

Moody's affirms 3 Sri Lankan banks' ratings

31 Oct 2019

Singapore, October 31, 2019 -- Moody's Investors Service has affirmed the long-term/short-term local currency deposit ratings of Bank of Ceylon (BOC), Hatton National Bank Ltd. (HNB) and Sampath Bank PLC at B2/NP.

At the same time, Moody's has affirmed the long-term foreign currency issuer ratings and long-term/short-term foreign currency deposit ratings of these three banks at B2 and B3/NP respectively.

Moody's has also affirmed the Baseline Credit Assessments (BCAs) and adjusted BCAs of the three banks at b2. As a result, Moody's has affirmed their local and foreign currency Counterparty Risk Ratings (CRRs) and Counterparty Risk Assessments (CR Assessments) at B1/NP and B1(cr)/NP(cr), respectively.

Moody's has maintained the rating outlooks of the banks at stable.

RATINGS RATIONALE

Moody's has affirmed the ratings and assessments of the three Sri Lankan banks because they have adequate capital buffers against the backdrop of deteriorating asset quality and profitability. Moreover, these banks have stable funding and liquidity which support their standalone credit profiles.

The asset quality of the banks is deteriorating mainly because of weaknesses in the agriculture and construction segments and dampened consumer sentiment, against the backdrop of a challenging operating environment in the country. Moody's expects some problems in the tourism-related exposures once the debt moratorium ends in July 2020.

As a result, Moody's expects the banks' profitability to remain strained by elevated credit costs, higher taxes and muted loan growth. Moody's also expects that the recent central bank's mandated cut to the lending rates will add pressure to net interest margins, further straining bank profitability.

For BOC, Moody's notes downward pressure on its standalone credit profile stemming from its weaker asset quality and profitability. BOC's annualized return on assets (ROA) declined to 0.6% in the first half of 2019 from 0.8% in 2018.

BOC's capitalization is also modest, with a common equity tier 1 (CET1) ratio of 10.7% at the end of June 2019. Nevertheless, Moody's expects that the bank will maintain stable capital ratio by lowering dividend payouts. Slow credit growth will also support its capitalization.

HNB and Sampath maintain adequate capital buffers against rising credit risk, as measured by their CET1 ratios of 13.0% and 13.7%, respectively, as of 30 June 2019. Nevertheless, their ROAs has also deteriorated to 0.9% each in the first half of 2019 from 1.7% and 1.3%, respectively, in 2018.

For the three banks, their weakening asset quality and profitability are balanced by their good funding and liquidity, as underpinned by their strong deposit franchises, with sizeable market shares in system deposits.

Moody's does not have any particular governance concern for the three Sri Lankan banks, and does not apply any corporate behavior adjustment to the banks. Moody's views their risk management framework as consistent and commensurate with their risk appetite.

AFFIRMATION OF LONG-TERM RATINGS

Moody's government support assumptions for the three banks are driven by the systemic importance of these banks, as well as the government's track record of supporting the banking system.

Moody's incorporates a very high level of government support in the ratings of BOC, given its 100% ownership by the Government of Sri Lanka (B2 stable) and dominant share of system loans and deposits. Moody's incorporates a high level of government support in the ratings of HNB and Sampath, based on their significant market shares of system loans and deposits.

Nevertheless, given that the adjusted BCAs of these banks are already at the same level as the sovereign rating, their long-term local currency deposit and foreign currency issuer ratings do not benefit from any uplift due to government support.

The B3 long-term foreign currency deposit ratings of the banks are constrained by Sri Lanka's foreign currency deposit ceiling.

WHAT COULD MOVE THE RATING UP

An upgrade of the banks' long-term ratings is unlikely, because the ratings are already at the same level as the sovereign rating, and the sovereign rating outlook is stable.

WHAT COULD MOVE THE RATING DOWN

A downgrade of the sovereign rating would result in a downgrade of the banks' long-term ratings.

Moody's could also downgrade the banks' BCAs if there is a material deterioration in solvency factors, such as asset quality or capital. Tighter liquidity and increased reliance on market funding could also lead to a downgrade of the BCA.

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Bank of Ceylon, headquartered in Colombo, reported total assets of LKR2.28 trillion at 30 June 2019.

Hatton National Bank Ltd., headquartered in Colombo, reported total assets of LKR1.14 trillion at 30 June 2019.

Sampath Bank PLC, headquartered in Colombo, reported total assets of LKR962 billion at 30 June 2019.