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CENTRAL BANK OF SRI LANKA

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Press Release

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Statement by the Monetary Board of the Central Bank of Sri Lanka (CBSL)

Statement by the Monetary Board of the Central Bank of Sri Lanka (CBSL) relating to the Recommendations of the Commission of Inquiry to Investigate, Inquire and Report on the Issuance of Treasury Bonds (COI) during the period from 1st February 2015 to 31st March 2016 and measures taken to improve the management and control of Public Debt and the Employees' Provident Fund.

On 10, January 2018 the Secretary to the President, handed over a copy of the report of the Commission of Inquiry to Investigate, Inquire and Report on the Issuance of Treasury Bonds (COI) during the period from 1st February 2015 to 31st March 2016 to Governor, Central Bank of Sri Lanka (CBSL) entrusting the task of considering giving effect to the recommendations contained in the Report.

The Central Bank has already implemented some of the recommendations therein, while measures have already been initiated to implement most of the other recommendations. The Monetary Board has consulted the AttorneyGeneral, as appropriate, in the actions it has taken. It considers it appropriate to keep the public informed of the status of actions and initiatives that have or are being taken on the recommendations made in the Report and to generally improve transparency in the management of public debt and the Employees Provident Fund. The Report is continuing to be studied and the Monetary Board will initiate further actions, as appropriate.

1. Legislative amendments :

- A process of law reforms which commenced in mid 2017, is currently underway and new provisions/amendments to the Monetary Law Act (MLA) No 58 of 1949 as well as other key legislations, including the Registered Stocks and Securities Ordinance and Local Treasury Bills Ordinance are being formulated taking into consideration the current economic and financial environment.

- A new Liability Management Act (LMA) is expected to come into force in early 2018. The LMA will give flexibility for active debt management initiatives such as buy-backs, switching and pre-funding arrangements and it will minimize the rollover risk of the underlying debt stock by altering the maturity profile of the outstanding debt stock. Further, it will enable the maintenance of special funds raised from the proceeds of sale of non-strategic assets. The provisions of the LMA are expected to improve the risk profile of both domestic and foreign public debt.

2. Measures taken to increase efficiency and enhance transparency of debt management operations:

2.1 Introduction of a new Auction System for Primary Issuances of Government Securities and improve the secondary market for Sri Lanka Development Bonds (SLDBs):

- In July 2017, a new primary issuance system for Treasury bonds was introduced, replacing the fully auction based issuance system for Treasury bonds to further enhance efficiency and transparency of domestic borrowings of the government. A new system for the issuance of Treasury bills will be introduced shortly.

- As a result of the above measures, the Central Bank has been able to raise all Treasury funding requirements from the market without requiring the Central Bank to finance any shortfalls in auctions since July 2017. In addition, under the new auction system, the Central Bank was able to raise an additional Rs 110.16 billion through new Treasury bond issuances during the 2nd half of 2017 to meet the high funding requirement of the Treasury, in early 2018.

- An electronic bidding system for SLDBs will also be introduced and secondary market activities of SLDBs will be facilitated.

2.2 Measures taken to strengthen the internal controls and transparency of public debt operations and secondary market transactions in government securities:

- Increased information sharing with Primary Dealers and investors through pre-bid meetings prior to primary issuances of government securities;

- Publishing of a quarterly calendar of Treasury bill & Treasury bond issuances and aligning issuances in line with the published calendar. For issuance of SLDBs, a calendar based on redemption and authorized limit for issuances, is being explored;

- The amount accepted in aggregate at the auctions is limited to the amount offered, promoting predictability;

- The representation of Ministry of Finance at the Tender Boards of Treasury bills, Treasury bonds and SLDBs has been strengthened with two nominees by the Secretary to the Treasury.

- Mandating Primary Dealers and licensed banks to use an electronic bond trading platform for government securities transactions since 2016.
- Secondary market transactions in government securities are reported in the Bloomberg platform and secondary market transaction summary reports are published in the CBSL website on a daily basis to improve price discovery and reduce asymmetry of information.
- Voice Recording System (VRS) is used in the Front Office of the Public Debt Department (PDD) and a CCTV system has been installed in the PDD. Access restrictions are in place in the PDD and external visitors are required to register through a dedicated CBSL visitor registration arrangement.
- Procedures including surveillance, control, oversight, security and security of data of PDD have been strengthened and further enhancements are to be implemented with expert technical assistance.
- Preliminary work has commenced with the aim of implementing an Electronic Trading Platform and Central Counter Party System to reduce risk to counterparties.

