Lanka Rating Agency

Rating Report

National Savings Bank

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
05-Jan-2024	AAA	-	Stable	Maintain	-
30-Dec-2022	AAA	-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The rating of the National Savings Bank (NSB or the Bank) reflects 100% ownership of the Government of Sri Lanka and the government's explicit guarantee on all of its deposits mandated by the National Savings Bank Act. The Act requires the Bank to invest 60% of its deposits in government securities, which lowers its risk and improves liquidity. Being a government-owned savings bank, NSB has a strong foothold in Sri Lankan household. This has led to significant market share in industry deposits (9.2% of industry deposits) for the Bank. The Bank remains exposed to interest rate risk due to high exposure in government securities, as reflected by variance in the Bank's profitability over the years. The Profit Before Tax (PBT) remained low in 9M23 (LKR 499Mn) while Profit After Tax (PAT) stood at LKR 4.9Bn as the interest expense increased in higher proportion, resulting in lower core spread. The Bank is expected to improve its spread going forward as it re-prices its deposits. The Bank recorded PAT of LKR 2.5Bn and LKR 22.1Bn in CY22 and CY21, respectively. The Bank’s Impaired Loans (Stage 3) Ratio (net of stage 3 Impairment) was well below the industry average which stood at 3.06% in 9MCY23. Despite a recent decrease in margins, increased provisioning expense and decrease profitability, the capital adequacy of the Bank remained strong with Total Capital Adequacy Ratio (CAR) standing at 16.25% as of 9MCY23, well above the regulatory minimum requirement of 12.5%.

The rating is dependent on continuation of government's guarantee on the deposits of the Bank as per the National Saving Bank Act. Any significant change in the Act or significant deterioration in the Bank's liquidity position amidst the government's inability to support the Bank can impact ratings. The Bank's continuous ability to meet regulatory requirements will remain key. At the same time, minimizing asset liability gap remains important for the rating.

Disclosure

Name of Rated Entity	National Savings Bank
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution Rating(Jun-22)
Related Research	Sector Study | Commercial Bank (Sep-23)
Rating Analysts	Gayani Randima Ariyawansa | gayani@lra.com.lk | +92-42-35869504

Profile

Structure National Savings Bank (NSB or the Bank) was incorporated in 1972 by the National Savings Bank Act, No.30 of 1971. It is regulated by the Central Bank of Sri Lanka. The Bank was granted the status of a Licensed Specialized Bank in terms of the Banking Act No. 30 of 1988.

Background The Bank initially known as "The Ceylon Savings Bank", commenced operations in the year 1832 by Sir Robert Wilmot Horton to inculcate the savings habit amongst the people as well as to introduce formal banking practices to the nation.

Operations NSB operates with 262 branches spread across the island and has 4,528 staff members. Principal activities of the Bank are accepting deposits, retail lending, corporate lending, international banking, treasury, and trade finance services.

Ownership

Ownership Structure 100% of the shares are held by the Government of Sri Lanka (GoSL) in the name of the Secretary to the Treasury in his/her official capacity and who shall not dispose of those shares in any manner whatsoever.

Stability NSB as one of the state-owned specialized banks and is of strategic importance to the Government of Sri Lanka. The Bank's ownership has remained stable, with the government maintaining its ownership since 1971.

Business Acumen The GoSL provides NSB with industry-specific working knowledge and strategic thinking capabilities as the only shareholder. The Ministry of Finance appoints the relevant individuals with the requisite experience to run the affairs of the Bank and enable the Bank to achieve its objectives.

Financial Strength The Bank operates under the Ministry of Finance and is the only Bank in the country with 100% Government guarantee on all deposits as per National Savings Bank Act No 30. of 1971. Hence, the financial strength of the government to support the Bank is considered excellent as the government also has the ability to print the money, if needed.

Governance

Board Structure The overall control of the Bank vests in the seven-member Board of Directors as per the National Savings Bank Act, No.30 of 1971 however, present Board consists of four members.

