Media Release

RAM Ratings Lanka assigns long term rating of 'A' for State Mortgage & Investment Bank

RAM Ratings Lanka has assigned respective long- and short-term financial institutions rating of A and P1 to State Mortgage and Investment Bank ("SMIB" or "the Bank"). The ratings are primarily based on the state ownership of the Bank, tempered by the wide asset-liability maturity mismatch ("ALMM") inherent in its business model.

SMIB is a licensed specialised bank ("LSB") created by the Government of Sri Lanka ("GOSL") under the State Mortgage and Investment Bank Act No. 13 of 1975, following the amalgamation of 2 state-owned banks. SMIB comes under the purview of the Ministry of Finance and Planning ("MOF"). The Bank is only permitted to disburse loans for housing, agriculture or for industry. It is a medium-sized bank that accounted for 3.34% of the industry's assets as at end-December 2008, and has limited geographic reach; of its 13 branches, 6 are in the western province. Whereas the market's largest player took up 67.49%, with a branch network of over 130.

SMIB has been aggressively expanding its loan portfolio in the past 2 years, despite the weakening macroeconomic environment. The Bank's loan portfolio consists of housing loans collateralised either by property or by the Employees' Provident Fund ("EPF"). EPF-backed loans took up 42.77% of SMIB's total loans as at the end of FYE 31 December 2008 ("FY Dec 2008"); loans backed by property accounted for another 55.24%. Although SMIB's gross non-performing-loan ("NPL") ratio (classified on a 3-months-past-due basis) stood at 27.58% as at end-FY Dec 2008, we note that NPLs from its EPF-backed loan portfolio accounted for 80.31% of the Bank's total NPLs. Excluding these NPLs (since they are reimbursed by the Central Bank), SMIB's NPL ratio would stand at a much lower 11.45% (end-June 2009: 14.54%) – albeit weaker than the industry average of 7.6%. RAM Ratings Lanka notes that the high level of NPLs reflects the Bank's social objective vis-a-vis providing housing for the masses. As the arrears (capital and interest) on loans collateralised by the EPF are only settled by the Central Bank once every year, rendering its cash inflow volatile.

Nonetheless, SMIB's funding and liquidity position is deemed adequate, underpinned by its deposit franchise (derived from state ownership). Amid waning public confidence in private financial institutions, SMIB's deposit base augmented by LKR 2.01 billion as at end-June 2009, reflecting its deposit franchise. Concurrently, customer deposits accounted for 92.69% of total interest bearing funding as at the same date. However, the Bank has an inherent negative gap in its ALMM, as it provides long term housing financing funded by short tenure deposits. Majority (end-FY Dec 2008: 84.91%) of its deposits were within the 1 year bucket while bulk (end-FY Dec 2008: 67.15%) of loans were in the greater than 5 year bucket. Exposing the Bank to both interest rate and liquidity risks.

Being a state linked entity, SMIB had been a beneficiary of concessionary funding through the MOF. The Bank received funding from the Asian Development Bank ("ADB") and the United States Agency for International Development ("USAID").

The interest rate mismatch in the Bank's ALMM pressured its financial performance. Short term deposits re-priced upwards in the rising interest rate environment, while rates on long term loans inched-up at a slower pace. Accordingly SMIB's net interest margin ("NIM") narrowed from 7.96% as at end-FY Dec 2006 to 3.47% as at end-FY Dec 2008. However, this was still better than the industry averages of 4.2% and 2.8%, respectively. Concurrently, SMIB's return on assets ("ROA") and return on equity ("ROE") also weakened to 0.40% (end-FY Dec 2006: 3.28%) and 2.18% (end-FY Dec 2006: 13.02%), respectively.

Despite the Bank's moderate financial performance, which had suppressed its internal rate of capital generation ("IRCG"), SMIB's capital adequacy is deemed healthy as its risk-weighted capital-adequacy ratios ("RWCARs") are well above the regulatory minimums. The Bank's tier-1 and overall RWCARs clocked in at 27.81% and 28.47%, respectively, as at end-FY Dec 2008 - well above the corresponding regulatory floors of 5% and 10%. At the same time, the Banks regular payments to the State has also hampered its capital growth. Over the past 5 years, the Bank has contributed LKR 326.00 million of its total post-tax profits (LKR 980.62 million).

Published by RAM Rating Lanka Ltd

Analyst Contact
Prakash Jerome
prakash@ram.com.lk