



RATING ACTION COMMENTARY

Fitch Downgrades 10 Sri Lankan Banks' Ratings

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Fitch Ratings - Colombo - 12 Jan 2023: Fitch Ratings has downgraded the National Long-Term Ratings of 10 Sri Lankan banks following the recent sovereign downgrade and recalibration of the agency's Sri Lankan national rating scale.

The recalibration is to reflect changes in the relative creditworthiness among Sri Lankan issuers following Fitch's downgrade of Sri Lanka's Long-Term Local Currency Issuer Default Rating (IDR) to 'CC' from 'CCC'/Under Criteria Observation on 1 December 2022. Fitch typically does not assign Outlooks or apply modifiers to sovereigns with a rating of 'CCC+' or below.

National scale ratings are a risk ranking of issuers in a particular market designed to help local investors differentiate risk. Sri Lanka's national scale ratings are denoted by the unique identifier '(lka)'. Fitch adds this identifier to reflect the unique nature of the Sri Lankan national scale. National scales are not comparable with Fitch's international rating scales or with other countries' national rating scales. For details, see [Fitch Ratings Recalibrates Sri Lanka's National Rating Scale](#), dated 19 December 2022.

The National Ratings of the Sri Lankan banks consider their creditworthiness relative to other issuers in the country. The recalibration of the Sri Lankan National Rating scale has resulted in downgrades of the National Long-Term Ratings of the following banks:

Bank of Ceylon (BOC) to 'A(lka)'/Rating Watch Negative (RWN) from 'AA-(lka)'/RWN

People's Bank (Sri Lanka) (PB) to 'A(Ika)'/RWN from 'AA-(Ika)'/RWN

Commercial Bank of Ceylon PLC (CB) to 'A(Ika)'/RWN from 'AA-(Ika)'/RWN

Hatton National Bank PLC (HNB) to 'A(Ika)'/RWN from 'AA-(Ika)'/RWN

Sampath Bank PLC (Sampath) to 'A(Ika)'/RWN from 'AA-(Ika)'/RWN

Cargills Bank Limited (CBL) to 'A(Ika)'/RWN from 'A+(Ika)'/RWN

DFCC Bank PLC (DFCC) to 'A-(Ika)'/RWN from 'A+(Ika)'/RWN

National Development Bank PLC (NDB) to 'A-(Ika)'/RWN from 'A(Ika)'/RWN

Seylan Bank PLC (Seylan) to 'A-(Ika)'/RWN from 'A(Ika)'/RWN

Nations Trust Bank PLC (NTB) to 'A-(Ika)'/RWN from 'A(Ika)'/RWN

A full list of ratings is at the end of this commentary.

Other Sri Lankan banks' national ratings, which are not mentioned in this commentary, have not been affected by the recalibration exercise.

KEY RATING DRIVERS

The downgrades of the National Ratings of the 10 banks are driven by the downgrade of the sovereign's Long-Term Local-Currency IDR and the recalibration of the national rating scale while also reflecting the relative creditworthiness among Sri Lankan issuers. A probable default on the sovereign's local-currency obligations increases the risk that authorities will impose restrictions on banks servicing their local-currency obligations. That said, we believe this risk is lower than non-payment by the sovereign.

The downgrade of CBL's rating incorporates the additional consideration of parent CT Holdings PLC's (CTH) limited ability to provide extraordinary support. This is reflected in CBL's large size relative to the group and the bank's weak standalone credit profile.

We have maintained the national ratings on RWN to reflect the potential for these banks' creditworthiness relative to other entities on the Sri Lankan national ratings scale to further deteriorate amid the likelihood of capital and funding stress as the default risk on domestic debt increases while access to foreign-currency funding remains constrained. The

RWN on CBL's rating reflects our view that CBL is not immune to these system-wide stresses despite parental support.

RATING SENSITIVITIES

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

The National Ratings are sensitive to a change in the banks' creditworthiness relative to other Sri Lankan issuers.

The RWN reflects rising risks to the banks' ratings from funding stresses, which could lead to a multiple-notch downgrade. We expect to resolve the RWN once the impact on the issuers' credit profiles becomes more apparent, which may take more than six months. Developments that could lead to a multiple-notch downgrades include:

- funding stress that impedes the banks' repayment ability;
- significant banking-sector intervention by authorities that constrains the banks' ability to service their obligations;
- a temporary negotiated waiver or standstill agreement following a payment default on a large financial obligation;
- Fitch's belief that a bank has entered into a grace or cure period following non-payment of a large financial obligation.

