institution is likely to reflect a viable business model and ability to continue as a going concern. In the context of banks, the debt service coverage ratio metric carries less meaning for a business premised on earning margins from lending out the funds it borrows, unlike other businesses whose use of funds from debt may carry higher uncertainty in translating into profit. For that reason, we focus on an institution's ability to maintain steady profitability in relation to risks undertaken and may take size in comparison to peers into account.

Anchor Indicator: Profit Before Tax / Total Assets* (%)

* Excludes intangible assets

Our anchor indicator for the profitability score measures an institution's return on assets (RoA), with intangible assets removed from the computation. We believe RoA sufficiently differentiates institutions by their ability to generate profit from their assets and adjusts well to differences in the scale of the institutions we rate. To account for potential earnings volatility, we may consider the trend or average performance over an institution's past three financial years.

Rating Sub-factors

(i) Interest Margins

We value the ability of an institution to grow while maintaining its margins from borrowing and lending funds. In this regard, we take the net interest margin (NIM) into account from the perspective of trends and performance relative to peers. NIMs are generally expected to improve in a rising interest rate environment and contract when rates decrease, as an institution's loans typically reprice faster than its deposits. We seek to supplement our assessment by explaining shifts in NIM that stem from reasons other than changes to BNM's Overnight Policy Rate (OPR).

(ii) Earnings Sustainability

In this rating sub-factor, we look at an institution's earnings growth over time, taking note of the split between net interest income (NII) and non-interest income (NOII). We believe that NII should, in most cases, form the core of an institution's operating income given its role as a source of recurring income. Diversification between NII and NOII is viewed positively, but a high attribution of earnings to NOII is likely to negatively affect an institution's profitability score to the extent we believe NOII may see future moderation. Volatility in NOII is typically expected when realised and unrealised gains from the disposal or revaluation of securities dominate NOII, for which we make further scoring adjustments if there are concerns on whether the profitability score suggested by the current RoA is sustainable.

In the context of investment banks, by nature of their business, NOII may be the primary source of income, exhibiting correlation with the performance of capital markets in their advisory, equity/debt issuance and stockbroking activities. We generally reflect the earnings sustainability of these banks as inherently weaker than their commercial bank counterparts. Negative adjustments from this perspective may be tempered by assessments of the sustainability of NOII sources, such as the order pipeline supporting fee income from advisory activities as well as commissions earned from stockbroking activities.

(iii) Risk Efficiency

The measure of risk efficiency that we use to assess this rating sub-factor is the Return on Risk-Weighted Assets (RRWA), which we compute using profit before tax as the numerator. An institution with superior ability to generate returns relative to the level of risks undertaken would display a higher RRWA in comparison to peers. We also look at an institution's ability to maintain or improve its RRWA over time, and may make adjustments to the profitability score where this aspect is a sufficient point of differentiation.

(iv) Operating Cost Flexibility
An institution's overhead expenses include its fixed costs, where high overhead expenses relative to its operating income suggest greater erosion in overall profit margin if the institution experiences negative variance in its income. We look at the cost-to-income (CTI) ratio as the indicator for operating cost flexibility. An institution with a CTI ratio greater than 60% is likely to receive a negative adjustment to its profitability score, while a positive adjustment may be accorded for a CTI ratio below 30%.

Rating Factor 4: Capital Adequacy (20%)

An institution's capital position signals its compliance with regulatory minimum capital requirements, ability to support future asset growth, and capacity to absorb losses from its assets or business. We recognise the importance of capital, but also its nature as a static and potentially transient figure in the face of sufficiently large financial losses. The comparatively lower weight we assign to capital adequacy reflects our favour towards a more forward-looking perspective as provided in our asset risk rating factor.

Anchor Indicator: Common Equity Tier 1 Ratio (CET 1 Ratio)
We borrow the regulatory CET 1 ratio applicable to banks as our main anchor in scoring an institution's capital adequacy score. The CET 1 ratio primarily consists of an institution's paid-up capital and retained earnings, representing the strongest form of capital. CET 1 also cleanly excludes Basel III capital instruments issued as bonds, which have loss absorption or equity conversion triggers linked to the CET 1 ratio that act as a reference point to the ratings we assign to these instruments.