Members' Profile The collective background of the BOD provides a balanced mix of skills and experience. The Chairperson, Dr. Harsha Cabral PC, assumed duties in May 2023. He currently serves as an Independent Non-Executive Director at DIMO PLC, Hayleys PLC, Alumex PLC, Tokyo Cement Company PLC etc.

Board Effectiveness The Board has constituted five Committees namely, Board Audit Committee (BAC), Board Integrated Risk Management Committee (BIRMC), Board Human Resources and Remuneration Committee (BHRRC), Board Nomination Committee (BNC) and Board Non-urgent Non-Essential Expenditure Committee (BNNEC).

Financial Transparency The Auditor General acts as the external auditor of the Bank. The Auditor has given an unqualified opinion on the financial statements for CY22.

Management

Organizational Structure NSB operates through a well-defined, detailed organization structure, which comprises main functional segments of the Bank.

Management Team As a result of retirement of previous CEO, currently Ms. G V A D D Silva has been assigned to oversee the functions of General Manager/ Chief Executive Officer. She is the current Deputy General Manager of Treasury and International Banking of the Bank. She is supported by a large and well versed corporate and executive management. The new GM/CEO is expected to take over the Bank in January 2024.

Effectiveness The Bank has formed eighteen management committees through which they effectively manage the operations.

MIS The Bank is in the process of implementing a new core banking solution that is expected to be launched by March/April 2024. This is considered a crucial milestone for the Bank as it intends to increase its digital footprint.

Risk Management Framework There are committees at both the Board and Management levels to ensure that all risks are appropriately managed and risk limits are established based on the appetite of the Bank.

Business Risk

Industry Dynamics The banking sector, as at 9MCY23, recorded an asset base of LKR 19.8Tn, which is an improvement of 2.8%, while investments increased by 18.1% compared to the same quarter of the previous year. The deposits increased by 6.1% as at 9MCY23 to LKR 16.1Tn and net loans and advances decreased by 7.6% to LKR 9.8Tn, compared to the same quarter of the previous year. The sector's Profit After Tax (PAT) recorded a notable increase of 71.1% as at 9MCY23 to LKR 146.4Bn, compared to LKR 85.5Bn in 9MCY22.

Relative Position NSB is considered a large-sized bank, holding the majority of the Licensed specialized banking sector in terms of total advances and total deposits for CY22. NSB's deposits (LKR 1.5Tn) account for 9.6% of total deposits of the banking sector in the country in CY22.

Revenues The interest income of the Bank has increased by 44.1% to LKR 170.2Bn in 9MCY23 (CY22: LKR 172.9Bn) compared to the same quarter of previous year. Similarly, the interest expense of the Bank increased by 71.4% to LKR 151.9Bn in 9MCY23 (CY22: LKR 140.5Bn) compared to 9MCY22. As a result, the Bank's Net Interest Income (NII) recorded at LKR 18.3Bn in 9MCY23 (CY22: LKR 32.5Bn) which indicates a decline of 37.8% compared to LKR 29.5Bn of the same quarter of previous year. This resulted in lower core spreads for the Bank.

Performance The Profit Before Tax (PBT) of the Bank in 9MCY23 stands at LKR 499Mn (CY22: LKR 4.5Bn) compared to LKR 4.9Bn in 9MCY22. PAT in 9MCY23 is LKR 4.9Bn after adjusting for deferred tax reversal of LKR 4.4Bn, which has improved by 54.5% from 9MCY22. However, the PAT has a drop by 88.7% to LKR 2.5Bn in CY22 from LKR 22.1Bn in CY21. The decline was due to considerable increase in interest expenses outpacing the growth in interest income and increase in operating expenses including impairment provisions.

Sustainability The Bank intends to focus on providing superior banking solutions to its clients by moving towards digitization and is adopting new technology platforms to sustain its competitive edge.

Financial Risk

Credit Risk The Bank has been able to maintain the Impaired Loans (Stage 3) Ratio (net of Stage 3 Impairment) significantly below the industry average over the periods. In 9MCY23, the Bank's Impaired Loans (Stage 3) Ratio (net of Stage 3 Impairment) stood at 3.06% while the industry ratio recorded at 13.6%.

