The Pakistan Credit Rating Agency Limited

Rating Report

National Bank of Pakistan

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jun-2021	AAA	A1+	Stable	Maintain	-
26-Jun-2020	AAA	A1+	Stable	Maintain	-
27-Dec-2019	AAA	A1+	Stable	Maintain	YES
28-Jun-2019	AAA	A1+	Stable	Maintain	YES
28-Dec-2018	AAA	A1+	Stable	Maintain	-
30-Jun-2018	AAA	A1+	Stable	Maintain	-
30-Dec-2017	AAA	A1+	Stable	Maintain	-
23-Jun-2017	AAA	A1+	Stable	Maintain	-
30-Jun-2016	AAA	A1+	Stable	Maintain	-
30-Jun-2015	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings continue to factor in formidable strength of National Bank of Pakistan (NBP) in the domestic commercial banking industry. The Bank's strong financial risk profile, characterized by firm risk absorption capacity and systemic importance provides strength to the ratings. NBP's strong domestic franchise along with extended outreach and high customer confidence aids the Bank in sustaining its position. NBP fortified its position as the second-largest bank in the country in terms of advances and deposits. The ratings are also driven by strong ownership structure (Government of Pakistan (GoP) holds majority stake) and healthy resource profile, with a high proportion of current and savings account (CASA) deposits. Advances, however, observed a slight contraction during CY20, mainly due to the nationwide lockdown to contain the spread of the COVID-19 pandemic. NBP has provided moratorium to its borrowers in line with the relief measures provided by the State Bank of Pakistan (SBP). Any delay in return to normalcy will put further pressure on recovery and asset quality metrics of the industry players. However, the management is confident that the infection will be curtained in future. The Bank has developed a system for early warning pertaining to the risks of NPLs, wherein some refinement may also be beneficial. In terms of absolute equity, the Bank stands at the first position in the industry. Furthermore, profitability of the Bank has also witnessed an improvement, with the Bank reporting profit after tax (PAT) of PKR 30.6bln for CY20 on the back of well managed and diversified earning asset mix. With focused efforts, NBP has managed to bring volumes in Islamic banking (Aitemaad) though limited; it is targeted to contribute towards growth.
COVID-19 is an ongoing challenge. While it has taken a toll on many businesses, its ramifications are still unfolding. The proactive measures taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from this pandemic. As a result, the banking industry remained protected and in fact posted record profits. Vigilance is required as the loan repayment cycle remains amid variants of the pandemic continue to re-emerge.

The ratings are dependent upon the management's ability to maintain the relative standing of the Bank in the industry in all key parameters. Cost optimization and sustenance in the asset quality is important as it will improve the profitability. Moreover, the Bank in a case related to pension benefits to retired employees has filed a review petition against the Supreme Court judgment and has also moved an application for the constitution of the larger bench which has been accepted.

Disclosure

Name of Rated Entity	National Bank of Pakistan
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | FI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Commercial Bank(Jun-21)
Rating Analysts	Muhammad Noor Ul Haq | noorulhaq@pacra.com | +92-42-35869504

Profile

Structure National Bank of Pakistan (NBP) was incorporated as a public limited company, under NBP Ordinance 1949, and is listed on Pakistan Stock Exchange (PSX).

Background The primary objective of the Bank was to give credit to the agricultural sector. NBP is authorized to act as an agent of State Bank of Pakistan (SBP) and handles treasury operations for the Government of Pakistan (GoP). At the same time, the Bank acts as a trustee of public funds.

Operations The Bank is engaged in providing commercial banking and related services in Pakistan and overseas. The Bank operates 1,514 branches – including 190 Islamic branches. NBP also operates 21 overseas branches in 19 countries to cater the needs of local as well as expatriates. The registered office of the Bank is located at I.I. Chundrigar Road, Karachi.

Ownership

Ownership Structure NBP is majorly owned (75.6%) by the Government of Pakistan (GoP), mainly through the SBP (75.2%). The remaining shareholding is widely spread.

Stability Being the largest public sector commercial bank, NBP is of strategic importance to the GoP. An implicit guarantee is provided against liabilities (deposits) of NBP under the Bank's (Nationalization) Act, 1974.

Business Acumen SBP, which has a major stake in NBP on behalf of GoP, stands to provide it with the industry-specific working knowledge and strategic thinking capability as it has a holistic view of the entire industry.

Financial Strength The GoP has provided assistance to the Bank in the past and shall continue to support it.

Governance

Board Structure According to Bank's (Nationalization) Act, 1974, the Bank is required to have a minimum of five members BoD at any point in time. During CY20, the overall control of the Bank vests in the eight-member Board of Directors (BoD) including the CEO.

Members' Profile The Board carries diversified experience including the financial sector, particularly banking, civil services, and other businesses. The majority of the directors have above two decades of experience. The directors having requisite experience and education are exempt from, SECP's Code of Corporate Governance. Majority of the Directors have already under gone the training.

