Banking Industry - Key Success Factors

BUSINESS RISK ASSESSMENT

Market Position
The analysis includes comprehensive assessments of the bank's market shares and sizes in key business lines or sectors as well as its future prospect, the bank's existing products, future products, market expansion, and other real advantages resulting from the bank's market position (pricing power vs. funding base) either in national market, regional market, or in any specific segment/sector. The vulnerability of the bank's market position is also considered by comparing its competitive advantages against its peers.

Infrastructure and Quality Of Service
The analysis covers detailed assessments on the bank's distribution network such as branches, ATM, and IT capabilities to support its daily banking operation in an effort to provide better and integrated products and give better services to its customers. The bank's quality of service is also diligently assessed, as it is considered as an important factor for a retail bank to attract customers and support the bank's sustainable growth, particularly in the intense business competition. Other factors that are also assessed are, among others, employees' capabilities in providing banking services and handling complaints from customers, speed of services, accessibility, timeliness, and etc.

Diversification
The analysis covers thorough assessments on the bank's business network/base with regard to geographical/location spread, business lines, products, revenues structures, customers base of funding and lending, credit risk (broken down by economic sector, size, and customer base), as well as economic diversity of the bank's market, etc.

Management & Human Resources
The analysis includes detailed assessments on the bank's quality and credibility of the management and key personnel, the bank's management strategies to maintain sustainable growths (external and internal), the bank's quality in financial planning and strategy (aggressive vs. conservative), the bank's organizational structure, the bank's quality of business, which are generally measured from its underwriting criteria, process of credit approval, delegation of credit approval and authorities, collateral valuations, monitoring of credit exposures, internal rating/scoring system, tools or system to identify potential problem exposures as well as roles and reliabilities of internal audit and compliance department, and the bank's managerial efficiency and effectiveness. The implementation of good corporate governance, particularly accountability of the management and transparency of its financial statement, is also reviewed.

FINANCIAL RISK ASSESSMENT

Capitalization
The analysis includes diligent assessments on the bank's capital composition (equity, subordinated debt, revalued assets, unrealized capital gains, and other types of quasi-reorganization), the bank's capital position with respect to Central Bank (Bank Indonesia) requirements, level of Capital Adequacy Ratio (total and Tier 1 CAR), dividend pay out ratio, internal growth rate of capital, ability to get external sources of capital, capital in comparison with assets, as well as management philosophy and strategy on leveraging its capital.

Assets Quality
The analysis includes intensive assessments on the bank's non performing loans broken down by category, the bank's credit portfolio by economic sector, size, and currency, concentration on credit risks (total exposures to certain industry, company, or individual), settlements on problem loans (past due loans,
PEFINDO Rating Criteria & Methodology

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restructured loans, or other types of problematic loans), and the bank's loan loss reserve policy and adequacy. In addition, thorough analysis is also conducted on the qualitative aspects on assets quality such as whether the bank fully identifies and discloses its problematic loans, the bank's write off policy and whether the bank implements it rightly, and other credit judgment that can provide clues about the bank's credit culture, policy, and procedures and the effects into its asset quality.

**Profitability**
The analysis includes thorough assessments on the bank's net interest income and margin (trends, ability to grow, as well as sustainability), non interest income (size, diversity, as well as growth potential), quality of earnings, ability to price risks into various products, operating profits, and net income (trend, sustainability, and potential growth). The bank's cost structure (trends, ability to raise cheaper funding, stability, and etc), cost to income ratio (to measure efficiency), and management strategy to control operational expenses and improve fee based income are also diligently assessed.

**Liquidity and Financial Flexibility**
The analysis covers the assessments on current market condition and its effect on the bank's liquidity, examination on the bank's liquidity management (in terms of policy and strategy), and ability to earn immediate cash flow (internally or externally) and its contingency plans to support its liquidity demand. The examination on the bank's interest rate and maturity mismatches, net open position, loan to deposit ratio and evaluation on the proportion of the bank's liquid assets as compared to its short term liabilities are also incorporated in the assessments. Analysis on financial flexibility includes careful assessments on the bank's ability to access various funding markets and raise capital from public, or private sources as well as the likelihood of supports from the government, particularly under distress conditions.

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