VIS

Credit Rating Company Limited

SECURITIES FIRMS

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SCOPE OF RATINGS

This methodology applies to the credit rating of securities brokers and futures brokers operating under the Securities Brokers (Licensing and Operations) Regulations, 2016 and the Futures Brokers (Licensing and Operations) Regulations, 2018, as issued by the Securities and Exchange Commission of Pakistan (SECP). It also encompasses Agri-Only futures brokers and companies offering Shariah-compliant brokerage services.

To operate as a brokerage firm, entities must obtain a securities license from SECP, along with a Trading Rights Entitlement Certificate (TREC) from the Pakistan Stock Exchange (PSX). Additionally, they must be participants of the Central Depository Company (CDC) and members of the National Clearing Company of Pakistan Limited (NCCPL).

The Securities and Exchange Commission of Pakistan (SECP) classifies securities brokers into the following categories:

- Trading Only – These brokers are authorized to execute proprietary trades and trades on behalf of their customers but are not permitted to settle executed trades or hold custody of securities or funds belonging to themselves or their customers. This category includes a subcategory:
  - Online-Only Broker – A securities broker that exclusively executes trades on behalf of customers through online or electronic platforms, without offering brokerage services through any physical office.
- Trading & Self-Clearing – These brokers can execute and settle their proprietary trades as well as trades conducted on behalf of customers. They are permitted to hold custody of securities and funds belonging to themselves and their customers, subject to conditions set by the Commission.
- Trading & Clearing – These brokers have the authority to execute and settle their proprietary trades and customer trades, as well as hold custody of securities and cash belonging to themselves and their customers. Additionally, they are permitted to settle trades for other securities brokers and their clients, maintaining custody of the securities and cash of those brokers and their customers, as per the conditions imposed by the Commission.

SUMMARY OF CRITERIA CHANGES

The scope of the rating methodology has been updated to include new categories of brokers allowed under the Securities Brokers (Licensing and Operations) Regulations, 2016 and the Futures Brokers (Licensing and Operations) Regulations, 2018, as issued by the Securities and Exchange Commission of Pakistan (SECP). In addition, the ratings framework has been redefined for greater clarity.

OVERVIEW OF RATINGS FRAMEWORK

VIS Credit Rating Co. Ltd.'s (VIS) rating objective for a securities firm is to assess likelihood of the company being able to make timely payment against its obligations. A rating being prospective in nature, VIS integrates analysis of an entity's recent financial and operating performance with an assessment of the firm's strategic plan.

In undertaking its rating assessment, VIS is reliant on acceptable quality work being done by other independent third parties. In addition to financial audit, securities firms are required to undergo systems audit, and audit by the Central Depository Company Limited (CDC); the results of these various external evaluations provide basis for the veracity of reported financial numbers and the robustness of the internal structure set in place. The strengthening of the reporting requirements at regulatory level for the securities firms has supported the risk profile of securities firms. Level of adoption of international guidelines on conflict of interest and code of ethics will also be evaluated to gauge a firm's adherence to best practices.

The methodology for assessing securities firms focuses on industry dynamics and the regulatory framework, along with business risk evaluation characterized by franchise value, client retention, service diversification, and management effectiveness in strategic execution, governance, procedures, systems and level of controls and regulatory compliance. In addition, the methodology encompasses the assessment of financial risk profile based on capitalization, liquidity management, market risk exposure, and credit risk controls.

INDUSTRY DYNAMICS AND REGULATORY FRAMEWORK

Securities firms operate in a highly competitive industry where trading activity is significantly influenced by interest rates and economic cycles. Additionally, the sector is vulnerable to event risk, particularly arising from regulatory and political developments, leading to higher volatility in earnings and profitability compared to other industries.

These firms primarily engage in distributing and trading financial instruments, arranging financing for customer positions, and offering advisory and underwriting services. The economic importance of these functions, the size of the customer base, and the availability of substitute products or alternative service providers play a crucial role in determining credit ratings.

VIS assesses the regulatory landscape governing securities firms and periodically evaluates changes to determine the level of protection afforded to market participants and the potential risks assumed by these firms. This includes reviewing policies and regulations that influence the development of money and capital markets, such as the regulation of stock-trading commissions, transaction costs, and taxes.

To ensure creditor protection, VIS examines regulations that establish minimum capital requirements, exposure limits, and margin requirements. Additionally, firms' efforts in risk management and internal controls in line with their business models are closely analyzed. Given the dynamic nature of the legislative and regulatory environment, it is essential to understand the primary regulators and the historical precedents shaping securities firm regulations.

FRANCHISE VALUE & BUSINESS RISK

A securities firm's franchise value is largely determined by its competitive positioning, niche market strength, and ability to scale operations while adapting to changing industry trends. A firm's ability to sustain operations within its niche and expand its client base reflects its business viability and growth potential. Additionally, adaptability to evolving customer needs—such as offering digital trading platforms, research reports, and value-added services—enhances client retention and market relevance. Market share and client growth trends are crucial indicators of a firm's strength, as a growing client base and increased trading volumes demonstrate its competitive standing. Evaluating operational scale involves assessing the size of the marketing force, customer profile, client retention, and trading turnover, all of which contribute to long-term business sustainability. A strong franchise ultimately translates into pricing power, sustained margins, and a competitive advantage, positioning the firm favorably against industry fluctuations and ensuring long-term stability.

