

What Investors Want To Know: Impact Of Sri Lanka National Scale Recalibration On Bank Ratings

Domestic Bank Ratings Constrained by Sovereign's Credit Profile

Sri Lanka — National Ratings Correspondence Table

Updated: December 22, 2020

This table indicates the correspondence of Local-Currency International ratings to ratings that have been assigned on the Sri Lankan National Scale where entities have both a Local-Currency International and Sri Lankan National Rating. The table considers Fitch's public and private Issuer Default Ratings that existed as of 22 December 2020.

International scale	Sri Lanka (lka)
B and above	AAA
B-	AAA/AA+/AA
CCC+	AA-
CCC	AA- to B+
CCC-	B+ to B-
CC	CCC/CC
C	C
D	D
RD	RD
Date of last revision	December 22, 2020

Source: Fitch Ratings

Scale Recalibrated on Sovereign Downgrade

Following Fitch Ratings' downgrade of Sri Lanka's sovereign rating to 'CCC' from 'B-' on 27 November 2020, the Sri Lankan National Rating scale was recalibrated to reflect changes in the relative creditworthiness among Sri Lankan issuers. The current relationship between international and national scale ratings is shown in the table on the left.

The recalibration of the Sri Lankan National Rating scale resulted in the revision of some ratings due to changes in relativities in the portfolio. After the recalibration, the highest national rating for domestic banks with ratings driven by their intrinsic credit profile is 'AA-(lka)'. This is the highest point on the national scale that corresponds to an international scale rating of 'CCC'.

We now have six banks rated at 'AA-(lka)': Bank of Ceylon (BOC), People's Bank (Sri Lanka), Commercial Bank of Ceylon PLC (CB), Hatton National Bank PLC (HNB), Sampath Bank PLC and Cargills Bank Limited. The National Ratings of other Sri Lankan banks rated below this level on the national scale were not affected by the recalibration.

Sri Lanka's national scale ratings are denoted by the unique identifier '(lka)'. National scales are not comparable with Fitch's international ratings scales or with other jurisdictions' national rating scales.

The following are some recent questions from investors about the recalibration and impact on bank ratings in Sri Lanka:

Related Research

[Fitch Revises 9 Sri Lankan Financial Institutions' Ratings on Recalibration; 2 Downgrades \(January 2021\)](#)

[Fitch Ratings Recalibrates its Sri Lankan National Rating Scale \(December 2020\)](#)

[Fitch Downgrades Sri Lanka to 'CCC' \(November 2020\)](#)

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[What Was the Reason for the Recalibration of the National Ratings on Sri Lankan banks?](#)

[Why Are Sri Lankan Banks Not Rated Above the Sri Lankan Sovereign?](#)

[Is the Sovereign Rated 'AAA' on the National Rating Scale?](#)

[Which Sri Lankan Bank National Ratings were Affected by the Recent National Scale Recalibration?](#)

[What Effect Did These Rating Revisions Have on Other Ratings Linked to These Banks?](#)

[Why Were the National Ratings on Other Banks Not Affected by the Recalibration?](#)

[What is the Difference Between a Rating Revision and a Rating Upgrade or Downgrade?](#)

What Was the Reason for the Recalibration of the National Ratings on Sri Lankan Banks?

Fitch recalibrates National Rating Correspondence Tables to limit rating movements in the national scale that result from systemic factors. For instance, a sovereign rating change could drive multiple international rating changes, which would affect a large number of issuers on the national scale if a reassessment of the rating relationship between international and national ratings is not undertaken.

The recalibration of Sri Lankan National Rating scale followed the downgrade of the sovereign to 'CCC' from 'B-' in November 2020.

The sovereign rating may act as a key rating driver or constraint for the ratings of other local issuers and drive multiple international scale rating actions. For example, Fitch downgraded BOC's Long-Term Issuer Default Rating (IDR) and Viability Rating to 'CCC' and 'ccc' respectively, after the downgrade of the sovereign IDR, and our assessment of the operating environment, which is a key rating driver for Sri Lankan banks.

As per Fitch's National Scale Rating Criteria, the starting point to derive a national rating is an international scale rating. Fitch will take rating actions on the international scale, and will make rating changes on the national scale if specific issuers have changed their rankings relative to other issuers because of the sovereign change.

Why Are Sri Lankan Banks Not Rated Above the Sri Lankan Sovereign?

Bank ratings are usually constrained by the sovereign rating, mainly due to the strong correlation between sovereign and bank credit profiles. This is because banks typically have high exposure to the government, the wider domestic economy and local financial markets. A bank may well not retain the capacity to service its obligations following a sovereign default.

The sovereign rating also usually constrains banks' operating environment score due to the linkage between the sovereign credit profile and the risk of doing banking business in that country. A sovereign default is usually accompanied by a sharp deterioration in the operating environment. This deterioration often includes recession, weaker public- and private-sector balance sheets, funding market dislocations and macroeconomic volatility.

The Sri Lankan banks' operating environment (ccc/negative) continues to have a high influence on their ratings, as the risk of doing business also affects our assessments of the banks' financial and non-financial profiles.

Current conditions do not allow Viability Ratings and Local-Currency IDRs on the international scale assigned to Sri Lankan banks to be above the sovereign's Local-Currency IDR and operating environment score for Sri Lankan banks.