Board Effectiveness During CY20, 14 board meetings were held; attendance of directors remained high. Relatively, a large number of meetings reflect continuous monitoring of affairs pertaining to oversee operations. The high attendance of members reflects active oversight.

Financial Transparency The Board Audit Committee comprises three members, all of whom are non-executive directors. This ensures effective, transparent and independent oversight. The Bank has joint External Auditors; Yousaf Adil Chartered Accountants and Grant Thornton Anjum Rahman Chartered Accountants. Joint auditors expressed an unqualified opinion on the Bank's financial statements for the year ended December 31, 2020.

Management

Organizational Structure NBP has a lean organizational structure that clearly defines responsibilities, authority and reporting lines with proper monitoring and compliance mechanism.

Management Team NBP's senior management team comprises experienced bankers. The CEO/ President, Mr. Arif Usmani is a seasoned banker having over three decades of experience in domestic and international markets. He has been serving at Mashreq Bank and his previous experience includes stints as global head of wholesale banking at Abu Dhabi Islamic Bank PJSC, managing director and country officer of Citibank Pakistan.

Effectiveness NBP has an effective mix of management committees that are established to monitor performance and assure the adherence to the policies and procedures.

MIS NBP uses "Profile" as its core banking application (CBA). The Bank is using Misys Kondor for Treasury function while SAP is used for Financial General Ledger and Human Resources Management. The Bank has established a new division – Payment Services and Digital Banking Group. This is in line with management's strategy of adopting digitization.

Risk Management Framework NBP's risk management framework resides with the Risk Management Group (RMG). RMG develops risk management policies and tools in line with SBP guidelines while ensuring implementation by respective departments. RMG has 8 functions; i) Credit Risk Architecture, ii) Enterprise Risk Management, iii) E-CIB and Data Management, iv) Operational Risk Management, v) Market & Liquidity Risk Management, vi) Business Process Review & COSO Project, vii) Information Security Division and viii) Credit Administration.

Business Risk

Industry Dynamics The indicators of the banking sector reflected mixed trend where economy is recovering from the effects of COVID-19 pandemic. Despite challenging economic conditions prevailing in CY20 due to COVID-19 outbreak, the banking sector managed to grow by a decent pace. Deposits of the banking sector grew by 16.1% to PKR 18,519bln (CY19: PKR 15,953bln) as compared to 11.9% growth in CY19. The surge in deposits provided the necessary funding support to finance the robust rise in investments (CY20: PKR 11,935bln; CY19: PKR 8,939bln) and particularly towards government instruments. During CY20, advances witnessed a mild contraction owing to slackness amid COVID-19 pandemic outbreak. The policy measures rolled out by the SBP enabled the sector to enhance profitability, improve resilience and limit the credit risk. With the completion of deferment period allowed, the aftermath is yet to be comprehended by the industry.

Relative Position NBP maintains well diversified deposits and advances portfolio with no single sector having a major impact or control. The Bank's customer's deposit increased by 12.4% to PKR 2,021bln, maintaining its system share at 12.0%.

Revenues During CY20, NBP was largely able to manage a healthy profit through its diversified and stable earning asset mix. Based on the favorable interest rate environment facilitated higher net markup income, grew by 44.8% to PKR 104.2bln over the year. Income on investments grew at an accelerated pace of 21.7% to PKR 158.0bln whereas, on advances side, gross markup income decreased by 9.0% to PKR 99.8bln. During 3MCY21, the net mark-up income of the Bank stood at 21.6bln, being 30.3% higher than the corresponding period last year. This growth was majorly owing to the efficient deposit mobilization strategy of the Bank.

Performance During CY20, NBP's asset yield increased from 9.8% to 10.0% whereas, cost of funds reduced to 5.9% in CY20 as against 6.6% in CY19. Non-markup income marginally down by 0.3%, mainly on account of lower fee income and decrease in dividend income. Despite inflationary pressures, the Bank succeeded in controlling the growth in operating expenses that amounted to PKR 63.1bln for CY20, which decreased by 4.2%, as compared to the previous year. Ultimately, the Bank's PAT grew significantly by 93.3% to PKR 30.6bln (CY19: 15.8bln) in CY20. During 3MCY21, PAT of the Bank grew by 87.1% to PKR 7.7bln (3MCY19: PKR 4.1bln).

Sustainability The Bank is pursuing a more risk -prudent strategy for loan growth with a focus on small-ticket loans to high quality borrowers in the SME sector. However, recovery from infected portfolio would remain one of the key targets in CY21.

