



## Fitch Downgrades Bank of Ceylon's Local Currency IDR to 'CCC-'; Maintains RWN

Fitch Ratings - Colombo - 06 Dec 2022: Fitch Ratings has downgraded Bank of Ceylon's (BOC) Long-Term Local-Currency Issuer Default Rating (IDR) to 'CCC-' from 'CCC' and maintained it on Rating Watch Negative (RWN). At the same time, Fitch has affirmed BOC's Long-Term Foreign-Currency IDR and Short-Term IDR at 'RD', Viability Rating (VR) at 'f' and Government Support Rating at 'ns'.

BOC's National Long-Term Rating of 'AA-(lka)' on RWN was not considered in this review.

The rating actions follow the downgrade of Sri Lanka's Long-Term Local-Currency IDR to 'CC' from 'CCC' on 1 December 2022. For details, please see [Fitch Downgrades Sri Lanka's Long-Term Local-Currency IDR to 'CC'; Affirms 'RD' Foreign-Currency IDR](#).

### KEY RATING DRIVERS

**Long-Term Local-Currency IDR Downgraded:** The downgrade of BOC's Long-Term Local-Currency IDR stems from the downgrade of the sovereign's Long-Term Local-Currency IDR. The RWN on the bank's Long-Term Local-Currency IDR reflects heightened near-term downside risks to its credit profile from potential capital and funding stress as default risk on domestic debt increases while access to foreign-currency funding remains constrained.

The bank's Long-Term Local-Currency IDR is one notch above that of Sri Lanka, reflecting our view of a lower risk the authorities will impose restrictions on banks servicing their local-currency obligations than non-payment by the sovereign. This approach is consistent with Fitch's criteria under certain circumstances when bank and sovereign ratings are both at very low levels.

**Other Ratings Affirmed:** The affirmation of BOC's Long-Term Foreign-Currency IDR, Short-Term IDR and VR reflect the bank's unpaid foreign-currency obligations. BOC's foreign-currency funding and liquidity profile remains stretched with inflow of foreign currency via remittances and export proceeds still inadequate to meet its obligations, despite some improvement. The bank's access to foreign-currency funding remains constrained by the sovereign's weakened credit profile.

Rupee liquidity remains tight following the bank's sizeable lending to the state in 2021, but we expect local-currency liquidity to be more manageable than foreign-currency, supported by BOC's strong domestic franchise as well as its ability to access liquidity from the central bank.

**Risks to OE Intensify:** We have lowered Sri Lanka banks' operating environment score to 'ccc-' with negative outlook, from 'ccc/negative', reflecting our view that a probable default on sovereign domestic debt and the ensuing risks to the broader macroeconomic environment could intensify risks to banks' already stressed credit profiles following the

sovereign's default on foreign-currency instruments, thus further hindering banks' operational flexibility.

**Potential Sovereign Restructuring Threatens Solvency:** We have lowered BOC's capitalisation and leverage score to 'cc' from 'ccc'. This reflects our view that a potential restructuring of the sovereign's domestic debt, in addition to a possible haircut on foreign-currency securities, could have a significant effect on the bank's solvency given its large holdings of sovereign securities relative to its common equity Tier 1 (CET1) capital (nearly 8 times of BOC's CET1 capital at end-3Q22). The bank could then require recapitalisation to restore viability without further regulatory forbearance.

## **RATING SENSITIVITIES**

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

The Long-Term Foreign-Currency IDR, Short-Term IDR and VR are already at the lowest level on the scale and cannot be downgraded.

We expect to resolve the RWN on BOC's Long-Term Local-Currency IDR when the impact on the bank's credit profile becomes more apparent, which may take longer than six months. Potential triggers that could lead to a downgrade include:

- funding stress that impedes the bank's repayment ability in local currency
- significant banking-sector intervention by authorities that constrain banks' ability to service their local-currency obligations
- a temporary negotiated waiver or standstill agreement following a payment default on a large local-currency financial obligation
- where Fitch believes a bank has entered into a grace or cure period following non-payment of a large local-currency financial obligation.
- a reduction in CET1 below regulatory minimum (4.5% without any buffers), even if there is regulatory forbearance regarding such a shortfall.

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

The Long-Term Foreign-Currency IDR, Short-Term IDR and VR are unlikely to be upgraded until Fitch believes that BOC is able to meet its foreign-currency obligations in a full and timely manner, which would be evident from a material improvement in its foreign-currency funding and liquidity position, while also taking into consideration other weaknesses in the bank's credit profile and performance challenges that domestic banks are facing.

There is limited scope for upward rating action on the Long-Term Local-Currency IDR in light of the RWN, and the negative outlook we have on several VR factors.

**State Support Unlikely:** The Government Support Rating of 'ns' reflects our assessment that there is no reasonable assumption of government support being forthcoming.

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

The rating is already at its lowest level and thus has no downside risk.

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

The Government Support Rating is constrained by the sovereign rating. An upward revision is possible, provided the sovereign's ability to provide support significantly improves. However, this appears unlikely in the near to medium term.

## **VR ADJUSTMENTS**

The assigned VR is below the implied VR, reflecting a negative adjustment from the weakest link of BOC's funding and liquidity, which has a greater impact on the VR than what the weighting suggests.

BOC has a 1.78% equity stake in Fitch Ratings Lanka Ltd. No shareholder other than Fitch, Inc. is involved in the day-to-day rating operations of, or credit reviews undertaken by, Fitch Ratings Lanka Ltd.

## **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**

Bank of Ceylon has an ESG Relevance Score of '4' for Governance Structure due to ownership concentration, with a 100% state shareholding and several related-party transactions with the state and state-owned entities, which has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

Bank of Ceylon has an ESG Relevance Score of '4' for Financial Transparency. It reflects our view that the recent regulatory forbearance measured announced by the Central Bank of Sri Lanka could distort the true solvency and liquidity position of the bank thereby limiting financial transparency.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

### RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
<input type="text"/>	<input type="text"/>			<input type="text"/>
Bank of Ceylon	LT IDR	RD	Affirmed	RD
	ST IDR	RD	Affirmed	RD
	LC LT IDR	CCC-	Downgrade	CCC
	Viability	f	Affirmed	f
	Government Support	ns	Affirmed	ns

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[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

### PARTICIPATION STATUS

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### APPLICABLE CRITERIA

- [Bank Rating Criteria \(pub. 08 Sep 2022\) \(including rating assumption sensitivity\)](#)

### ADDITIONAL DISCLOSURES

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

- [Endorsement Policy](#)

## **ENDORSEMENT STATUS**

Bank of Ceylon EU Endorsed, UK Endorsed

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