

Brokerage Rating:

Brokerage Houses play an important role in the capital market by facilitating transactions in the stock exchanges for all categories of investors. With the development of the capital market, the brokerage activities have expanded all over the country with a large number of brokers and sub brokers. The role of Stock Brokerages is critical in the development of a stable capital market structure. Although the brokerage houses of the country have registered significant growth in their financial performance over the past few years during FY 2007 – FY 2010, they have witnessed one of the worst scenarios of the capital market during the beginning of FY2011 which has exposed their vulnerability to the various business risks associated with capital market operations.

NCR's rating methodology for Brokerage Houses provides an analytical framework that focuses on the key operational, financial and qualitative factors. These factors are most critical in assessing the overall performance, competitive positioning and its ability to withstand adverse operating environment & service its debt obligations. NCR's rating methodology involves an in-depth analysis of several qualitative and quantitative factors. Only the analysis of financial parameters based on annual reports would not be able to evaluate the business risks associated with stock brokerage houses, unlike commercial banks and non banking financial institutions.

Brokerage Industry; Operating Environment

The brokerage industry is extremely sensitive to information and time. Investors are keen to execute transactions quickly and satisfactorily without fail. It becomes imperative for a broker to put processes and practices in place to ensure prompt and adequate customer services. A brokerage house should have robust systems for interaction of the investors with sufficient speed and accuracy. Strong processes and practices backed by efficient use of technology is a prerequisite to ensure the desired speed and reliability of transactions on a sustained basis.

The broker houses are exposed to large counter party risk for transactions during the period up to the settlement of deal. Without having a strictly implemented margin loan system, failure of a single client can potentially have domino impact into losses for other clients. A brokerage house must have robust risk management policies in place for managing the counterparty risk.

The brokerage houses are required to maintain strict compliance to the rules and regulations of the Securities and Exchange Commission and the bourses (DSE & CSE). Any deviation from the rules and regulations may cause the suspension of trading. The continuity of brokerage services is dependent on the compliance of existing rules. The broker's ability and intention to abide by the rules and guidelines is therefore very important.

A brokerage firm's trading on its own portfolio increases its risk profile. The likelihood of diversion of customer's deposits and stocks to meet margin requirements also increases with the trading on its own

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769

account. Sudden price movements put broking firms under stress of liquidity problems unless they are able to mobilize resources in time to overcome such situations. NCR uses the key parameters listed below to assess the quality of operations of a broking firm and the services offered by it. Each parameter is assessed individually; these assessments are then aggregated to arrive at the final rating.

Qualitative Factors:

- Ownership
- Governance
- Systems framework
 - MIS
 - Back Office Operations
- Quality of Compliance
 - Compliance records
 - Internal controls measures for compliance
- Management
 - Stability and Experience of the top management
 - Track record of success
- Customer Relationship
 - Adequacy of practices
 - Range of products

Quantitative Factors:

Risk Management Framework

- Credit risk
 - Credit appraisal system
 - Counter-party limits
 - Margin call policy
 - Concentration of business
- Market Risk
 - Policy based exposure limits
 - Auto square off mechanism
 - Own portfolio transaction volume

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769

- Operational Risk
 - Process and Procedures
 - Use of technology
- Liquidity Risk
 - Policy framework
 - Unutilized credit lines
 - Margin adequacy
- Financial Strength
 - Profitability
 - Sustainability
 - Efficiency

Ownership

Our assessment framework involves reviewing the promoter's track record in terms of growth of the business, risk appetite, transparency in running the operations and their commitment and financial support to the business in distress situations. A conservative business growth with no history of litigations or regulatory actions is considered favorably over an aggressive business growth by compromising on the business ethics. In NCR's view, **companies operating as subsidiaries of strong institutions are expected to derive higher comfort as compared with companies backed by individual promoters.**

Governance

An independent Board of Directors provides valuable inputs to the company's financial and business strategies and corporate actions. NCR's analytical framework involves assessment of the depth of the board of directors, their participation in the Board meetings, and their independence from the day to day operations. NCR's analysis of corporate governance practices involves review of the delegation of authorities and responsibilities among the Board and the management and the rules and procedures laid down and followed for making decisions on corporate affairs. The emphasis of NCR's analysis is on the **corporate business practices and quality of disclosure standards that address the requirements of the regulators.**

Systems Framework

A robust systems is required to enable a broker provide services to its clients effectively and efficiently. The systems should be efficient enough for recording, processing and reporting all transactions with 100% accuracy. NCR assesses systems framework through assessment of the processes and procedures deployed and the degree of automation. Assessment of Systems includes **risk assessment systems, adherence to KYC and the reports generated from MIS.**

