



Fitch Downgrades Sri Lanka Insurance Corp's IFS to 'CC'; Places IFS, 'AA(Ika)' National IFS on RWN

Fitch Ratings - Sydney/Hong Kong - 21 Apr 2022: Fitch Ratings has downgraded Sri Lanka Insurance Corporation Limited's (SLIC) Insurer Financial Strength (IFS) Rating to 'CC', from 'CCC+', and has placed the rating on Rating Watch Negative (RWN).

SLIC's National IFS Rating of 'AA(Ika)' has also been placed on RWN.

Fitch has also taken rating action on seven other Sri Lankan insurers; please see [Fitch Places Seven Sri Lankan Insurers on Rating Watch Negative](#), published 21 April 2022.

KEY RATING DRIVERS

The downgrade reflects the probability that ceased or interrupted payments could occur on SLIC's foreign-currency obligations due to weak foreign-currency liquidity in the local banking system. Fitch believes counterparty risk of SLIC's foreign-currency assets have risen following recent negative rating action on the Sri Lanka sovereign and various financial institutions. The insurer has foreign-currency exposure via investments in Sri Lanka development bonds and deposits with local banks.

The RWN is driven by heightened near-term downside risks to the insurer's credit profile, including elevated investment and liquidity risk, pressure on its regulatory capital position and a weaker financial performance outlook. The RWN also reflects potential pressure on SLIC's foreign-currency obligations due to stretched foreign-currency liquidity in the local banking system and the uncertain impact from SLIC's non-insurance subsidiaries.

Fitch believes the recent negative rating action on the Sri Lanka sovereign and various financial institutions underscores SLIC's investment risks, as its investment portfolio is dominated by fixed-income securities issued or guaranteed by the government. It also includes deposits and securities issued by local banks, non-bank financial institutions and corporations; Fitch [downgraded the Sri Lankan sovereign's Long-Term Foreign-Currency Issuer Default Rating to 'C', from 'CC'](#), and had placed the ratings of several financial institutions on RWN, see [Fitch Places 13 Sri Lankan Banks on Rating Watch Negative](#) and [Fitch Places Bank of Ceylon on Rating Watch Negative](#).

Fitch assumes the Ministry of Finance's 12 April 2022 announcement that the state and public sector borrowers will cease all foreign-currency debt payments on borrowings that are governed by law other than Sri Lankan law will not apply to SLIC's policyholder obligations or its subsidiaries' debt obligations. SLIC's insurance operation does not have any debt in its capital structure. However, one of its non-insurance subsidiaries has foreign-currency borrowings from a state-owned bank, according to the latest annual report. It is not clear if the subsidiary will have to stop payment on these borrowings or if this would become SLIC's direct liability should the subsidiary be unable to pay, as the entity is ultimately owned by the state.

SLIC's foreign-currency denominated insurance contract obligations tend to be small and limited to certain non-motor classes, according to the company. The insurer, like other domestic insurers, relies on access to foreign-currency to make premium payments to foreign reinsurers and meet other costs that are typically sourced from overseas.

SLIC's Fitch-calculated risky asset ratio (end-2020: 529%) is partly driven by the insurer's large investment in listed and unlisted equities. Fitch believes the recent five-day closure of the Colombo Stock Exchange undermines the liquidity of SLIC's listed investments, especially if such closures become recurrent.

Fitch believes the heightened investment risks and earnings pressure could affect SLIC's regulatory capital profile. A significant deterioration in the credit profiles of financial institutions could lead to lower regulatory risk-based capital (RBC) ratios, as investments will be subject to incremental risk charges according to local regulatory RBC rules. SLIC's Fitch Prism Model score is 'Somewhat Weak', based on 2020 results, and is driven by high asset risk charges.

Fitch expects the weak operating environment to affect SLIC's earnings, similarly to the rest of the industry. Growth in motor insurance - the largest contributor to non-life premiums - is likely to remain subdued, as Fitch expects the government's ban on auto imports, imposed in 2020 to control currency depreciation, to continue. In addition, underwriting profit will be squeezed by rising motor spare-part costs due to currency devaluation, while overall costs will climb with rising inflation. Insurers, including SLIC, also have limited ability to reprice policies, given the dent in customers' disposable incomes.

SLIC, like other Sri Lankan non-life insurers, relies on international reinsurers to protect its non-motor businesses. Fitch thinks any material changes to reinsurance structures upon renewal due to rising reinsurance costs could undermine the insurer's risk management practices and ability to write new business.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Fitch expects to resolve the RWN in the next six months once the impact on the insurer's credit profile becomes more apparent. Fitch also seeks greater clarity on the government's restrictions on servicing foreign-currency obligations, including the impact on SLIC's policyholder obligations and the debt obligations of its non-insurance subsidiaries. Potential triggers that could lead to a downgrade include:

- inability to access foreign- or local-currency assets to meet liabilities
- any government restrictions that impede the insurer's ability, or that of subsidiaries, to service foreign- or local-currency policyholder or debt obligations
- rising investment and asset risks, including a downgrade of the ratings of financial institutions
- a sustained drop in the regulatory RBC ratio, with no plans to rectify the situation

- sustained weakness in financial performance and earnings or risk management practices
- a downgrade of the sovereign rating stemming from a default event.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- There is limited scope for upward rating action given the RWN.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅			PRIOR ⇅
Sri Lanka Insurance Corporation Limited	Ins Fin Str	CC ⇅	Downgrade	CCC+
	Natl Ins Fin Str	AA(Ika) ⇅	Rating Watch On	AA(Ika) ●

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APPLICABLE CRITERIA

- [Insurance Rating Criteria \(pub. 26 Nov 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Prism Factor-Based Capital Model, v1.7.2 ([1](#))

ADDITIONAL DISCLOSURES

- [Dodd-Frank Rating Information Disclosure Form](#)
- [Solicitation Status](#)
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ENDORSEMENT STATUS

Sri Lanka Insurance Corporation Limited EU Endorsed, UK Endorsed

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