



Fitch Affirms Bank of Ceylon's IDRs; Places Viability Rating on Rating Watch Negative

Fitch Ratings - Colombo - 29 Nov 2023: Fitch Ratings has placed Bank of Ceylon's Viability Rating (VR) of 'cc' on Rating Watch Negative (RWN). At the same time, Fitch has affirmed BOC's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'CC'. The rating does not carry an Outlook because of the potential for high volatility at this rating level, in line with Fitch's rating definitions. Fitch has also affirmed BOC's Long-Term Local-Currency IDR of 'CCC-' with a Stable Outlook, and the Short-Term IDR at 'C'.

BOC's national ratings were not considered in this review.

A full list of rating actions is at the end of this commentary.

KEY RATING DRIVERS

Downside Risks to VR: The RWN on the VR reflects risks to BOC's standalone credit profile from potential capital stress stemming from the restructuring of loans granted to state-owned entities. The government budget unveiled on 13 November 2023 allocated LKR450 billion for the recapitalisation of two state banks, including BOC, to ensure financial system stability.

This recapitalisation plan, should it materialise to address potential capital erosion, may constitute extraordinary support. In accordance with Fitch's Bank Rating Criteria, extraordinary capital support to restore viability would be viewed by Fitch as "bank failure" and would lead to the bank's VR being downgraded to 'f' but subsequently, upon recapitalisation, be upgraded to a level commensurate with its standalone credit profile.

IDRs Affirmed as Default Risk Unchanged: We have affirmed BOC's IDRs at current levels as the potential development has not changed our view on the bank's ability service its foreign-currency and local-currency obligations. BOC's Long-Term Foreign-Currency and Short-Term IDRs continue to reflect a high risk of default from the sovereign's restructuring of debt.

Risks to OE Subsiding: Fitch revised the outlook on Sri Lankan banks' operating environment (OE) to stable from negative to reflect our view that downside risks to the OE have largely abated following the successful completion of the sovereign's local-currency debt restructuring and the meaningful improvement in economic variables relative to the significant deterioration last year. We expect the economic recovery to improve banks' operational flexibility in the near to medium term.

Debt Restructuring Weighs on Capitalisation: We think the potential restructuring of debt of state-owned enterprises that has been assumed by the government could have a significant impact on the bank's capital position, as reflected in the allocation of LKR450 billion by the government for the recapitalisation of the state banks, including BOC.

RATING SENSITIVITIES

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

We expect to resolve the RWN on BOC's VR when the impact to its capital becomes more apparent, which may take longer than six months.

If the proposed restructuring of state debt leads to a material capital shortfall that necessitates recapitalisation by the authorities to restore viability or the granting of any regulatory capital forbearance regarding such a shortfall, Fitch would downgrade BOC's VR to 'f' and subsequently, upon any recapitalisation, upgrade it to a level commensurate with its standalone credit profile, likely driven by its risk profile and capitalisation.

A downgrade of the VR may not necessarily lead to a downgrade of the Long-Term Foreign- and Local-Currency IDRs.

Fitch would downgrade BOC's Long-Term Foreign- and/or Local-Currency IDRs if we perceive there is an increased likelihood that the bank would default on or seek a restructuring of its senior foreign- and/or local-currency obligations to non-government creditors.

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

There is limited scope for upward rating action on the VR given the RWN. Fitch may resolve the Rating Watch with an affirmation if we view that large capital shortfalls that threaten the bank's viability are not likely to arise.

An upgrade of BOC's Long-Term Foreign- and/or Local-Currency IDRs would most likely result from an improvement in the sovereign's credit profile, which could occur after the successful restructuring of the sovereign's external debt.

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

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 operating environment score of 'ccc-' is below the 'b' category implied score due to the following adjustment reason: sovereign rating (negative).

The business profile score of 'ccc-' is below the 'b' category implied score due to the following adjustment reason: business model (negative).

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.

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

BOC 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.

BOC has an ESG Relevance Score of '4' for Financial Transparency. It reflects our view that the recent regulatory forbearance measures announced by the Central Bank of Sri Lanka could distort the true solvency and liquidity position of the bank, thereby limiting financial transparency. This has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

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 <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
<input type="text"/>	<input type="text"/>	<input type="text"/>
Bank of Ceylon	LT IDR CC Affirmed	CC
	ST IDR C Affirmed	C
	LC LT IDR CCC-● Affirmed	CCC-●
	Viability cc◆ Rating Watch On	cc
	Government Support ns Affirmed	ns

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[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- [Bank Rating Criteria \(pub. 02 Sep 2023\) \(including rating assumption sensitivity\)](#)

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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