



RATING ACTION COMMENTARY

Fitch Maintains National Development Bank's 'A-(Ika)' National Rating on Watch Negative

Tue 25 Jul, 2023 - 7:11 AM ET

Fitch Ratings - Colombo - 25 Jul 2023: Fitch Ratings has maintained National Development Bank PLC's (NDB) National Long-Term Rating of 'A-(Ika)' on Rating Watch Negative (RWN). Fitch has also maintained the bank's 'BBB(Ika)' subordinated debt rating on RWN.

KEY RATING DRIVERS

RWN Maintained: The RWN on NDB's National-Long Term Rating reflects the potential for the bank's creditworthiness relative to other entities on our Sri Lankan National Ratings scale to deteriorate. This reflects heightened near-term downside risks to NDB's credit profile from potential capital and funding stress from the restructuring of sovereign's debt obligations while access to foreign-currency funding remains constrained.

The resolution of the RWN with an affirmation of the ratings could result when there is further clarity around the sovereign debt restructuring process pointing to a reduction in stresses that have affected the banking sector in the past several quarters.

Debt Restructuring Weighs on OE: We believe risks to Sri Lankan banks' operating environment (OE) remains high despite the exclusion of the banks' holdings in Sri Lankan rupee-denominated government securities from the sovereign domestic debt restructuring. This is due to the banks' predominant exposure to the very weak domestic economy and debilitated sovereign's credit profile (Long-Term Issuer Default Rating (IDR): RD; Short-Term IDR: C), which continues to hinder banks' operational flexibility.

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

OE Risks Pressures Business Profile: NDB's business profile reflects the elevated vulnerability to heightened risks in the domestic market, which continue to affect its ability to generate and defend business volumes. Limited lending opportunities and tight liquidity in the banking sector, together with the bank's low capital buffers, saw the bank's share of net loans in total assets decrease to 63.0% by end-1Q23 (end-2021: 71.0%) while securities investments rose to 27.0% of total assets (end-2021: 20.5%), similar to peers.

Sovereign Exposure Risk: NDB's risk profile remains constrained by its exposure to the sovereign's debilitated credit profile via its investment securities, making the bank vulnerable to the sovereign's repayment capacity and liquidity position. This is despite the exclusion of NDB's holdings of rupee-denominated debt from any debt restructuring or optimisation exercise. The bank held 25% of its assets in foreign- and local-currency-denominated government securities at end-2022.

Stressed Asset Quality: Fitch expects NDB's asset-quality metrics to remain under pressure from rising stage 3 loans amid a challenging OE as well as the bank's above-average exposure to the sovereign's weak credit profile through investments in foreign-currency-denominated government securities. We estimate the bank's impaired (stage 3) loans to have increased to 13.6% in 1Q23, slightly below the 13.9% average for Fitch-rated large Sri Lankan banks, from 11.2% at end-2022.

Profitability Challenges Remain: Fitch expects NDB's earnings and profitability to remain challenged by weakening asset quality, muted loan growth prospects, sharp downward adjustment of interest rates and any potential impact to earnings from the proposed domestic debt optimisation strategy. NDB's operating profit/risk-weighted assets ratio improved to 1.2% by end-1Q23 (end-2022: 0.5%) but remains the weakest among the Fitch-rated large Sri Lankan banks.

Thin Capital Buffers: We believe that weakening loan quality, high capital encumbrance from unprovided impaired loans and susceptibility to even moderate shocks weigh on NDB's capitalisation, despite the exclusion of its holdings of rupee-denominated treasury securities alleviating some stress on its capital. NDB's regulatory common equity Tier 1 (CET1) ratio of 10.6% at end-1Q23 (group level; bank level - 10.1%) was one of the lowest among the Fitch-rated Sri Lanka banks, and we estimate this ratio would have been only 17% higher had the 1Q23 profit been included.

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

foreign-currency wholesale funding remains constrained by the sovereign's weak credit profile. The bank's local-currency funding and liquidity position is also susceptible to any setbacks to the domestic debt restructuring.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

NDB's National Rating is sensitive to a change in the bank's creditworthiness relative to other Sri Lankan issuers.

The RWN reflects rising risks to the bank's rating from funding stresses, which could lead to a multiple-notch downgrade. We expect to resolve the RWN when the impact on the issuers' credit profiles becomes more apparent, which may take more than six months. Developments that could lead to a multiple-notch downgrade include:

- funding stress that impedes the bank's repayment ability;
- significant intervention in the banking sector by authorities that constrains the bank's ability to service its obligations;
- a temporary negotiated waiver or standstill agreement following a payment default on a large financial obligation;
- Fitch's belief that the bank has entered into a grace or cure period following non-payment of a large financial obligation.

A deterioration in NDB's key credit metrics beyond our base-case expectations relative to peers would also lead to increased downward pressure on the bank's rating, which is driven by its intrinsic financial strength.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

There is limited scope for upward rating action given the RWN. Resolution of the Rating Watch with an affirmation could be driven by our view that risks from funding and capital stresses have abated, at both the individual bank and the sector level, to the extent that we

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

SUBORDINATED DEBT

NDB's Basel II and Basel III-compliant rupee subordinated debt is rated two notches below the National Long-Term Rating anchor. This reflects Fitch's baseline notching for loss severity for this type of debt and our expectations of poor recoveries. There is no additional notching for non-performance risks, as the notes do not incorporate going-concern loss-absorption features. The RWN on the subordinated debt rating stems from the RWN on the National Long-Term Rating.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The subordinated debt ratings will move in tandem with the bank's National Long-Term Rating.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
National Development Bank PLC	Natl LT A-(lka) Rating Watch Negative Rating Watch Maintained	A-(lka) Rating Watch Negative
subordinated	Natl LT BBB(lka) Rating Watch Negative Rating Watch Maintained	BBB(lka) Rating Watch Negative

[VIEW ADDITIONAL RATING DETAILS](#)

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

+94 11 2541 900

jeewanthi.malagala@fitchratings.com

Fitch Ratings Lanka Ltd.

15-02 East Tower, World Trade Center Echelon Square, Colombo 00100

Prakash Pandey

Associate Director

Secondary Rating Analyst

+91 22 4000 1773

prakash.pandey@fitchratings.com

David Wong

Senior Director

Committee Chairperson

+852 2263 9927

david.wong@fitchratings.com

MEDIA CONTACTS

Kyoshi Quyn

Colombo

+94 11 2541 900

kyoshi.quyn@fitchratings.com

Peter Hoflich

Singapore

+65 6796 7229

peter.hoflich@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

[Bank Rating Criteria \(pub. 08 Sep 2022\) \(including rating assumption sensitivity\)](#)**ADDITIONAL DISCLOSURES**[Solicitation Status](#)[Endorsement Policy](#)[Potential Conflicts Resulting from Revenue Concentrations](#)**ENDORSEMENT STATUS**

National Development Bank PLC -

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers.

Please read these limitations and disclaimers by following this link:

<https://www.fitchratings.com/understandingcreditratings>. In addition, the following <https://www.fitchratings.com/rating-definitions-document> details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at <https://www.fitchratings.com/site/regulatory>. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001. Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Copyright © 2023 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our Privacy Policy.

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

We use cookies to deliver our online services, to understand how they are used and for advertising purposes. Details of the cookies we use and instructions on how to disable them are set out in our [Privacy Policy](#).