8

FINANCIAL SECTOR PERFORMANCE AND SYSTEM STABILITY

8.1 Overview

During the year 2020, the stability of Sri Lanka's financial system was preserved amidst challenging domestic and global market conditions posed by the COVID-19 pandemic. Despite the challenging economic environment resulting from the pandemic, and regional or countrywide lockdown periods disrupting business activities to a larger extent, the banking sector exhibited moderate growth in terms of loans and advances, investments, and deposit base. However, deterioration in credit quality, sovereign rating downgrades and decreased foreign inflows due to the pandemic, exerted pressure on the banking sector operations. Having identified the importance of reviving adversely affected sectors in the economy, the Central Bank implemented several extraordinary regulatory measures to provide flexibility to Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs) in supporting businesses and individuals affected by the pandemic. The Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) sector recorded sluggish performance as reflected by the decline in asset base, loans and advances and deposits as well as increasing Non-Performing Loans (NPLs) and declining profitability during the year, mainly due to the COVID-19 pandemic related growth impediments and the lack of public confidence in some weak LFCs. The Central Bank initiated several regulatory actions along with the introduction of the Financial Sector Consolidation Master Plan to avoid further deterioration of the financial position of LFCs, maintain the stability of the sector and safeguard the interest of depositors. Other sectors in the financial system recorded a mixed performance. Meanwhile, the Central Bank ensured the availability of liquidity in the money market, particularly considering the need for supporting the financial system and facilitating economic activities during the COVID-19 pandemic period by introducing several monetary policy relaxation measures in 2020. Though the pressure on the exchange rate observed in March - April eased thereafter, with the imposition of restrictions on non- essential imports and selected outward remittances, improved workers' remittances and the rebound of export earnings, the pressure re-emerged due to relatively low level of Foreign Exchange (FX) inflows together with the gradual relaxations of restrictions and FX repatriations. This situation was further aggravated by the consecutive sovereign rating downgrades by global rating agencies. However, owing to the modest FX interventions and several policy measures taken by the Central Bank, the exchange rate stood at around Rs. 185 by end 2020. The Colombo Stock Exchange (CSE) *recovered from the significant decline it witnessed with the spread of COVID-19 pandemic, to a record high in terms of overall price index. Domestic investors' preference shifting towards equity investments in a low interest rate regime helped market recovery although foreign outflows continued. Meanwhile, the Central Bank continued to ensure uninterrupted payment and settlement services in the country amidst the COVID-19 pandemic.*

8.2 Performance of the Banking Sector

Despite enduring challenges stemming from the COVID-19 pandemic, the banking sector remained resilient mainly due to the capital and liquidity buffers built over the past few years, and continued to expand at a notable pace during 2020 compared to 2019. Additionally, to alleviate the impact of the pandemic, the Central Bank implemented a number of extraordinary regulatory measures to provide flexibility to licensed banks in supporting businesses and individuals affected by the pandemic.

Table 8.1
Total Assets of the Financial System

	2019 (a)		2020 (b)	
	Rs. bn	Share (%)	Rs. bn	Share (%)
Banking Sector	**14,442.1**	**72.0**	**17,087.9**	**72.5**
Central Bank	1,919.4	9.6	2,421.6	10.3
Licensed Commercial Banks (LCBs)	10,944.0	54.5	12,828.8	54.4
Licensed Specialised Banks (LSBs)	1,578.7	7.9	1,837.5	7.8
Other Deposit Taking Financial Institutions	**1,553.2**	**7.7**	**1,637.6**	**6.9**
Licensed Finance Companies (LFCs)	1,390.8	6.9	1,367.9	5.8
Co-operative Rural Banks (c)	161.7	0.8	268.9	1.1
Thrift and Credit Co-operative Societies	0.8	0.0	0.8	0.0
Specialised Financial Institutions	**286.7**	**1.4**	**415.3**	**1.8**
Specialised Leasing Companies (SLCs)	41.9	0.2	33.7	0.1
Licensed Microfinance Companies	5.8	0.0	6.8	0.0
Primary Dealers	77.5	0.4	87.2	0.4
Stock Brokers (c)	9.7	0.0	17.1	0.1
Unit Trusts / Unit Trust Management Companies (c)	113.8	0.6	190.5	0.8
Market Intermediaries (d)	18.4	0.1	60.1	0.3
Venture Capital Companies	19.5	0.1	19.9	0.1
Contractual Savings Institutions	**3,787.5**	**18.9**	**4,429.8**	**18.8**
Insurance Companies	689.6	3.4	790.1	3.4
Employees' Provident Fund	2,540.4	12.7	2,824.3	12.0
Employees' Trust Fund	343.3	1.7	380.4	1.6
Approved Pension and Provident Funds (e)	149.1	0.7	364.9	1.5
Public Service Provident Fund	63.7	0.3	70.1	0.3
Total	**20,068.2**	**100.0**	**23,570.6**	**100.0**

(a) Revised
(b) Provisional
(c) Due to unavailability of data for Q4 2020, Q-o-Q growth for Q3 2020 was used to estimate the asset base for year 2020
(d) Includes Investment Managers, Margin Providers, Underwriters and Credit Rating Agencies and due to unavailability of data for Q4 2020, Q-o-Q growth for Q3 2020 was used to estimate the asset base for year 2020
(e) Due to unavailability of data, 2019 asset base of Approved Pension and Provident Funds was taken as same as 2018.

Source: Central Bank of Sri Lanka
Department of Co-operative Development
Department of Labour
Department of Pensions
Employees' Trust Fund Board
Insurance Regulatory Commission of Sri Lanka
SANASA Federation
Securities and Exchange Commission of Sri Lanka
Unit Trust Association of Sri Lanka
Venture Capital Companies

The banking sector dominated the financial sector accounting for 72.5 per cent of total assets as at end 2020. Despite the challenging economic environment resulting from the on-going pandemic and regional or countrywide lock-down periods disrupting business activities to a greater extent, credit growth of the banking sector improved during 2020 compared to 2019. Deposits were the dominant source of funding, while there was a notable decline in foreign currency borrowings during 2020 due to decreased FX inflows as a result of the pandemic and sovereign rating downgrades. The banking sector profits improved compared to the previous year due to notable increase in non-interest income as a result of movements in the interest rates and exchange rates, decrease in non-interest expenses and reduction of taxes.

Business Expansion: By end 2020, the banking sector comprised 30 banks, i.e., 24 LCBs including 11 branches of foreign banks, and 6 LSBs. Upon completion of the closure procedures which commenced in 2019, based on decisions taken by their Head Offices, the banking licences issued to ICICI Bank Limited and Axis Bank Limited to operate in Sri Lanka were cancelled during the year 2020. The banking sector continued to support economic growth and promote

Figure 8.1
Performance of the Financial Sector

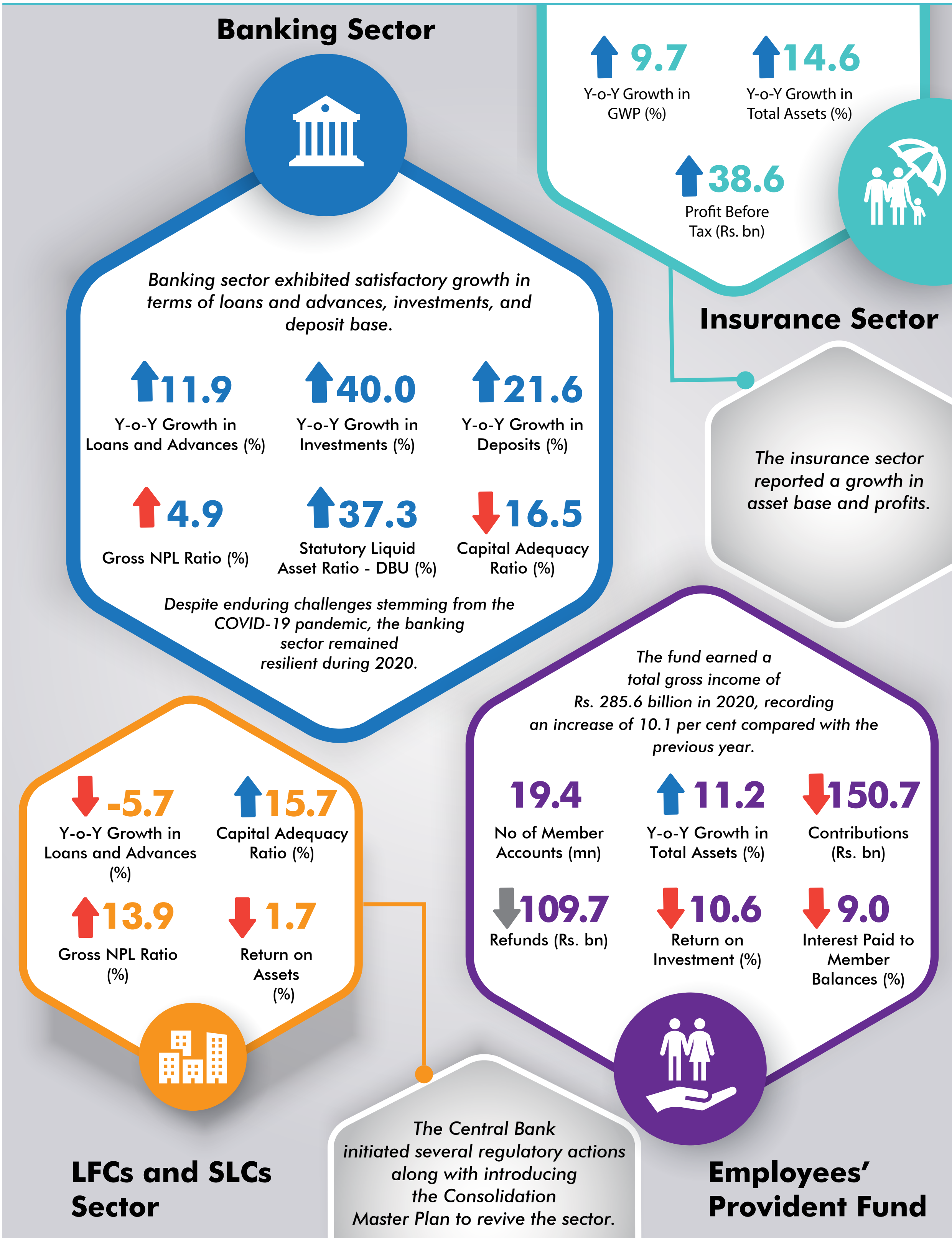

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Table 8.2
Distribution of Banks, Bank Branches and Other Banking Outlets

Category	End 2019 (a)	End 2020 (b)
Licensed Commercial Banks (LCBs)		
I. Total No. of LCBs	26	24
Domestic banks	13	13
Foreign banks	13	11
II.Total No. of LCB Banking Outlets	6,690	6,703
Branches (c)	2,907	2,916
Domestic Banks	2,842	2,854
Foreign Banks	50	47
Student Savings Units	3,783	3,787
III.Automated Teller Machines	5,393	5,744
Licensed Specialised Banks (LSBs)		
I. Total No. of LSBs	6	6
National Level Savings Banks	1	1
Housing Finance Institutions	2	2
Other LSBs	3	3
II. Total No. of LSB Banking Outlets	700	703
Branches (c)	700	703
National Level Savings Banks	262	265
Housing Finance Institutions	64	64
Other LSBs	374	374
III. Automated Teller Machines	401	432
Total No. of Bank Branches and Other Outlets	7,390	7,406
Total No. of Automated Teller Machines	5,794	6,176

(a) Revised
(b) Provisional
(c) All Banking Outlets excluding Student Savings Units.

Source: Central Bank of Sri Lanka

financial inclusion by enhancing banking services and expanding the banking network. In 2020, with the restrictions on physically accessing banks due to curfew and lockdowns imposed to prevent the spread of COVID-19, most banks introduced technology-based products/services to facilitate financial inclusion.

Assets: The banking sector asset base increased by Rs. 2.1 trillion during the year surpassing Rs. 14.6 trillion by end December 2020, recording a year-on-year growth of 17.1 per cent compared to that of 6.2 per cent reported as at end 2019. Despite the challenging economic and business environment due to the on-going pandemic, growth in investments and credit contributed to the assets growth. Growth in loans and advances improved from 5.6 per cent in 2019 to 11.9 per cent in 2020. Approximately, 83 per cent of the increase in the loan portfolio during 2020 was attributed to the increase in rupee loans. Increase in credit was diversified across the major sectors of the economy. In terms of products, re-scheduled loans (38.0 per cent), housing loans (18.0 per cent) and term loans (14.1 per cent) were the main products which reported higher growth rates during 2020. Meanwhile, the year-on-year growth in investments exceeded that of credit during the year, increasing from 12.2 per cent as at end 2019 to 40.0 per cent as at end 2020. The Held to Maturity (HTM) portfolio grew by 41.8 per cent during 2020 due to Treasury Bonds and Treasury Bills increasing by Rs. 804.7 billion and Rs. 55.9 billion, respectively, while investments in Sri Lanka Development Bonds (SLDBs) decreased by Rs. 73.3 billion. The trading portfolio grew by 32.4 per cent, with investments in Treasury bills, Treasury bonds and SLDBs increasing by Rs. 78.8 billion, Rs. 68.3 billion and Rs. 35.5 billion, respectively.

Liabilities: Deposits continued to be the main source of funding followed by borrowings. Term deposits accounted for 47.0 per cent of the increase in deposits during the year despite a decrease in its share in total deposits from 66.5 per cent as at end 2019 to 63.0 per cent as at end 2020. Meanwhile, savings and current deposits accounted for 28.3 per cent and 6.2 per cent,

Table 8.3
Composition of Assets and Liabilities of the Banking Sector

Item	2019 (a)		2020 (b)		Change (%)	
	Rs. bn	Share (%)	Rs. bn	Share (%)	2019 (a)	2020 (b)
Assets						
Loans and Advances	8,122.4	64.9	9,091.7	62.0	5.6	11.9
Investments	2,996.7	23.9	4,195.8	28.6	12.2	40.0
Other (c)	1,403.6	11.2	1,378.8	9.4	-1.8	-1.8
Liabilities						
Deposits	9,162.3	73.2	11,140.9	76.0	7.9	21.6
Borrowings	1,679.4	13.4	1,692.2	11.5	-4.8	0.8
Capital Funds	1,129.9	9.0	1,254.2	8.6	9.7	11.0
Other	551.1	4.4	578.9	3.9	8.5	5.0
Total Assets/ Liabilities	12,522.7	100.0	14,666.3	100.0	6.2	17.1

(a) Revised
(b) Provisional
(c) Includes cash and bank balances, placements, reverse repurchase agreements and fixed assets.

Source: Central Bank of Sri Lanka

BOX 7

A New Era in Banking : Green and Beyond

Introduction

Sustainable Finance can be broadly defined as financial services integrating environmental, social and governance (ESG) criteria into the decision-making process and business activities of firms, aiming at long lasting benefits for the firm, its clients and the society at large. However, there is no single, agreed global definition on what constitutes Sustainable Finance.

Green Finance is a component of Sustainable Financing. Green Finance, in general, refers to the channelling of financial flows towards meeting the challenges of climate change and the transition into a low-carbon economy. The Organisation for Economic Co-operation and Development (OECD) defines Green Finance as finance for achieving economic growth while reducing pollution and greenhouse gas emissions, minimising waste and improving efficiency in the use of natural resources.

Today, as a consequence of population growth, environmental degradation, climate change, poverty and inequality, Sustainable Finance practices are fast becoming the future in banking. The United Nations (UN) also recognised the importance of sustainable development and introduced the Sustainable Development Goals (SDGs) to address such challenges and call for action by all countries to promote prosperity while protecting the planet.

Sustainable Finance Journey and Roadmap of the Central Bank of Sri Lanka

The importance of initiating Sustainable Finance in Sri Lanka has been widely discussed among the stakeholders of the financial sector. In 2016, the Central Bank joined the International Finance Corporation (IFC) supported Sustainable Banking Network (SBN), which represents 86 per cent of banking assets in emerging markets.

In 2017, the Central Bank initiated the process of developing a Roadmap for Sustainable Finance in Sri Lanka to facilitate and promote sustainable finance practices in consultation with relevant government agencies, the banking industry and a wide range of financial sector stakeholders. The Central Bank also appointed a steering committee to facilitate developing the Sustainable Finance Roadmap for the financial sector in Sri Lanka through an inclusive multi-stakeholder process.

The Roadmap for Sustainable Finance was launched in June 2019 with the financial assistance of the Biodiversity Finance Initiative (BIOFIN) of the United Nations Development Programme (UNDP) along with technical assistance of the IFC. The Roadmap was developed in consultation with stakeholders including the Sri Lanka Banks' Association (Guarantee) Ltd. (SLBA), the Finance Houses Association of Sri Lanka, the Insurance Regulatory Commission of Sri Lanka and the Securities and Exchange Commission of Sri Lanka.

This Roadmap provides a broader direction to financial regulators and financial institutions to effectively manage ESG risks associated with projects they finance, and promote assistance to businesses that are greener, climate-friendly and socially inclusive. It attempts to scale up the contribution of the financial sector, including banking and finance, capital markets and insurance industry, and help build a more resilient and sustainable green economy.

The SLBA launched the Sustainable Banking Initiative (SL-SBI) in July 2015. Its purpose is to provide a platform to enhance understanding and action on responsible banking practices that can facilitate sustainable economic growth in Sri Lanka. Since its inception, the SL-SBI has successfully crafted and launched a set of 11 Sustainable Banking Principles. These principles, developed by a committee of participating banks, define how the Sri Lankan banking sector can conduct business to facilitate more sustainable economic growth locally.

Each country has adopted a unique route to promote Sustainable Finance in response to its local context and priorities. In countries such as Bangladesh, Brazil, China, Indonesia, Morocco, Nigeria and Vietnam, regulators have taken the lead through policy-based initiatives. On the contrary, in countries such as Colombia, Ecuador, Kenya, Mexico, Mongolia, South Africa and Turkey, banking associations have coordinated voluntary, industry-led initiatives. Sri Lanka is in a unique position with the SLBA launching the SL-SBI, the Central Bank collaborating with stakeholders, and launching the Roadmap where both approaches have been harmonised.

Most of the large licensed banks in Sri Lanka have already set up Sustainable Finance banking units and have launched sustainability initiatives focusing on areas such as renewable energy, entrepreneur development, environment protection and women empowerment. Many Sri Lankan licensed banks have been reporting on 'Sustainability' in their Annual Reports for over a decade using the guidelines published by the Global Reporting Initiative. Further, SLBA led initiatives and the Centre for Banking Studies have conducted many programmes to enhance the awareness and capacity on Sustainable Finance within the banking industry, and the SL-SBI also launched an e-Learning platform to facilitate capacity building on Sustainable Finance.

