

OBJECTIVES, FUNCTIONS & ORGANIZATION



CENTRAL BANK OF SRI LANKA



Central Bank of Sri Lanka

Objectives, Functions & Organization

June 2014

VISION

A credible and dynamic central bank contributing to the prosperity of Sri Lanka.

MISSION

Maintaining economic and price stability and financial system stability to support sustainable growth through policy stimulus, advice, commitment and excellence.

1. CENTRAL BANK OF SRI LANKA

The Central Bank of Sri Lanka (CBSL)¹ was established by the Monetary Law Act (MLA) of 1949 with capital appropriated from the Board of Commissioners of Currency and commenced operations on August 28, 1950. The CBSL is at the apex of Sri Lanka's financial system and is responsible for safeguarding both the value of the Sri Lankan Rupee and the country's financial system.

2. OBJECTIVES

The CBSL's focus and functions have evolved since its formation, in response to the changing economic environment. In keeping with trends in central banking, the objectives of the CBSL were streamlined by amending the MLA in 2002, to enable it to pursue two core objectives and to free it from the multiple objectives that were originally assigned to it.

The objectives of the CBSL are:

- Maintaining economic and price stability
- Maintaining financial system stability

with a view to encouraging and promoting the development of productive resources of Sri Lanka.

Prior to the amendment of the MLA in 2002, the CBSL had multiple objectives such as stabilization of domestic monetary values, preservation of the stability of the exchange rate, promotion of a high level of production, employment and real income and encouragement and promotion of the full development of the productive resources. At times, these multiple objectives were in conflict or inconsistent with each other. Meanwhile, a consensus had developed internationally that a central bank's primary goal should be the maintenance of price stability. As price stability is crucially dependent on stable macroeconomic conditions, one of the core objectives of the CBSL was specified as "economic and price stability".

Furthermore, experience has shown that the stability of the financial system is also crucial for maintaining economic stability. Hence, financial system stability was also identified as a core objective of the CBSL. The two objectives are correlated and complement each other. Ensuring financial system stability is of prime importance as monetary policy is transmitted through financial intermediaries (institutions) to achieve price stability. Price stability is important for financial system stability as interest rates, exchange rates and other asset prices move in response to changes in the general price level, impacting on the risk

1. Known as the Central Bank of Ceylon until 1985.

profile of financial institutions. Economic, price and financial system stability are necessary for sustained economic growth. Hence the two objectives are in harmony and this enables the CBSL to perform its main functions more effectively.

The CBSL has been given a high degree of autonomy to enable it to achieve its objectives. In this regard, the CBSL closely liaises with the Ministry of Finance in making policy decisions and the Secretary to the Ministry of Finance is a member of the Monetary Board, which is the governing body of the CBSL.

2.1. Price Stability

Price stability safeguards the value of the currency in terms of what it will purchase at home and in terms of other currencies. Price stability is interpreted to mean low and stable inflation. Experience has shown that the economy performs well when inflation is low and is expected to remain low. Interest rates are also low in these conditions. Such an environment allows the economy to achieve its growth potential and fosters high employment. Free from the disruptive effects of high and variable inflation, both consumers and producers make economic decisions with confidence. Low inflation or price stability fosters sustainable long-term economic growth and employment. The CBSL uses monetary policy measures to control inflation.

2.2. Financial System Stability

A stable financial system is able to function smoothly, helping carry out economic activity in an uninterrupted manner. Furthermore, a stable financial system generates a conducive environment for savers and investors that encourages efficient financial intermediation and promotes investment and economic growth.

Financial system stability can be defined as the ability of the financial system to perform its main functions of resource mobilization and allocation, risk management and the settlement of payments, effectively at all times, even under stressful circumstances. Therefore a stable financial system is typically characterized by the effective functioning of financial institutions, markets and infrastructure.

Financial system stability is founded on the confidence of the public in the financial system and largely depends on the soundness and resilience of its principal components i.e. financial institutions, financial markets and financial infrastructure to collectively withstand risks.

