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Statement by Deshamanya Professor W.D. Lakshman
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The Sri Lankan Financial System Remains Resilient and All Possible Measures are Taken to Ensure the Safety of Deposits of the General Public

There has been speculation by various groups and individuals that Sri Lanka's financial system and financial institutions are in a weak position and that the general public is at risk of losing their deposits made at those institutions.

As the regulator of both banking and non-bank financial institutions that accept public deposits in the country, the Central Bank of Sri Lanka wishes to assure the general public that it will continue to take all possible measures to ensure the safety of public deposits. Hence this statement to educate the general public on the true state of affairs about financial institutions and their stability.

The COVID-19 pandemic and the resultant slowdown in the domestic as well as the global economy have created a challenging environment for the operations, not only of the financial sector but also for all types of economic activities in the country. The performance of the real economy and the financial sector are closely intertwined. The future performance of the financial sector depends on the survival and growth of domestic businesses. The government and the Central Bank have therefore requested the financial sector, particularly the banking sector on the back of its inbuilt balance sheet strength, to continue to support the economy in various ways, while the Central Bank is providing the necessary liquidity and regulatory support to the financial sector to meet these challenges. Even prior to the onset of the outbreak, going back to 2018 and 2019, there was a rise in non-performing loans in both banks and non-bank financial institutions, particularly due to the sluggish growth in private sector credit and overall economic activity. By the time of the pandemic impact, the government and the Central Bank had taken decisive measures to revive the economy including the establishment of a more conducive tax regime and a more favourable monetary policy stance, supporting growth of the real economy. We are confident that, despite the temporary setback caused by the Covid-19 pandemic, the Sri Lankan economy and the financial sector continue to remain dynamic and resilient. Conditions would become stronger in the period ahead as the economy recovers.

The banking sector remains strong with total capital adequacy ratio above 16 per cent, net stable funding ratio above 130 per cent, liquidity coverage ratio above 175 per cent and statutory liquid asset ratio above 32 per cent. The non-performing loans ratio has shown some decline while the provision coverage ratio also picked up during the first quarter of 2020. Benefitting from the new tax regime, profits after tax of the banking sector for the first quarter of 2020 were considerably higher than in the same quarter last year. With these performance indicators, I do not think anyone needs an additional assurance on the current strength of the banking system, which accounts for 62 per cent of Sri Lanka's financial sector.

Let us now turn to the non-bank financial institutions, particularly the licensed financial companies sector. These institutions in the country's financial sector play an important role in serving diverse quality credit needs of relatively low income segments of the economy. Certain measures introduced recently to stabilise the macro-economy, particularly the curtailment of the importation of motor vehicles, had a disproportionate adverse impact on finance companies. As part of its financial sector stability objective, the Central Bank has availed required liquidity support for licensed finance companies, while standing ready to provide emergency support for the sector if needed.

It is with the cancellation of the licence of The Finance Company PLC by the Central Bank recently that the speculation I highlighted at the outset has gathered pace. However, I must emphasise that the cancellation of the licence of The Finance Company PLC and regulatory action against a few other finance companies in the recent past were done to protect the depositors and to ensure financial system stability. The cancellation of the licence has enabled us to provide full compensation through the Sri Lanka Deposit Insurance and Liquidity Support Scheme for 93 per cent of depositors of The Finance Company PLC numbering 135,100. The remaining 10,072 depositors of the Company will also get compensation up to Rs 600,000 per deposit holder at the outset. In similar previous cancellations of licences of Central Investments and Finance PLC and The Standard Credit Finance Ltd, 95 per cent of depositors in each of these companies have been fully compensated by now. Compensation payments to depositors of TKS Finance Ltd have been delayed and limited to 26 per cent, due to judicial proceedings, but the Central Bank has recommenced the process of compensation and expects to cover almost all depositors of this company. I am certain that the general public would understand that the Central Bank action in respect of The Finance Company PLC to protect the interests of depositors was made necessary by various longstanding, legacy issues. Corrective regulatory action taken in respect of a few institutions does not mean that the entire non-bank financial institutions sector is in trouble. We indeed observe that some licensed finance companies are on par with small or mid-sized banking institutions. Therefore, I would like to urge the general public not to be distracted or misled by baseless comments and malicious speculations expressing doubt about the health of our non-bank financial institutions sector as a whole.

Having said that let me re-emphasise an important general caveat in banking and finance business that the Central Bank has reiterated in the past. Although various financial institutions are licensed, regulated and supervised by the Central Bank, it does not mean that all their operations are managed by the Central Bank on a day to day basis. Business models of these institutions are different from one another, enabling them to offer different levels of interest compensation for depositors benefitting from their investments in businesses generating higher returns. The general public must therefore take note of the fact that higher interest rates offered on deposits generally mean that the relevant institutions are engaged in more risky ventures.

In respect of the non-bank financial sector, the Central Bank message is the need for consolidation. The smaller should consider consolidating with the stronger. We have highlighted, time and again, that Sri Lanka has too many financial institutions given the size of its economy. At the same time, we urge financial institutions to diversify their business models, particularly to support domestic production activity, rather than being driven purely by short term gains through financing imports and other business activities familiar to them. The Central Bank will use its authority and powers in the future to get the non-bank financial institutions as well as banking institutions behave as suggested above.

Let me conclude by reiterating that the Central Bank will use all available tools at its disposal to maintain financial system stability. It remains committed to keep the deposits of the general public safe from economic and financial fallout of COVID-19 and similar future unforeseen events. It also must be noted that the Central Bank will not hesitate to take legal action against individuals and groups spreading false or misleading information with intentions of creating unjustified disruptions in the bank and non-bank financial sectors.