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769

Management Information System

A robust Management Information System (MIS) plays a crucial role for a brokerage house in monitoring the operational efficiency. The MIS helps monitoring of dealer limits, client limits besides ensuring smooth running of the normal business operations. NCR's assessment framework involves evaluation of the **quality and timeliness of the reports generated through the MIS and its relevance for the broker in improving upon its business performance.**

Back Office

The strength of the Back office operations play an important role for ensuring efficient services to the clients while mitigating the risk by assigning dealer-wise, terminal-wise, sub-broker-wise and client-wise exposure limits. Brokerage Houses with poor back-office infrastructure are likely to compromise both on risk management as well as customer services. The systems deployed have to be strong enough to be able to record and report every transaction of clients with 100% accuracy. Broker's back office operation also helps in recording the client's transaction history. NCR's evaluation of broker's back office operations comprises of assessment of the **processes, quality of the data recorded, storage facility, and the level of automation.**

Quality of Compliance

The legal compliance is very important for a brokerage house because of the stringent enforcement of rules by the regulators. Our assessment of the quality of compliance involves examination of the compliance record of the brokerage house along with the internal control measures adopted for ensuring adequate legal and regulatory compliance. Attitude of management towards legal compliance and the **internal systems in place for assuring compliance parameters for assessing the probability that broker's service continuity will not be affected by the action of the regulators.**

Management Quality

NCR assess the strength of the organizational structure and its ability to effectively deliver services to meet the customers need. Only strong management would help a brokerage house continue its operation during financial stress. The assessment of the management quality involves evaluation of the Stability and Experience of the top Management. NCR's assesses the experience of the management in capital market operations and their track record of success in response to changes in industry dynamics. NCR also analyses the company's ability to attract and retain talent, frequency and quality of the training provided to the employees and the succession plan for the top management. A brokerage house with a proven **track record of managing the business efficiently through various business cycles, professional management structure, good market reputation and history of fair practices are indicators of sound management.**

Customer Relationship

A broker's standard practices in providing services to its clients are evaluated. The adequacy of these practices and their actual implementation are assessed. **The range of products offered by a brokerage house and their transparency in dealing with clients are also evaluated.** Education programs offered

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769

to the investors, research reports, news updates are important parameters for evaluating customer relationship.

Risk Management Framework:

A Brokerage house is inherently exposed to risks of the volatile capital market. It is of important for a brokerage house to maintain a separate risk management team to follow a standardized, system driven, policy based risk management procedures. NCR evaluates the **participation of BoD in reviewing policies and control effectiveness, delegation of responsibility for monitoring and reporting risk, documented policies and standard procedures, capital allocation for various lines of business and independence of the risk management team.**

Credit Risk Management

NCR evaluates the credit **appraisal system and procedures for approving new clients and the initial deposit requirement, setting up of counter-party limits, margin call policy, efficiency of the follow ups in case of margin shortfall,** procedures for approving under-writing deals or merchant banking investments, and concentration of business with any particular client.

Management of Market risk

A brokerage house is exposed to huge counterparty risk for a period from the time of transaction till the settlement of the deal. Market risk management is assessed through evaluation of robustness and reliability of the risk management systems. NCR evaluates the market risk on the broking client in terms of **setting up and monitoring the client-wise exposure limits, quality of the collateral placed by client as margin, allowable time to take the delivery of the stocks in cash segment and margin cover maintained on margin funding clients.** A brokerage house with small volume of own portfolio as compared to the overall asset size, risk based trading policy, policy based conservative exposure limits & margin cover and auto-square off mechanism in the event of margin shortfall are indicators of sound market risk management.

Operational Risk Management

Brokerage houses are engaged in processing large number of transactions and transferring huge amount of cash and shares/securities every day as a routine business operation. For executing such huge data based transactions, it is necessary to have an efficient internal control system. NCR's assessment involves evaluation of **the adequacy of the internal control and information systems, history of operational failure, ability to restore the operation system, availability of the back-up system, and adequate systems to implement market and credit risk policies.**

Liquidity Risk Management

A well defined policy of maintaining adequate liquidity in terms of **un-utilized credit lines with banks and partly utilized margins placed with the exchange houses are important indicators of liquidity management.** Usually Brokerage houses are not supposed to face liquidity crisis for debt re-financing obligations as they do not have high borrowing levels, they need to maintain adequate margin cover at the exchange houses to ensure smooth functioning of its terminals during volatile periods.

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769

Financial Strength

The financial strength of brokerage houses is assessed to determine the sustainability of its operations. The diversity of revenue streams, dependence on a few big clients is assessed. **The various avenues of revenues and their trends are assessed along with parameters such as market share, and client profiles. The profitability, capital adequacy, and leverage indicators are evaluated.**

DISCLAIMER:

NCR has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. NCR shall owe no liability whatsoever to any loss or damage caused by or resulting error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without NCR's written consent. Our reports and ratings constitute opinions, not recommended to buy or to sell.

Tel: 88 02 9359878, Fax: 008 02 9332769
