



Fitch Downgrades Sri Lanka's Long-Term Local-Currency IDR to 'RD'

Fitch Ratings - Hong Kong - 14 Sep 2023: Fitch Ratings has downgraded Sri Lanka's Long-Term Local-Currency (LTLFC) Issuer Default Rating (IDR) to 'RD' (Restricted Default) from 'C'. The ratings on its local-currency bonds tendered in the domestic debt exchange have been downgraded to 'D' from 'C' while its other four local-currency bonds not tendered in the domestic debt exchange have been affirmed at 'C'.

The Long-Term Foreign-Currency (LTFC) IDR has been affirmed at 'RD', and the ratings on Sri Lanka's foreign-currency bonds have been affirmed at 'D'.

All issue ratings have subsequently been withdrawn.

Fitch typically does not assign Outlooks to sovereigns with a rating of 'CCC+' or below.

A full list of rating actions is detailed below.

Fitch has withdrawn the issue ratings of Sri Lanka's foreign and local-currency bonds as these are no longer considered to be relevant to the agency's coverage.

KEY RATING DRIVERS

Distressed Debt Exchange: The downgrade of Sri Lanka's LTLC IDR reflects the partial completion of an exchange of Sri Lanka's T-bonds on 14 September as part of a broader domestic debt optimisation (DDO) launched in July 2023. The DDO also includes conversion of T-bills held by the Central Bank of Sri Lanka (CBSL) into treasury bonds (T-bonds), which has not yet been completed.

In Fitch's view, the exchange of T-bonds constitutes a distressed debt exchange (DDE) under the agency's criteria, given that the maturity extension of the tendered bonds represents a material reduction in terms versus the original contractual terms, and given that the exchange is needed to avoid a traditional payment default.

Reduction in Terms: Eligible bonds for which tenders were received and accepted have been exchanged into 12 new instruments of equal size and the same aggregate principal amount, maturing between 2027 and 2038. Accepted tenders reached about 37% of the outstanding principal amount of eligible bonds outstanding as of 28 June 2023. Accepted tenders were predominantly by superannuation funds, which will face higher tax rates on income from T-bonds if they did not meet a participation threshold.

Local-Currency Debt Service Continuing: Fitch believes that Sri Lanka has continued to service the T-bonds throughout the DDO process, and that T-bonds not tendered in the exchange will continue to be serviced as per their original terms, including but not limited to the entirety of the 12 series of T-bonds (out of 61 eligible series) for which no valid tenders were received. Four of these 12 series were rated by Fitch and were affirmed at 'C' prior to withdrawal.

Local-Currency Restructuring Incomplete: Under Fitch's rating criteria, the LTLC IDR will remain in 'RD' until the debt exchange is completed in its entirety. Fitch deems the process incomplete, as the exchange of T-bills held by CBSL is still pending. Fitch regards the T-bills as public debt securities, and they are also held by private investors.

Foreign-Currency IDR in Default: The sovereign remains in default on foreign-currency obligations and has initiated a debt restructuring with official and private external creditors. The Ministry of Finance had issued a statement on 12 April 2022 that it had suspended normal debt servicing of several categories of external debt, including bonds issued in international capital markets, foreign currency-denominated loans and credit facilities with commercial banks and institutional lenders.

ESG - Governance: Sri Lanka has an ESG Relevance Score of '5' for Political Stability and Rights as well as for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGi) have in our proprietary Sovereign Rating Model (SRM). Sri Lanka has a medium WBGi ranking in the 45th percentile, reflecting a recent record of peaceful political transitions, a moderate level of rights for participation in the political process, moderate institutional capacity, established rule of law and a moderate level of corruption.

ESG - Creditor Rights: Sri Lanka has an ESG Relevance Score of '5' for Creditor Rights, as willingness to service and repay debt is highly relevant to the rating and is a key rating driver with a high weight. The affirmation of Sri Lanka's LTFC IDR at 'RD' and downgrade of LTLC IDR to 'RD' reflect a default event.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- The Long-Term IDRs are at the lowest level, and cannot be downgraded further
- The Short-Term Local-Currency IDR will be downgraded to 'RD' on the completion of the exchange of T-bills

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Following completion of the debt exchange with CBSL, Fitch will assign Sri Lanka's LTLC IDR based on a forward-looking assessment of its willingness and capacity to honour its local-currency debt
- For the LTFC IDR, completion of the foreign-currency commercial debt restructuring that Fitch judges to have normalised relationship with private-sector creditors may result in an upgrade

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

In accordance with the rating criteria for ratings in the 'CCC' range and below, Fitch's sovereign rating committee has not used the SRM and QO to explain the ratings, which are instead guided by the agency's rating definitions.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LTFC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the LTFC IDR, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Sri Lanka is 'B-'. For sovereigns rated 'CCC+' or below, Fitch assumes a starting point of 'CCC+' for determining the Country Ceiling. Fitch's Country Ceiling Model produced a starting point uplift of zero notches. Fitch's rating committee applied a +1 notch qualitative adjustment to this, under the balance of payments restrictions pillar, reflecting that the private sector has not been prevented or significantly impeded from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch does not assign Country Ceilings below 'CCC+', and only assigns a Country Ceiling of 'CCC+' in the event that transfer and convertibility risk has materialised and is affecting the vast majority of economic sectors and asset classes.

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

Sri Lanka has an ESG Relevance Score of '5' for Political Stability and Rights as WBI have the highest weight in Fitch's SRM and are highly relevant to the rating and a key rating driver with a high weight. As Sri Lanka has a percentile rank below 50, for the respective governance indicator, this has a negative impact on the credit profile.

Sri Lanka has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Sri Lanka has a percentile rank below 50 for the respective governance indicators, this has a negative impact on the credit profile.

Sri Lanka has an ESG Relevance Score of '4' for Human Rights and Political Freedoms, as the Voice and Accountability pillar of the WBI is relevant to the rating and a rating driver. As Sri Lanka has a percentile rank below 50 for the respective governance indicator, this has a negative impact on the credit profile.

Sri Lanka has an ESG Relevance Score of '5' for Creditor Rights as willingness to service and repay debt is highly relevant to the rating and is a key rating driver with a high weight. Sri Lanka's LTFC & LTLC IDRs are 'RD' as the sovereign is in default on its foreign- and local-currency debt obligations.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
<input type="text"/>	<input type="text"/>			<input type="text"/>
Sri Lanka	LT IDR	RD	Affirmed	RD
	ST IDR	C	Affirmed	C
	LC LT IDR	RD	Downgrade	C
	LC ST IDR	C	Affirmed	C
	Country Ceiling	B-	Affirmed	B-
senior unsecured	LT	D	Downgrade	C
senior unsecured	LT	WD	Withdrawn	D

[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the

following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

- [Sovereign Rating Criteria \(pub. 06 Apr 2023\) \(including rating assumption sensitivity\)](#)
- [Country Ceiling Criteria \(pub. 24 Jul 2023\)](#)

APPLICABLE MODELS

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

- Country Ceiling Model, v2.0.0 ([1](#))
- Macro-Prudential Indicator Model, v1.5.0 ([1](#))
- Sovereign Rating Model, v3.14.0 ([1](#))

ADDITIONAL DISCLOSURES

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

ENDORSEMENT STATUS

Sri Lanka EU Endorsed, UK Endorsed

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