

## EXEMPLARY STEWARDSHIP

and Institutional Capital Formation

# INSTITUTIONAL CAPITAL, AN OUTCOME OF EXEMPLARY STEWARDSHIP

Covers a broad spectrum of non-financial components that are, vital to the Bank and the Group for the value creation process.

Institutional capital, an outcome of exemplary stewardship, covers a broad spectrum of non-financial components that are, like financial capital, internal to the Bank and the Group. It is a collection of intangibles that includes aspects such as;

- Corporate Governance
- Managing Risk
- Values that Drive Business
- Brand Equity
- Systems and Processes
- Procurement Policy
- Outsourcing Policy
- Information Technology
- Transactional and Institutional Capital

### Corporate Governance

Corporate governance is a process used to direct and manage the business and affairs of the Bank in order to balance the attainment of corporate objectives and the alignment of corporate behaviours with the expectations of society whilst being accountable to its shareholders.

Good governance is an all pervading principle at the Bank, from setting the tone from the top at the Board room to instilling the required mindset amongst all employees, and even business partners.

### Role of the Board

We believe that a robust and transparent corporate governance framework is vital for the sustainable success of the Bank. The Board of Directors is the highest governance body of the Bank. Briefly, the Board is responsible for:

- *Oversight* in the conduct of the Bank's affairs;
- *Strategic direction* that aligns priorities with the mission of the Bank and the best interests of stakeholders;
- *Risk management* in the context of approving the Bank's risk appetite that aligns with business strategy, assists decision making and enhances management effectiveness while optimizing resource allocation; and
- *Compliance* with all relevant laws and regulations.

### Board Committees

The Board delegates the day-to-day operations of the business to the following Board Committees which are chaired by Non-Executive Directors:

- Board Audit Committee
- Integrated Risk Management Committee
- Human Resources and Remuneration Committee
- Nomination Committee
- Related Party Transactions Review Committee

- Strategic Issues Committee (non-statutory)
- Corporate Governance and Legal Affairs Committee (non-statutory)

### Management Committees

The Board and the Chief Executive Officer are further supported by the following Management Committees:

- Asset and Liability Management Committee
- Investment Committee
- Credit Committees
- HR Committee
- IT Steering Committee
- Credit and Market Risk Policy Committee
- Operational Risk Policy Committee
- Outsourcing Committee
- Procurement Committee

### Good Governance

The Governance Structure of the Bank ensures that the Directors take all necessary steps to avoid *conflicts of interest*, or the appearance of conflicts of interest, in their activities. Safeguard measures include the disclosure of any material conflict of interest, abstaining from voting and the presence of Independent Non-Executive Directors at Board meetings.

The Bank has in place an effective *Disclosure Policy* to provide stakeholders with timely, accurate

and relevant information which would enable them to make an accurate assessment of the Bank's activities, performance and risk profile. However, the Bank ensures that confidentiality is strictly maintained in respect of material confidential information which is not publicly available. The Bank's *Compliance Policy* and *Code of Conduct* sets out the safeguards to be taken to maintain material confidential information.

To encourage engagement with customers and stakeholders, the Bank has in place a *Customer Charter*, a *Complaint Handling Procedure* supported by an internally developed MIS system and a *Communications Policy*.

The Bank's *Compliance Policy* and *Code of Conduct* govern all employees. The Code provides a general outline of the standards of professional and ethical conduct that all employees of the Bank are expected to follow including areas such as general conduct and competence, confidentiality and misuse of material confidential information, managing conflicts of interest situations and insider dealing provisions. The Bank's Code also has policies that prohibit bribery and discrimination. The Bank applies an equitable standard of fair treatment to all of its employees, and conducts its business in a non-discriminatory manner without regard to age, gender, nationality, marital status, race, religion, disability etc.

A detailed account of the Bank's performance on governance is given in the Corporate Governance Report (pages 128 to 174).

## Managing Risk

As a provider of banking and financial services, risk is at the core of our day-to-day activities. We actively manage risk through an integrated risk management framework at all

levels of the Bank, which helps to align business in assuming and managing risks objectively. It ensures that our risk profile remains acceptable and within the Bank's risk appetite, which describes the type and quantum of risk we are willing to accept in achieving our strategic objectives.

## Risk Profile

In a nutshell, the Bank's risk profile is characterized by a highly diversified portfolio, stable capital and liquidity position together with a robust risk governance structure and an experienced team.

