



Fitch Affirms Bank of Ceylon's Ratings; Outlook Negative

Fitch Ratings - Singapore/Colombo - 27 Jul 2020: Fitch Ratings has affirmed Bank of Ceylon's (BOC) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'B-' and National Long-Term Rating at 'AA+(lka)'. The Outlook on the IDRs and National Long-Term Rating is Negative. At the same time, Fitch has affirmed BOC's Viability Rating (VR) at 'b-', Support Rating (SR) at '5' and Support Rating Floor(SRF) at 'B-'.

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

KEY RATING DRIVERS

IDRS, VR AND NATIONAL LONG-TERM RATING

The IDRs of BOC are at the same level as the VR and SRF. BOC's National Long-Term Rating benefits from the expectation of extraordinary support from the sovereign, stemming from its quasi-sovereign status, its role as one of the key lenders to the government, full state ownership and high systemic importance.

The Negative Outlooks on the IDRs and National Long-Term Rating are aligned with the Outlook on Sri Lanka's sovereign rating (B-/Negative) and Sri Lanka's operating environment mid-point(b-/negative). The National-Long-Term Rating could be downgraded should there be negative rating action on the sovereign, resulting in a reassessment of the rating relativities of the universe of Sri Lankan issuers.

BOC's VR is highly influenced by our assessment of its operating environment at 'b-' with a negative outlook. The operating environment in Sri Lanka remains challenging against our expectations for GDP contraction of 1.3% in 2020 due to the impact from the coronavirus pandemic. We forecast GDP growth of 4.2% for Sri Lanka in 2021, although growth prospects will depend in part on how the pandemic develops in Sri Lanka and globally. The outlook on the operating environment assessment is maintained at negative to reflect the possibility of further risk should the effects of the pandemic be more pronounced or persist. The operating environment for Sri Lankan banks has a high influence on the banks' ratings, as it is likely to constrain their intrinsic credit profiles through its effect on financial and non-financial key rating factors. All of the financial factor scores remain on negative outlook to reflect the pressure from the operating environment.

The outlook on the risk appetite assessment has been revised to negative from stable to reflect BOC's significant exposure to the sovereign's credit profile and the potential pressure on the bank's risk appetite in relation non-state related exposures due to the operating environment.

The bank's asset-quality score of 'b-/negative reflects the pressure on BOC's asset quality due to the pandemic. There is also the potential for asset quality to come under more pressure than its domestic peers due to its state linkages. Its impaired-loans ratio based on stage 3 loans had risen to 10.6% by 1Q20 (9.2% at end-2018), reflecting deterioration prior to the full onset of economic disruptions from the pandemic. Its credit concentration to state and state-related entities remains high at 45% of net loans at end-2019. Underlying asset-quality stress could continue to build amid the economic shock, despite the regulatory relief in the form of a moratorium for affected customers that has to a large extent halted the recognition of credit impairment.

BOC's earnings and profitability score of 'b-/negative reflects the potential pressure on income generation and higher credit costs. Operating profit/risk-weighted assets decreased to 2.7% in 1Q20, from 3.5% in 2019, due largely to consecutive sharp increases in loan impairment charges. Pre-provision buffers could be supported through possible higher-than-sector loan expansion, but the extent of credit costs is uncertain.

The bank's capitalisation and leverage score has been lowered to 'b-/negative from 'b-/negative. The score reflects the heightened constraints on accessing capital from the state in the event that capital needs to be replenished. BOC is dependent on the state to access capital as a fully state-owned bank, and in anticipation of the absence of a capital infusion, the bank has retained more profit in 2019 and has raised additional Tier 1 capital in 2020. The score also takes into consideration BOC's thinner adjusted common equity Tier 1 (CET1) ratio relative to the reported ratio (CET1 ratio of 11.4% at end-2019) due to its substantial exposures to the state sector that are mostly risk-weighted at 0%. Notwithstanding the adjustment, BOC's capitalisation remains thin, and there is potential for its capital buffers to be reduced further if it uses its capital-conservation buffer of 1% as permitted as part of pandemic-related relief measures.

The bank's funding and liquidity score of 'b-/negative reflects the increased challenges in the access to - and pricing of - foreign-currency funding stemming from the deteriorating sovereign credit profile. BOC's loans/deposit ratio continued to be moderate - 84% at 1Q20 - because of its entrenched domestic deposit franchise as reflected in its leading market share of deposits and the Central Bank of Sri Lanka's (CBSL) accommodative stance has supported its Sri Lankan rupee liquidity position.