Banking Regulation and Sustainable Finance

The Central Bank is currently in the process of implementing the Action Plan as set out in the Roadmap to achieve targeted actions with the support of relevant stakeholders.

A key issue identified by many of the Green and Sustainable Finance initiatives is the need to develop standard definitions, a taxonomy of what constitutes Sustainable Finance, comparable metrics, and methodology for measuring the impact of Sustainable Finance. A sustainable taxonomy is a classification system, establishing a list of environmentally and socially sustainable economic activities.

In operationalising the actions of the Roadmap, the Central Bank has recognised the need for devising an applicable taxonomy, which is a key requirement in facilitating the financial sector towards sustainable finance. Currently, the Central Bank is in the process of developing a taxonomy for the financial sector of Sri Lanka to serve as a classification system that enables categorisation of economic activities/sectors that play key roles in climate change mitigation and adaptation in the Sri Lankan context.

The Regulatory Toolkit available for regulators on Sustainable Finance includes tools such as:

- Introduction of ceilings on credit extension to certain carbon intensive or polluting activities
- Green Finance Guidelines and Frameworks
- Climate-related stress testing
- Disclosure requirements on climate related and green financing risks
- Directed Green Credit Policy Instruments, and
- Green Differentiated Reserve Requirements.

Sri Lanka intends to initiate suitable instruments for the purpose of promoting Sustainable Finance, in line with the Roadmap of the Central Bank, considering market developments and needs. Sustainable Finance tools such as Green Finance Guidelines and Frameworks will be considered for implementation in the future after giving due supervisory considerations.

Regulators around the globe have thus far not explicitly taken into account the green or brown nature of the underlying assets when computing their perceived riskiness. Some central banks and supervisors have further integrated climate-related risks into the supervisory framework by adjusting and communicating their supervisory expectations.

Going forward, banks could also look at the feasibility of incorporating scenarios that estimate the potential impact on financial stability from supplying credit to environmentally unsustainable or sustainable activities over time into the banks' Pillar 2 Supervisory Review stress tests under the Basel Capital Framework.

Challenges

Currently, no uniform Sustainable Finance taxonomy has been implemented globally. This has led to ESG factors considered in the assessment of Sustainable Finance being inconsistent and incomparable.

Lack of expertise and capacity will be a barrier faced by all stakeholders including the regulators. Especially new green products and technologies will evolve dynamically, and expertise and experience will be required to assess viability. Therefore, capacity building efforts and technical guidance are paramount for the successful implementation of the Sustainable Finance initiative.

Information asymmetry on Sustainable Finance from both loan origination and risk management may hinder Sustainable Finance initiatives. Therefore, information systems and information flows must be improved to cater to evolving Sustainable Finance needs.

In the future, financial institutions will be expected to integrate ESG risks comprehensively into the risk management framework to ensure ESG risks are considered holistically in risk management practices. Accordingly, going forward, finding the right recipe for Sustainable Finance initiatives to thrive in the Sri Lankan context would be a challenge for all stakeholders involved.

Way Forward

The Roadmap of the Central Bank articulates a series of strategic activities to implement Sustainable Finance in Sri Lanka, while detailing an action plan to be implemented over the short, medium and long term by the respective stakeholders. The Central Bank expects to issue a taxonomy on Sustainable Finance in collaboration with stakeholders by the end of 2021. Disclosures by financial institutions and other entities on material information on sustainability should be further strengthened giving due consideration to all ESG aspects.

The economic shock stemming from the COVID-19 pandemic has highlighted the need for enhanced resilience in the global economy. Accordingly, policymakers across the globe will focus on ensuring that the recovery from the pandemic is carried out in a sustainable manner. Going forward, coordinated policy actions are needed to ensure enhanced readiness for Sustainable Finance initiatives across regions and countries. Accordingly, in the new era of post pandemic banking, Sustainable Finance will become an essential lever for achieving social, economic and environmental goals in an economy.

References

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2. Sustainable Banking Network Website (https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/company-resources/sustainable-finance/sbn)
3. Sri Lanka Banks' Association's Sustainable Banking Initiative Website (https://sustainablebanking.lk/)

Table 8.4
Composition of Deposits of the Banking Sector

Item	2019(a)		2020(b)		Change (%)	
	Rs.bn	Share (%)	Rs.bn	Share (%)	2019 (a)	2020 (b)
Demand Deposits	528.8	5.8	693.7	6.2	-2.8	31.2
Savings Deposits	2,344.1	25.6	3,153.2	28.3	8.0	34.5
Time Deposits	6,092.5	66.5	7,022.1	63.0	9.5	15.3
Other Deposits	196.9	2.1	271.9	2.4	-7.5	38.1
Total Deposits	**9,162.3**	**100.0**	**11,140.9**	**100.0**	**7.9**	**21.6**

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

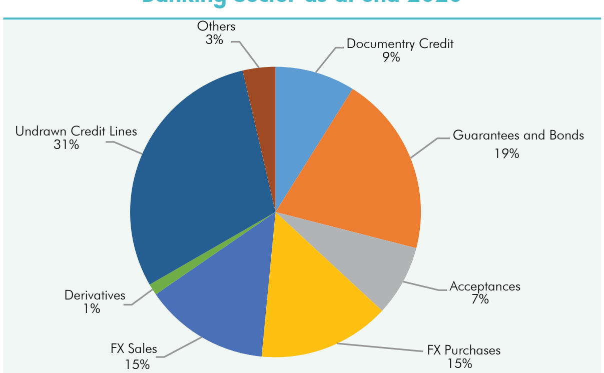
respectively, of total deposits as at end 2020. Accordingly, Current and Savings Account (CASA) ratio increased from 31.4 per cent as at end 2019 to 34.5 per cent as at end 2020. Total borrowings of the banking sector increased by Rs. 12.8 billion (0.8 per cent) in 2020 compared to a decrease of Rs. 84.0 billion (negative growth of 4.8 per cent) in 2019. This increase was mainly attributed to Sri Lankan rupee borrowings which reported a growth of 14.3 per cent (Rs. 99.4 billion) in 2020, while foreign currency borrowings decreased by 11.1 per cent (US dollar 603.1 million) during 2020 along with the sovereign rating downgrades.

Off-balance sheet exposures: Despite the challenging business environment, off-balance sheet exposures reported a growth of 16.1 per cent (Rs. 675.2 billion) during 2020 compared to a negative growth of 5.3 per cent (decrease of Rs. 233.5 billion) during 2019. The main increases during 2020 were in undrawn credit lines (Rs. 279.9 billion), FX exposures (Rs. 278.3 billion) and guarantees & bonds (Rs. 66.8 billion).

Risks in the Banking Sector

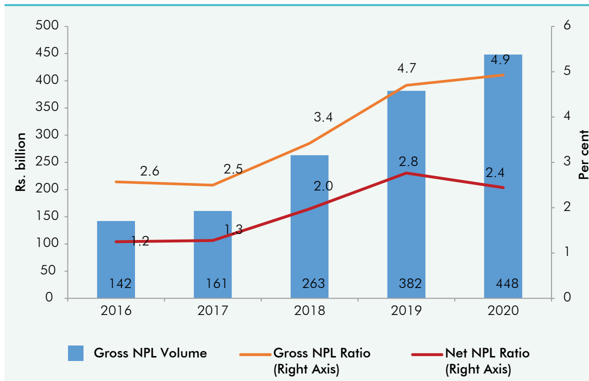
Credit Risk: Considering the difficulties faced by borrowers due to COVID-19 pandemic, moratoria were introduced initially for different segments of the economy and further extended for certain sectors considering the longer recovery period of those sectors affected by the COVID-19 pandemic. Classification of loans to non-performing categories were frozen during the period under moratorium and normal classification rules will be applied upon cessation of the moratorium. Despite the freezing of classification of credit facilities under moratorium, NPLs increased by Rs. 66.4 billion during 2020 compared to an increase of Rs. 118.5 billion during 2019, stemming from the challenging business environment that prevailed for a substantial period in 2020 resulting in an increase in gross NPL ratio to 4.9 per cent by end 2020. However, the migration of NPLs to categories requiring higher provisions had reduced the net NPL ratio during 2020. Nevertheless, the actual NPL position will only be reflected subsequent to cessation of the moratoria which

Figure 8.2
Off-Balance Sheet Exposure of the Banking Sector as at end 2020



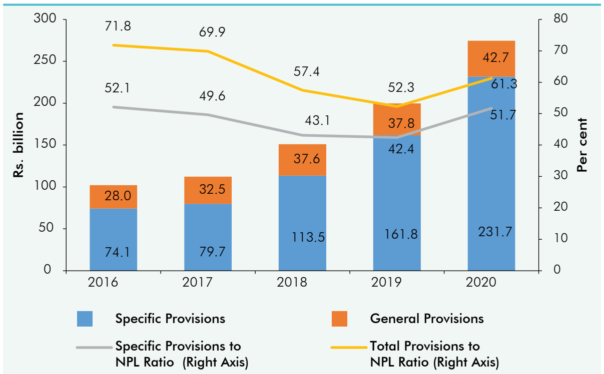
Source: Central Bank of Sri Lanka

Figure 8.3
Non-Performing Loans of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 8.4
Provisions for Non-Performing Loans of the Banking Sector



Source: Central Bank of Sri Lanka

are still in effect for certain sectors of the economy. During 2020, total provisions increased by Rs. 74.9 billion, of which specific provisions accounted for 93.5 per cent. Despite the growth in NPLs, higher increase in provisions resulted in increases in specific and total provision ratios.

Although 73.1 per cent of credit was mainly concentrated to 6 economic sectors, individual banks have diversified their businesses among various sectors in the economy. Out of the main sectors, manufacturing, wholesale & retail trade, agriculture, forestry & fishing, tourism, and construction sectors reported NPL ratios higher than the total banking sector average of 4.9 per cent as at end 2020. Despite the increase in NPL ratios during 2020, it is still at a manageable level as the banking sector operated with sufficient provisions and capital buffers to absorb any adverse impact.

Market Risk

Interest Rate: Interest rate sensitivity ratio (interest bearing assets as a share of interest-bearing liabilities with maturities of less than 12 months) decreased to 74.9 per cent as at end 2020 from 76.5 per cent as at end 2019, thereby increasing the exposure to interest rate risk by end 2020 compared to end 2019. Capital gains on Treasury bonds during 2020 stood at

Table 8.5
Sectorwise Composition of Loans and Advances of the Banking Industry (at end 2020)

Sectors	Amount Rs. bn (a)	Share of Total Loans %	NPL Ratio %
Consumption	1,664.2	18.3	4.3
Construction	1,481.9	16.3	6.4
Wholesale & retail trade	1,126.8	12.4	7.4
Manufacturing	860.9	9.5	8.7
Infrastructure development	815.6	9.0	1.8
Agriculture, forestry & fishing	697.9	7.7	6.9
Lending to Ministry of Finance	603.4	6.6	-
Health care, social services & support services	376.7	4.1	2.8
Lending to overseas entites	365.5	4.0	2.0
Financial services	338.2	3.7	1.2
Tourism	331.2	3.6	6.8
Transportation & storage	200.6	2.2	3.9
Professional, scientific & technical activities	115.2	1.3	3.1
Information technology and communi-cation services	53.0	0.6	5.0
Education	48.1	0.5	3.3
Arts, entertainment & recreation	12.3	0.1	6.4
Total Loans	**9,091.7**	**100.0**	**4.9**

(a) Provisional
Source: Central Bank of Sri Lanka

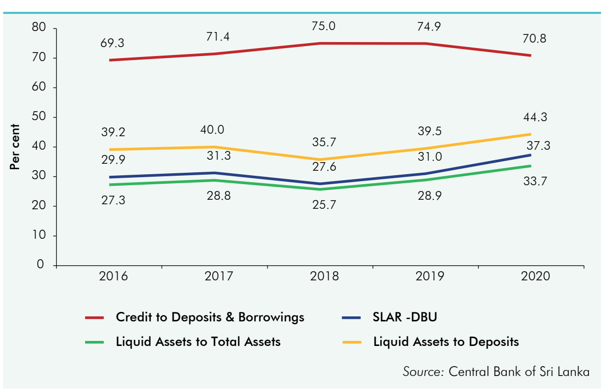
Rs. 12.2 billion and was higher than Rs. 3.4 billion recorded during 2019. This was due to more funds being directed to government securities in 2020 compared to 2019 and the downward movement in interest rates.

Equity Prices: Equity risk of the banking sector was minimal throughout 2020. The exposure of banks' trading portfolio to the equity market was Rs. 11.7 billion, which was only 0.1 per cent and 1.5 per cent of total assets and investments held for trading, respectively, at end 2020.

Exchange Rates: The net foreign currency exposure of the banking sector decreased to a short position of US dollar 30.0 million as at end 2020 compared to a long position of US dollar 90.3 million as at end 2019, with a higher increase in foreign currency liabilities compared to the increase in foreign currency assets. The net foreign currency exposure as a percentage of banks' on-balance sheet foreign currency assets stood at 0.3 per cent as at end 2020, decreasing from 1.1 per cent at end 2019. During 2020, on-balance sheet foreign currency assets increased mainly due to the increase in placements with banks and investments, while the increase in off-balance sheet assets was from forward purchases and other derivative products. The increase in on-balance sheet foreign currency liabilities was attributed to the increase in customer deposits while the increase in off-balance sheet liabilities was mainly from forward sales. The banking sector reported a net foreign currency revaluation gain of Rs. 16.5 billion during 2020 compared to Rs. 14.2 billion during 2019.

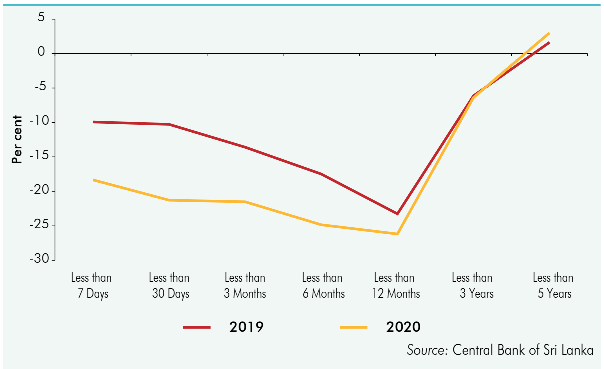
Liquidity Risk: With a higher portion of funds being directed to liquid assets during 2020, the banking sector operated with an adequate level of liquidity. The Domestic Banking Units (DBUs) of LCBs and LSBs are required to maintain their Statutory Liquid Assets Ratios (SLARs) above 20.0 per cent. The DBU SLAR increased from 31.0 per cent in December 2019 to 37.3 per cent in December 2020, while the SLAR of Offshore Banking Units decreased from 47.1 per cent to 43.2 per cent during this period. Further, the higher growth in investments during 2020 resulted in a decrease in the credit to deposits and borrowings ratio while liquid assets to total assets and liquid assets to deposits ratios increased.

Figure 8.5
Liquidity Ratios of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 8.6
Cumulative Maturity Gap as a percentage of Cumulative Liabilities



Source: Central Bank of Sri Lanka

The Rupee and All Currency Liquidity Coverage Ratios (LCRs) of the banking industry stood at 255.9 per cent and 202.1 per cent, respectively, by end 2020, well above the regulatory minimum of 90.0 per cent applicable till end June 2021. In addition, the Net Stable Funding Ratio (NSFR) introduced in 2019, stood at 140.7 per cent, well above the regulatory requirement of 90 per cent applicable until end June 2021. Total liquid assets amounted to Rs. 4.9 trillion as at end 2020, of which investments in government securities represented 69.6 per cent. The cumulative maturity gap as a percentage of cumulative liabilities of the banking sector for maturity buckets up to less than 12 months maturities widened as at end 2020 compared to end 2019, indicating better management of assets and liabilities in the short-term considering the declining trend in interest rates where more liabilities get repriced at lower interest rates compared to assets. However, excessive widening of maturity gap may lead to an increase in liquidity risk.

Profitability: Despite interest income of the banking sector contracting at a lower rate (4.2 per cent) compared to interest expenses (6.0 per cent) during 2020 compared to the previous year, net interest income contracted only marginally (0.9 per cent). As a result, the

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Table 8.6
Composition of Liquid Assets of the Banking Sector

Item	2019 (a)		2020 (b)		Change (Rs.bn)	
	Rs.bn	Share (%)	Rs.bn	Share (%)	2019 (a)	2020 (b)
Treasury bills	871.2	24.1	1,111.8	22.5	186.2	240.6
Treasury bonds	1,203.4	33.2	1,685.3	34.1	262.1	481.8
Sri Lanka Development Bonds	569.7	15.7	638.7	12.9	26.7	69.1
Cash	196.9	5.4	203.1	4.1	13.0	6.2
Money at Call	168.8	4.7	337.7	6.8	48.0	168.9
Balance with Banks Abroad	427.5	11.8	471.3	9.5	41.4	43.8
Other	183.8	5.1	490.5	9.9	7.9	306.7
Total Liquid Assets	**3,621.2**	**100.0**	**4,938.3**	**100.0**	**585.3**	**1,317.1**

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

net interest margin decreased from 3.6 per cent as at end 2019 to 3.1 per cent as at end 2020. Net interest income decreased by Rs. 3.8 billion during 2020 compared to the previous year, while non-interest income increased by Rs. 9.8 billion, mainly due to higher capital gains on Treasury bonds and higher foreign currency revaluation gains during 2020, as a result of depreciation of Sri Lanka rupee against US dollar. Non-interest expenses decreased by Rs. 12.1 billion, largely due to the premises, equipment and establishment expenses reducing by Rs. 7.7 billion, while loan loss provisions increased by Rs. 22.6 billion during 2020. As a result, profit before corporate tax was Rs. 190.0 billion in 2020, which was Rs. 18.2 billion higher than the previous year.