In Sri Lanka, Fitch has not rated banks above the assessment of the sovereign's credit profile, other than in the case of Citibank N.A. - Colombo Branch and Standard Chartered Bank, Sri Lanka Branch, both of which retained their 'AAA(lka)' national ratings after the recalibration, reflecting the capacity for these international banks to support their Sri Lankan branches, if necessary.

Sri Lankan corporate ratings are not as constrained by the sovereign rating relative to those of banks and this distinction has driven the national scale rating changes.

Is the Sovereign Rated 'AAA' on the National Rating Scale?

Fitch does not assign a national scale rating to the sovereign.

Under Fitch's National Scale Rating Criteria, the agency will not assign a 'AAA' rating on the national scale to issuers rated below 'B-' on the international scale.

The highest-rated entities will drive the national scale reference point. The highest-rated entities may not include the sovereign. The reference point represents the lowest international scale rating level that corresponds to 'AAA' on a specific country's national scale. For Sri Lanka, this is 'B-'.

This reference point on the international scale will be set through an analysis of the strongest issuers in the country to determine the level that will allow for ratings differentiation on the national scale. It may be below the best credit in the country and may not be the same as the sovereign rating, which 'CCC' for Sri Lanka.

Which Sri Lankan Bank National Ratings were Affected by the Recent National Scale Recalibration?

The national scale recalibration resulted in the revision of the ratings of three banks – CB, HNB and Cargills Bank. The revision of the national ratings of CB and HNB to 'AA-(lka)' with Stable Outlook from 'AA+(lka)' with Negative Outlook reflects the constraint placed on these ratings by the sovereign's credit profile. The revision of the national rating of Cargills Bank, stemmed from the change in the relativity of its corporate parent due to the recalibration of the corporate parents National Ratings.

What Effect Did These Rating Revisions Have on Other Ratings Linked to These Banks?

The revision of the national ratings on CB and HNB resulted in the revision of the ratings of their finance company subsidiaries CBC Finance LTD and HNB Finance PLC to 'A(lka)' with Stable Outlook from 'AA-(lka)' with Negative Outlook.

Fitch also took corresponding rating action on the national scale debt ratings of CB, HNB and HNB Finance, where assigned. The senior debt ratings are at the same level as the National Long-Term Ratings. National Ratings assigned to Tier 2 issues are two notches below the National Rating anchors.

Why Were the National Ratings on Other Banks Not Affected by the Recalibration?

The National Ratings on other Sri Lankan banks were not affected by the recalibration as the relative creditworthiness of these banks remains unchanged. The recalibration also reflects the different

levels of constraint placed on Sri Lankan issuers due to the sovereign's credit profile. This has resulted in rating compression for the banks on the national scale.

As such, banks whose ratings were closer to and constrained by the sovereign's credit profile, such as CB and HNB, were more affected by the recalibration. The credit profiles of most Sri Lankan banks were constrained by the sovereign's IDRs following the downgrade in November (see [Why Are Sri Lankan Banks Not Rated Above the Sri Lankan Sovereign?](#)).

As per the National Scale Rating Criteria, a one-notch change in a rating on the international scale can imply a multi-notch rating change on the national scale. For example, this could happen if an international rating is downgraded by one notch, and the associated national rating was previously at the high end of the implied national rating range.

What is the Difference Between a Rating Revision and a Rating Upgrade or Downgrade?

Revision ratings reflect changes in the national rating scale driven purely by a recalibration of a National Ratings Correspondence Table.

For instance, the National Ratings on BOC and People's Bank (Sri Lanka) were downgraded and not revised. This is to reflect Fitch's assessment that extraordinary support from the sovereign to these banks can no longer be relied upon as its ability to do so is severely constrained, as reflected by its 'CCC' rating. As such the National Ratings on BOC and People's Bank are now driven by their intrinsic credit profiles rather than sovereign support.

National Ratings on Domestic Sri Lankan Banks

Bank	Pre-Recalibration	Post-Recalibration
Bank of Ceylon	AA+(lka)/Negative	AA-(lka)/Stable
People's Bank (Sri Lanka)	AA+(lka)/Negative	AA-(lka)/Stable
Commercial Bank of Ceylon PLC	AA+(lka)/Negative	AA-(lka)/Stable
Hatton National Bank PLC	AA+(lka)/Negative	AA-(lka)/Stable
Sampath Bank PLC	AA-(lka)/Stable	AA-(lka)/Stable
Cargills Bank Limited	A+(lka)/Stable	AA-(lka)/Stable
National Development Bank PLC	A+(lka)/Stable	A+(lka)/Stable
DFCC Bank PLC	A+(lka)/Stable	A+(lka)/Stable
Nations Trust Bank PLC	A(lka)/Stable	A(lka)/Stable
Seylan Bank PLC	A(lka)/Stable	A(lka)/Stable
Union Bank of Colombo PLC	BBB-(lka)/Stable	BBB-(lka)/Stable
Pan Asia Banking Corporation PLC	BBB-(lka)/Stable	BBB-(lka)/Stable
HDFC Bank PLC	BB+(lka)/Stable	BB+(lka)/Stable
Sanasa Development Bank PLC	BB+(lka)/Stable	BB+(lka)/Stable
Amana Bank PLC	BB+(lka)/Stable	BB+(lka)/Stable

Source: Fitch Ratings

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