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CENTRAL BANK OF SRI LANKA

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# Press Release

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## Clarification on Lending to an Entity (concern) where the Director of a Bank has an Interest

The Central Bank of Sri Lanka wishes to clarify the regulatory and supervisory procedure in relation to lending to a concern in which a director of a licensed bank (bank) has directly/indirectly an interest, consequent to the concerns raised in print and electronic media in the recent past.

In general, banks extend credit facilities to various types of borrowers such as individuals, companies, Government, public corporations, statutory bodies, associations of persons and any other institutions. Such credit facilities are sanctioned based on credit policies, credit appraisal, and lending practices of the bank. Credit risk of the bank shall be managed according to the bank's integrated risk management framework and the Board should establish and periodically review the credit risk strategy and credit risk policies of the bank. In the event there is a default in the repayment of the credit facilities, banks are required to classify them as non-performing, make provisions and suspend income recognition according to applicable Directions issued by the Central Bank of Sri Lanka. Further, no individual or entity or group of entities can be granted credit facilities beyond a maximum limit specified in the Banking Act Directions.

In terms of the Banking Act and applicable Directions issued, banks are not prohibited from granting credit facilities to a director, or to a close relation of such director, or to a concern in which any director of the bank has directly/indirectly an interest. However, banks are required to comply with additional prudential requirements when extending such credit facilities due to the nature of the relationship such persons have with the bank, i.e., the potential to exert undue influence detrimental to the interest of the bank and its other stakeholders.

Accordingly, these additional prudential requirements are as follows:

- (i) Credit facilities to any of its directors or to a close relation of such director, or to a concern in which any director of the bank has a substantial interest, i.e., holding over 10% of the capital, shall be sanctioned at a meeting of its Board with not less than 2/3 of the total number of directors, constituting the Board (other than the director concerned) voting in favour of such extension of credit facilities. Such transactions are identified as related party transactions.
- (ii) Credit facilities mentioned in (i) above need to be secured by security/collateral approved by the Monetary Board of the Central Bank of Sri Lanka.
- (iii) In the event a person, a close relation of a person or any concern in which the person has a substantial interest has been granted credit facilities, and if such person is appointed to the Board of a bank, the bank shall obtain security approved by the Monetary Board from the concerned party within one year as specified in the Banking Act.
- (iv) The director of a bank who is in any manner whatsoever, whether directly or indirectly interested in any credit facility from the bank shall as soon as practicable declare the nature of his interest to the Board of such bank.
- (v) Director concerned shall not take part in any deliberations or decisions of the Board with regard to any business transacted in which the director or a close relation of the director, or a concern in which the director has a substantial interest, is interested, and the director shall withdraw from the meeting of the Board at which such business is discussed or transacted while the deliberation is in progress or decision is being made.
- (vi) Credit facilities granted to a director or a close relation of such director during the course of any financial year shall be disclosed in the accounts for that financial year and for each subsequent financial year till such credit facilities have been repaid or settled in full.

- (vii) No credit facilities granted to directors or to a close relation of such director, or to a concern in which any director of the bank has a substantial interest shall be written off without the prior approval of the Monetary Board.
- (viii) The Board shall ensure that the bank does not engage in transactions with “related parties” in a manner that would grant such parties “more favourable treatment” than that accorded to other constituents of the bank carrying on the same business.

In addition to the above, the Board of each bank is required to establish additional risk management measures commensurate with the size, nature and complexity of each bank.

The Central Bank of Sri Lanka, in conducting its supervisory role focuses on sustainability, corporate governance, risk management and internal controls, which includes lending to a concern in which a director of the respective bank has directly/indirectly an interest. In the event of any non-compliances in this regard, appropriate regulatory actions are taken on banks. The Central Bank of Sri Lanka follows up on addressing such non-compliances by banks and where necessary impose regulatory restrictions.

Accordingly, the Central Bank of Sri Lanka conducts supervision of banks in order to examine whether such banks are in a sound financial condition and are carrying on business in accordance with the provisions of the Banking Act and the relevant Directions issued thereunder with a view to safeguard the interest of depositors and other creditors and ensure the stability of the financial system.