Table 8.7
Profit of the Banking Sector

Item	2019 (a)		2020 (b)	
	Amount (Rs.bn)	As a % of Avg. Assets	Amount (Rs.bn)	As a % of Avg. Assets
Net Interest Income	**431.1**	**3.6**	**427.4**	**3.1**
Interest Income	1212.0	10.1	1,161.4	8.5
Interest Expenses	780.8	6.5	734.0	5.4
Non-Interest Income	**132.3**	**1.1**	**142.1**	**1.0**
Foreign Exchange Income	26.7	0.2	31.7	0.2
Non-Interest Expenses	**264.7**	**2.2**	**252.6**	**1.9**
Staff Cost	126.5	1.1	128.0	0.9
Loan Loss Provisions	**60.9**	**0.5**	**83.5**	**0.6**
Profit Before Tax (after VAT)	**173.0**	**1.4**	**190.0**	**1.4**
Profit After Tax	**111.7**	**0.9**	**136.0**	**1.0**

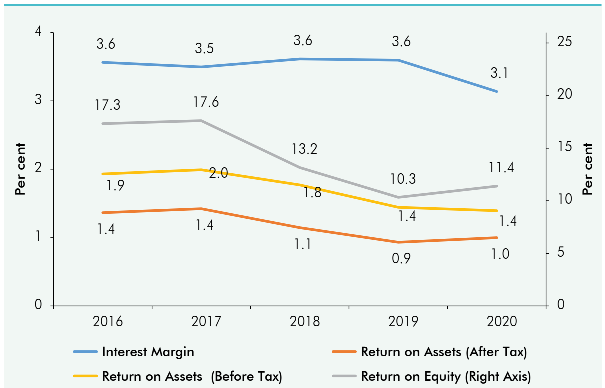
(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

Profit after tax of the banking industry was Rs. 136.0 billion during 2020 and increased by 21.7 per cent compared to the previous year due to changes in tax policies commencing from year of assessment 2020/21. The increase in profits was commensurate with the increase in assets and was reflected in Return on Assets (ROA) – before tax remaining static at 1.4 per cent as at end 2019 and end 2020. Meanwhile, Return on Equity (ROE) – after tax improved from 10.3 per cent to 11.4 per cent. The decrease in operating costs resulted in the improvement of the efficiency ratio from 52.6 per cent in 2019 to 51.8 per cent in 2020.

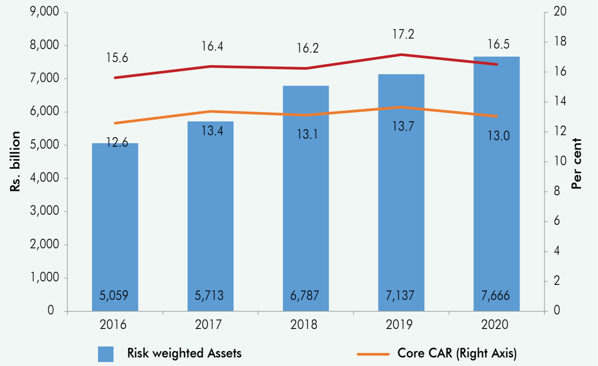
Capital: The banking sector was in compliance with the capital requirements during 2020. Despite the relaxation provided

Figure 8.7
Profitability Ratios of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 8.8
Capital Adequacy of the Banking Sector



Source: Central Bank of Sri Lanka

Table 8.8
Composition of Regulatory Capital of the Banking Sector

Item	Amount (Rs. bn)		Composition (%)	
	2019 (a)	2020 (b)	2019 (a)	2020 (b)
Tier I: Capital	974.6	999.8	100.0	100.0
Share Capital	323.3	333.5	33.2	33.4
Statutory Reserve Funds	61.0	62.3	6.3	6.2
Retained Profits	387.0	385.0	39.7	38.5
General and Other Reserves	239.2	247.4	24.5	24.7
Others	10.8	30.7	1.1	3.1
Regulatory Adjustments	-46.6	-59.1	-4.8	-5.8
Tier II: Capital	251.0	265.6	100.0	100.0
Revaluation Reserves	26.1	26.5	10.4	10.0
Subordinated Term Debt	173.8	167.4	69.2	63.0
General Provisions and Other	55.6	73.1	22.2	27.5
Regulatory Adjustments	-4.6	-1.4	-1.8	-0.5
Total Regulatory Capital Base	1,225.5	1,265.4		

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

to drawdown the Capital Conservation Buffer (CCB) by 100 basis points for Domestic Systematically Important Banks (D-SIBs) and 50 basis points for non D-SIBs considering the difficulties faced by the banking sector due to the COVID-19 pandemic, the banking sector was largely in compliance with the required Capital Adequacy Ratios without drawing down the CCB.

Considering the challenges in raising fresh capital under the current environment, the deadline to meet the enhanced minimum capital requirement for banks was extended till December 2022. With the extension of recognising the first day impact from implementation of Sri Lanka Financial Reporting Standards 9 (SLFRS 9) which is considered for capital on a staggered basis over a period of 4 years and also to comply with the Basel III capital requirements, banks were encouraged to raise high quality capital. As a result, banks had raised Tier I capital through issuance of new shares (Rs. 10.2 billion) and buildup of reserves (Rs. 8.2 billion) during 2020. The regulatory capital of the banking sector reported a growth of 3.3 per cent during the year, of which Tier I capital contributed to 63.2 per cent.

Supervisory and Regulatory Developments

During 2020, the Central Bank continued to introduce prudential policy measures and regulations to strengthen the safety and soundness of the banking sector, while cautiously relaxing some of the regulations to facilitate banking sector to adjust to the new normal and to provide concessions to economic sectors affected by the COVID-19 outbreak.

A credit support scheme to accelerate the economic growth was introduced for eligible Small and Medium Enterprise (SME) borrowers to complement the fiscal incentives announced by the Government. This credit support scheme was followed by a six-month moratorium scheme and a Rs. 50 billion re-finance scheme to support the businesses and individuals affected by the COVID-19 pandemic, which was introduced in March 2020. In this regard, the Central Bank also introduced a series of extraordinary regulatory measures to provide flexibility to licensed banks to support affected businesses and individuals and to provide liquidity to banks, considering the potential impact of COVID-19 on the licensed banks.

BOX 8
Regulation and Supervision of Banks in the 'New Normal' amidst the COVID-19 Outbreak

Introduction

Economic Impact of the COVID-19 Outbreak

The COVID-19 outbreak, an unprecedented global health crisis that emerged in late 2019 has led to many adverse social and economic implications necessitating countries to introduce new strategies and economic measures to overcome the ensuing adverse situation. The lockdown measures implemented owing to the COVID-19 outbreak have restricted cross border movement of people and goods resulting in disruption to economic and trade activities worldwide. Further, reduced investment, i.e., foreign direct investment, and remittances have adversely impacted emerging economies. Therefore, the sharp decline in global GDP amidst the COVID-19 outbreak may result in a slower economic recovery than expected, since the virus is still prevalent with multiple outbreaks and spikes in infections still being reported worldwide. Hence, given the uncertainty and prolonged nature of the COVID-19 outbreak, individuals and business entities including banks need to adapt and transform their business operations to suit the 'new normal'.

Impact on the Banking Sector

The COVID-19 outbreak has adversely impacted the income and earning capacity of borrowers affecting their ability to service their debt obligations to banks. Further, the creditworthiness of certain borrowers may deteriorate in the long term, and accordingly, the credit quality of the banking sector will depend on the nature and pace of economic recovery. Therefore, it is difficult for banks to fully assess the impact of the COVID-19 outbreak on loan classification, expected credit losses, provisioning, credit risk weightings, and capital.

The governments and regulatory authorities have mandated, encouraged, or granted payment holidays and debt moratoria to borrowers under which repayments of interest and principal are delayed creating a potential adverse impact on the cash flows and liquidity positions of banks. Therefore, reduced revenue flows and higher potential losses may adversely affect profitability and reduce capital ratios of banks.

Consumers switching to digital banking platforms and services could also become victims of financial crime or misconduct as deceptive parties may identify

Table B 8.1
Regulatory Measures Implemented by Several Regulatory Authorities

Jurisdiction	Government Guarantees	Capital Requirements	Asset Classification	Expected Loss Provisioning	Dividends and Other Payouts
Australia	Yes	Encouragement to use buffers	New guidance	-	Expectation to limit
Canada	Yes	Lower Domestic Stability Buffer, Encouragement to use buffers	New guidance	New guidance, Introduction of transitional arrangements	Expectation to halt increases
European Union	Yes (*)	Release Countercyclical Capital Buffer (CCyB) and encouragement to use buffers	New guidance	New guidance	Expectation to halt
India	Yes	Deferred implementation of last tranche of CCB	New guidance	-	Expectation to halt
Japan	Yes	Encouragement to use buffers	Adjusted risk weights of certain loans	-	-
Malaysia	Yes	Encouragement to use buffers	Clarity on interpretations of capital and accounting rules applicable to repayment assistance programmes	New guidance	-
Thailand	Yes	-	Relaxed regulations regarding classification of borrowers	Easing of loan loss provision rules	Expectation to halt
United Kingdom	Yes	Release CCyB, encouragement to use buffers	New guidance	New guidance	Expectation to halt
United States	Yes	Encouragement to use buffers, adjust supplementary Leverage Ratio	New guidance, Definition of restructured debt	Optional suspension, Extension of transitional arrangements	Expectation of prudent decisions, Smoothening of automatic restrictions

* Conditions vary across some countries.

Source: FSI Briefs: Reflections on regulatory responses to the COVID-19 Pandemic, websites of Bank Negara Malaysia, Bank of Thailand, and the Reserve Bank of India

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opportunities for fraud, scams or other unlawful activities which may pose legal risks to banks. Many institutions including banks have moved to flexible working arrangements in the 'new normal', such as working from home and other remote working arrangements, duty shifts, flexible hours, etc. However, work from home arrangements may also have an adverse impact on operational activities of banks in terms of IT and data security, internal and external fraud, cyber-attacks, internal network capacity, and control mechanisms such as anti-money laundering (AML) and know-your-customer (KYC) requirements.

Regulatory Measures adopted to suit the 'New Normal'

Regulatory and supervisory authorities worldwide have adopted a wide range of regulatory measures to facilitate banks to support individuals and businesses affected by the COVID-19 outbreak whilst ensuring the safety and stability of the banking sector. The regulatory measures adopted by several regulatory and supervisory authorities to facilitate supply of credit to the economy are given in Table B 8.1.

Therefore, regulators have facilitated banks to provide debt moratoria including credit guarantee schemes to provide relief to affected borrowers. These measures have allowed credit facilities to be rescheduled or restructured in ways that may be beneficial for both banks and borrowers, to avoid placing borrowers with immediate cash flow constraints in the 'default' category and to help restore their business activities. Accordingly, various regulatory authorities have provided guidance on the assessment of asset quality of banks by providing more flexible interpretations on conditions for reclassification of loans.

Flexibility given in global standards, viz. Basel III framework to draw down available capital buffers, i.e. Countercyclical Capital Buffer (CCyB) and Capital Conservation Buffer (CCB) built during good times, have been utilised by regulators to allow banks to absorb losses arising from the COVID-19 outbreak without breaching applicable minimum regulatory requirements and to create space for credit growth and facilitate key banking services to the real economy. Further, relaxations have also been provided by reducing liquidity buffers, viz. Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) to below 100 per cent to provide liquidity to banks in accordance with guidelines under the Basel III framework.

Many regulatory authorities have also imposed temporary restrictions on capital distributions and other discretionary payments of banks to help preserve capital levels and provide flexibility for banks to support the real economy. Further, certain regulators have deferred the implementation of some regulatory standards and/or extended transitional arrangements, viz. Basel III implementation, capital requirements and accounting rules, to ease the regulatory and compliance burdens on banks.

Supervisory Capacity: Supervisory Processes and Procedures in the 'New Normal'

The increase in banking sector risks arising from the COVID-19 outbreak, along with pressures on supervisory capacity due to lockdowns, travel restrictions and the need to maintain social distancing, have restricted the conduct of on-site supervision and holding physical meetings with management of banks. Therefore, alternative methods have been adopted to address these limitations such as more intensified off-site supervision and monitoring of banks. Accordingly, banks are required to report more granular data at a higher frequency with existing data templates/formats being updated and specific reporting formats being developed on an ad-hoc basis as and when required, to support the enhanced off-site supervisory monitoring requirements. Further, regulators have also taken measures to continuously reassess supervisory priorities based on risks emanating from the COVID-19 outbreak such as asset quality, capital adequacy, liquidity profiles, and operational resilience of banks. This is to confirm the adequacy of safeguards and buffers to ensure the resilience of banks. In this regard, stress testing is being carried out by supervisory authorities to assess the post COVID-19 impact on banks against a range of possible scenarios to assess credit exposures, liquidity positions, capital, and solvency of individual banks as well as the banking sector. Further, regulators have also required banks to review and strengthen their recovery plans which are essential tools for crisis management in order to identify recovery options that could be quickly implemented, if required.

With on-site supervision being restricted due to lockdown measures, regulatory authorities have taken steps to maintain channels of communication with management and relevant officers of banks through virtual communication modes to obtain the required information. Further, regulatory authorities have also resorted to conducting virtual meetings rather than in person meetings with the Board of Directors, senior management and staff of banks, considering the necessity of adhering to social distancing requirements in the 'new normal'.

Regulatory and Supervisory Measures adopted by the Central Bank of Sri Lanka amidst the COVID-19 Outbreak

Regulatory Measures Adopted

Various relief measures were provided by the Central Bank to assist businesses and individuals adversely affected by the COVID-19 outbreak to tide over the difficulties faced during the lock down period by way of debt moratoria, provision of credit facilities at concessionary interest rates and credit guarantee schemes. Further, the Central Bank also implemented various extraordinary regulatory measures to provide flexibility to licensed banks to facilitate credit flows to the economy including permitting Domestic Systemically Important Banks (D-SIBs) and non D-SIBs to draw down the CCBs built during good times, allowing relaxations on classification of non-performing loans, permitting recovery of foreign currency loans in rupees subject to conditions, deferring the enhancement of minimum capital requirements by licensed banks from end 2020 to end 2022, and permitting certain assets to be considered as liquid assets, subject to conditions, for the purpose of computing the Statutory Liquid Assets Ratio.

Further, the minimum requirement for LCR and NSFR was reduced to 90 per cent until 30 June 2021 subject to enhanced supervision and frequent reporting. Licensed banks were also allowed to avail of liquidity in rupees, if required, under the framework of emergency loans and advances to licensed banks based on acceptable collateral and liquidity forecasts. Banking Act Directions were issued temporarily restricting discretionary payments of licensed banks to ensure maintenance of appropriate levels of liquidity and prudent management of cash flows by banks. Further, licensed banks were also required to exercise prudence and extreme due diligence when incurring capital expenditure, and to refrain to the extent possible from incurring non-essential expenditure. Accordingly, it is expected that licensed banks would avail these relaxations in the best interest of supporting their customers, and the economy at large, the benefits of which would, in return accrue to the banking sector to remain resilient.

To ease the pressure on the exchange rate and the stress on financial markets due to the impact of COVID-19 outbreak, the Central Bank issued Directions extending the maximum period for the settlement of export credit facilities out of export proceeds to 180 days from the date of shipment, and measures to curtail certain non-essential imports and foreign currency investments by respective banks.

The Central Bank took various steps to keep the general public informed of the regulatory measures adopted amidst the COVID-19 outbreak by issuing press releases, having a dedicated webpage in the Central Bank website providing information on COVID-19 relief measures and conducting virtual educational seminars for the public. Further, the Central Bank also developed a pictorial poster informing the general public on how to conduct banking activities during the COVID-19 outbreak safely and digitally, which was displayed in the Central Bank website and social media and was also circulated among licensed banks. This poster drew the attention of the general public to be vigilant with respect to scams.

Supervisory Measures Adopted in Relation to On-site and Off-site Supervision

Following the initial COVID-19 outbreak, the timelines for addressing supervisory concerns by licensed banks were re-set by granting extended time periods for addressing supervisory concerns which were to be addressed up to 31 May 2020 depending on the severity. Further, the deadline for submission of statutory returns to Bank Supervision Department was extended by two weeks, and the publication of quarterly financial statements was extended by one month.

During the lockdown period, on-site examinations of licensed banks were temporarily halted and examinations of licensed banks were conducted on a remote basis based on information obtained via e-mails and other electronic means in a secure manner (password protected). Off-site monitoring and supervision of licensed banks were strengthened during the lock down period, requiring more frequent reporting and submitting of returns and information by banks to ensure the safety and soundness of banks.

Subsequent to the lifting of the curfew, on-site examinations were recommenced with the emphasis on reviewing the status of addressing previous supervisory concerns, level of internal controls, and nature and extent of actions taken by the bank in response to the pandemic, along with a review of details of any internal assessments of the impact. Bank supervision examiners were advised to strictly adhere to health guidelines published by the authorities and to limit physical interactions with front line bank employees. Measures were also taken to conduct more virtual meetings rather than in person meetings with banks' management, auditors, etc., considering the requirements to adhere to health guidelines and to minimise possibilities of contracting COVID-19.

Way Forward

The COVID-19 outbreak required supervisory and regulatory authorities as well as the banking sector to adapt to the operational constraints and heightened risks resulting from the COVID-19 outbreak. Consequently, regulatory authorities would also need to continuously adapt and monitor early warning frameworks of banks to identify and remedy banks' critical deficiencies and gauge whether supervisory action towards specific banks is warranted on the basis of risk assessments. The Central Bank will also continue to closely monitor the liquidity and capital positions of licensed banks and any early warnings of stress to ensure the safety and soundness of the banking sector. Further, the Central Bank may also consider implementing additional extraordinary regulatory measures to address any potential challenges to the banking sector, if required. Therefore, supervisory flexibility to quickly respond to such changes is essential in the 'new normal' amidst the COVID-19 outbreak. Hence, supervisory authorities including the Central Bank would need to improve and extend the use of technology, viz. Suptech via Artificial Intelligence (AI), machine learning and data analytics, etc. Adoption of Suptech could help improve oversight, surveillance and analytical capabilities of supervisory authorities, and help generate real time risk indicator dashboards to support more forward looking, risk based supervisory approaches and practices going forward in the 'new normal' amidst the COVID-19 outbreak.

References

1. Borio C & Restoy F, "Financial Stability Institute (FSI) Briefs: Reflections on regulatory responses to the COVID-19 pandemic", (April 2020).
2. A Joint IMF-World Bank Staff Position Note, "COVID-19: The Regulatory and Supervisory Implications for the Banking Sector", (May 2020).
3. Toronto Centre, "Guide to Supervision in the COVID-19 World", (September 2020).

Further concessions were granted in 2021 to identified economic sectors such as tourism and passenger transportation sectors, on need basis, considering the ongoing travel restrictions and disruption to economic activities due to the subsequent waves of the COVID-19 pandemic.