The pursuit of financial stability entails the oversight of the financial system to detect and reduce system-wide risks that could cause disruption of key financial services and have a negative impact on the economy. As the main components of the financial system are inter-connected, risks in one area can spread to another through a contagion effect leading to instability in the entire system. In addition, imbalances, such as booms and busts associated with financial cycles could build up and cause instability in the financial system and adverse consequences for the economy. Financial system instability can be caused by bank /financial institution failures, excessive credit growth and asset price volatilities, collapse of market liquidity or a disruption in the payment system.

Financial system stability is multifaceted and requires a stable macro-economic environment, sound financial institutions, well-functioning financial markets, an effective regulatory and supervisory framework, safe and robust payment and settlement infrastructure and a crisis management and resolution framework.

The CBSL uses both macroprudential and microprudential policy to maintain financial system stability. Macroprudential policy involves the oversight of the whole financial system and the use of prudential tools to limit systemic risks and to prevent disruption to vital financial services required for carrying out economic activity. Microprudential policy involves the regulation and supervision of individual financial institutions and uses prudential tools to mitigate risks and promote soundness in individual financial institutions.

Sri Lanka has a multiple financial regulatory system. The CBSL regulates the banking sector, certain non – bank financial institutions and the payment system, while the Securities and Exchange Commission of Sri Lanka regulates the securities sector and the Insurance Board of Sri Lanka regulates the insurance sector. Hence, the CBSL also coordinates with other financial regulators and the Ministry of Finance to maintain financial system stability.

3. THE MONETARY BOARD

The CBSL has a unique legal structure where the Monetary Board is conferred with the corporate status and vested with all powers, functions and duties. As the governing body, the Monetary Board is responsible for making all policy decisions and for the management, operation and administration of the CBSL.

The Monetary Board of the CBSL consists of five (5) members.

- The Governor ;
- The Secretary to the Ministry of Finance (ex-officio) ;
- Three (3) non – executive members.

The Governor is the Chairman of the Monetary Board and also functions as the Chief Executive Officer of the CBSL.

The Governor and the non-executive Board members are appointed by the President, on the recommendation of the Minister of Finance.

The term of office of the Governor and the non–executive Board members is six (6) years. The quorum for Monetary Board meetings is three (3) members. The concurrence of three (3) members is required for decisions of the Monetary Board to be valid. However, in cases where an unanimous decision is required, the concurrence of all five (5) members is necessary.

If there is a difference of opinion on monetary policy between the Minister of Finance and the Monetary Board, the Minister of Finance may inform the Monetary Board that the Government accepts responsibility for the Monetary Board adopting policies in accordance with the opinion of Government and direct the Monetary Board to adopt Government policy.

There is a Monetary Board appointed 3 member Audit Committee chaired by a non–executive Board member. The other two members who are required to have expertise in financial matters, have been drawn from outside the CBSL. The Audit Committee reviews and advises the Monetary Board on the CBSL's financial reporting process, the adequacy and effectiveness of the internal controls and the scope and results of the internal and external audit.

4. FUNCTIONS

Core Functions

The core functions of the CBSL are:

- (a) Conduct of monetary policy.
- (b) Conduct of exchange rate policy.
- (c) Management of the official international reserves.
- (d) Oversight of the financial system.
- (e) Licensing, regulation and supervision of banks and selecting non – bank financial institutions.
- (f) Provision of settlement facilities and the regulation of the payment system.
- (g) Issue and distribution of the national currency.
- (h) Compilation and dissemination of economic data and statistics.
- (i) Acting as the banker and financial adviser to the Government.

Agency Functions

In addition, the CBSL also performs the following agency functions on behalf of the Government of Sri Lanka:

- (a) Management of the public debt.
- (b) Foreign exchange management.
- (c) Fund management and acting as the custodian of the Employees' Provident Fund.
- (d) Facilitating financial inclusion.
- (e) Financial intelligence services to detect and prevent money laundering and terrorist financing.