A downgrade of the sovereign's Long-Term Local-Currency IDR could also lead to a downgrade of the banks' ratings.

A deterioration in their key credit metrics beyond our base-case expectations relative to peers would also lead to increased downward pressure on the banks' ratings, which are driven by their intrinsic financial strength.

CBL's rating is sensitive to changes in CTH's credit profile as well as Fitch's opinion around the ability or propensity of CTH to extend timely extraordinary support. We expect to resolve the RWN once the impact on the banking sector becomes more apparent, which may take more than six months. Developments that could lead to a multiple-notch downgrade for CBL include:

- insufficient or delayed liquidity support from CTH relative to CBL's needs, which hinders CBL's ability to meet its senior obligations in a timely manner;
- banking-sector intervention by authorities that constrains CBL's ability to service its obligations;
- significant increase in CBL's balance sheet relative to that of CTH that makes extraordinary support more onerous for the parent.

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

There is limited scope for upward rating action given the RWN. The resolution of the Rating Watch with an affirmation could be driven by our view that risks from funding stresses have abated, both at the individual banks as well as the sector, to the extent that we believe the banks' ability to service their obligations in local and foreign currency is not hindered.

BOC and PB have a 1.78% equity stake each 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.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Fitch has taken corresponding rating action on the banks' national scale debt ratings, where assigned. The senior unsecured debt ratings of HNB and DFCC are at the same level as the banks' National Long-Term Ratings, in accordance with Fitch's criteria. This is because the debt ranks equally with the claims of the banks' other senior unsecured creditors.

The outstanding Sri Lankan rupee-denominated subordinated debt of BOC, CB, HNB, Sampath, NDB, Seylan, DFCC and NTB are two notches below the National Rating anchor. This reflects Fitch's baseline notching for loss severity for this type of debt and our expectations of poor recoveries upon non-performance. There is no additional notching for non-performance risks, as the notes do not incorporate going-concern loss-absorption features.

Fitch has simultaneously assigned Sampath's proposed Sri Lankan rupee-denominated Basel III-compliant subordinated debentures of up to LKR10 billion a final National Long-Term Rating of 'BBB+(Ika)' on RWN. The final rating differs from the expected rating of 'A(EXP)(Ika)' assigned on 11 November 2022 due to the downgrade of the bank's national rating. The final documents conform to information already received with regard to the structure of the instrument.

The RWN on the debt ratings reflect the RWN on the anchor rating.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The assigned senior and subordinated debt ratings will move in tandem with the banks' National Long-Term Rating.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

CBL's National Long-Term Rating is driven by support from its ultimate parent, CTH.

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
People's Bank (Sri Lanka)	Natl LT A(Ika) Rating Watch Negative Downgrade	AA-(Ika) Rating Watch Negative
Cargills Bank Limited	Natl LT A(Ika) Rating Watch Negative Downgrade	A+(Ika) Rating Watch Negative
DFCC Bank PLC	Natl LT A-(Ika) Rating Watch Negative Downgrade	A+(Ika) Rating Watch Negative
senior unsecured	Natl LT A-(Ika) Rating Watch Negative Downgrade	A+(Ika) Rating Watch Negative

subordinated	Natl LT	BBB(Ika) Rating Watch Negative	A-(Ika) Rating Watch Negative
		Downgrade	
Seylan Bank PLC	Natl LT	A-(Ika) Rating Watch Negative	A(Ika) Rating Watch Negative
		Downgrade	
subordinated	Natl LT	BBB(Ika) Rating Watch Negative	BBB+ (Ika) Rating Watch Negative
		Downgrade	
National Development Bank PLC	Natl LT	A-(Ika) Rating Watch Negative	A(Ika) Rating Watch Negative
		Downgrade	
subordinated	Natl LT	BBB(Ika) Rating Watch Negative	BBB+ (Ika) Rating Watch Negative
		Downgrade	
Sampath Bank PLC	Natl LT	A(Ika) Rating Watch Negative	AA- (Ika) Rating Watch Negative
		Downgrade	

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

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

ADDITIONAL DISCLOSURES

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Bank of Ceylon

EU Endorsed, UK Endorsed

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Banks Asia-Pacific Sri Lanka