Maximum interest rates applicable on lending products were reduced to support marginal borrowers. Maximum interest rates for pawning advances were imposed considering the necessity to provide relief to individuals who are pawning gold jewellery to meet short-term financing needs due to the adverse economic conditions resulting from the COVID-19 outbreak. Interest rates on lending products of licensed banks were further reduced in August 2020 to help marginal borrowers. Further, in December 2020, the maximum interest rate for mortgage-backed housing loans obtained by salaried employees in confirmed service in the public and private sectors was capped at 7 per cent per annum, considering the reduction of policy interest rates, significant levels of excess liquidity prevailing in the domestic money market and the need for a continued downward adjustment in lending rates to revive the economy. This measure is also expected to support the expansion of home ownership of salaried employees and provide an additional stimulus to the domestic construction sector and its supply chains.

Considering the multifaceted challenges faced by the economy during 2020, the Central Bank introduced a range of policy measures to ensure stability of the financial sector. These policy measures include the extension of the maximum period for the recovery of accommodation to exporters to 180 days from the date of shipment, measures to curtail imports and investments in Sri Lanka International Sovereign Bonds (ISBs) by LCBs and National Savings Bank to ease the pressure on the exchange rate and the stress on financial markets due to the impact of COVID-19 outbreak, amending the regulations on ownership limits on issued capital carrying voting rights for licensed banks, considering the benefits to the banking system through the investments by Multilateral Financial Organisations (MFOs) in the shareholdings of licensed banks, and introducing amendments to regulations to facilitate Financial Derivative Transactions of licensed banks considering the necessity to encourage foreign currency inflows to the country.

During the year 2020, amendments were made to certain regulations applicable for licensed banks. Guidelines on adoption of SLFRS 9: Financial Instruments by licensed banks were issued to establish consistent practice of accounting treatments by banks amidst the COVID-19 environment. Enhancing the annual turnover threshold for SMEs to Rs. 1 billion for regulatory purposes of licensed banks and updating the eligibility criteria for valuers of licensed banks under the Regulatory Framework on Valuation of Immovable Properties of licensed banks, are some other amendments done during the year. All prudential regulations issued to licensed banks during the year 2020, including extraordinary measures taken amidst COVID-19 outbreak, are provided in Part III of this report.

During 2020, the Central Bank adopted a more robust risk-based examination mechanism, and a comprehensive supervisory guidance framework based on the rating outcomes of an internal rating model: Bank Sustainability Rating Indicator (BSRI). The Central Bank also initiated formulating a framework for Group-wide Consolidated Risk-based Supervision (GCRS) of banking groups and necessary amendments to facilitate GCRS are also being drafted in the new Banking Act, considering the need to address any contagion risk to the licensed banks arising from the entities within banking groups.

Further, the Central Bank prepared a Concept Paper to establish a dedicated Asset Management Company (AMC) to purchase and manage non-performing assets of both banks and non-banking financial institutions (NBFIs) which are under resolution and are operating in a viable manner. Establishment of an AMC will be beneficial in reinforcing the financial system stability by enabling banks and NBFIs to restructure their balance sheets through reduction of NPLs and to utilise liquidity generated through such measures to direct credit to more productive economic sectors.

8.3. Performance of Non-Bank Financial Institutions

Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) Sector

The LFCs and SLCs sector performance deteriorated during the year, with negative credit growth and high NPLs. In addition to the COVID-19 pandemic related growth impediments, the reduction of consumer confidence due to issues observed in the sector contributed towards the sluggish performance. However, despite certain institutions encountering difficulties to fulfill regulatory requirements at an individual level, the sector remained stable with capital and liquidity maintained at healthy levels above the minimum regulatory requirements. Total assets of the sector stood at Rs. 1,401.6 billion by end-December 2020, representing 5.9 per cent of Sri Lanka's financial system. The funding mix

Table 8.9
Distribution of Branches of LFCs and SLCs Sector by Province

Province	End 2019	End 2020 (a)	Movement during the year
Central	160	166	6
Eastern	117	119	2
North Central	99	107	8
North Western	156	165	9
Northern	89	96	7
Sabaragamuwa	113	116	3
Southern	151	162	11
Uva	67	70	3
Western	480	516	36
Total	**1,432**	**1,517**	**85**

(a) Provisional Source: Central Bank of Sri Lanka

was dominated by deposits while borrowings of the sector declined compared to the previous year. The Central Bank continued to introduce prudential measures to maintain the stability of the sector and granted regulatory flexibility to support the sector to face the challenges posed by the COVID-19 pandemic.

Business Expansion

Outreach: At end-2020, the sector comprised 40 LFCs[1] and 3 SLCs. There were 1,517 branches and 460 other outlets of the sector, of which 1,001 branches (66.0 per cent) were concentrated outside the Western Province.

Assets: Assets of the sector contracted, recording a negative growth rate of 2.2 per cent (Rs. 31.0 billion) during the year reaching Rs. 1,401.6 billion compared to the 0.1 per cent

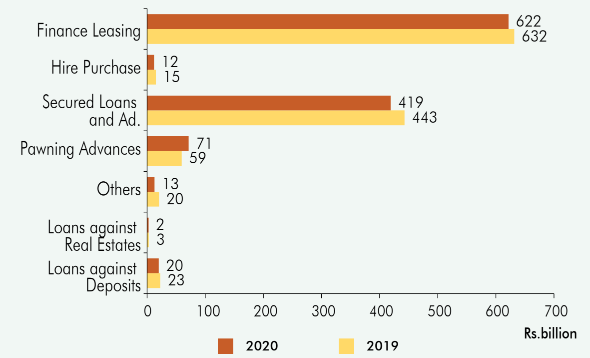
1 Including two companies whose business operations were suspended on 13 July 2020 by the Monetary Board

Table 8.10
Composition of Assets and Liabilities of the LFCs and SLCs Sector

Item	2019		2020 (a)		Change (%)	
	Rs. bn	Share (%)	Rs. bn	Share (%)	2019	2020 (a)
Assets						
Loans and Advances (net)	1,102.7	77.0	1,039.9	74.2	-3.0	-5.7
Investments	132.2	9.2	158.8	11.3	20.5	20.2
Other	197.8	13.8	202.9	14.5	7.1	2.6
Liabilities						
Total Deposits	756.7	52.8	748.6	53.4	5.6	-1.1
Total Borrowings	405.6	28.3	328.0	23.4	-12.6	-19.1
Capital Base	203.2	14.2	248.0	17.7	10.6	22.1
Other	67.2	4.7	77.0	5.5	0.3	14.6
Total Assets/Liabilities	**1,432.7**	**100.0**	**1,401.6**	**100.0**	**0.1**	**-2.2**

(a) Provisional Source: Central Bank of Sri Lanka

Figure 8.9
Total Loans and Advances (Gross) by Productwise for 2019 and 2020



Source: Central Bank of Sri Lanka

growth reported in 2019. Loans and advances accounted for 74.2 per cent of the total assets of the sector. Finance leases accounted for the highest share of loans and advances, representing 53.7 per cent, followed by the secured loans and advances (36.2 per cent). Lending of the sector slowed considerably during the year as business activities continued to contract amidst the COVID-19 lockdowns and curtailment of vehicle imports. Credit provided by the LFCs and SLCs sector contracted by 5.7 per cent (Rs. 62.9 billion) to Rs. 1,039.9 billion compared to the contraction of 3.0 per cent in the corresponding period of 2019.

The investment portfolio recorded a growth of 20.2 per cent to Rs. 158.8 billion in 2020 compared to the growth of 20.5 per cent in 2019, mainly due to increase in prices of shares, increased investments in unit trusts, debt securities held for trading and government securities maturing in less than 12 months free of lien. Other assets, mainly cash balances with banks and financial institutions and fixed assets, increased by 2.6 per cent during the year.

Liabilities: Customer deposits continued to dominate the liabilities of the LFCs and SLCs sector, accounting for a share of 53.4 per cent of liabilities. The deposits contracted by

Table 8.11
Composition of Deposits of the LFCs Sector

Item	Amount (Rs. bn)		Composition (%)	
	2019	2020 (a)	2019	2020 (a)
Time Deposits	722.2	710.5	95.4	94.9
Savings Deposits	33.5	37.3	4.4	5.0
Certificate of Deposits	0.9	0.8	0.1	0.1
Total Deposits	**756.7**	**748.6**	**100.0**	**100.0**

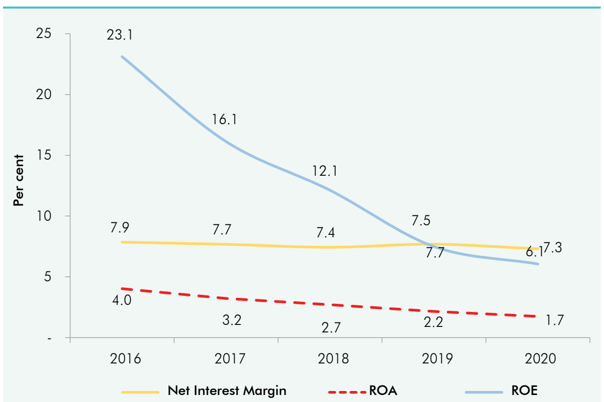
(a) Provisional Source: Central Bank of Sri Lanka

1.1 per cent (Rs. 8.1 billion) to reach Rs.748.6 billion while borrowings recorded a sharp decline of 19.1 per cent (Rs. 77.6 billion) reaching Rs. 328.0 billion during the year.

Resources

Profitability: Net interest income of the sector during the year was Rs. 111.2 billion, which was a decline of 5.3 per cent (Rs. 6.2 billion) compared to 2019. This was due to the decline in economic activities with the COVID-19 outbreak resulting in a reduction in both interest income and interest expenses. The interest income and interest expenses declined by 12.0 per cent (Rs. 31.3 billion) and 17.6 per cent (Rs. 25.0 billion), respectively. Net interest margin of the sector (net interest income as a percentage of average assets) declined to 7.3 per cent in 2020 from the 7.7 per cent in 2019, due to a decline in the net interest income and a marginal increase in (gross) average assets.

Figure 8.10
Profitability Indicators of the LFCs and SLCs sector



Source: Central Bank of Sri Lanka

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Table 8.12
Composition of Income and Expenses of the LFCs and SLCs Sector

Item	2019		2020 (a)	
	Amount (Rs. bn)	As a % of Avg. Assets	Amount (Rs. bn)	As a % of Avg. Assets
Interest Income	259.8	17.0	228.5	15.0
Interest Expenses	142.4	9.3	117.4	7.7
Net Interest Income	**117.4**	**7.7**	**111.2**	**7.3**
Non-Interest Income	39.4	2.6	32.0	2.1
Non-Interest Expenses	93.8	6.1	78.4	5.2
Loan Loss Provisions (Net)	30.2	2.0	38.2	2.5
Profit Before Tax	**32.8**	**2.2**	**26.6**	**1.7**
Profit After Tax	14.5	1.0	13.7	0.9

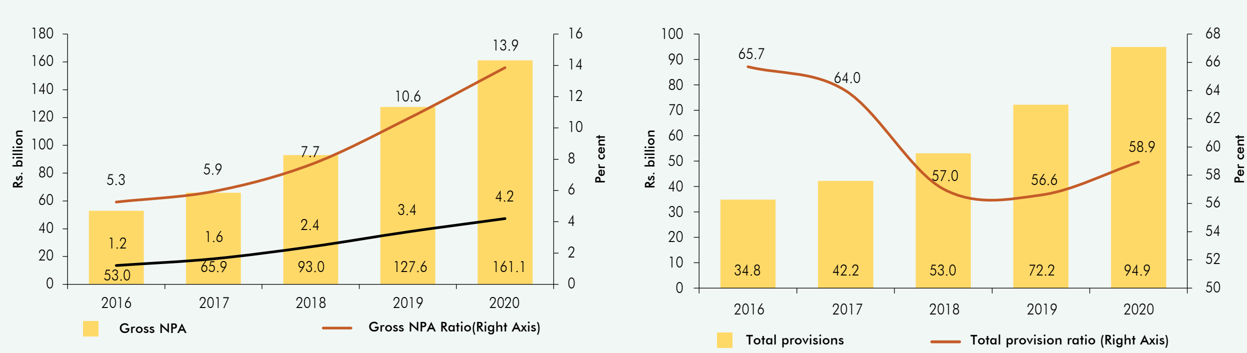
(a) Provisional — *Source:* Central Bank of Sri Lanka

Non-interest income declined by 18.7 per cent (Rs. 7.4 billion), while non-interest expenses declined by 16.4 per cent (Rs. 15.4 billion) during 2020, affecting sector profitability. Non-interest expenses declined mainly due to decreased administrative expenses (Rs. 6.0 billion), loss on valuation/disposal of repossessed items (Rs. 1.9 billion), reduction in staff costs (Rs. 3.3 billion) and other expenses (Rs. 2.2 billion). The loan loss provisions made against NPLs during the year was Rs. 38.2 billion, which was an increase of 26.4 per cent (Rs. 8.0 billion), when compared with the provision made in 2019. The sector posted a profit after tax of Rs. 13.7 billion, a decline of 6.1 per cent compared to the profit recorded in year 2019, mainly due to the significant decline in interest income recorded during the period.

Capital: The sector as a whole remained resilient with capital maintained above the minimum required levels during the year. The capital base improved to Rs. 218.9 billion by end December 2020 compared with Rs. 182.0 billion recorded by end December 2019, with the infusion of new capital by LFCs to meet regulatory requirements and cancellation of licence of a LFC with a large negative net worth. Upon reaching the deadline, an extension of 12 months was granted to LFCs to comply with minimum core capital requirements considering the economic impact of the COVID-19 outbreak. The new target is to reach Rs. 2.5 billion by 01 January 2022. The sector core capital and total risk weighted capital ratios increased to 14.5 per cent and 15.7 per cent, respectively, by end December 2020 from the reported levels of 11.1 per cent and 12.5 per cent at end December 2019.

Further, the Financial Sector Consolidation Master Plan (FSCMP) was introduced to address non-compliance with the minimum core capital requirement and/or the minimum capital adequacy ratios by several LFCs. Several regulatory actions were initiated by the Central Bank in addition to introducing the FSCMP with a view to avoid further deterioration of the financial position, maintain the stability of such institutions and safeguard the interest of depositors.

Figure 8.11
Non Performing Loans and Provision Coverage of the LFCs and SLCs Sector



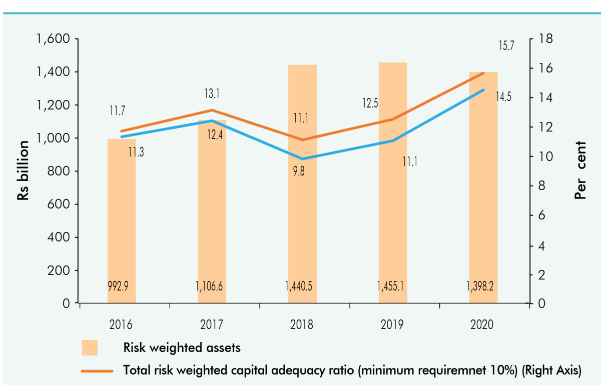
Source: Central Bank of Sri Lanka

Risks in the LFCs and SLCs Sector

Credit Risk: Total gross loans and advances reduced by 3.0 per cent (Rs. 35.9 billion) by end December 2020 on year-on-year basis, compared to a reduction of 0.9 per cent (Rs. 10.3 billion) recorded at end December 2019. The gross NPL ratio increased to 13.9 per cent by end December 2020 from 10.6 per cent reported as at end December 2019, showing a severe deterioration in the asset quality of the sector. The net NPL ratio also increased to 4.2 per cent by end December 2020 from 3.4 per cent reported at end December 2019. This was mainly due to the slowing down in the economic activities following the COVID-19 pandemic. Gross NPL ratio has slightly reduced when compared with the end June 2020 ratio of 14.1 per cent. NPLs of the sector could be underestimated due to debt moratorium together with other concessions and NPL levels may increase further after the end of the debt moratorium. Provision coverage ratio marginally increased to 58.9 per cent in December 2020, compared with 56.6 per cent reported in December 2019.

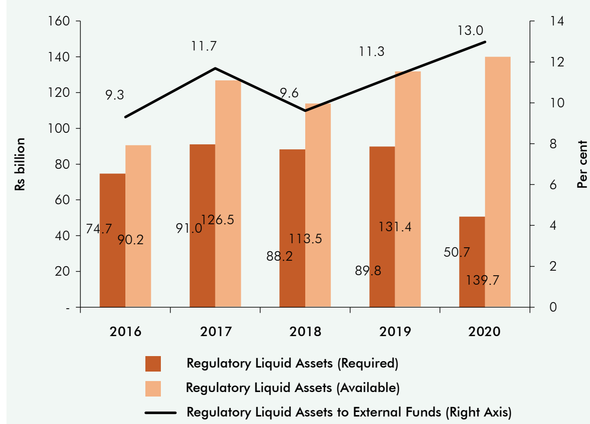
Market Risk: The sector continued to experience low market risk which comprise of interest rate risk and equity risk.

Figure 8.12
Risk weighted assets and CAR of the LFCs and SLCs Sector



Source: Central Bank of Sri Lanka

Figure 8.13
Regulatory Liquidity Indicators of the LFCs and SLCs Sector



Source: Central Bank of Sri Lanka

Interest Rate Risk: With the objective of reducing interest rates on lending, maximum interest rates on deposits and debt instruments were further reduced since April 2020. Accordingly, interest rate risk of the sector decelerated with the prevailing negative mismatch in the maturity profile of the interest-bearing assets and liabilities.

Equity Risk: Equity risk of the sector remained low during the period under review as the exposure to equity market in the form of investment in listed shares is 1.0 per cent of the sector assets at the end December 2020.

Liquidity Risk: The sector maintained adequate liquidity buffers well above the regulatory minimum levels by end December 2020. The overall regulatory liquid assets available in the sector indicated a surplus of Rs. 89.0 billion as against the stipulated minimum requirement of Rs. 50.7 billion. The regulatory relaxations of the Central Bank by relaxing the liquid asset requirements also facilitated the sector to escalate the liquidity surplus. The liquidity ratio (liquid assets against deposits and borrowing) increased to 13.0 per cent by end December 2020, compared to 11.3 per cent recorded at end December 2019.