Market Risk At the end of CY22, the Bank's investment book comprised mainly of government securities (83.9%). Most of these are treasury bonds. This exposes the Bank to interest rate risk. The Bank intends to change the mix of its government securities portfolio slightly towards treasury bills to reduce the risk and minimize its asset liability gap.

Liquidity And Funding NSB reported a deposit base of LKR 1.5Tn as of 9MCY23, which was only a marginal decrease compared to CY22. Majority of the deposits are maturing in next 6 months. The Bank has a strong retention rate and is expected to rationalize expensive deposits. The Bank's Statutory Liquid Asset Ratio (SLAR) and Net Stable Funding Ratio (NSFR) remained strong at 40.62% in CY22 (9MCY23: LKR 52.57%) and 180.51% in CY22 (9MCY23: LKR 177.46%) respectively, whereas the Central Bank stipulated minimum requirements are 20% and 100%.

Capitalization The Bank's Total Capital Adequacy Ratio (CAR) reduced to 17.99% in CY22 from 20.83% in CY21 and marginally reduced in 9MCY23 to 16.25% from CY22, but it is well above the regulatory minimum requirement of 12.50%.

LRA

Financials (Summary) in LKR mln

Lanka Rating Agency

National Savings Bank Public Limited Company	Sep-23	Jun-23	Dec-22	Dec-21
	9M	6M	12M	12M
A BALANCE SHEET				
1 Stage I | Advances - net	486,701	492,588	515,658	504,897
2 Stage II | Advances - net	31,255	28,343	21,774	20,350
3 Stage III | Advances (NPLs)	30,166	27,445	25,509	19,999
4 Stage III | Impairment Provision	(13,806)	(11,839)	(9,913)	(6,304)
5 Investments	890,133	858,766	834,008	845,480
6 Debt Instruments	131,771	138,572	134,298	128,071
7 Other Earning Assets	19,556	12,749	10,466	7,121
8 Non-Earning Assets	111,431	104,535	84,887	59,484
Total Assets	1,687,207	1,651,158	1,616,686	1,579,098
6 Deposits	1,474,536	1,470,662	1,476,740	1,428,467
7 Borrowings	107,378	79,862	44,631	52,935
8 Other Liabilities (Non-Interest Bearing)	25,210	21,353	22,423	21,682
Total Liabilities	1,607,124	1,571,876	1,543,794	1,503,085
Equity	80,083	79,282	72,892	76,013
B INCOME STATEMENT				
1 Mark Up Earned	170,276	112,601	172,940	131,438
2 Mark Up Expensed	(151,936)	(100,558)	(140,477)	(76,809)
3 Non Mark Up Income	2,598	1,389	1,617	3,501
Total Income	20,938	13,432	34,080	58,131
4 Non-Mark Up Expenses	(17,560)	(11,154)	(21,455)	(19,283)
5 Provisions/Write offs/Reversals	(2,877)	(1,697)	(4,862)	(4,304)
Pre-Tax Profit	500	582	7,763	34,544
6 Taxes	4,419	3,385	(5,233)	(12,424)
Profit After Tax	4,919	3,967	2,530	22,120
C RATIO ANALYSIS				
1 Revenues				
Advances' Yield	16.9%	16.7%	13.1%	9.3%
Spread | Asset Yield - Cost of Funds	1.7%	1.7%	2.1%	3.8%
2 Performance				
Cost of Funds [Mark Up Expensed / Average (Deposits + Borrowings)]	13.1%	13.1%	9.4%	5.5%
ROE	8.6%	10.4%	3.4%	33.9%
3 Capital Adequacy				
Capital Adequacy Ratio	16.3%	17.1%	18.0%	20.8%
Net Stable Funding Ratio [Available Stable Funding / Required Stable Funding]	177.5%	172.2%	180.5%	160.8%
4 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	54.2%	54.0%	54.3%	57.0%
Demand & Saving Deposit Coverage Ratio	3.1	3.1	3.1	2.6
Top 20 Deposits / Deposits	7.9%	8.4%	9.4%	13.5%
5 Credit Risk				
Impaired Loan Ratio | [Stage III | Advances (NPLs) / Gross Advances]	5.4%	4.9%	4.5%	3.6%
Provision Coverage Ratio | [Impairment Provision / Stage III | Advances (NPLs)]	45.8%	43.1%	38.9%	31.5%