4.1. Core Functions

4.1.1. Conduct of Monetary Policy

The CBSL conducts monetary policy to maintain price stability in the domestic economy. Monetary policy operates primarily by influencing the cost and/or availability of money. This is done through the interest rate and the credit availability mechanism.

The CBSL sets the policy interest rates for its own dealings with commercial banks and these rates then affect the whole range of interest rates set by commercial banks and other financial institutions for borrowers and savers. This in turn influences spending, investment and output decisions in the economy, and eventually the cost of production and the prices of goods and services.

The main monetary policy tool used by the CBSL is the over-night interest rates called the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR). The SDFR was formerly known as the Repurchase (Repo) Rate while the SLFR was known as the Reverse Repurchase (Reverse Repo) Rate. A change in the CBSL's SDFR and SLFR would have an almost immediate impact on interest rates in the inter-bank call money market (the money market among commercial banks). Changes in call rates would lead within a very short period to changes in other flexible short-term rates, such as the yield on Treasury Bills and the lending rates of commercial banks to their prime customers. These changes would with a time lag affect the general lending rates of commercial banks, the yields on medium term Government securities (Treasury Bonds) and deposit rates offered by banks. The next step would be the impact on the levels of credit given by commercial banks, as changes in market interest rates would influence the demand for credit from firms (for investment) and consumers (for consumption expenditure). The final step in the process would be the impact of the change in interest rates and credit on the aggregate demand and hence on prices and output.

If future inflation is expected to be higher than the desirable rate, the CBSL will raise policy interest rates (the SDFR and the SLFR) to reduce inflation. Likewise, if future inflation is expected to be lower than the tolerable level, the CBSL will lower its policy interest rates (the SDFR and the SLFR) to stimulate the economy. It is estimated that monetary policy has its greatest impact on inflation with a time lag spreading upto about two years.

Generally speaking, the CBSL sets interest rates (the SDFR and the SLFR) at a level to ensure that demand in the economy is in line with the productive capacity of the economy. If the interest rates are set too

low, demand may exceed supply and lead to the emergence of inflationary pressures, so that inflation is likely to rise. If interest rates are set too high, output is likely to be unnecessarily low and inflation is likely to fall.

4.1.1.1. Monetary Policy Instruments

The CBSL possesses a wide array of instruments with which to conduct monetary policy.

The main instruments of monetary policy are:

- Open Market Operations (OMO): These are used by the CBSL to absorb or inject liquidity into the banking system and generally involve the sale and purchase of Government securities. The CBSL will issue its own securities in case the stock of Government securities available in its portfolio is not adequate for the required absorption of liquidity. Commercial banks and primary dealers participate in OMOs.

Currently, OMO consists of:

- A Standing Facility where commercial banks and primary dealers can deposit funds with the CBSL at SDFR or borrow funds from the CBSL at SLFR. The Standing Deposit Facility requires no collateral while the Standing Lending Facility requires the allocation of collateral in the form of Government securities. As at June 2014, the SDFR is 6.5 % and the SLFR is 8.0 %.
- Repo and Reverse Repo Auctions involve the purchase or sale of Government /CBSL securities on an overnight or short-term basis under a Repo/Reverse Repo agreement (described below) at rates determined by the auction.
- Outright Transactions where, Government/CBSL securities are purchased or sold on outright basis by the CBSL in order to inject or absorb liquidity on a longer term basis.
- Statutory Reserve Requirements (SRR): This is the proportion of deposit liabilities that commercial banks are required to keep as a cash deposit with the CBSL. At present, demand, time and savings deposits of commercial banks denominated in Rupees are subject to a reserve ratio of 6.0 %.
- Bank Rate: This is the interest rate at which the CBSL lends money to commercial banks in periods of emergency or imminent financial panic which directly threaten monetary and banking stability (as the lender of last resort). The Bank Rate is much higher than the SLFR and is a penal interest rate. The current Bank Rate is 15.0 %.