Primary Dealer Companies in Government Securities

As at end 2020, there were 6 LCBs and 7 Primary Dealer companies appointed as Primary Dealers (PDs) in the government securities market. Union Bank of Colombo PLC ceased its operations as a PD with effect from 01 May 2020 and the appointment of the Natwealth Security Limited (NWSL) was withdrawn w.e.f. 30 November 2020. Pan Asia Banking Corporation PLC (PABC) and Perpetual Treasuries Limited (PTL) have been suspended from carrying on business and activities of a PD since 15 August 2017 and 06 July 2017, respectively. Participation in primary auctions was prohibited for Entrust Securities PLC (ESP) w.e.f. 24 July 2017. Accordingly, only 5 LCBs and 5 PD companies were active in the government securities market as PDs.

Assets and Liabilities: The total assets of PD companies increased by 12.4 per cent to Rs. 87.2 billion in 2020. The total investment portfolio of government securities, consisting of trading, available for sale and held to maturity portfolios amounted to Rs. 80.1 billion at end 2020, recording an increase of 15.5 per cent during the year. The trading portfolio increased to Rs. 62.6 billion by end 2020, from Rs. 57.5 billion recorded at end 2019 while the held to maturity portfolio increased to Rs. 14.7 billion at end 2020 from Rs. 8.6 billion at end 2019. Available for Sale Portfolio decreased to Rs. 2.8 billion by end 2020 compared to Rs. 3.3 billion as at end 2019.

Profitability: PD companies reported profit after tax of Rs. 4.9 billion during 2020 against that of Rs. 3.8 billion during 2019, indicating a significant improvement in profitability consequent to the decline in yield rates. The significant increase in capital gains recorded in 2020 compared to 2019 has largely contributed to the increase in profits despite the mark-to-market loss recorded by PD companies in year 2020. Consequently, Return on Assets (ROA) and Return on Equity (ROE) of PD companies increased to 7.6 per cent and 30.5 per cent, respectively, by end 2020 from 6.0 per cent and 28.5 per cent recorded in 2019, respectively.

Capital: Equity of PD companies increased by 11.2 per cent largely due to accumulation of profit during the year. The Risk Weighted Capital Adequacy Ratio (RWCAR) of the PD companies was well above the minimum required amount of 10.0 per cent despite marginal decline to 27.0 per cent as at the end 2020 from 27.6 per cent reported as at the end 2019.

Exposure to Risks

Market Risk: The proportion of trading portfolio to total investment portfolio of PD companies decreased marginally and was recorded at 78.2 per cent as at end 2020 compared to 82.9 per cent as at end 2019, reflecting a marginal decrease in the relative market risk exposure of the industry.

Liquidity Risk: The overall liquidity risk exposure of PD companies increased due to the increase in over-night negative mismatch in the maturity profile of assets and liabilities of the PD companies by end 2020. The overnight negative mismatch increased to Rs. 13.1 billion or 79.5 per cent of the overnight liabilities as at end 2020, from Rs. 11.0 billion (72.1 per cent) as at end 2019. In view of holding a large volume of government securities, which are free of credit risk, by PDs and also the ability to use such government securities as collateral for obtaining funds to bridge any unforeseen liquidity gaps, the liquidity risk profile of PDs remained low throughout the year except for one PD who was facing liquidity issues. Most of the PDs had stand-by contingency funding arrangements to bridge any liquidity gaps.

Market Conduct

Primary Market Activities: The participation in primary auctions in respect of Treasury bills and Treasury bonds by PDs has shown a mixed performance during 2020. Of the total bids accepted at 53 T-bills auctions conducted in 2020, the effective participation of LCBs appointed as PDs, PD Companies and Employees' Provident Fund (EPF) accounted to 58.4 per cent, 41.3 per cent and 0.3 per cent, respectively. At 15 T-bond auctions conducted during 2020, effective participation of LCBs appointed as PDs, PD companies and EPF accounted to 31.5 per cent, 35.3 per cent and 33.2 per cent, respectively.

Secondary Market Activities of PD companies: Secondary market transactions in government securities (in terms of value) by PD companies decreased by 6.6 per cent to Rs. 7,576.5 billion in 2020, out of which repo transactions accounted to 72.4 per cent. During 2020, outright purchases and outright sales by PD Companies increased by 12.5 per cent and 35.8 per cent respectively, compared to 2019.

Licensed Microfinance Companies

Licensed Microfinance Companies (LMFC) sector reported assets of Rs. 6.8 billion as at end 2020 with a 16.0 per cent growth, compared to the preceding year. Sejaya Microcredit Limited was granted a licence, under the Microfinance Act, No. 6 of 2016 by the Monetary Board of the Central Bank as the fourth LMFC. Microfinance loans and advances accounted for the largest share of total assets with 85.3 per cent. Microfinance loans and advances were recorded at Rs. 5.8 billion by end 2020 in comparison to the Rs. 4.7 billion reported at end 2019, with a growth of 21.5 per cent. The LMFCs were adversely affected by the COVID-19 pandemic, which resulted in the sector reporting a loss of Rs. 0.1 billion during 2020. In order to enable such LMFCs to utilise the available liquid assets to meet operational costs the Monetary Board withdrew the requirement for LMFCS to maintain liquid assets as per the Microfinance Act. The core capital level of the sector remained at Rs. 2.2 billion and all LMFCs were compliant with the minimum prudential regulations on core capital.

Insurance Sector

By end 2020, there were 27 insurance companies operating in the country, comprising 13 long-term insurance companies, 12 general insurance companies and 2 companies involved in both long-term and general insurance business.

The insurance sector reported a significant growth in its asset base in 2020. The total assets of the insurance sector grew by 14.6 per cent by end 2020 on a y-o-y basis and reached Rs. 790.1 billion. The asset base of the long-term insurance subsector increased by 16.1 per cent from Rs. 485.7 billion by end 2019 to Rs. 563.9 billion by end 2020 whereas, the asset base of the general insurance subsector increased by 11.0 per cent

Table 8.13
Performance of the Insurance Sector

Rs. billion

Item	2019 (a)	2020 (b)
Total Assets	689.6	790.1
Government Securities	248.2	291.3
Equities	40.9	43.5
Cash & Deposits	107.5	131.3
Gross Premium	190.2	208.6
Total Income	245.8	264.4
Premium Income	190.2	208.6
Investment Income	55.5	55.7
Profit Before Tax	30.7	38.6
Capital Adequacy Ratio (%) - Long-term Insurance	298.0	352.0
- General Insurance	231.0	246.0
Retention Ratio (%) - Long-term Insurance	95.8	95.4
- General Insurance	83.4	77.6
Claims Ratio (%) - Long-term Insurance	41.4	38.6
- General Insurance	66.4	49.3
Combined Operating Ratio (%) - Long-term Insurance	91.0	83.7
- General Insurance	104.4	88.3
Return on Assets (ROA) (%) - Long term Insurance	4.3	3.0
- General Insurance	5.6	8.6
Return on Equity (ROE) (%) - Long term Insurance	18.1	13.3
- General Insurance	5.6	17.8
Underwriting Ratio (%) - General Insurance	14.3	33.0

(a) Revised
(b) Provisional

Source: Insurance Regulatory Commission of Sri Lanka

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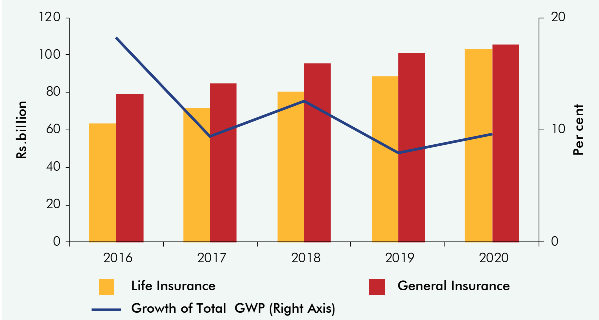
and reached Rs. 226.2 billion by end 2020. The share of the asset base of the long-term insurance subsector over total insurance sector asset base remained high at 71.4 per cent by end 2020 which was an increase from 70.4 per cent recorded by end 2019. Corresponding to this increase, the share of general insurance subsector assets over total assets declined slightly to 28.6 per cent by end 2020 from 29.6 per cent by end 2019.

Gross written premium of the insurance sector grew by 9.7 per cent to Rs. 208.6 billion by end 2020 from Rs. 190.2 billion by end 2019. Gross written premium of the long-term insurance sector increased by 16.0 per cent, whereas the gross written premium of the general insurance subsector increased by 4.2 per cent during the period under consideration. However, the general insurance subsector remained as the main contributor of the gross written premium of the insurance sector which recorded a share of 50.6 per cent by end 2020. The general insurance subsector was mainly concentrated on motor insurance and its gross written premium decreased slightly by 1.9 per cent by end 2020.

Profitability of the insurance sector increased by 25.9 per cent during the year. The increase of profitability was observed in general insurance sub-sector by 104.9 per cent during the year while a decline in profitability was observed in the long-term insurance subsector by 19.1 per cent in 2020. Decline in claims due to lockdowns imposed by the Government for controlling the spread of COVID-19 virus, may have contributed to this increase. Meanwhile, the underwriting profits of the sector also increased by 126.6 per cent by end 2020.

The insurance sector reported a decrease in its claims by 14.1 per cent amounting to Rs. 80.5 billion by end 2020. The claims of the general insurance subsector decreased by 27.1 per cent, while claims of the long-term insurance subsector increased by 7.5 per cent by end 2020.

Figure 8.14
Gross Written Premium of the Insurance Sector



Source: Insurance Regulatory Commission of Sri Lanka

ROA and ROE of the general insurance subsector increased, while ROA and ROE of the long-term insurance subsector declined during the year compared to 2019. ROA of the general insurance subsector increased to 8.6 per cent, while ROA of the long-term insurance subsector decreased to 3.0 per cent by end 2020. The ROE of the general insurance subsector increased to 17.8 per cent by end 2020 from 5.6 per cent recorded by end 2019, whereas the ROE for the long-term insurance subsector declined to 13.3 per cent by end 2020 from 18.1 per cent recorded by end 2019. The underwriting ratio increased to 33.0 per cent by end 2020 from 14.3 per cent reported by end 2019.

Capital to total assets of the long-term insurance subsector declined from 23.4 per cent by end 2019 to 22.0 per cent by end 2020, whereas the capital to total assets of the general insurance subsector increased to 49.7 per cent by end 2020 from 46.0 per cent reported by end 2019.

The investments made by the insurance sector continued to be highly concentrated on government securities. Share of long-term insurance subsector assets on government securities increased to 40.4 per cent by end 2020 compared to 39.8 per cent reported by end 2019. Meanwhile, the assets of the general insurance subsector invested on government securities also increased to 28.1 per cent by end 2020 compared to 26.9 per cent reported by end 2019. On the other hand, the share of investments on equity of the long-term insurance subsector decreased to 6.5 per cent by end 2020 compared to 6.8 per cent by end 2019. Also, the general insurance subsector's investment on equity decreased to 7.4 per cent by end 2020 from 7.7 per cent recorded by end 2019.

Superannuation Funds

The total assets of the superannuation funds were reported to be Rs. 3,639.7 billion at end 2020 contributing to 15.4 per cent of the financial sector assets. The sector was dominated by the Employees' Provident Fund (EPF), which accounts for 77.6 per cent of the total assets of the superannuation sector. In addition to EPF, there are two other publicly managed funds, namely, the Employees' Trust Fund (ETF) and the state sector Public Service Provident Fund (PSPF).

Employees' Provident Fund

As per the Employees' Provident Fund Act, No. 15 of 1958, the Monetary Board of the Central Bank is entrusted with the custodianship of the Fund while the Commissioner of Labour is entrusted with the general administration of the Fund. The EPF Department facilitates the Monetary Board to perform its powers, duties and functions as per the provisions of the EPF Act.

The total value of the Fund increased by Rs. 283.9 billion to Rs. 2,824.3 billion as at end 2020 from Rs. 2,540.4 billion recorded by end 2019, recording an 11.2 per cent growth. This increase was due to the combined effect of the net contributions of the members (contributions less refund payments) and the income generated through investments of the Fund. Total liability to the members stood at Rs. 2,767.8 billion as at

Table 8.14
Five year Performance Summary of EPF

Item	2016	2017	2018	2019	2020(a)
Total Value of the Fund (Rs. bn)	1,841.5	2,066.3	2,289.4	2,540.4	2,824.3
Total Liability to the Members (Rs. bn)	1,810.6	2,020.8	2,254.2	2,497.6	2,767.8
Total Contribution (Rs. bn)	118.3	133.3	145.0	157.2	150.7
Total Refunds (Rs. bn)	108.4	117.5	108.0	126.3	109.7
Net Contribution (Rs. bn)	9.9	15.8	37.0	30.9	41.0
Interest rate (%)	10.50	10.50	9.50	9.25	9.00

(a) Provisional

Source: Central Bank of Sri Lanka

end 2020 recording a 10.8 per cent increase from Rs. 2,497.6 billion as at end 2019. The total contribution for the year 2020 decreased by 4.1 per cent to Rs. 150.7 billion, while the total amount of refunds made to the members and their legal heirs was Rs. 109.7 billion in 2020, which was a decrease of 13.1 per cent over 2019. Accordingly, the net contribution to the Fund was Rs. 41.0 billion compared to Rs. 30.9 billion recorded in the previous year. The annual profit of the Fund increased by 9.9 per cent to Rs. 244.9 billion in 2020 from Rs. 222.8 billion recorded in the previous year. This was mainly due to the increase in the interest income by Rs. 22.7 billion.

The total investment portfolio (book value) of the Fund grew by 11.0 per cent to Rs. 2,829.5 billion as at end of 2020 from Rs. 2,548.7 billion as at end of 2019. The investment policy of the Fund is focused on providing a long-term positive real rate of return to the members, while ensuring the safety of the Fund and availability of adequate level of liquidity to meet refund payments and other expenses of the Fund. Accordingly, as at end 2020, the investment portfolio consisted of 93.4 per cent in government securities, 2.8 per cent in equity, 1.2 per cent in corporate debentures, 2.0 per cent in fixed deposits and the remaining 0.6 per cent in Reverse Repurchase agreements**.**

Investment Income: The total investment income of the Fund was Rs. 285.4 billion in 2020, and recorded an increase of 10.2 per cent compared to previous year. Interest income, including amortisation gains, continued to be the major source of income to the Fund which grew by 8.9 per cent to Rs. 277.4 billion in 2020 from Rs. 254.7 billion in 2019. Dividend income decreased by 52.2 per cent to Rs. 3.0 billion in 2020 compared to Rs. 6.2 billion in 2019. Net Gain/Loss on financial instruments at fair value through profit or loss recorded a net gain of Rs. 5.0 billion in 2020 compared to net loss of Rs. 1.9 billion in 2019.

Overall Return of the Fund: The Fund earned a total gross income of Rs. 285.6 billion in 2020, recording an increase of 10.1 per cent compared with the previous year. After adjusting for operating expenditure and tax expenditure, the net profit for the year 2020 was Rs. 244.9 billion which is an increase of 9.9 per cent compared to that of 2019. EPF was able to earn 10.6 per cent Return on Average Investment in 2020 while maintaining operating expenses to gross income ratio at 0.58 per cent in 2020. Furthermore, the tax expenditure of the Fund increased by Rs. 4.1 billion compared to 2019. Nevertheless, the adoption of SLFRS 9, the Accounting Standard applicable for classification and measurement of Financial Instruments, where listed equity instruments were measured at fair value and under the prevailed market conditions, a marked to market gain of Rs. 5.0 billion was recorded as an income for the year 2020. Accordingly, EPF has taken measures to declare an interest rate of around 9.0 per cent on member balances in 2020 after transferring Rs. 13.0 billion to the Profit Equalisation Reserve.

Risk Management: Even under the COVID-19 pandemic situation, the investment activities were conducted in adherence with the existing risk management framework while maintaining the internal control environment as appropriate. Accordingly, the investment activities were continued throughout the year while ensuring the safety and optimal return of the Fund. Further, the regular processes of reporting the departmental risks to the Monetary Board through the related oversight committees of the Central Bank was continued throughout the year to maintain the accountability and transparency of such activities. However, the significant changes that took place during the year due to sharp reductions in the market interest rates, unexpected fluctuations in the equity market and changes in risk ratings of counterparties led the necessity of reshaping the prevailing risk parameters as well. Accordingly, action has been initiated to revisit and revise the prevailing investment guidelines in order to provide an acceptable avenue for the business units to take the investment decisions considering the market situations.

Employees' Trust Fund

The Employees' Trust Fund (ETF) that contributed to 10.5 per cent of the asset base of the superannuation sector recorded an improvement in terms of its asset base, number of members and the total contributions during the year. Out of 15.9 million member accounts of the ETF, only 2.5 million accounts were active in 2020. The number of employers contributing to the fund declined to 75,756 by end 2020 from 82,375 by end 2019. Total member balance of the ETF increased by 2.5 per cent and reached Rs. 347.6 billion by end 2020 compared to Rs. 339.2 billion by end 2019. The total contribution of the ETF decreased by 1.8 per cent and reached Rs. 27.0 billion, while total refunds decreased by 6.1 per cent and reached Rs. 18.6 billion, during 2020.

The total assets of the ETF increased by 10.8 per cent during the year and reached Rs. 380.4 billion by end 2020. ETF's investments improved to Rs. 358.4 billion in 2020, which is an increase of 6.9 per cent compared to 2019. Out of these investments, in 2020, 81.0 per cent was invested in government securities compared to 77.7 per cent recorded in 2019. The share of investments in fixed deposits decreased to 13.6 per cent in 2020 compared to 16.7 per cent in 2019. However, the share of investments in equity increased marginally to 3.3 per cent in year 2020 compared to 3.2 per cent reported in 2019. The fund managed to secure a rate of return of 8.0 per cent on its member balances for the year.

Other Superannuation Funds

The Public Service Provident Fund (PSPF), which accounted for 1.9 per cent of the superannuation sector, increased in terms of the number of members and the net contributions, while reporting a growth of 10.1 per cent and reached Rs. 70 billion in terms of assets. The number of active members of the fund increased to 235,884 by end 2020, compared to 222,739 by end 2019. Meanwhile, the investments of the fund also grew by 11.7 per cent reaching Rs. 69.6 billion by end 2020. The net contribution was Rs. 507.0 million during 2020, compared to the net contribution of Rs. 491.0 million reported in 2019. PSPF invested 40.5 per cent of its total investments in government securities in 2020. The rate of return on member balances was 9.8 per cent for the year 2020.

Approved Pension and Provident Funds (APPFs) accounts for 10.0 per cent of the superannuation sector by end 2020. The number of members covered by private provident funds was 186,491 at end 2020 and total assets of the APPFs is estimated to be Rs. 364.9 billion at end 2020.