Credit Rating

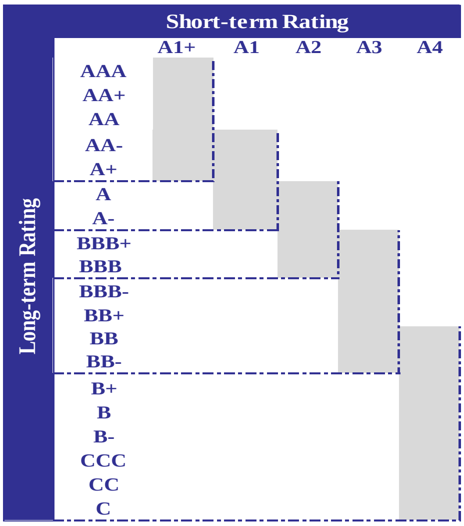
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Rating Team Statements
(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit- worthiness of any issuer or a specific issue of securities. https://www.sec.gov.lk/credit-rating-agency/

Conflict of Interest
(2) i. LRA will disclose to the Commission all other business activities it is engaged in at the time of applying for its licence and inform the Commission in writing prior to engaging in any other business activity after obtaining a licence from the Commission. (Section 34 – Rules applicable to Credit Rating Agencies)
(2) ii.LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)
(2) iii.In the conduct of any such other business activity, the LRA will ensure that proper processes are in place to have a clear demarcation of the different functions pertaining to such businesses. (Section 36 – Rules applicable to Credit Rating Agencies)

Restrictions
(3) (i) LRA will not be outsource any part of its work, which has a direct bearing on the function of rating. (Section 24 – Rules applicable to Credit Rating Agencies)
(3) (ii) LRA will enter into a written agreement with the party to whom any work is outsourced. Such agreement contains an undertaking from the party to whom any work is outsourced that they shall comply with the laws, rules, and directives that the LRA is bound to follow. (Section 25 – Rules applicable to Credit Rating Agencies)

(4) The LRA will not appoint any individual as a member of the rating committee who:
(a) has a business development function of the Credit Rating Agency; or
(b) who initiates or participates in discussions regarding fees or payments with any Client of the LRA. (Section 28 – Rules applicable to Credit Rating Agencies)

Conduct of Business
(5) Prior to the commencement of a rating or during such process the LRA will not promise, assure or guarantee to a Client that a particular rating will be assigned. (Section 39 – Rules applicable to Credit Rating Agencies)

(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies will be made available to the Commission for perusal, upon request. (Section 41 – Rules applicable to Credit Rating Agencies)

Independence & Conflict of interest
(7) LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA´s opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity, and independence of its ratings.

(8) LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(9) LRA will structure its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 47 – Rules applicable to Credit Rating Agencies)

Monitoring and review
(10) For purposes of transparency the LRA will publish sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies shall also be disclosed. (Section 44 – Rules applicable to Credit Rating Agencies)

LRA maintain the following records pertaining to Clients:
(a) all internal records to support its credit rating opinions;
(b) all particulars relating to Clients at its office which shall include the name and registered address and contact numbers of such Client, names and addresses of their directors as at the date of rating, its issued share capital and the nature of business; and
(c) a written record of all complaints received from Clients and action taken thereon by the LRA. (Section 48 – Rules applicable to Credit Rating Agencies)

(11) LRA maintains confidentiality of all non-public information entrusted to it by Clients at all times including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law, or unless authorised by the Client to disclose such information. (Section 50 – Rules applicable to Credit Rating Agencies)

(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the Credit Rating Agency which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination (Section 53 – Rules applicable to Credit Rating Agencies)

Probability of Default
(13) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).

Proprietary Information