Financial Risk

Credit Risk Given the limited loan demand in the private sector, gross advances of the Bank dropped marginally by 1.4% to PKR 988.6bln (CY19: PKR 1,002.6bln). Contribution of top-3 sectors' exposure was largely maintained. The asset quality observed deterioration as domestic NPLs increased to PKR 128.9bln in CY20. Moreover, borrowers, having aggregate outstanding exposure of PKR 38.8bln, have availed regulatory relief; the risk of increase in credit losses persists. During 3MCY21, advances further dropped by 4.7% to PKR 942.6bln.

Market Risk During CY20, the funds generated from deposits were invested in government securities. The Bank's investment portfolio constituting 53.9% of the total earning assets. The mix of government securities in overall investments stood at 92.1%, consist on T-Bills (44.5%) and PIBs (45.6%) and others (9.9%).

Liquidity And Funding During CY20, customer deposits remained the key source of funding for the Bank. CASA mix surged to 83.8%. Meanwhile, top-20 deposits concentration stood at 19.2%.; considered good. Overall the Bank's liquidity position remained strong and the liquidity ratio improved to 63.5% on account of significant growth in Govt. securities.

Capitalization The Bank's capitalization remained healthy with equity to total assets at 8.9% at end-Dec20 (end-Dec19: 7.4%). NBP's Capital Adequacy Ratio (CAR) is strong (CY20: 19.8%) and predominantly comprises Tier-I capital 15.0%.

PKR mln

National Bank of Pakistan Listed Public Limited	Mar-21 3M	Dec-20 12M	Dec-19 12M	Dec-18 12M
A BALANCE SHEET				
1 Total Finances - net	995,353	1,044,379	1,058,604	982,662
2 Investments	1,783,976	1,407,530	1,382,898	1,227,769
3 Other Earning Assets	107,094	158,507	183,602	134,853
4 Non-Earning Assets	448,997	403,367	493,488	453,387
5 Non-Performing Finances-net	4,909	(5,257)	5,798	(105)
Total Assets	3,340,330	3,008,527	3,124,389	2,798,566
6 Deposits	2,280,375	2,418,966	2,198,049	2,011,385
7 Borrowings	610,874	146,073	479,398	392,739
8 Other Liabilities (Non-Interest Bearing)	179,267	175,929	214,328	187,573
Total Liabilities	3,070,516	2,740,968	2,891,775	2,591,698
Equity	269,813	267,559	232,614	206,869
B INCOME STATEMENT				
1 Mark Up Earned	48,472	257,811	239,477	149,969
2 Mark Up Expensed	(26,878)	(153,656)	(167,570)	(89,302)
3 Non Mark Up Income	8,492	36,077	36,199	36,249
Total Income	30,086	140,232	108,107	96,915
4 Non-Mark Up Expenses	(14,337)	(63,112)	(65,853)	(55,931)
5 Provisions/Write offs/Reversals	(3,112)	(30,896)	(14,250)	(11,300)
Pre-Tax Profit	12,637	46,224	28,003	29,683
6 Taxes	(4,929)	(15,665)	(12,194)	(9,668)
Profit After Tax	7,708	30,559	15,810	20,015
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.7%	3.4%	2.4%	2.3%
Non-Mark Up Expenses / Total Income	47.7%	45.0%	60.9%	57.7%
ROE	11.5%	12.2%	7.2%	10.5%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	8.1%	8.9%	7.4%	7.4%
Capital Adequacy Ratio	21.9%	19.8%	15.5%	16.3%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	65.1%	63.5%	56.3%	55.4%
(Advances + Net Non-Performing Advances) / Deposits	41.6%	40.6%	45.9%	46.0%
CA Deposits / Deposits	54.7%	54.4%	54.8%	54.8%
SA Deposits / Deposits	30.5%	29.4%	27.0%	26.7%
4 Credit Risk				
Non-Performing Advances / Gross Advances	16.2%	14.8%	12.9%	12.6%
Non-Performing Finances-net / Equity	1.8%	-2.0%	2.5%	-0.1%

Credit Rating

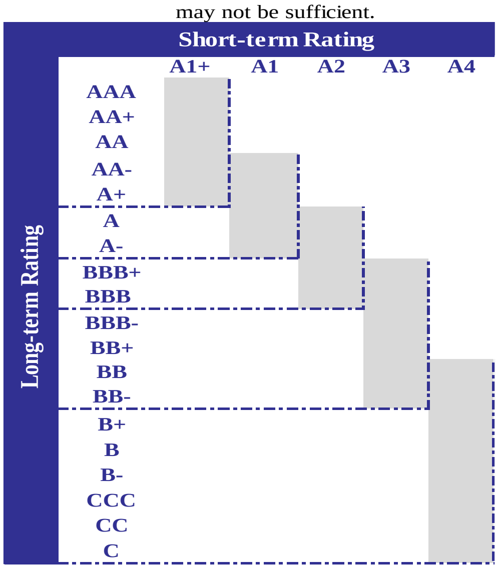
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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
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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA 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 PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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