Table 8.15
Performance of the EPF and the ETF

Item	EPF		ETF	
	2019 (a)	2020 (b)	2019 (a)	2020 (b)
Total Assets (Rs. bn)	2,540.4	2,824.3	343.3	380.4
Total Member Balance (Rs. bn)	2,497.6	2,767.8	339.2	347.6
Number of Member Accounts (mn)	19.4	19.4	15.3	15.9
Number of Active Member Accounts (mn)	2.9	2.0	2.6	2.5
Number of Employers Contributing	94,171	70,552	82,375	75,756
Total Contributions (Rs. bn)	157.2	150.7	27.5	27.0
Total Refunds (Rs. bn)	126.3	109.7	19.8	18.6
Total Investments Portfolio (Rs. bn)	2,548.7	2,829.5	335.2	358.4
o/w : Government Securities (%)	93.8	93.4	77.7	81.0
Gross Income (Rs. bn)	259.3	285.6	32.1	34.5
Profit Available for Distribution (Rs. bn)	223.0	245.1	25.5	27.8
Return on Investments (%)	10.7	10.6	9.1	8.8
Interest Rate Paid on Member Balances (%)	9.3	9.0	8.0	8.0

(a) Revised
(b) Provisional

Sources: Central Bank of Sri Lanka
Employees' Trust Fund Board

8.4 Performance of Financial Markets

Domestic Money Market

Market Liquidity

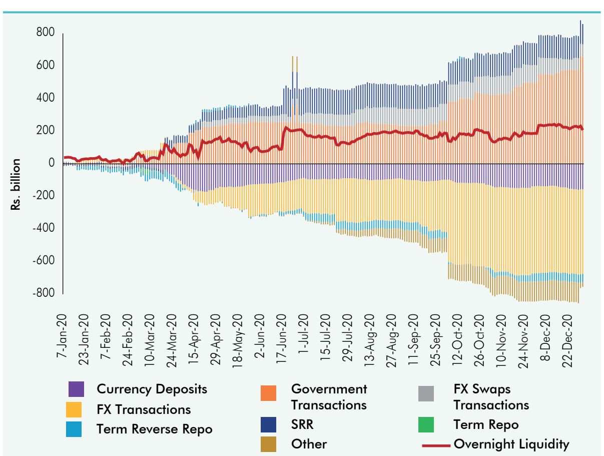
The domestic money market recorded a persistent liquidity surplus during 2020. This was mainly driven by a number of factors, such as the reduction in the Statutory Reserve Ratio (SRR), purchasing Treasury bills at the primary market and foreign exchange purchases by the Central Bank. Funds disbursement under the special loan schemes introduced by the Central Bank in view of the COVID-19 pandemic and the monetary operations of the Central Bank also contributed to the liquidity surplus. The Central Bank continued its accommodative monetary policy stance in order to address disturbances arising due to the COVID-19 pandemic, and reduced the policy interest rates by a cumulative of 250 basis points in five occasions during 2020. As a result, the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) were reduced to their lowest levels of 4.50 per cent and 5.50 per cent, respectively. In addition, the Central Bank introduced several monetary policy relaxation measures to ensure certainty of the availability of liquidity in the money market, considering the need for supporting the financial system and economic activities. Further, the Central Bank also reduced the SRR applicable on rupee deposit liabilities of LCBs by 3.00 percentage points during the year in two stages in March and June 2020 to a low level of 2.00 per cent, thereby injecting around Rs. 180 billion liquidity to the domestic money market. At the same time, since mid-April 2020, with the view to provide more flexibility in liquidity management, LCBs were permitted to reduce the minimum daily reserve balances held by a LCB with the Central Bank from 90 per cent to 20 per cent of the required reserves on any given day. Along with the revision to SRR, the amount of till cash (currency notes and coins at the vaults of LCBs) considered for the computation of SRR of LCBs was also reduced to 1.00 per cent from 2.00 per cent from mid-June 2020. In order to ensure the availability of emergency funding to banking institutions at reduced interest rates, the Central Bank reduced the Bank Rate, which is an administratively determined interest rate by the Central Bank, by 650 basis points in April, May and July 2020 to 8.5 per cent while allowing it to be determined automatically with a margin of 300 basis points above the SLFR.

The Central Bank conducted both repurchase and reverse repurchase auctions under Open Market Operations (OMOs) in the first half of 2020 depending on the variations in market liquidity levels. However, as surplus liquidity position continued to prevail in the domestic money market, the Central Bank abstained from conducting auctions under OMOs during the period from 17 June 2020 to 24 September 2020, while continuing to absorb excess liquidity through the Standing Deposit Facility (SDF) on overnight basis. Recognising the need for ensuring the availability of adequate liquidity, mainly in view of the anticipated reduction in domestic rupee liquidity due to scheduled foreign loan repayments of the country, the auctions under OMOs were recommenced since 25 September 2020, in spite of the continued surplus liquidity in the domestic money market. Accordingly, the Central Bank conducted long term and short term reverse repo auctions for LCBs, and Standalone Primary Dealers (SPDs) on need basis. As the domestic money market liquidity was augmented to substantially high levels due to primary purchases of Treasury bills by the Central Bank, auctions under OMOs were not conducted since 12 November 2020.

Money Market Interest Rates

Following the monetary policy relaxation measures of the Central Bank, the Average Weighted Call Money Rate (AWCMR), which is the operating target of the current monetary policy framework of the Central Bank, was allowed to move towards the lower bound of the Standing Rate Corridor (SRC) in order to induce a downward adjustment in the market interest rates. During the first half of 2020, the

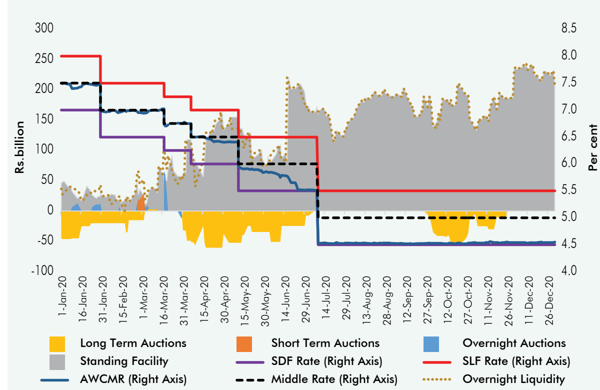
Figure 8.15
Daily Changes in the Money Market Liquidity



Source: Central Bank of Sri Lanka

Central Bank was able to maintain the AWCMR around the middle rate of the SRC through its monetary operations. Nevertheless, during the second half of the year, with an aim to drive down market lending rates in a bid to bolster economic activities, while allowing high liquidity surplus to prevail in the money market, the Central Bank facilitated the AWCMR to remain closer to the floor rate of the SRC. Accordingly, by end December 2020, the AWCMR remained just above the lower bound of the SRC at 4.55 per cent. At the same time, the Average Weighted Repo Rate (AWRR) also moved broadly in line with the movements of the AWCMR. Accordingly, AWRR remained at 4.57 per cent by end December 2020 indicating a substantial fund availability in the repurchase market.

Figure 8.16
Open Market Opearations, Standing Rate Corridor and Money Market Interest Rates



Source: Central Bank of Sri Lanka

Other Developments

Monetary policy implementation of the Central Bank during 2020, was focused on assuring the availability of adequate liquidity in the domestic money market. Adequate liquidity with low interest rates, enabled smooth operations of the financial system during the COVID-19 pandemic. In 2020, the Central Bank provided long-term liquidity assistance to LCBs through long term reverse repo auctions for an extended period of three months. Moreover, the Central Bank extended the Liquidity Support Facility (LSF) for SPDs for a period up to 15 days. Introduction of new loan schemes by the Central Bank to provide credit facilities at concessionary interest rates towards the businesses affected by the COVID-19 pandemic was instrumental in expanding the collateral base eligible for obtaining funds from the Central Bank. In order to ensure availability of adequate funds towards economically significant sectors having special liquidity needs during the COVID-19 pandemic period and to support the revival of economic activities, the Central Bank introduced new credit schemes based on the provisions of the Section 83(1) of the Monetary Law Act, No. 58 of 1949 (MLA). Accordingly, the Central Bank introduced a liquidity facility, namely Liquidity Facility to the Contractors and Suppliers (LFCS) to provide funds to LCBs at a concessionary rate of 1.00 per cent per annum for a period of up to 180 days for the purpose of on-lending to the contractors and suppliers of the Government in construction, pharmaceutical and such other identified sectors at a rate not exceeding 4.00 per cent. The LCBs provided credit facilities to such contractors and suppliers of the Government, upon the receipt of a letter of acceptance for payment of outstanding bills issued by the Government, and the Central Bank disbursed funds under the LFCS to LCBs based on the promissory notes from such LCBs which have been backed by Treasury bills and Treasury bonds as eligible collaterals. As at end December 2020, about Rs. 7.2 billion was disbursed by the Central Bank to LCBs under the LFCS in order to support the eligible borrowers. In addition, the Central Bank provided funds to LCBs under the Saubagya COVID-19 Renaissance Facility (SCRF) at the concessionary rate of 1.00 per cent against the pledge of a broad spectrum of collaterals, on the condition that LCBs in turn will on-lend to domestic businesses at a rate not exceeding 4.00 per cent. By end December 2020, about Rs. 83.4 billion was disbursed to LCBs under SCRF.

Domestic Foreign Exchange Market

During the year, Sri Lankan rupee depreciated against US dollar by 2.6 per cent from Rs. 181.63 as at end December 2019 to Rs. 186.41 as at end December 2020. Subsequent to the post-election economic stability, the year 2020 started at an enduring exchange rate around Rs. 181 level, however, which did not prevail for long. A significant pressure on the exchange rate was observed since mid-March and exchange rate reached almost Rs. 200 levels in April due to lower levels of export conversions, tourism related inflows and remittances as well as increased repatriations of foreign investments from the capital markets following the COVID-19 pandemic. However, this pressure was eased through modest FX interventions by the Central Bank along with the introduction of new Sell – Buy FX Swap auctions to the market and the policy directions taken by the Government and the Central Bank. Though the pressure was gradually eased towards the end-September 2020, with the emergence of a second wave of COVID-19 pandemic, the pressure on the exchange rate was again observed due to low level of FX inflows to the market together with the FX outflows on account of imports with the gradual relaxations of the restrictions and FX repatriations, such as dividends and FX loan repayments. This situation was further aggravated by the consecutive rating downgrading of Sri Lanka by global rating agencies. However, owing to the modest FX interventions and several policy measures taken by the Central Bank, exchange rate was stood at around Rs. 185 levels by end 2020. Further, in line with the overall depreciation of Sri Lankan Rupee against the US dollar, the average US dollar buying and selling exchange rates of commercial banks

Figure 8.17
USD/LKR Movement of the year 2020

Source: Central Bank of Sri Lanka

for telegraphic transfers as of end 2020 were at Rs. 184.12 and Rs. 189.18, whilst comparative figures in end 2019 were at Rs. 179.66 and Rs. 183.33, respectively. Meanwhile, during the year 2020, the Sri Lankan rupee depreciated against euro, Sterling pound, Japanese yen and Australian dollar.

The Central Bank was a net buyer in the domestic foreign exchange market during the year 2020. Despite the modest sale of foreign exchange to the market to minimise the excessive volatility in the exchange rate, the Central Bank was able to resume purchasing of FX from the market to build-up foreign exchange reserves of the country. Accordingly, during the year 2020, the Central Bank absorbed US dollars 685.4 million and supplied US dollars 402.9 million resulting in a net purchase of US dollars 282.5 million.

During the year 2020, trading volumes in the domestic foreign exchange inter-bank market decreased by 5.4 per cent compared to that of 2019. The total volume of inter-bank foreign exchange transactions amounted to US dollars 18.4 billion during the year 2020 compared to US dollars 19.4 billion in 2019. In line with this, the daily average volumes in the inter-bank foreign exchange market decreased to US dollars 77 million in 2020, from US dollars 80 million in 2019.

Government Securities Market

A downward adjustment in government securities yield rates was generally observed throughout 2020. The predictable issuance calendar published in line with envisaged strategic issuance arrangements, resource availability, and enhanced money market liquidity were the contributory factors for the downward adjustment in the short-term government securities yield rates during the early part of 2020. Meanwhile, in view of the measures taken to combat the adverse economic implications of the COVID-19 pandemic, particularly the continuation of the accommodative monetary policy stance, issuance arrangements envisaged in line with the availability of debt service payment in the market and the arrangements to publish the maximum yield rates for acceptance for Treasury bills and Treasury bond maturities offered at primary auctions, resulted in continuous downward momentum in the primary market yield rates in the second and third quarters of 2020. However, with the on-set of a second wave of the COVID-19 pandemic and negative rating actions towards the latter part of the year, during the fourth quarter of 2020, reversal of the downward momentum in the yield rates was observed in both primary and secondary markets of government securities. Accordingly, the primary market Weighted Average Yield Rate (WAYR) of the benchmark 364-day Treasury bill reduced to 5.05 per cent by end 2020 from 8.45 per cent recorded at end December 2019 while other government securities' primary market yield rates, including medium to long-term Treasury bonds also recorded significant reduction in yields by end 2020.

Table 8.16
Yield Rates of Government Securities

Per cent per annum

Item	Primary Market 2019	Primary Market 2020	Secondary Market 2019	Secondary Market 2020
Treasury bills				
91-Days	7.45 - 9.55	4.51 - 7.55	7.40 - 9.79	4.50 - 7.54
182-Days	7.58 - 9.95	3.87 - 8.15	7.55 - 9.96	4.61 - 8.12
364-Days	8.11 - 10.99	4.13 - 8.61	8.04 - 10.91	4.80 - 8.57
Treasury bonds				
2 Years	9.79 - 10.85	5.47 - 5.86	8.46 - 11.16	5.16 - 8.94
3 Years	9.65 - 10.72	5.72 - 9.33	8.86 - 11.42	5.59 - 9.38
4 Years	-	6.32 - 9.39	9.37 - 11.53	6.02 - 9.59
5 Years	9.83 - 11.58	6.50 - 9.81	9.56 - 11.58	6.30 - 9.81
6 Years	-	6.57 - 8.59	9.79 - 11.64	6.37 - 9.89
8 Years	10.24 - 11.30	7.07 - 9.99	9.85 - 11.69	6.63 - 9.99
10 Years	10.23 - 11.73	9.99	9.94 - 11.87	6.84 - 10.05
15 Years	10.59	7.84	10.11 - 12.01	7.13 - 10.18
20 Years	10.29 - 10.68	-	10.23 - 12.12	7.15 - 10.25
30 Years	-	-	10.36 - 12.15	7.61 - 10.52

Source: Central Bank of Sri Lanka

The unfavourable international capital market conditions with elevated secondary market yield levels for Sri Lanka's International Sovereign Bonds (ISBs), continuous tension with respect to sovereign rating actions and general risk averseness by investors for papers issued by frontier and developing economies restricted raising new funds from the conventional foreign capital markets in 2020. As a result, the ISB matured in October 2020 was settled without resorting to new ISB issuance with a strategic perspective to reduce external liabilities through a mixture of financing, accumulation of foreign reserves and management of foreign exchange outflows. In the domestic foreign currency financing front, significantly reduced demand and liquidity for Sri Lanka Development Bonds were observed and only US dollars 507.0 million was raised against the maturing amount of US dollars 952.8 million during 2020.

Reflecting the withdrawal of foreign portfolio investments from the frontier and developing economies due to pandemic and Sri Lanka

Table 8.17
Primary Market (Auction) Weighted Average Yield Rates of Treasury Bills

Per cent per annum

Year	Maturity 91-days	Maturity 182-days	Maturity 364-days	Annualised Overall Average
2016	8.26	9.23	10.20	9.38
2017	9.01	9.80	10.07	9.77
2018	8.40	8.58	9.68	9.36
2019	8.15	8.44	9.40	9.06
2020	5.93	5.72	6.37	6.09

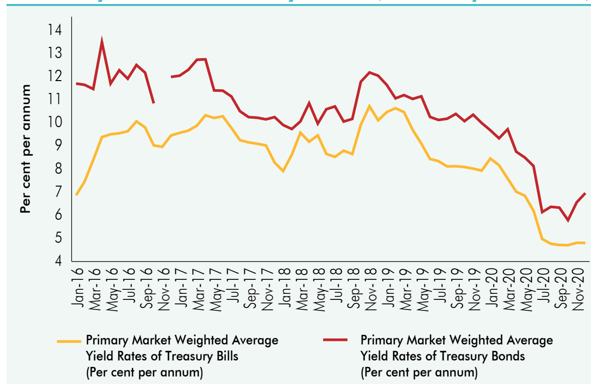
Source: Central Bank of Sri Lanka

specific credit rating downgrades, net outflows of foreign investments in the Sri Lankan government securities market was observed in 2020. Total net outflow of foreign investments in Treasury bonds and Treasury bills amounted to US dollars 552.7 million during the year. The outstanding foreign holdings of Treasury bonds and Treasury bills at end 2020 amounted to Rs. 6.7 billion compared to Rs. 103.9 billion at end 2019, recording a noteworthy decrease.

Among the main focuses of the Government's medium-term debt management strategy, the reduction of the share of foreign debt to total debt by converting part of the foreign debt to domestic debt was successful in 2020. Accordingly, the share of foreign debt reduced to 42.8 per cent at end December 2020 from 49.1 per cent recorded at end December 2019 and expected to further reduce to around one third of the total public debt in the medium-term. However, outstanding amount of short-term domestic debt stock partly increased relative to the long-term debt stock mainly owing to issuances of new Treasury bills and short-term Treasury bonds to meet the cash flow requirement of the Government during the pandemic period. Accordingly, average time to maturity of outstanding central government domestic currency debt stock decreased to 4.71 years by end 2020 compared to 5.78 years at end 2019.