## Integrated Risk Management Framework

The Bank's approach to risk management is explained in the Integrated Risk Management Framework approved by the Board Sub-Committee on Integrated Risk Management and the Board of Directors. The framework sets out the process for identifying, measuring, monitoring and controlling the different types of risk and the governance structure.

In discharging its responsibilities, the Board operates through two key Sub-committees, namely, the Integrated Risk Management Committee and the Board Audit Committee. These Committees are supplemented by management committees that comprise of individuals with specialized knowledge of the business areas and risk management professionals.

A detailed account of the Bank's performance on managing risk is given in the section on Risk Management (pages 212 to 254).

## Values that Drive Business

Embedding our five core corporate values into every aspect of our business is a top priority for the Bank

and the Group. These values are articulated and internalized during recruitment, training, performance management and other people-related activities.

Our values are fundamental in moulding the Bank's corporate culture, and are particularly important in the context of developments in regulatory requirements, investor confidence and society's expectations of banks. We expect our employees to act accordingly in the execution of their duties in the following ways:

### Integrity

We are devoted to uphold honesty, truthfulness and sincerity while remaining fair and ethical at all times – even in the most challenging situations. We will inspire trust by saying what we mean, matching our behaviours to our words and taking responsibility for our actions.

### Excellence

We have the right attitude to diligently deliver what we promise while adding value that goes beyond what is expected. We achieve excellence through innovation, expertise, thoroughness and experience in everything we do.

### Creativity

We are driven by a desire to reach beyond the norm, challenge the status quo and shape new vistas for our stakeholders. We are creative in our thinking and futuristic in our approach – while working towards the end goal of delivering unsurpassed value to all our stakeholders.

### Accountability

We remain responsible, accountable and transparent in everything we do. Our corporate strategy is shaped by the willingness to take ownership for our actions which affect our stakeholders.

## Sincerity

We believe in building productive, long-term relationships based on sincerity with our clients and stakeholders. We regard our sincerity towards each other just as valuable as what we collectively achieve.

## Business Ethics and Integrity

As discussed in the Corporate Governance Report (pages 128 to 174) several frameworks, codes and control mechanisms are in place that shape our business ethics and integrity. The Bank's Code of Conduct guides employees to maintain high standards of personal and corporate integrity. The Code specifies how employees should conduct themselves when interacting with external customers, internal customers such as work colleagues, supervisors and subordinates as well as suppliers and business partners.

All customers receive high standards of service and responsiveness. Respect, efficiency, integrity and suitable protection to customers in accordance with the appropriate regulatory, contractual or fiduciary responsibility are key components of serving our customers.

To ensure ethics and integrity in the relationships maintained with business partners, the Bank implements a formal Sustainable Supply Chain Management process which takes into account an assessment of suppliers in the context of environmental, labour and social factors.

## Brand Equity

As a diversified financial institution the Bank endeavours to financially empower individuals, organizations and communities while continuing to strengthen the infrastructure development and production

capabilities of the country – thus contributing to national economic development.

Having transformed from a development bank to a fully-fledged commercial bank, the current positioning of the Bank's brand is distinct. It is a household name across diverse customer segments and industry sectors, and has been listed amongst the top 20 brands in Sri Lanka over the past six years. Within the banking and financial services industry in the country, 'NDB' ranks 16th with a brand value of LKR 6.85 billion and a brand rating of AA- as per 'Brands Annual 2015' by Brand Finance.

During the year under review, the Bank continued to strengthen its brand presence amongst relevant target audiences by advertising in key media such as selected television and radio networks, magazines, national newspapers, strategic outdoor locations, branch premises as well as via online and digital media. The key message across all media reiterated the unique strengths of the NDB Group – a diversified conglomerate with the ability to deliver multiple financial services under one roof. The numerous product/brand name advertising conducted throughout the year also contributed to the brand equity of the NDB brand while portraying the brand as a dynamic force within the industry.

We also organized workshops and training programmes for grass root level micro industrialists and small and medium enterprises (SME), as well as events and sponsorships to strengthen relationships with large corporates and premium clients. The NDB-RCGC Inter-School Golf Tournament and Build Sri Lanka were some of the key highlights of such strategic sponsorships. We further reinforced our online brand presence, particularly targeting tech savvy young customers and prospects through many social media platforms including Facebook, Twitter, YouTube and LinkedIn.