- Foreign exchange operations: When the CBSL purchases foreign currency this has the effect of injecting liquidity and vice versa. In addition, the CBSL may enter into Foreign Exchange Swap Agreements where it purchases/sells foreign currency with the undertaking of selling/buying foreign currency at a future date.
- Quantitative restrictions on credit: The CBSL could impose restrictions on credit growth of banks.
- Ceilings on interest rate: The CBSL could impose maximum interest rates that are charged by financial institutions. At present, there are ceilings on interest rates for credit cards and housing loans and on penal interest rates.
- Refinance facilities: The CBSL may provide loans to credit institutions for on-lending to borrowers for productive purposes.
- Moral suasion: This involves regular communications with counterparties to update them on the latest economic developments.

At present, the monetary policy places greater reliance on market based policy instruments. As a consequence, Policy Rates, OMO and SRR are the main policy instruments used by the CBSL.

4.1.1.2. Interest Rate Corridor

The CBSL makes a daily assessment of liquidity in the banking system and conducts either Repo or Reverse Repo auctions for an amount determined by the CBSL, to reduce large fluctuations in the inter-bank interest rate. A Repo/Reverse Repo is an agreement to sell/buy securities with an undertaking to buy/sell them back at an agreed date and at an agreed price. If there is excess liquidity in the market, the CBSL will conduct a Repo auction to mop-up the surplus money. Likewise, if there is a shortage of liquidity in the market, the CBSL will conduct a Reverse Repo auction to put money into the market. The auction interest rate is determined by the counter-parties (commercial banks and primary dealers) through their bids.

If any party cannot meet their entire liquidity requirement at the auction, they can deposit funds at the SDFR or borrow at the SLFR. Accordingly, the CBSL's SDFR and SLFR form an interest rate corridor for the inter-bank call money market rates, with the SDFR being the lower limit and the SLFR being the upper limit. This reduces potential large fluctuations in the short-term market interest rates. Market interest rates would generally be around the middle of the interest rate corridor, if the market liquidity condition is broadly in balance.

The limits of the interest rate corridor (i.e. the SDFR and SLFR) are reviewed at least once a month, as a part of the CBSL's monetary policy evaluation and changes in these rates is the signaling mechanism of its monetary policy stance. The rates will be changed, as necessary, to achieve the monetary targets, which are considered intermediate targets in the process of monetary transmission.

4.1.1.3. Monetary Policy Targets

Excessive growth in money supply generates inflation. This happens when the growth in money supply is greater than the growth in output.

To maintain price stability, the CBSL influences the growth in overall money supply, by determining the level of reserve money. This is done by targeting the level of reserve money needed to achieve the desired path for the growth of money supply.

Money supply is defined as currency held by the public and demand, time and savings deposits held by the public in commercial banks. This definition of money supply is known as M_{2b} . Reserve money is defined as currency in circulation and commercial bank deposits with the CBSL. The relationship between money supply and reserve money is determined by the money multiplier (the number of times reserve money is used in generating money supply, i.e. money supply divided by reserve money).

The reserve money targeting framework is operated through a monetary programme. The monetary programme sets out the desired path for growth in money supply and determines the reserve money target necessary to achieve this money growth. The monetary programme is prepared by the CBSL taking into account factors such as the expected economic growth, fiscal and balance of payments developments, desired level of growth in credit and inflation. The CBSL conducts open market operations to achieve the planned target for reserve money.

The monetary programme is a dynamic framework that has the flexibility to change as economic conditions vary. Hence, it is revised whenever necessary to accommodate unexpected changes and to provide a broad guideline for the CBSL's open market operations.