3. Measures taken to improve Transparency and Governance of the Investment Decision Making Process as well as the internal control framework of the EPF

3.1 Actions taken with regard to EPF's Investments

- With effect from May 2016, secondary market transactions were gradually reduced and due to concerns arising from its market activities, the Monetary Board in October 2016 restricted the EPF to participate in the secondary market for Treasury bonds and Reverse Repos until such time internal control measures are strengthened.
- Considering the limited investment opportunities available to the EPF, the Monetary Board, as an interim measure, has allowed alternative avenues for investments such as Fixed Deposits with State Banks and access to the Standing Deposit Facility of the Central Bank.
- Having considered the measures taken recently to strengthen the investment decision making process as well as streamlining of the portfolio management activities of the EPF, effective from 06.07.2017, the Monetary Board approved the re-commencement of Repo transactions with market participants and to only purchase government securities from the secondary market, in strict compliance with the Investment and Trading Guidelines formulated by the Investment Committee.

3.2 Measures taken to enhance the credibility of the Investment Decision Making Process of EPF

- In order to further strengthen internal controls of the investment decision making process of the EPF, the Investment Committee (IC), chaired by the Deputy Governor in charge of EPF commenced daily meetings from November 2016.
- Since November 2016, all investments are being made with the approval of the IC, while prior approval of the Monetary Board is being obtained for investments outside government securities.

3.3 Measures that were taken to strengthen the Internal Control Framework

- The Risk Management Department has been entrusted with the responsibility of overseeing the investment activities of EPF and formulation of risk parameters for investments including revision of the Investment and Trading Guideline.

- Physical access controls and voice recordings were introduced to the front office and these will be extended to the middle, back offices and senior managers involved in fund management shortly. A project to install CCTV is in progress.
- Arrangements were made to use electronic trading platforms (Bloomberg) in engaging secondary market transactions of government securities while Bloomberg platforms were made available for other sections of the Fund Management Division as well.
- The EPF Department continues to receive technical assistance from the Asian Development Bank under the Capital Market Development Project with the aim of enhancing the institutional capacity building process. In addition, the EPF receives assistance from the World Bank to improve its overall investment strategy.
- The discussions at the IC meetings with respect to investments are being recorded with effect from January 2017.
- Additional staff was deployed in the Fund Management Division (FMD) and the FMD was shifted to the head office of the Central Bank with access control system.

4. Regulatory Actions Taken on Perpetual Treasuries Limited and Pan Asia Banking Corporation PLC

4.1 Perpetual Treasuries Limited

Based on the supervisory concerns and non-compliances identified in the on-site examination report of Perpetual Treasuries Limited (PTL) and other investigations, the Monetary Board issued Directions to PTL on 07/11/2016 curtailing their levels of operation in the primary and secondary market and preventing the alienation of funds. Based on continuing investigations, further Directions have since been issued from time to time and as of now their business activities are suspended and PTL are prevented from the disposal of assets, distribution of profits and making payments without the prior approval of CBSL. The Directions are in force until 6th July 2018. CBSL has frozen the assets of PTL held with CBSL and has informed the Securities and Exchange Commission to take appropriate action with regard to assets of PTL coming under its purview.

4.2 Pan Asia Banking Corporation PLC

Following investigations, which revealed that Pan Asia Banking Corporation PLC (PABC) has engaged in transactions which appeared, prima facie, to have caused significant manipulations in the Government Securities market, the Monetary Board, after due process, suspended the business and activities of PABC on 14.08.2017 as a Primary Dealer for a period of 6 months, with effect from 15.08.2017. Investigations are ongoing in this respect and further action will be taken based on the outcome.

5 Disciplinary proceedings

Subsequent to the internal examinations and investigations conducted by the Central Bank and based on the findings of such examinations and investigations, disciplinary actions have been taken with respect to few members of the staff in conformity with the Classification, Control and Appeal Rules

of the Manual of the Central Bank of Sri Lanka. In this regard, four officers are currently under interdiction.

6 Other measures

- The Central Bank has already drafted Codes of Conduct for members of the Monetary Board and the staff in general, and with specific codes of conduct for staff in the Employees Provident Fund (EPF) and the Public Debt Department (PDD). These will be given effect to, once approved by the Monetary Board.
- As a broader measure for follow-up and adherence, the Central Bank has already taken measures to strengthen the Legal & Compliance Department (LCD) and established the Resolution and Enforcement Department (RED) with effect from 01st January 2018.
- The Monetary Board will assess the Internal Audit Function of the Central Bank with a view to further expanding its scope and strengthening its processes in order to enhance its effectiveness in providing independent assurance to the Monetary Board.

7 The Central Bank will initiate measures to carry out forensic audits in relation to the issuance of Treasury bonds during the 2008 to 2014 and the Treasury bond auctions held in March 2016.