The Bank further repositioned the brand by introducing new vision and mission statements and corporate values, while introducing the tag line '*our commitment, your success*'.

## Systems and Processes

The Bank has developed several internal systems, processes and procedures over the years which are unique to the institution.

The Bank's internally developed Environmental and Social Management System (ESMS) screens all projects to be financed against related laws, regulations and norms as well as inherent risks. It includes downstream aspects during project implementation. Our ESMS meets all relevant national regulatory standards, as well as those of international lending institutions.

Targeting the SME sector the Bank developed a Receivables Management System and a Purchase Order Management System in 2013, both of which continue to be fully operational. This was part of a larger reorganization that brought all support functions – Central Processing, Trade Finance, Treasury Operations, Human Resources and Administration - under the umbrella of the Operations Department.

The staff Performance Development System that was revamped in 2014 with the active participation of employees saw a full year of implementation during the year. The system was re-engineered to cater to the rapid expansion of the Bank and its scope of operation and the consequential rise in the number of staff. The process is aimed at providing career progression to employees depending on abilities, commitment and performance. With a longer term focus on staff retention, the Bank regularly reviews its Equity Linked Compensation Plan with new criteria that also aims to draw in a larger section of employees.

## Procurement Policy

Procurement is a key business support function which ensures the provision of quality goods, services and works for the smooth conduct of the operations of the Bank and its Group companies. The process is governed by a Board approved Procurement Policy, which ensures adherence to prescribed standards, specifications, rules, regulations and good governance principles.

The Policy focuses on cost effectiveness, timeliness and quality and ensures that our procedures provide fair, transparent, equal and maximum opportunity for eligible interested parties to participate in the Bank's procurement. The Bank is committed to ensuring fairness, transparency and consistency in the evaluation and selection procedure and maintains confidentiality of information provided by bidders.

A Sustainable Procurement and Supplier Policy was developed during the year to strengthen the sustainability of the Bank's value chain. This Policy sets out the criteria for screening suppliers, products and services based on economic, social and environmental aspects and all suppliers have adhered to this.

In addition to the Board approved policy, procurement is guided by a eight-member procurement committee appointed by the Chief Executive Officer of the Bank.

With the centralization of the finance function across the Bank and Group companies (except for Bangladesh operations), procurement is also centralized across the Group. The Group procurement process has been instrumental in considerable cost reductions and improved quality of goods, services and works sourced thereby complementing two important strategic objectives of the Bank, namely, cost optimization and operational excellence.

It should be noted that 100% of the Bank and Group companies' (except for Bangladesh operations) suppliers are local operations.

## Outsourcing Policy

Outsourcing allows an organization to focus on its core business whilst the non-core functions are taken care of by experts external to the business. The Bank's Board-approved Outsourcing Policy ensures that an optimal balance is achieved between the quality of human resources engaged and the costs for the same. Outsourcing activities are directed by an Outsourcing Committee.

Regular review of the Policy and Committee activities are carried out by the Board Audit Committee of the Bank. While outsourcing presents many advantages, it also has disadvantages which the Bank needs to manage critically, such as confidentiality, business continuity, quality of work and timeliness. In view of the above, there are regulations imposed by the Central Bank of Sri Lanka (CBSL) on outsourcing. The Bank is in full compliance with the Banking Act Direction No. 2 of 2012 of the CBSL on outsourcing business operations of a Licensed Commercial Bank.

## Information Technology

Information Technology underpins the business of banking. The Bank's core banking system, implemented in 2011, serves to integrate multiple applications into one seamless platform.

Combining customer convenience and environmental sustainability, the Bank introduced e-Statements during the year, successfully delivering several benefits such as improved customer service through a consolidated view of a customer's relationship, timely and reliable delivery as well as reduced costs arising from savings in stationery, postage etc.

The Bank established connectivity with the Lanka Clear Common Payment Switch, a national initiative supporting social inclusion, which allows greater reach, service offering and convenience to customers through a common platform. It offers significant savings in foreign exchange to the country as well, as all LankaPay ATM transactions are channelled through a domestic network. The Bank also joined the Common Electronic Fund Transfer Switch (CEFTS) initiative, linking LankaPay CEFTS members to facilitate domestic interbank real-time fund transfers originating from any electronic payment channel such as internet banking and teller counters.