4.1.1.4. Monetary Policy Statement

The Monetary Board of the CBSL is responsible for conducting monetary policy, and is advised by the Monetary Policy Committee (MPC). The MPC was formed in 2001, to study and make recommendations on monetary policy, for the consideration of the Monetary Board. The MPC is chaired by the Deputy

Governor in charge of Price Stability. The MPC meets once a month to evaluate the monetary policy stance and to make recommendations on monetary policy to the Governor and the Monetary Board.

Following the Monetary Board meeting, the CBSL issues a monthly statement on its monetary policy stance. The monthly Monetary Policy Statement contains announcements on changes in policy measures, if any, and the rationale for such changes. It also includes detailed information on current economic developments and economic projections. The monthly Monetary Policy Statement is conveyed to the public through press releases and media conferences and is posted on the CBSL website. The date of release of the monthly Monetary Policy Statement is communicated to the public in advance through the CBSL website.

There is also a Monetary Policy Consultative Committee consisting of persons drawn from outside the CBSL whose expertise and experience would assist the CBSL in its monetary policy decision making process.

4.1.1.5. Action to preserve domestic monetary stability

Whenever the Monetary Board is of the view that the domestic monetary stability is threatened by anticipated economic disturbances or abnormal movements in the money supply or in the price level, it shall adopt policies and take remedial action as appropriate and authorized by the MLA. In addition, the Monetary Board is required to submit to the Minister of Finance and if not prejudicial to public interest, make public, a detailed report analyzing the causes of such disturbances or abnormal movements, its effects on production, employment and real income and the measures already taken and further monetary, fiscal or administrative measures which it proposes to take or recommends for adoption by the Government. The Monetary Board is also required to submit a similar report if the money supply has increased or decreased by more than 15 per cent or the cost of living index has increased by more than 10 per cent.

4.1.2. Conduct of Exchange Rate Policy

A flexible exchange rate system was adopted in June 2001. The exchange rate is determined by market forces of demand and supply, reflecting the macroeconomic fundamentals in the economy. The CBSL may intervene in the foreign exchange market to prevent excessive volatility in exchange rates and to maintain a comfortable level of external reserves. The CBSL's buying and selling of foreign exchange is done at or near market rates.

Whenever the Monetary Board is of the view that there is an actual or potential threat to the international stability of the Sri Lanka Rupee through a decline in international reserves or through international payments or remittances, it shall adopt appropriate policies and remedial measures as authorized by the MLA and submit a report to the Minister of Finance on the causes and magnitude of the actual or potential threat to the international stability of Sri Lanka Rupee and the measures already taken and further measures which it proposes to take or recommends for adoption by the Government.

4.1.3. Management of the Official International Reserves

The CBSL manages the official international reserves of the country. The MLA stipulates that the CBSL should maintain adequate foreign exchange reserves in liquid foreign currencies and a small reserve in gold to maintain the international stability of the Rupee and freedom in current international transactions.

The foreign exchange reserves are invested in the international money and capital markets in such a manner as to maintain an appropriate balance between liquidity and the rate of return on the country's assets. A major part of the international reserve is invested in fixed income securities (foreign Government securities) and the balance in foreign fixed deposits, call and current accounts and gold. At present, the main currencies in which reserves are held in are US Dollars, Sterling Pounds, Euro, Yen, Australian Dollars, Chinese Yuan and Indian Rupees. The public debt repayment requirements and the income generating capacity of the currencies are considered in determining the currency composition.

4.1.4. Oversight of the Financial System

As part of its mandate of financial system stability, the CBSL undertakes surveillance and oversight of the entire financial system taking into account its interaction with the real economy to monitor and limit systemic risks which could lead to financial and economic crises. Systemic risk is the risk that could cause the collapse or disruption of the whole financial system as opposed to the risk associated with one entity or group within the system that can be contained without harming the entire financial system. Macroprudential regulation addresses systemic risk while microprudential regulation addresses individual entity/group risk. It is recognized that macroprudential regulation fills the gap between macroeconomic policy and microprudential regulation.

