Lanka Rating Agency

Rating Report

National Savings Bank

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
30-Dec-2022	AAA	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of the National Savings Bank (NSB or The Bank) reflect 100% ownership of the Government of Sri Lanka. The rating of the Bank is driven by the government's explicit guarantee on 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, the Bank has a strong foothold in Sri Lankan households. The ratings reflect the Bank's significant market share in industry deposits (11% of industry deposits). Due to the statutory requirement of 60% investment in government securities, the Advances to Deposit Ratio (ADR) of the Bank remains low and the lending book of the Bank is granular exhibiting lower risk. The recent steep increase in policy rates has impacted the margins of the Bank but overall performance remains strong with 9MCY22 profit standing at LKR ~3bn. The Bank enjoys strong asset quality but under current circumstances, Bank has acted prudently and booked a provisioning of LKR 7.2bn in 9MCY22 which will act as a cushion for the rising NPLs. An expected decrease in policy rates by mid-next year may improve the margins and in turn performance. The Bank has a strong asset base of LKR 1.6tn and strong equity well above the regulatory requirements. Despite a recent decrease in margins, increased provisioning expense, and decrease profitability, the capital adequacy of the Bank remained strong with CAR standing at ~17.7% as of 9MCY22.

The rating is dependent on the guarantee of the government 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. Any haircut imposed by the government on its government securities for managing government debt can impact the margins of the Bank and in turn 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 (Jun-22)
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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 4,538 staff members. Rooted as the nation's savings bank, the Bank is mandated to foster a savings culture amongst the Sri Lankans. The Bank also engages in 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 in the name of the Secretary to the Treasury in his official capacity and who shall not dispose of those shares in any manner whatsoever.

Stability NSB as one of the state-owned specialized banks is of strategic importance to the Government of Sri Lanka(GoSL). 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 a 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 have 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 which is appointed by the Government.

Members’ Profile The collective background of the BoD provides a balanced mix of skills and experience. The Chairperson, Ms. Keasila Jayawardena assumed duties in January 2020. She was previously the Chairperson of the Kadurata Development Bank & Regional Development Bank.

Board Effectiveness The Board has constituted four Committees namely, Board Audit Committee (BAC), Board Integrated Risk Management Committee (BIRMC), Board Human Resources and Remuneration Committee (BHRRC), and Board Nomination Committee (BNC).

Financial Transparency The Auditor General acts as the external auditor of the Bank. The Auditor has given an unqualified opinion on the financial statements as of 31st December 2021.

Management

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

Management Team The management team is headed by Mr. M P A W Peiris, the General Manager/ CEO. In the 33 years, he has been a part of NSB, he has gathered experience in various aspects of the Bank.

Effectiveness The Bank has formed seventeen management committees, namely i) Marketing Committee, ii) Credit Committee, iii) IT Steering Committee, iv) Corporate Management Committee, v) Assets and Liability Management Committee, vi) Investment Committee, vii) Tender and New Investment Committee, viii) Operational Risk Management Committee, ix) Corporate Procurement Committee Major and Minor, x) Branch Operations Steering Committee, xi) Performance Review Committee, xii) Product Development Committee, xiii) Human Resources Committee, xiv) Executive Procurement Committee, xv) Corporate Sustainability Committee, xvi) Senior Management Committee & xvii) Information Security Committee.

MIS The Bank will move to a new core banking system, Temanos T24 system, to increase efficiency. The Bank introduced the NSB Pay App recently as a QR-based payment solution. The MIS reports generated by the Bank are submitted monthly to the Board and the management for decision-making purposes.

Risk Management Framework There are committees at both the Board and the 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 asset base increased by LKR 2.3tn in CY21 recording a y-o-y growth of 15.4% compared to 17.1% growth in CY20. With the sudden rise of the policy rate in CY22, the banking industry's spreads have deteriorated and NPAs have increased. This situation is expected to persist till mid of CY23 when interest rates may start coming down.

Relative Position In comparison to all commercial banks, NSB is considered a large-sized bank, holding just 8.3% of the total assets of the banking sector. NSB holds 9.98% of the shares out of the banking sector deposits for 9MCY22. The total asset base of the Bank grew by 1.9% in 9MCY22 against the asset base of LKR 1.57tn in CY21, which was mainly due to the growth in customers' deposits.