Other activities during the year included an upgrade of the Bank's IT hardware infrastructure to enhance system performance and customer service, and the verification of our risk management capabilities by conducting two full scale disaster recovery simulations in line with the Bank's Business Continuity Plan.

## Transactional and Institutional Banking

The Cash Management Unit and the Correspondent & Institutional Banking Unit come under the main umbrella of the Transactional and Institutional Banking Division. These units support the cash management and international trade activities of corporate, retail and SME clients of the Bank, including domestic and cross-border payments and facilitate inward worker remittances.

The scope of the Cash Management Unit covers the areas of corporate electronic banking, management of financial and institutional relationships, the Chinese Desk and capital market transactions. The Chinese Desk, which exclusively caters to multiple banking needs of the Chinese business community, has managed to create a unique value proposition to clients.

The online banking platform has been regularly upgraded with better product features enabling our corporate and SME clients to better manage their payments electronically. As a result the cash management business arm has brick walled many client relationships and attracted new clients to NDB Bank during the year 2015.

In the current year too, the Cash Management Unit continued to successfully serve as the banker for many capital market transactions. The ETF platform was rolled out during the year that enables corporate clients to make their ETF payments directly to the Employee's Trust Fund Board. We are now looking at further value additions via EPF and dividend modules during the year 2016.

Relationships with a strong network of correspondent banks are important for trade finance activities, cross border payments and for the Bank's own liquidity management. The Correspondent & Institutional Banking Unit supports such activities of the Bank through a strong global network of correspondent banks covering all parts of the world. During 2015 the Bank added new strategic relationships to the existing portfolio based on emerging geographical business opportunities. The Unit also takes responsibility for evaluating and setting up counterparty limits for the Bank's liquidity management and foreign exchange trading.

Worker remittances have become an increasingly prominent source of foreign earnings for many developing countries like Sri Lanka. The Bank considers this to be a priority area of development. The upgraded remittance system at the Bank is one of the most convenient ways of receiving money by a beneficiary in Sri Lanka.

## Compliance

The Bank's Legal Department has not been informed of or have pursued any actions where any fines were imposed on the Bank in relation to non-compliance with laws & regulations relating to corruption, anti-competitive behaviour, anti-trust, monopoly practices or laws & regulations concerning the provision and use of products and services and related matters during the year. There were no fines charged or non-monetary sanctions for non-compliance with laws & regulations.

## Support Services

### Legal Department

The Legal Department of the Bank is located at the head office and consists of 20 Lawyers.

The Legal Department handles all matters pertaining to the evaluation of title of lands, preparing loan/security documentation of SME, Project Financing, Housing-loans, Personal loans and leases, drafting, negotiating and execution of all types of agreements, drafting formats for the products and services offered by the Bank, and providing legal advice to the Bank and the branch network on a day-to-day basis, on legal issues. The Lawyers also assist in structuring of products offered by the Bank. In certain instances legal matters of the NDB Group are handled by the department as well. The Bank obtains the assistance of External Lawyers or legal firms on a selective basis.

All members attached to the Legal Department strive to maintain the highest professional standards and corporate governance in carrying out their functions.

## Centralized Recoveries Department

In April 2014, the Bank took a strategic decision to setup the Centralized Recoveries Department in order to have special focus/emphasis on the collection/recoveries effort of the Bank and especially to proactively manage the Bank's Probable Non-Performing Loans (NPLs) and the current NPLs. This move has proved to be an undoubted success with the Bank's NPL Ratio progressively improving to 2.43% by end 2015 which is among the lowest in the industry.

Key contributors to the low NPL Ratio are given below:

01. Significant decline in Project Finance NPLs.
02. Substantial decrease of the NPL Ratio in the SME Segment.
03. Less than 2% NPL Ratio for both Retail and Leasing Segments far below industry. Unsold yard vehicles have been kept to minimal levels.
04. Near total reduction of Pawning-related NPLs even in a declining gold prices scenario.
05. Significant sales of acquired assets with well over half the assets acquired being sold during the year.
06. Sound preventive measures and credit curtailing new NPLs.

The performance of the above sectors has jointly contributed to negate some NPL increases in the corporate sector.

### Key Challenges of 2016

The key challenge for the Bank's NPLs in 2016 will be to regularize a significant portion of the same. Sound preventive measures, notably tightening of granting credit will also be taken in respect of the Probable NPLs. Legal action where ever deemed appropriate will also speeded up in the case of wilful defaulters.