ESG - Governance: BOC has an ESG Relevance Score of 4 for Corporate Governance due to ownership concentration with a 100% state shareholding and several related-party transactions with the state and state-owned entities. This has a negative effect on the bank's standalone credit profile, and is relevant to the rating in conjunction with other factors.

SR AND SRF

The SR and the SRF of BOC are sensitive to perceived changes in the state's ability and propensity to support BOC. They reflect our assessment that while state support may be possible, the ability of the sovereign to provide timely support has declined in light of the sovereign's weakened financial flexibility and the size of the banking sector relative to the economy.

We still assess there to be a high propensity for state support, as BOC is the largest bank in Sri Lanka, accounting for around 20% of banking sector assets, and is classified as a bucket 2 domestic systemically important bank by the CBSL. Its full state ownership and quasi-sovereign status further underscore the high propensity for state support. We believe that while BOC does not have a specified policy role, as a large state bank it is likely to support government policy objectives, and as such it may take a greater role in intermediating many of the relief measures to cushion the impact of the economic fallout.

SUBORDINATED DEBT

The Basel II Sri Lanka rupee-denominated subordinated debt of BOC is rated two notches below its National Long-Term Rating, in line with Fitch's baseline notching for loss severity for this type of debt and our expectations of poor recovery.

RATING SENSITIVITIES

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

IDRS, VR AND NATIONAL LONG-TERM RATING

A revision of the Outlook to Stable on BOC's IDRS and National Long-Term Rating, or an upgrade of BOC's IDRs would most likely result from positive rating action on the sovereign. Positive rating action on the sovereign would also enhance the likelihood of positive action on the assessment of the operating environment and therefore the VR. Upside for BOC's ratings is limited in the near term, however, due to our assessment of the sovereign rating and operating environment, both of which are on a negative outlook.

SR AND SRF

The SR and the SRF are constrained by the sovereign rating. An upgrade of the sovereign rating is most likely to lead to an upgrade of the SR and the SRF, although this is unlikely in the near term.

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

IDRS, VR AND NATIONAL LONG-TERM RATING

Pressure on BOC's IDRs and National Long-Term Rating could stem from a downgrade of Sri Lanka's sovereign rating. A sovereign rating at 'CCC+' or below would make it unlikely that we would factor in expectations of support to any bank in Sri Lanka and it will likely also constrain the standalone credit profiles of domestic banks.

BOC's VR is most sensitive to deterioration in the operating environment, which could be triggered by a sovereign rating downgrade or a further weakening of the economy beyond our base-case expectation, leading to additional weakening of the bank's key credit metrics. In particular, BOC's VR may also come under pressure if there is a continued erosion of its capital buffers with a CET1 ratio below 9%.

SR AND SRF

BOC's SR is already at its lowest level. A downgrade of the sovereign rating would most likely lead to a downgrade of the SRF to 'No Floor'.

SUBORDINATED DEBT

BOC's subordinated debt rating will move in tandem with the National-Long Term Rating.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

BOC's Long-Term IDRs, SR, SRF and National Long-Term Rating are driven by the Sri Lankan sovereign rating.







ESG CONSIDERATIONS

BOC has an ESG Relevance Score of 4 for Corporate Governance due to the ownership concentration, as discussed in the Key Rating Drivers section.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. The means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or 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.

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.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Bank of Ceylon	LT IDR	B- 	Affirmed	B- 
	ST IDR	B	Affirmed	B
	LC LT IDR	B- 	Affirmed	B- 
	Natl LT	AA+(lka) 	Affirmed	AA+ (lka) 
	Viability	b-	Affirmed	b-
	Support	5	Affirmed	5
	Support Floor	B-	Affirmed	B-
● subordinated	Natl LT	AA-(lka)	Affirmed	AA- (lka)

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

- [Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)
- [National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

ADDITIONAL DISCLOSURES

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

ENDORSEMENT STATUS

Bank of Ceylon EU Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS

LINK: <HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATING>
S. IN ADDITION, THE FOLLOWING

[READ MORE](#)

COPYRIGHT

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (in

[READ MORE](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.