Revenues The Bank’s spread in 9MCY22 reduced to 1.8% from 3.7% in CY21. The yield on advances reduced to 8.38% in 9MCY22 whereas the cost of deposits also reduced to 6.6%. The CBSL reduced policy rates in CY20 and CY21 to tackle the macroeconomic challenges. However, in Apr-22 the policy rates were bumped up by 700bps, affecting the spreads. By 9MCY22 the Bank’s average spread reduced to 1.8%.

Performance Non-interest income specifically the fee and commission income witnessed an increase of 12.5% (CY21: LKR 3.05bn, CY20: LKR 2.7bn). The Bank has been prudent in its provisioning, given the macro-economic challenges, and therefore, has increased its impairment provisioning up to 153.1% in 9MCY22 (Profit before income tax and provisioning in 9MCY22: LKR 12.1bn, CY21: LKR 32.7bn, CY20: LKR 20.5bn). Despite the decrease in spread and increase in the provisioning expense, the Bank expects to close the CY22 in profit with profit at 9MCY22 standing at LKR 3.2 bn (CY21: 22.1bn).

Sustainability NSB is focusing on growing the deposit base to LKR.2tn by CY24 alongside the retail credit portfolio being increased up to LKR 700bn. The Bank intends to focus on providing superior banking solutions to its clients by moving toward digitization and is adopting new technology platforms to sustain its competitive edge.

Financial Risk

Credit Risk Amidst the challenging economic conditions that prevailed in the country as a result of the COVID-19 pandemic, loans and advances increased by 4.3% while the maximum exposure to credit risk increased by 14.6%. NSB’s high exposure to long-term loans (CY21:87%, CY20:88%) and pawning (CY21: 9.5%, CY20: 9.4%) indicates the Bank’s risk appetite.

Market Risk At the end of CY21, the Bank's investment book represented 85% of the total assets in government securities which is a decrease from 92.7% in CY20. This indicates the Bank’s market risk appetite to be more risk tolerant due to the fact the Act regulates 60% of the funds being invested in government securities. Hence, interest rate risk remains the largest source of risk.

Liquidity And Funding NSB reported a deposit base of LKR 1.5bn as of 9MCY22 which was only a marginal increase compared to CY21. The Liquidity Coverage Ratio (LCR) of the Bank stood at 192% for 9MCY22. Bank’s top 20 depositors account for 13.5% of total deposits in CY21. NSB reported a Statutory Liquid Asset Ratio (SLAR) of 42.5% for 9MCY22 which is well above the regulatory requirement of 20%

Capitalization NSB's Tier 1 Capital of LKR 56bn and total CAR of 17.7% as of 9MCY22 remain well above regulatory requirements of 20bn and 12.5% respectively. For capital purposes, the Bank has issued LKR 5bn Basel III compliant Additional Tier 1, Capital Bond.

LRA

Financials (Summary) in LKR mln

Lanka Rating Agency

LKR mln

National Savings Bank	Sep-22	Dec-21	Dec-20	Dec-19
Licensed Specialized Bank	9M	12M	12M	12M
A BALANCE SHEET				
1 Stage I | Advances - net	521,461	504,897	485,354	417,694
2 Stage II | Advances - net	20,069	20,350	19,645	29,957
3 Stage III | Advances (NPLs)	24,458	19,999	16,941	9,139
4 Stage III | Impairment Provision	(9,337)	(6,304)	(5,146)	(2,395)
5 Investments	842,600	845,480	750,196	622,808
6 Debt Instruments	126,672	128,071	35,362	12,587
7 Other Earning Assets	7,388	7,121	13,253	12,364
8 Non-Earning Assets	75,826	59,484	48,202	55,812
Total Assets	1,609,137	1,579,098	1,363,808	1,157,967
6 Deposits	1,477,226	1,428,467	1,237,124	1,016,574
7 Borrowings	40,876	54,160	53,752	83,923
8 Other Liabilities (Non-Interest Bearing)	18,741	20,459	18,520	11,544
Total Liabilities	1,536,843	1,503,087	1,309,396	1,112,041
Equity	72,295	76,013	54,414	45,925
B INCOME STATEMENT				
1 Mark Up Earned	118,165	131,438	122,512	118,730
2 Mark Up Expensed	(88,654)	(76,809)	(87,622)	(89,898)
3 Non Mark Up Income	1,452	3,501	5,035	3,199
Total Income	30,964	58,131	39,925	32,031
4 Non-Mark Up Expenses	(16,147)	(19,283)	(15,620)	(15,807)
5 Provisions/Write offs/Reversals	(7,188)	(4,304)	(4,874)	(566)
Pre-Tax Profit	7,628	34,544	19,431	15,659
6 Taxes	(4,445)	(12,424)	(9,323)	(9,278)
Profit After Tax	3,183	22,120	10,108	6,381
C RATIO ANALYSIS				
1 Revenues				
Advances' Yield	10.5%	9.3%	10.8%	13.0%
Spread | Asset Yield - Cost of Funds	2.5%	3.8%	2.9%	2.7%
2 Performance				
Cost of Funds [Mark Up Expensed / Average (Deposits + Borrowings)]	7.9%	5.5%	7.3%	8.2%
ROE	5.7%	33.9%	20.1%	13.9%
3 Capital Adequacy				
Capital Adequacy Ratio	17.8%	20.8%	13.6%	14.3%
Net Stable Funding Ratio [Available Stable Funding / Required Stable Funding]	175.0%	160.8%	169.0%	175.0%
4 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	55.5%	57.2%	58.0%	55.7%
Demand & Saving Deposit Coverage Ratio	2.5	2.6	2.7	2.7
Top 20 Deposits / Deposits	10.5%	13.5%	15.6%	0.0%
5 Credit Risk				
Impaired Loan Ratio | [Stage III | Advances (NPLs) / Gross Advances]	4.3%	3.6%	3.2%	2.0%
Provision Coverage Ratio | [Impairment Provision / Stage III | Advances (NPLs)]	38.2%	31.5%	30.4%	26.2%