MANAGEMENT

The effectiveness of a securities firm's management team in developing and executing strategies is crucial for long-term success. Leadership stability and depth play a key role, as continuity in management and corporate structure ensures consistent strategic direction. A firm’s ability to adapt to regulatory changes and competitive pressures demonstrates its strategic flexibility and responsiveness to market dynamics. Additionally, a strong focus on core competencies and risk awareness reflects management’s commitment to innovation, compliance, and sustainable growth. Training and development of employees to assimilate them with the ongoing changes in market place and regulatory changes is also considered. Per employee revenues and costs would help determine management efficiency and economic utilization of resources. Governance and legal structure further influence a firm's financial risk and operational framework, with ownership structures—whether private or public—affecting decision-making and accountability standards. Ultimately, effective management should be evident in financial performance, operational efficiency, and the firm's ability to manage risk, positioning it for long-term stability and competitive strength.

RISK ADMINISTRATION & CONTROLS

A securities firm’s internal controls and governance structure are assessed to ensure risk mitigation. This includes adherence to internal risk management policies, exposure limits on clients, and margin requirements to reduce counterparty credit risk. Firms with strong underwriting guidelines and controlled exposure to equity underwriting are generally viewed more favorably. The expertise and experience of the management team in handling underwriting transactions, risk modeling, and financial analysis also play a role in evaluating the firm's overall risk profile.

PERFORMANCE & COST EFFICIENCY

Assessing a securities firm's performance involves evaluating its revenue stability, cost efficiency, and overall financial flexibility. A key factor is the firm's revenue mix and stability, where sustainable income from brokerage and advisory services is preferable to volatile proprietary trading gains, which can fluctuate with market conditions. Firms with a well-diversified revenue stream are better positioned to withstand market downturns and sustain long-term profitability. Tracking revenue trends, pre-tax profitability, and market share provides insights into a firm's competitive standing and growth trajectory.

Cost efficiency plays a significant role in determining a firm’s resilience during periods of economic downturn. Firms that demonstrate effective cost rationalization by optimizing expenses without compromising operational efficiency tend to outperform their peers. Scalability is also a critical factor, as firms with flexible cost structures can adjust to fluctuating market conditions while maintaining profitability. Moreover, investment in technology adoption, such as digital trading platforms, automation, and advanced risk management systems, can enhance operational efficiency and provide a competitive edge. By leveraging technological advancements, firms can reduce operational costs, improve client experience, and increase transaction volumes.

Larger firms generally benefit from economies of scale, allowing them to spread fixed costs over a broader client base and enhance pricing power. This advantage enables them to maintain stable revenue streams, reduce per-unit costs, and mitigate the impact of cyclicality in financial markets. In contrast, smaller firms may struggle with higher operational costs and revenue volatility, making them more vulnerable to market downturns. Therefore, firms that effectively manage performance and cost efficiency are better positioned for long-term sustainability and competitive success.

FINANCIAL RISK PROFILE

A securities firm's financial risk profile is primarily evaluated based on its sponsors' strength, capitalization, and liquidity. The financial backing and franchise value of a firm’s sponsors play a crucial role in determining its operational resilience and credit risk. Brokerage houses owned or controlled by financially robust institutions or corporations typically exhibit lower operational and credit risks, enhancing stability during market fluctuations.

MARKET RISK

A firm's approach to market risk, trading discipline, and internal controls significantly impacts its financial risk profile. Effective risk management extends beyond technology-driven solutions to include a strong risk culture, dedicated compliance personnel, and well-defined governance mechanisms. Securities firms are assessed on their ability to manage trading risks, limit exposure to illiquid instruments, and maintain independent risk oversight. Firms that enforce strict trading accountability, implement robust compliance measures, and conduct rigorous internal audits tend to exhibit lower risk exposure. However, the quantum of investment in proprietary portfolio is assessed in comparison to net worth of the company and accordingly treated where a lower proportion to net worth is considered sound from rating perspective.

CREDIT RISK

Credit risk is another critical area of evaluation. Securities firms face exposure from margin loans to customers, unsecured credit to corporate clients, and counterparty transactions. Assessing a firm's credit risk appetite, client exposure concentration, collateral adequacy, and credit loss history provides insights into its financial resilience. The firm's underwriting standards, counterparty credit limits, and risk monitoring systems are examined to ensure adequate safeguards against credit risk.

CAPITALIZATION AND LIQUIDITY

Capital requirements vary depending on a firm's business model, market activities, and risk appetite. A firm's capital strength is assessed relative to its operational scale and competitive landscape. Firms with higher capital reserves and diversified business operations generally demonstrate stronger financial resilience.

Liquidity management is equally vital, as securities firms rely on multiple funding sources, including market-based funding, secured financing, and credit lines. The composition, maturity, and diversification of funding sources are key indicators of liquidity strength. Effective liquidity management entails the ability to liquidate assets quickly and maintain adequate collateral for borrowings. Firms that maintain a liquidity buffer exceeding short-term obligations are better positioned to withstand market stress.

RATING SCALE & DEFINITIONS

Rating scale and Definitions may be accessed at (https://docs.vis.com.pk/docs/VISRatingScales.pdf)

Faheem Ahmad

President & CEO, VIS Credit Rating Company Limited
Founder, VIS Group Chairman,
Vice-Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. 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.

Javed A. Callea - Member

Advisor

Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate. Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.

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 genrosity 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.

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, VIS is positioned to aim for an international mark. In this regard, the global experience of our international affiliates and partners have 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, VIS continues its endeavour to remain an emblem of trust.

INTERNATIONAL

Affiliates

Islamic International Rating Agency – **Bahrain –** iira.com

Credit Rating Information & Services Ltd. – **Bangladesh –** crislbd.com

Collaborations

Japan Credit Rating Agency, Ltd. - **Japan**

China Chengxin International Credit Rating Company Limited - **China**

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