As a result of the introduction of maximum yield rate announcements, along with accommodative monetary policy stance, raising domestic currency denominated debt at all time low yields was possible during 2020, resulting in a substantive amount of cost savings to the Government compared to previous years. The WAYR of Treasury bills and Treasury bonds observed around 300 basis point reduction in 2020 compared to 2019. Treasury bonds amounting to Rs. 1,332.1 billion with a WAYR of 7.39 per cent were issued in 2020 compared to Rs. 798.0 billion with a WAYR of 10.74 per cent in 2019. Moreover, Treasury bills amounting to Rs 2,590.5 billion were issued in 2020 with an overall WAYR of 5.82 per cent compared to Rs. 1,719.3 billion with an overall WAYR of 8.92 per cent in 2019.[2]

Figure 8.18
Primary Market Weighted Average Yield Rates of Treasury Bills and Treasury Bonds (Per cent per annum)



Source: Central Bank of Sri Lanka

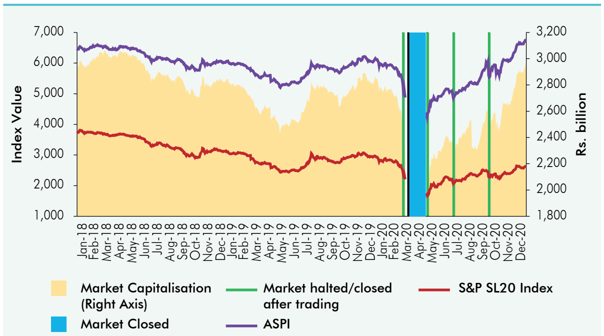
Equity Market

The Colombo Stock Exchange (CSE) experienced short-term volatilities throughout the year due to unprecedented challenges created by the COVID-19 pandemic. Index-based circuit breakers were activated on several occasions due to excessive volatility in the market. The All Share Price Index (ASPI) on 12 May 2020 recorded its lowest point in over a decade but recovered recording a growth of 10.5 per cent by end 2020, the highest annual increase since 2014. Even though S&P SL20 index showed a similar trend and recovered since mid-May, it recorded a 10.2 per cent decline during the year.

The majority of stock market indicators showed an improvement since mid-May 2020. Market capitalisation increased by 3.8 per cent during 2020 compared to end 2019 and stood at Rs. 2,960.6 billion by end 2020.

2 The overall WAYR includes the total average borrowing cost, including the cost of administratively instructed issuances.

Figure 8.19
Movement of Price Indices and Market Capitalisation



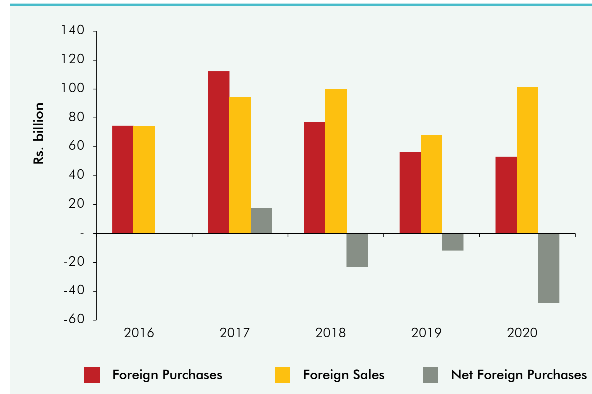
Source: Colombo Stock Exchange

The CSE recorded an extraordinary average daily turnover during 2020 which amounted to Rs. 3.2 billion compared to Rs. 711.2 million in 2019. This daily average turnover recorded in 2020 was the highest recorded for a year since 2011. This was mainly driven by domestic investors' preference shifting towards equity investments due to the prevailing low interest rate regime and attractive market valuations. Sri Lanka recorded one of the lowest Price to Earnings Ratio (PER) among its regional peers. The PER and Price to Book Value stood at 11.3 and 1.1, respectively, by end 2020.

However, net foreign outflows continue to remain a concern. Foreign contribution towards the total turnover was subpar compared to the previous year. Only 19.8 per cent of the total turnover originated from foreign purchases as against 36.4 per cent reported in the previous year. The CSE recorded Rs. 51.3 billion foreign outflows during 2020 compared to an outflow of Rs. 11.7 billion recorded during 2019.

The Securities and Exchange Commission of Sri Lanka (SEC), together with CSE, introduced a number of progressive measures during the year. Amendments to listing rules, introduction of three tiered circuit breaker structure, digitalisation and launch of new products, such as Real Estate Investment Trusts (REITs), were some of the new measures implemented towards ensuring the development and smooth functioning of the market.

Figure 8.20
Foreign Participation at the CSE



Source: Colombo Stock Exchange

Corporate Debt Securities Market

The Commercial Paper (CP) market was relatively active in 2020 compared to 2019. During 2020, Rs. 4.5 billion was raised through the CPs issued with the support of licensed banks compared to Rs. 4.2 billion raised through issues in 2019. Interest rates of CPs varied in the range from 6.50 to 15.50 per cent during the year compared to a range of 13.00 to 16.25 per cent reported in the previous year.

Activities of the corporate bond market were affected by the COVID-19 pandemic and the temporary closure of the CSE for a period of seven weeks. During 2020, there were 16 IPOs of corporate debentures issued by 8 companies in the CSE which raised Rs. 21.9 billion compared to Rs. 57.9 billion raised in 2019. Debentures with fixed interest rates were in the range of 9.00 to 13.25 per cent compared to the range of 12.30 to 15.50 per cent in the previous year.

8.5 Development Finance and Access to Finance

The Central Bank, in consultation with the Government, implemented several working capital loan schemes to support COVID-19 affected Micro, Small and Medium Enterprises

(MSMEs) during 2020, in addition to the continuation of several refinance, interest subsidy and credit guarantee loan schemes.

Extraordinary Measures taken by the Central Bank to cope with the COVID-19 pandemic: The Central Bank implemented the Saubagya COVID -19 Renaissance Facility (SCRF) in three phases, in order to provide working capital loans at an interest rate of 4.00 per cent to the borrower with a repayment period of 24-months, including a grace period of 6-months to COVID-19 affected MSMEs, including self-employed individuals.

Under Phase- I of the SCRF, Central Bank provided refinancing facility to the participating financial institutions (PFIs) in terms of Section 88 of the MLA. Under Phase – II of the SCRF, Central Bank provided loans to PFIs against collaterals approved by the Monetary Board in terms of Section 83 of the MLA. Under Phase - III of the SCRF , PFIs are expected to use their own funds to grant loans to the businesses and individuals at 4.00 per cent and the Central Bank provides credit guarantee ranging 50-80 per cent on loans granted and a 5.00 per cent per annum interest subsidy for PFIs to cover their credit risk and cost of funds in terms of the Section 108 of MLA.

The total value of working capital loans (WCLs) approved by the Central Bank under SCRF stood at Rs.179.3 billion for 62,573 beneficiaries at the end December 2020. About 52 per cent of the total WCLs approved by the Central Bank was provided to the services sector, while about 33 per cent and 15 per cent were provided to the SMEs and individuals in the industry sector and the agriculture sector, respectively.

Other Measures to Support the MSMEs: The Central Bank implemented the Supply Chain Re-Energising Loan Scheme (SCREL), a WCL scheme for the Tea Sector, in collaboration with the Ministry of Plantation and Sri Lanka Tea Board. Further, the Central Bank implemented a Credit Guarantee Loan Scheme for working capital requirements for MSMEs affected due to Easter Sunday Attack in collaboration with the Ministry of Finance.

The annual interest rates charged on loans granted under New Comprehensive Rural Credit Guarantee Scheme (NCRCS) and Saubagya Loan Scheme were reduced to 4.00 per cent per annum. The maximum loan amounts granted per borrower under the Self Employment Promotion Initiative (SEPI) loan scheme and Swashakthi Loan Scheme were increased.

Financial Inclusion: The National Financial Inclusion Strategy (NFIS), developed with the assistance of the International Finance Corporation (IFC) of the World Bank Group was officially launched on 04 March 2021 and the NFIS Secretariat was also established to coordinate the financial inclusion efforts in the country. The six Regional Offices of the Central Bank were brought under the Regional Development Department (RDD) in July 2020, with a view to strengthening the activities of Regional Offices in line with the financial inclusion objectives of the Central Bank.

Financial Literacy: The Central Bank continued to conduct programmes to improve financial literacy, targeting those who have been excluded from the formal financial sector. During 2020, 183 programmes on financial literacy, entrepreneurship development and skill development and MSME issues were conducted. Out of the 183 awareness programmes, six Regional offices conducted 157 programmes while RDD conducted 26 programmes including 3 Training of Trainers (TOT) programmes.

8.6 Financial Infrastructure

Payment and Settlement Systems

The Central Bank continued to ensure a well-functioning national payment and settlement system in the country, in order to cater to the payment needs of the individuals and institutions and to successfully facilitate the economic activities of the country. Amidst the COVID-19 pandemic, the Central Bank ensured the smooth functioning of the financial system by effectively mitigating the risks associated with the national payment and settlement system.

The LankaSettle System, which consists of the Real Time Gross Settlement (RTGS) System, the country's only large-value electronic payment system and the LankaSecure System functioned effectively and efficiently during the year under review. Accordingly, value of the RTGS transactions recorded an increase of 28.1 per cent, when compared with the previous year. In value terms, the share of RTGS transactions in total non-cash payments accounted for 90.9 per cent in 2020. The Central Bank continued to provide the interest free Intra-day Liquidity Facility (ILF) against the collateral of government securities to the Participating Institutions (PIs) who experienced liquidity problems. During the review period, the daily average of ILF utilised by PIs of the RTGS System was recorded an average value of Rs. 66.0 billion. During the year under review, the maximum per transaction fee of RTGS was reduced to Rs. 400.00 from Rs. 1,000.00. Simultaneously, the operator charge levied by the Central Bank as the operator of RTGS System was reduced from Rs. 450.00 to Rs. 200.00 per transaction.

At end 2020, total value of scripless securities held in LankaSecure amounted to Rs. 7,340.9 billion (Face Value). This consisted of Treasury bills of Rs. 1,621.4 billion and Treasury bonds of Rs. 5,719.5 billion.

The Cheque Clearing System of the country operated by LankaClear (Pvt.) Ltd (LCPL) functioned smoothly during 2020. When compared with 2019, the total volume of cheques cleared through the Cheque Clearing System recorded a negative growth of 28.1 per cent and the total value declined by 24.0 per cent in 2020.

During the year under review, the Sri Lanka Interbank Payment System (SLIPS), which mainly facilitates low-value retail bulk payments, recorded a growth in terms of both the volume and value of payments by 0.6 per cent and 7.2 per cent, respectively.

Common ATM Switch (CAS), the first phase of Common Card and Payment Switch (CCAPS), enables cash withdrawals and balance inquiries from any ATM connected to the CAS network. In 2020, the transaction volume and value of CAS increased by 3.2 per cent to 48.9 million and by 19.2 per cent to Rs. 506.9 billion, respectively. As at end 2020, 30 financial institutions were integrated to the CAS network. Shared ATM Switch (SAS) was launched in 2015 to provide services to financial institutions, which do not have the capacity to operate their own card management system had two members and continued its operations smoothly during the review period.

Common Electronic Fund Transfer Switch (CEFTS), another phase of CCAPS, was launched in 2015 to facilitate retail fund transfers among member institutions on a real time basis. The CEFTS transaction volume increased by 86.8 per cent to 27.6 million, while the CEFTS transaction value grew by 74.7 per cent to Rs. 2,415.3 billion in 2020. The Central Bank reduced the CEFTS transaction fee from Rs. 50.00 to Rs. 30.00 per transaction, and revised the minimum liability manager limits in CEFTS, thus increasing the utilisation of excess capacity of electronic payment systems.

BOX 9
Implications of the COVID-19 on Technology Adoption and Cybersecurity

Introduction

During 2020, COVID-19 created an unprecedented change in the lifestyles of people around the world. Demand for traditional goods and services changed significantly with demand for Information Technology related services increasing rapidly. The adoption of these new changes has led to the creation of new markets and opportunities, which have both positive and negative impacts. Two such key issues, which have garnered attention among both organisations and the general public, in the current situation, are cybersecurity and cybercrime.[1]

New Information Technology-based Economic Activities

Mobility restrictions adopted by countries due to the pandemic had led to the emergence of several new trends in the carrying out of conventional economic activities. Some of the key trends, which are mostly dependent on information technology and related services, are listed below.

a) Work from Home (WFH)

During the first wave of the pandemic, most countries did not have significant prior experience or did not possess the readiness to face the novel circumstances arising from the pandemic. In order to curb the spread of the virus, the immediate response across countries was to impose varying degrees of mobility restrictions. The urgent manner in which these were undertaken necessitated the urgent transition of workers from physical places of work to 'work-from-home' arrangements. Neither workers nor organisations were equipped with the appropriate infrastructure for such working arrangements. This dearth was observed not only in terms of equipment, such as laptops, but also in terms of secure access to organisational systems and networks. In addition to the increased use of email and the internet, many organisations immediately adopted the use of Virtual Private Networks (VPN) for this purpose. Further, personal electronic devices were also being used for official work on a large scale within a very short period. Most of these personal devices were not secured adequately in line with industry accepted standards.

1 Cyber security is the application of technologies, processes and controls to protect systems, networks, programs, devices and data from attack, damage, or unauthorised access. Cybercrime is any criminal activity that involves a computer, networked device or a network. While most cybercrimes are carried out in order to generate profit for the cybercriminals, some cybercrimes are carried out against computers or devices directly to damage or disable them, while others use computers or networks to spread malware, illegal information, images or other materials.

b) Online learning

Educational institutions experienced intermittent closures. Accordingly, all educational activities were shifted to online platforms with teaching staff delivering lessons through platforms, such as Zoom and Microsoft Teams. Assignments and other coursework were also shared through these platforms and others, such as WhatsApp, in order to improve the extent of outreach to students. Even pre-school children started having online learning sessions of 30 minutes to 1 hour. This provided the students the opportunity to use internet enabled mobile devices for longer durations than earlier without much restriction or supervision of their parents.

c) E-commerce

Many merchants who relied on conventional sales through physical outlets rapidly adopted online sales platforms. At the same time, customers also rapidly shifted to online shopping due to lockdowns and travel restrictions imposed to prevent the rapid spread of COVID-19. However, such a swift and widespread transition of sellers and customers to online platforms could not be handled by existing systems leading to system downtimes and interruptions. There was also a reduction in the usage of physical money, in light of the pandemic, thereby leading to a surge in online transactions.

d) Online financial services

Most banks and financial institutions (FI) encouraged their customers to use online financial services to minimise their visits to bank branches. This resulted in increased usage of online banking websites and mobile banking applications. People who possessed low levels of IT literacy also had to use these online financial services for their daily needs, and FIs had to relax some restrictions to widen the reach of these financial services.

e) Virtual meetings and conferences due to travel restrictions

With the pandemic induced travel restrictions and social distancing recommendations, many organisations had to shift in-person meetings and conferences to virtual platforms to ensure continuity, increased accessibility and inclusion. Although online meetings were not an entirely novel concept, it was a relative new experience for a substantial segment of workers. As different organisations used different tools for this purpose, it posed several challenges to data security. A wide range of confidential information including intellectual property and trade secrets had to be shared online and most meeting hosts and participants were not aware of security measures which were essential to preserve the confidentiality of meeting proceedings.

Cyber Criminal Activities amidst Pandemic-Induced Online Activity

a) Phishing emails

Work-from-home arrangements have provided several opportunities for cyber criminals to launch different types of cyber-attacks. Such attacks began with phishing or spam emails, which lure email users to disclose sensitive and confidential information to an unknown third party without their knowledge. Phishing emails have been created targeting a specific group of people or organisations. The sophistication of such phishing emails has increased to the extent that they can surpass spam filters. Through the collection of confidential information from these phishing mails, they were able to plan and execute cyber-attacks to business-critical systems and gain financial benefits.

b) Device sharing and free/cracked software

Many students have to use their parents' devices for their studies and cyber attackers have launched specific attacks targeting these students. Children tend to visit malicious websites, download and install free software and games to these devices. Such freeware come with malware used for different purposes, such as stealing information, key logging[2] and acting as bots[3] that initiate cyber-attacks on other devices connected to the internet.

c) Fake websites/apps

The boom of e-commerce has made it easy for cyber criminals to steal customers' sensitive data, such as credit card details by sending spam emails and setting up fake websites or mobile apps pretending to be an online store, banking website etc. Some organised criminals steal sensitive data from victims and create online banking profiles for accounts that belong to the victims and steal money from these accounts.

d) Loss of information security focus

With the sudden increase in demand for work-from-home arrangements, remote access and other needs, many organisations have lost focus on information security amidst trying to cope up with this surge in demand. When information security professionals also work from home and their focus is also diverted towards these new challenges, general work related to cybersecurity (system updates, patch management, log monitoring, and forensic investigation of security incidents) go unattended paving way for circumstances that provide a good opportunity for the cyber-attackers.

2 The practice of using a software program or hardware device (keylogger) to record all keystrokes on a computer keyboard, either overtly as a surveillance tool or covertly as spyware

3 A software program that can execute commands, reply to messages, or perform routine tasks, as online searches, either automatically or with minimal human intervention

Way Forward

The pandemic could prevail for a while, but the implications of the pandemic would linger on for several years to come. Therefore, it is vital for organisations to have short-term, medium-term and long-term plans to progress in line with the new norms and enhance cybersecurity and cyber resilience.

a) Strengthen cyber resilience

Sophistication of cybercrimes is continuously on the rise and even organisations that have adopted very high levels of cybersecurity measures have not been able to assure that they are fully secured against cyber-attacks. It is believed that some malware can stay undetected in an organisation's network for very long periods, as much as 240 days before an actual attack. Therefore, most organisations tend to concentrate on achieving cyber resilience, which ensures that the organisation could resume its normal operations with minimal disturbances subsequent to any cyber-attack related disruptions to IT systems. Developments in the IT infrastructure industry, including cloud computing, have enabled businesses to achieve the required business resilience.

b) Business Continuity Planning (BCP) for pandemic-related circumstances

It is mandatory for many industries, including the financial sector, to plan, test and implement business continuity programmes. Many of these BCPs cover test scenarios, such as natural or man-made disasters, technical failures, etc. However, it was observed that pandemic related BCPs had not been implemented or tested in many organisations. A pandemic is a special scenario where physical accessibility to information systems is not possible due to lockdowns and thereby the potential unavailability of key personnel. Organisations may not have enough information security professionals to duplicate or share roles. If these employees are affected by these unusual circumstances, it would create a vacuum in that particular area of work. Therefore, it has become essential for organisations to include remote working arrangements and adequate human resources in their business continuity planning.

c) Allocate adequate budget

With the new norms of work-from-home, it has been extremely difficult for organisations to protect their information systems as done in the past through restricted access and other stringent controls. While allowing these new facilities, organisations should implement immediate and long-term plans to protect their IT assets. Cybersecurity comes with an enormous cost that even large-scale organisations struggle with when deciding on budget allocations for information security. Cooperation among organisations, within a specific sector, to share information security related resources would be beneficial for all in the long term. In the short term, organisations should increase their focus on maximising the usage of available cybersecurity resources to protect their IT assets.

d) User awareness

User awareness can be considered as the most important part of cybersecurity, as it is the users who create system vulnerabilities that pave way for the entry of cyber criminals to enter into the organisational systems. The demarcation between official and personal tasks seems to have disintegrated as observed in the use of personal devices for official work and vice versa. Hence, this too, is a risk to cybersecurity if such devices are not maintained properly with the required security features. Users are often unaware of these risks. This puts the onus of awareness on cybersecurity and staying safe on all individuals. Organisations must focus more on creating user awareness among employees. Schools and universities should also do the same.

e) Working closely with National Computer Incident Response Teams (CIRT)

Most of the countries have established National Computer Incident Response Teams (CIRT) that serve as the national focus point for coordinating cybersecurity incident responses to cyber-attacks within a country. Sri Lanka Computer Emergency Readiness Team Coordination Centre (Sri Lanka CERT) is the national CIRT for Sri Lanka and their mission is to protect Information Technology users in the public and private sector organisations and the general public by providing up-to-date information on potential threats and vulnerabilities and by undertaking computer emergency response handling services. Therefore, any individual or organisation can obtain their services and consultancy in relation to cybersecurity when required.