Credit Rating

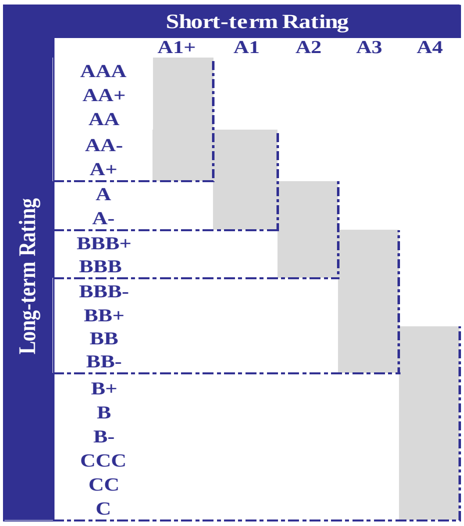
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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/index.php/credit-rating-agency/)

2) **Conflict of Interest**
i. LRA shall 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 33- Draft Rules Credit Rating Agency - 2021)

Restrictions
(3) LRA is not entitled to outsource any part of its work, which has a direct bearing on the act of rating. However, if any other function other than the core function of rating is to be outsourced, such fact shall be brought to the attention of the Client and be included in the Credit Rating Agreement entered into with the Client. (Section 22- Draft Rules Credit Rating Agency - 2021)
(4) LRA cannot appoint any individual as a member of the Rating Committee who has a business development function of the Credit Rating Agency, or who initiates or participates in discussions regarding fees or payments with any Client of Credit Rating Agency. (Section 26- Draft Rules Credit Rating Agency -2021)

Conduct of Business
(5) Prior to the commencement of a rating, LRA does not promise, assure or guarantee to a client that a particular rating will be assigned.
(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies shall be made available to the Commission for perusal, upon request. (Section 39- Draft Rules Credit Rating Agency -2021)

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 does not engage in any other business activity which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained (Section 33- Draft Rules Credit Rating Agency -2021)
(9) LRA structures its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 45 - Draft Rules Credit Rating Agency -2021)

Monitoring and review
(10) For purposes of transparency, LRA publishes 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 are also be disclosed. (Section 42- Draft Rules Credit Rating Agency -2021) LRA monitors below factors specifically, (a) all internal records to support our credit rating opinions; (b) all particulars relating to Clients at our office which shall include the name and registered address and contact numbers of such Client's, names and addresses of their Directors as at the date of rating, its issued share capital and the nature of business; and (c) a comprehensive written record of all complaints received from Clients and action taken thereon by LRA.
(11) LRA ensures confidentiality of all information at all times relating to Clients including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law. (Section 48 - Draft Rules Credit Rating Agency -2021)
(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the LRA 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 51 - Draft Rules Credit Rating Agency - 2021).
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
(14) All information contained herein is considered proprietary by LRA. Hence, none of the information in this document can 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 LRA's prior written consent