Rating Sub-factors

(i) Capital buffers
An institution with large capital buffers above minimum regulatory requirements is in a better position to support business growth and absorb financial losses. In this sub-rating factor, we supplement our assessment of the CET 1 ratio with the Total Capital Ratio (TCR) to provide a more complete picture of the institution's capital position. High buffers are generally viewed positively, but norms within an institution's peer group may moderate this view, such as investment banks' high levels of capitalisation relative to their commercial bank counterparts. We may adjust an institution's capital adequacy score if its capital position deviates significantly from peers, or if we expect its capital buffers to narrow sizeably due to business growth.

Additionally, we examine capital buffers in the context of risk emanating from an institution's business activities and balance sheet. Large capital buffers may be judged as only appropriate when viewed alongside factors such as concentration and chunkiness in an institution's credit exposures, which would generally result in a moderation to the institution's capital adequacy score.

(ii) Leverage
When looking at leverage in the context of banks, we start with a simple calculation of total liabilities divided by shareholders' equity. Leverage is inherently a core feature of the banking business and has the potential to magnify returns for a given amount of shareholders' funds. In this context, an institution with weaker RoA compared to peers may still exhibit a similar level of return on equity (RoE) by taking on higher leverage. Conversely, a higher degree of leverage also magnifies an institution's exposure to risks that may be inadequately captured under assumptions used in its calculation of RWA. We may make negative adjustments to an institution's capital adequacy score if its leverage is significantly higher compared to peers, with possible mitigation from a high amount of RWA provided relative to its assets. We may also take the regulatory leverage ratio into consideration in our assessment.

In assessing this sub-factor, we also consider off-balance sheet (OBS) exposures. Given the potential for OBS exposures to create additional institutional leverage, such as that which had contributed to the onset of the Global Financial Crisis, significant exposures to derivatives from trading activities may be viewed less favourably in the context of an institution's rating. We supplement our view with an analysis of income and balance sheet contribution from derivatives.

(iii) Capital preservation and access
Growth in the amount of capital is crucial for an institution to continue growing its business and balance sheet. Clear evidence of shareholder support in increasing an institution's capital base would be favourable to an institution's capital adequacy score. This may be in the form of injections to shareholders' funds or the execution of dividend reinvestment plans.

Rating Factor 5: Management and Other Qualitative Factors (20%)

Our interpretation of an institution's creditworthiness is influenced not just by its financial metrics, but also qualitative considerations which complement our assessment of its current financial position and performance to produce a more complete forward-looking perspective. The rating sub-factors we examine include assessments of the strength of leadership, franchise strength and the degree of expected support from shareholders. We incorporate these subjective assessments as part of our rating factors contributing to a financial institution's rating.

Rating Sub-factors

(i) Key management and leadership

An institution's management sets the tone from the top and charts the institution's strategic direction. An institution's scores across our quantitative rating factors typically validate the strength of its management, but we recognise the need in some instances to incorporate further considerations (e.g. track record, etc) beyond what is reflected in the institution's immediate financial performance. This sub-factor also considers exposure to key man risk whereby questions arise on the institution's ability to maintain its current level of success if there is a change in leadership.

(ii) Market position and franchise strength

An institution with high franchise value typically has multiple sources of advantage over its peers that help sustain customer loyalty and market share, such as distribution channels and economies of scale. We believe such institutions have greater resilience in sustaining earnings as well as accessing funding and capital, which we may incorporate by uplifting the score for this rating factor accordingly.

(iii) Business strategic plan – forward expectations

An institution may produce a mid-term strategic plan to turn its business around to improve financial performance. We may incorporate an uplift to the score for this rating factor if we believe those strategies have shown early evidence of success that are reasonably expected to continue.

(iv) Expectation of support from the government or major shareholder

Strong support from an institution's major shareholder would typically be in the form of expected capital injection if the need arises. Financial institutions owned by the government or a very strong shareholder would typically receive a higher score for this rating factor.

(v) Interdependencies within the Group

An institution may receive a better score for this rating factor if it has demonstrated an ability to tap into synergies with other entities within the Group it is a part of, to the extent these support the institution's earnings and growth. Conversely, we may apply a negative adjustment if these interdependencies are judged to expose the institution to greater risk instead.

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