



Fitch Downgrades Sri Lanka Financial Institutions on Sovereign Downgrade

Fitch Ratings-Singapore/Colombo-05 December 2018: Fitch Ratings has downgraded the Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) of the following Sri Lanka-based financial institutions following the downgrade of Sri Lanka's sovereign rating:

- National Savings Bank (NSB) to 'B' from 'B +'; Outlook Stable
- Bank of Ceylon (BOC) to 'B' from 'B +'; Outlook Stable
- DFCC Bank PLC (DFCC) to 'B' from 'B +'; Outlook Stable
- People's Leasing & Finance PLC's (PLC) to 'B-' from 'B'; Outlook Stable

The Stable Outlook on NSB, BOC and PLC reflects the Stable Outlook on the sovereign.

Fitch has also downgraded the Viability Ratings (VR) of BOC and DFCC to 'b' from 'b+' to reflect the more challenging operating environment in Sri Lanka.

Fitch has revised our assessment of the operating environment in Sri Lanka to 'b/stable' from 'b+/negative' to reflect the likely adverse impact on the banks' credit profiles following the deterioration in the Sri Lankan sovereign's credit profile amid difficult domestic and external conditions. The National Ratings of BOC, NSB, DFCC and PLC were not covered in this review.

Fitch downgraded the Sri Lankan sovereign to 'B' from 'B+' on 3 December 2018 (see "Fitch Downgrades Sri Lanka to 'B'; Outlook Stable" at www.fitchratings.com).

KEY RATING DRIVERS IDRS, VIABILITY RATINGS AND SENIOR DEBT RATINGS

The IDRs of NSB and BOC reflect Fitch's expectation of extraordinary support from the sovereign. The downgrades of their IDRs reflect Fitch's view that the state's ability to provide support to these banks has reduced, although the state's propensity to do so has not changed.

NSB

Fitch believes state support for NSB stems from its policy mandate of mobilising retail savings and investing them in government securities. The NSB Act contains an explicit deposit guarantee and Fitch is of the view that the authorities would support, if needed, the bank's depositors and its senior unsecured creditors to maintain confidence and stability in the system. Fitch has not assigned a Viability Rating to NSB as it is a policy bank.

The US dollar senior unsecured notes issued by NSB has also been downgraded by one notch to reflect the downgrade of its IDRs. The notes are rated at the same level as the bank's Long-Term Foreign-Currency IDR as they rank equally with other senior unsecured obligations. The notes have a Recovery Rating of 'RR4'.

BOC

Fitch expects state support for BOC to stem from its high systemic importance, quasi-sovereign status as well as its role as a key lender to the government and its full ownership by the state. BOC's Viability Rating (VR) reflects its thin capitalisation and asset quality pressures amid a difficult operating environment, but these are partly balanced by a stronger domestic funding franchise than the majority of sector peers.

DFCC

DFCC's IDRs are driven by its intrinsic strength as indicated by its VR. DFCC's VR captures its developing commercial banking franchise, and relatively weak asset quality and earnings, which are balanced against our expectation that DFCC would maintain higher capital buffers than similarly rated peers.

PLC

PLC's IDRs reflect Fitch's view that its parent, the state-owned and systemically important People's Bank (Sri Lanka), has a high propensity but limited ability to provide extraordinary support to PLC, if required. People's Bank's propensity to support PLC stems from PLC's role within the group as a strategically important subsidiary and the high reputational risk to People's Bank should PLC default, as the bank owns 75% of PLC and shares a common brand. Fitch believes People's Bank's ability to provide support to PLC is limited as indicated by the downgrade of the sovereign rating.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings for the banks remain unchanged but the Support Rating Floors (SRFs) of NSB and BOC have been downgraded following the sovereign rating downgrade, which indicates the state's reduced ability to provide support and consequently, more limited probability that the banks would receive timely support, if needed. This is despite the state's strong propensity to provide support to these banks given their high importance to the state and high systemic importance.

The SRF on DFCC was revised to 'No Floor' as its systemic importance is much lower relative to larger banks such as NSB and BOC, and with the downgrade of Sri Lanka's rating, we believe sovereign support for DFCC cannot be relied upon given the sovereign's weakened financial ability.

RATING SENSITIVITIES

IDRS, VIABILITY RATINGS AND SENIOR DEBT RATINGS

Further changes to Sri Lanka's sovereign rating and/or changes in our perception of state support to NSB and BOC, could result in a change in their IDRs.

NSB

A reduced expectation of state support through, for instance, the removal of preferential support extended to NSB, or a substantial change in its policy role or deviation from mandated core activities, indicating its reduced importance to the government, could result in a downgrade of NSB's ratings. However, this is not our base case scenario.

NSB's senior debt rating is sensitive to changes in the bank's Long-Term IDRs. The Recovery Rating on the bank's notes is sensitive to Fitch's assessment of potential recoveries for creditors in case of default or non-performance.

BOC

A downgrade of BOC's IDRs would most likely result from further negative rating action on the sovereign, which would reflect a further weakening in the state's ability to support the bank. BOC's Viability Rating may come under pressure if there is a continued decline in capitalisation through a surge in lending or high dividends. Further deterioration in the operating environment, leading to deterioration of BOC's key credit metrics, could also exert negative pressures on its rating.

DFCC

An inability to replenish its capital buffers to a level that is commensurate with its risk profile could put pressure on the bank's IDRs. Fitch sees limited upside for the bank's ratings due to its weak franchise. Further deterioration in the operating environment, leading to deterioration of DFCC's key credit metrics (especially to its capital buffers which is a rating strength for the bank), could also exert negative pressure on its rating.

PLC

A downgrade of PLC's IDR would occur if People's Bank's ability to support PLC was to weaken, if People's Bank was to reduce its majority ownership in PLC or if PLC's strategic importance to its parent was to diminish over time, reflecting a reduced propensity to support PLC. However, Fitch does not anticipate People's Bank's propensity to support PLC to weaken in the foreseeable future. PLC's IDR is also sensitive to changes in the sovereign rating, as this would affect People's Bank's ability to provide support to PLC.

SUPPORT RATING AND SUPPORT RATING FLOOR

Lower propensity of the state to support systemically important banks could result in further downward pressures to the banks' Support Ratings and Support Rating Floors, but Fitch believes this to be unlikely in the medium term. Further changes in the sovereign rating could also impact the banks' Support Ratings and Support Rating Floors.

The rating actions are as follows:

National Savings Bank:

Long-Term Foreign-Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Long-Term Local Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Short-Term Foreign-Currency IDR affirmed at 'B'

Support Rating affirmed at '4'

Support Rating Floor revised to 'B' from 'B+'

US dollar senior unsecured notes downgraded to 'B' from 'B+'; Recovery Rating at 'RR4'

Bank of Ceylon:

Long-Term Foreign-Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Long-Term Local Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Short-Term Foreign-Currency IDR affirmed at 'B'

Viability Rating downgraded to 'b' from 'b+'

Support Rating affirmed at '4'

Support Rating Floor revised to 'B' from 'B+'

DFCC Bank PLC:

Long-Term Foreign-Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Long-Term Local Currency IDR downgraded to 'B' from 'B+'; Outlook Stable

Short-Term Foreign-Currency IDR affirmed at 'B'

Viability Rating downgraded to 'b' from 'b+'

Support Rating affirmed at '5'

Support Rating Floor revised to 'No Floor' from 'B-'

People's Leasing & Finance PLC:

Long-Term Foreign-Currency IDR downgraded to 'B-' from 'B'; Outlook Stable

Long-Term Local-Currency IDR downgraded to 'B-' from 'B'; Outlook Stable

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