Conclusion

Cybersecurity should be made a topic of the boardroom and given extra attention considering the growing threats during the pandemic. While going through the second wave of the pandemic and with concerns of a possible third wave, every organisation should implement preventive measures for cyber-attacks while strengthening cyber-attack detection, response and recovery capabilities. It is the responsibility of every individual and management to protect themselves and their workplaces from cybercrimes in today's connected world. At the same time, a collective approach is required at organisational, sectoral, national and international levels to fight against cybercrimes and build a safer world for the present and future generations.

In order to facilitate online payments to governmental institutions, LankaPay Online Payment Platform (LPOPP) was launched in 2017. LPOPP currently facilitates online real time payments to three government Institutions and during the year under review, 85,010 transactions with an aggregate value of Rs. 66.9 billion were processed through LPOPP.

The Central Bank initiated the National Quick Response (QR) Code Standard for local currency payments, branded as "LANKAQR" in 2018. During the year under review, the total volume and value of LANKAQR transactions amounted to 159,218 and Rs. 539.2 million respectively. As at end 2020, there were 169,214 registered LANKAQR merchants. The Central Bank together with financial institutions with LANKAQR enabled mobile payment apps launched "රට පුරාම LANKAQR" public awareness campaign during the year under review.

The Central Bank continued its regulatory and supervisory activities with regard to payment cards and mobile payment systems, in terms of the provisions of the Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013 (Regulations). Accordingly, two financial institutions were granted licence under the National Card Scheme, while another financial institution was granted a licence to function as a financial acquirer of payment cards, in terms of the Regulations during the year 2020. Further, on-site and off-site supervisions were carried out by monitoring compliance with the regulations imposed to Service Providers of Mobile Payment Systems to ensure smooth functioning of the mobile phone based e-money systems.

The Central Bank took several measures to fulfil the payment needs of the general public during the COVID-19 outbreak in the country. These measures include enabling online registration facilities and facilitating Know-Your-Customer requirements digitally to all Licensed Banks and Licensed Finance Companies while temporarily increasing the limits imposed on several payment solutions to cater for the increased demand in online transactions.

The Central Bank announced the year 2020 as the "Year of Digital Transactions" and carried out number of programmes to increase customer awareness on digital payment mechanisms during the year.

The FinTech Regulatory Sandbox, launched in 2020, received several applications from innovators during 2020 to test their products and services without infringing the regulatory requirements. The Central Bank took several measures for the deployment and testing of the Proof Of Concept (POC) for the Blockchain Technology based Shared KYC facility, while the National Payments Council (NPC), the industry consultative and monitoring committee on payment and settlement systems, appointed two working committees to study Open Banking and Digital Payment Platform, during the review period. NPC further monitored the Payment System Road Map for 2020-2022, through the Road Map Monitoring Committee to introduce new payment products and increase efficiencies in the financial sector while monitoring the risks continuously, which would strengthen the payment and settlement infrastructure and enhance financial inclusion in Sri Lanka.

Table 8.18
Transactions Through Payment Systems

Payment system	2019(a)		2020(b)	
	"Volume ('000)"	"Value (Rs. bn)"	"Volume ('000)"	"Value (Rs. bn)"
Large Value Payment Systems				
RTGS System	428	117,151	397	150,051
Retail Value Payment Systems				
Main Cheque Clearing System	46,802	9,863	33,631	7,491
Sri Lanka Interbank Payment System (SLIPS)	36,612	2,104	36,830	2,257
Credit Cards	50,969	277	44,692	222
Debit Cards	71,096	195	75,094	210
Internet Banking	36,483	3,875	57,215	4,436
Phone Banking	17,630	339	27,350	491
Postal Instruments	906	6	646	5
Total	260,926	133,810	275,855	165,162
US Dollar Cheque Clearing System	50	49	32	48

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

Anti-Money Laundering and Countering the Financing of Terrorism

As the focal point of anti-money laundering and countering the financing of terrorism (AML/CFT) for the country, the Financial Intelligence Unit (FIU) continued to perform its core functions in line with international standards amidst many challenges, including the COVID-19 pandemic, during the year 2020. In terms of the Financial Transactions Reporting Act, No. 6 of 2006 (FTRA), the FIU performed its key role of receiving, analysing and disseminating of information on suspicious financial transactions relating to Money Laundering (ML)/Terrorist Financing (TF) or any other unlawful activity. During the year 2020, the FIU received 3,665 Suspicious Transaction Reports (STRs) from reporting institutions (RIs), law enforcement agencies (LEAs), regulatory authorities (RAs) and general public. Upon analysis of the information received through STRs together with other relevant information obtained from various sources, during the year, 2,825 STRs were referred, where necessary, to relevant LEAs and RAs for further investigation or regulatory actions. Further, in terms of Section 6 of the FTRA, the FIU continued to receive Cash Transactions Reports (CTRs) and Electronic Fund Transfers (EFTs-inwards and outwards) exceeding the reporting threshold of Rs. 1.0 million or its equivalent in any foreign currency from the RIs. Accordingly, 4.6 million CTRs and 7.3 million EFTs were reported to the FIU during the year.

In order to ensure institutional compliance with the AML/CFT requirements set out in the FTRA, Financial Institutions (Customer Due Diligence) Rules, No. 1 of 2016 (CDD Rules) and regulations issued under the FTRA, the FIU continued to conduct risk-based on-site examinations on Financial Institutions (FIs) and Designated Non-Finance Businesses and Professions (DNFBPs) during the year 2020. The FIU conducted 11 risk-based on-site examinations, 7 follow-up examinations and 16 on-site spot examinations on FIs, including joint examinations with sector specific regulators. Further, 11 risk-based on-site examinations and 7 follow-up examinations were conducted on high risk DNFBPs, i.e. real estate agents and gem and jewellery dealers. Based on the examinations conducted in 2020, penalties amounting to Rs. 2.3 million in total were imposed on 3 FIs for the violations of CDD Rules in relation to United Nations Security Council sanctions screening. Also, 14 letters informing the identified deficiencies and 8 show cause letters were issued to FIs on non-compliances with the provisions of the FTRA and the CDD Rules and regulations issued thereunder. The FIU also issued letters to 15 DNFBPs informing the identified deficiencies. Further, an interim offsite ML/TF risk assessment was conducted on DNFBPs during July 2020 to identify the impact on their business operations due to COVID-19 pandemic.

The FIU initiated various steps to enhance the awareness among all stakeholder involved. In order to strengthen the AML/ CFT supervision process and institutional compliance, the FIU issued several guidelines and circulars as well as conducted awareness programmes during the year 2020. In order to further strengthen the LEAs' effort in combating ML related to illicit drug trade, the FIU conducted awareness sessions for investigators and FIs, including their senior management and Boards of Directors. The FIU entered into a Memorandum of Understanding (MOU) with the Chief of National Intelligence to exchange intelligence related to the offences of ML/TF and related crimes, thereby increasing the total number of MOUs signed with domestic agencies by the FIU to 12 by end 2020.

In May 2020, the European Commission (EC) de-listed Sri Lanka from its list of High Risk Third Countries that have strategic deficiencies in their AML/CFT regimes. Sri Lanka was listed as a High Risk Third Country by the EC in February 2018, subsequent to Sri Lanka being identified by the Financial Action Task Force (FATF) as a jurisdiction with strategic AML/CFT deficiencies in its Compliance Document a.k.a "the Grey List" in October 2017. Subsequent to the de-listing by the FATF, the EC de-listed Sri Lanka from its list of High Risk Third Countries in May 2020. It is expected that the de-listing by the FATF and EC will negate the adverse consequences that prevailed during the previous years and further strengthen the positive economic outlook and financial integrity of the country.

Legal Reforms related to the Financial Sector

The Central Bank continued to introduce law reforms to major legislations administered by the Central Bank such as the Banking Act, Finance Business Act and the Registered Stock and Securities Ordinance, with the objective of strengthening and enhancing the regulatory and supervisory powers vested therein, in 2020. The new Banking Act would provide for a stronger legal foundation for regulation and supervision of licensed banks, enhanced governance requirements and an effective resolution regime for licensed banks while the amendments introduced to the Finance Business Act would augment the regulatory and supervisory powers on non-bank financial institutions. In addition, the Central Bank was engaged in drafting amendments to the Registered Stock and Securities Ordinance and the Finance Leasing Act. Further, during the year under review, multiple initiatives have been taken by the Central Bank under the capital market development project which aimed at introducing new laws on Netting and Clearing and insolvency, establishment of central counterparty and electronic trading platform for securities trading, which entailed significant changes to be made to the existing legal framework applicable for the capital market.

Financial Consumer Protection

With the objective of strengthening the financial consumer protection framework in Sri Lanka within the entities regulated by the Central Bank, Financial Consumer Relations Department (FCRD) was established in August 2020.

The department is expected to initiate new measures, which include but not limited to streamlining the processing of complaints and grievances, introducing suitable legal provisions to facilitate financial consumer protection framework either through new legislations or by making amendments to existing legislations and conducting examinations/ investigations on specific complaints. These measures will empower authorities to take prompt actions on financial consumer protection related issues, which will support to strengthen the financial system stability.

Since its inception in August 2020, the FCRD has attended to over 22,000 telephone calls while the complaints/ grievances received through faxes, emails and letters during the same period was over 3,500. Out of the said complaints/ grievances, about 44 per cent were related to LCBs and LSBs while about 35 per cent were related to LFCs and SLCs. Further, about 13 per cent of complaints/grievances received by FCRD were related to the entities not regulated by the Central Bank and about 5 per cent of the total complaints were related to 6 finance companies whose licenses were suspended or cancelled by the Central Bank. About 2 per cent of complaints were related to unauthorised financial institutions operating in Sri Lanka. The complaints and grievances directed to FCRD were mainly in the areas of high interest rates charged for financial facilities, higher penal interest rate, higher early settlement costs, various fees and chargers, Credit Information Bureau (CRIB) related issues, guarantor obligations, non-disclosure of information to the customer, unauthorised finance businesses, request for concessions on repayment of facilities and re-possession of leased vehicles.

Resolution and Enforcement Action on Weak Financial Institutions

The Central Bank continued with both resolution and enforcement functions while managing Sri Lanka Deposit Insurance and Liquidity Support Scheme (SLDILSS) during the corresponding period. Payment of compensation to the depositors of the licence cancelled/ suspended finance companies namely, The Finance Company PLC (TFC), ETI Finance Ltd. (ETIFL) and Swarnamahal Financial Services PLC (SFSP), was commenced during 2020 in addition to continuation of the payment of compensation to the depositors of three (03) licence cancelled finance companies namely, Central Investments and Finance PLC (CIFL), The Standard Credit Finance Ltd. (TSCFL) and TKS Finance Ltd. (TKSFL) through SLDILSS. As an extension to the existing compensation payment procedure, Agency Banking concept was introduced during the year under review for the purpose of compensating the insured depositors through SLDILSS in a timely and efficient manner. Accordingly, the People's Bank was appointed as the Agent Bank for the compensation payments to the depositors of TFC, ETIFL and SFSP. The Central Bank has paid compensation through SLDILSS to

66,731 depositors amounting to Rs. 21,114.9 million in relation to above six (06) companies, as at end 2020.

Enforcement actions were continued with the cooperation of the Attorney General's Department and the Criminal Investigation Department (CID) of Sri Lanka Police. Upon receiving complaints from the general public, several investigations were conducted on prohibited schemes under the relevant provisions of the Banking Act No.30 of 1988. Further, actions were taken to coordinate and follow up the investigations already referred to the Attorney General's Department for prosecutions with the support of Legal and Compliance Department (LCD) of the Central Bank. Further, several awareness programmes were conducted island-wide with a view of improving the financial literacy of different segments of the general public to educate them on the ill-effects of joining in various type of prohibited schemes.

The Central Bank is also in the process of formulating a resolution framework for banks and non-bank financial institutions with the assistance of international consultants, within the existing regulatory framework in which the resolution authority and its resolution powers are specified. Further, arrangements were made for inclusion of the provisions on resolution procedures and deposit insurance for banks, in the proposed new Banking Act.

Regulation and Supervision of Foreign Exchange

The Central Bank continuously engaged in facilitating foreign exchange operations during the year. Thus, considering the recent developments in the domestic foreign exchange market due to the pandemic, including the weakening foreign reserves, several measures were introduced under the provisions of the Foreign Exchange Act, No. 12 of 2017 (FEA). Accordingly, Directions were issued to Authorised Dealers (ADs) limiting release of foreign exchange for certain current transactions. Further, to support foreign currency reserve position of the country, an Order was issued under Section 22 of FEA, restricting outward remittances of certain capital transactions, including migrant fund transfers.

Moreover, to attract foreign currency inflows to the country, Special Deposit Accounts (SDAs) with an additional interest payment by the Government were introduced during early April 2020. With the view of enhancing more SDA deposits in the form of foreign currency, another Order was issued under Section 8 of FEA increasing the foreign currency possession by persons in, or resident in Sri Lanka up to US dollars 15,000. Directions were also issued permitting ADs to recover existing foreign currency loans granted to foreign exchange earners and to migrant workers, in Sri Lankan rupees, as a last resort, considering the difficulties faced by such foreign currency

Table 8.19
Summary of Transactions on Foreign Currency Accounts

USD million

Category of Account	Inward Remittances		Outward Remittances		Closing Balance as of 31 December	
	2020	2019	2020	2019	2020	2019
Personal Foreign Currency Accounts	755.9	841.6	200.4	279.1	2,713.4	2,528.7
Business Foreign Currency Accounts	6,796.7	7,660.9	2,805.7	3,174.1	1,951.0	1,335.0
Inward Investment Accounts	1,382.9	2,033.9	1,901.1	2,070.8	1,861.1	1,748.7
Special Deposit Accounts [1] (SDAs)	214.9 [2]	n.a.	3.2 [3]	n.a.	290.0 [4]	n.a.
Outward Investment Accounts	138.2	8.0	8.4	54.0	n.a.	n.a.

1 Regulations on SDAs were introduced on 08 April 2020. Hence, no comparative data are available for 2019.
2 Except for funds transferred from Inward Investment Accounts, Offshore Banking Unit Accounts and Foreign currency deposits.
3 Outward remittances were occurred from 07 October 2020 upon maturity of deposits under SDAs.
4 This closing balance is for 01 January 2021 (approx.).

Source: Central Bank of Sri Lanka

Table 8.20
Remittances on Capital Transaction Rupee Accounts (CTRAs) and Foreign Exchange Sales and Purchases against/into Sri Lanka Rupees

	2020	2019
Migrant Fund Transfers		
No. of CTRAs registered with the Central Bank for remitting migration allowance	742	1,353
Outward remittances through CTRAs (in USD mn)	12.7	40.7
Foreign Exchange Sales and Purchases (in USD mn)		
Foreign Exchange Sales (Form 1)	11,564.4	13,438.9
Foreign Exchange Purchases (Form 2)	16,813.5	17,546.3[1]

1. The amount is adjusted for the late submissions from the Authorised Dealers, which occured due to implementation issues of the newly introduced Form I and II online reporting system during the 2nd quarter of 2019

Source: Central Bank of Sri Lanka

borrowers. In line with the provisions of FEA, the Central Bank continuously monitored foreign exchange transactions.

Activities of Restricted Dealers (RDs) who are authorised to engage in money changing business, were continuously monitored to further develop domestic foreign exchange market. During the year, RDs have deposited US dollars 132.71 million to the banking system and sold US dollars 3.64 million recording a decline of 51 per cent and 83 per cent, respectively, compared to 2019. Overall, RDs showed declined performance inter-alia due to subdued economic activities caused by the pandemic. Actions were also taken to implement a comprehensive cross border and foreign currency transactions monitoring system to collect data from ADs in terms of the Regulations and Directions issued under FEA, including inflows/ outflows of the domestic foreign exchange market and whilst to support macroeconomic decision making on foreign exchange operations.

Credit Information

During 2020, the Credit Information Bureau (CRIB) issued 8.6 million credit reports to the industry (out of which 8.3 million were obtained by lending institutions) recording a 17.0 per cent decrease compared to the previous year. Demand for the self- inquiry credit reports (iReports) recorded a 43.0 per cent decrease in 2020, compared to 2019. During the year 2020, 10,724 customers have visited the Bureau to obtain their iReports and 1,903 customers have applied their iReports through banks. A total of 225 new individuals have been registered for the iReport online service and 1,336 users have accessed their iReports online in 2020. Mobility restrictions and bank lending interruptions caused by COVID-19 pandemic may have contributed to this decline.

Several developments were made to improve the facilities offered by CRIB in 2020. One such development was the launch of “ONLINE iReport” service in December 2020, which enables public to apply and obtain their iReport/CRIB Score report through the Bureau website. Further, CRIB issued the necessary data reporting guidelines to member lending institutions to report data during the moratorium period, so that the eligible borrowers in this scheme will not have an impact on their credit score in the future. CRIB facilitated all member lending institutions to enable access to credit information via the new Host-to-Host modality, starting from June 2020 which enables institutions to directly connect the core banking system with the Bureau system. Further, “CRIB Score”, a credit score, was developed through a partnership with Creditinfo International GMBH and was officially launched in January 2020. Further, member lending institutions are enabled to obtain CRIB scores for their existing customers in bulk mode, for risk evaluation purposes. Furthermore, the “Retrospective CRIB Score Analysis Report”, which can be used to predict the future, based on the past behavior of the credit portfolio, was also released to the member lending institutions in February 2020. Steps are being taken to reduce the price, changed for CRIB reports especially for microfinance service providers and digital lenders.