The main role of macroprudential policy is to curb excessive risk-taking by the financial system, as systemic risk, that is the risk of widespread disruptions to the provision of financial services could have serious adverse consequences for the economy at large. In this regard, systemic risk has both time and cross sectional dimensions.

- a) The time dimension deals with the evolution of systemic risk over time. This is linked to financial cycles and procyclicality where aggregated risks get amplified due to feedback loops between the financial system and the real economy. Financial forces can drive and feed economic expansions. Unsustainable developments can show up in rapid credit and asset price growth with increasing risk appetites which result in credit and asset price booms and busts. In this regard, asset markets such as stock/equity, real estate and gold have experienced high leverage and price volatilities. Therefore, during a “boom “ period, the financial system must build up the required capital and liquidity buffers necessary for withstanding a subsequent downturn. Hence, many of the tools that deal with this aspect of systemic risk focus on prudential policies to restrain excessive credit expansion and counter–cyclical measures.
- b) The cross-sectional dimension deals with how risk is distributed in the financial system at a given point in time through inter-linkages, inter-dependencies and common exposures between financial institutions, markets and infrastructure. Hence, the failure of one entity could have a cascading effect on other connected entities which could spread and bring down the entire financial system. Many of the policy tools that address this aspect of systemic risk relate to limits, caps and ceilings on exposures to single parties or groups. In addition, many models have been developed to assess interconnectedness across financial intermediaries.

The CBSL has used a number of macroprudential measures over the years. These include ceilings on credit growth, dynamic general provisions, time-varying capital requirements, time-varying margin requirements, reserve requirements, limits on net open foreign currency positions, caps on foreign currency lending and exposure limits. Some of these policy measures have been implemented by way of taking monetary policy measures while other policy measures were implemented as regulatory policy measures relating to banks and other financial institutions.

The stability of the financial system is assessed using several quantitative techniques under the macroprudential policy surveillance framework. Risks to the financial system are monitored through a number of macroprudential indicators covering developments in the global and domestic macroeconomic and real sector, the various financial markets (money, bond, foreign exchange, equity) and real estate and certain commodity markets, banks and other financial institutions and the corporate sector. Several composite indicators, such as the Financial Stability Indicator, Macroeconomic Stability Indicator, Financial Market Stability Indicator and the Banking Soundness Indicator are also used to assess the health of the financial system and to identify the build-up of risks. In addition, network analysis is used to identify inter-connectedness and risk concentrations among financial institutions. Stress testing is

also used to assess the resilience of the financial institutions. An Early Warning Indicator system has been developed to identify potential risks and vulnerabilities to the financial system stemming from movements in the rupee exchange rate.

4.1.4.1. Financial System Stability Review

The Financial System Stability Committee (FSSC) headed by the Deputy Governor in charge of Financial System Stability was formed in 2004 to co-ordinate work on financial system stability and to make recommendations to the Monetary Board on policies and measures to promote financial system stability. The FSSC meets once a month to assess the health and resilience of the financial system and the risk landscape and submits a report to the Governor and the Monetary Board. Further, the CBSL publishes an annual Financial System Stability Review to inform the public of its assessment of financial system stability, risks affecting the financial system and policies taken to reduce such risks and the outlook for the future.

There is also a Financial System Stability Consultative Committee consisting of persons drawn from outside the CBSL whose expertise and experience would assist the CBSL in financial sector matters.

4.1.5. Licensing, Regulating and Supervising of Banks and Selected Non-Bank Financial Institutions

The CBSL is responsible for regulating and supervising banks and selected non-bank financial institutions to promote their soundness and to safeguard the interests of depositors and investors. The regulation and supervision of individual financial institutions is referred to as microprudential policy.

The financial system of Sri Lanka is dominated by the banking sector. The regulation and supervision of banks is governed by the Banking Act and the Monetary Law Act. The CBSL is the licensing authority for banks in Sri Lanka and issues banking licenses under two categories namely, Licensed Commercial Banks and Licensed Specialized Banks (which are savings and development banks). The main distinction between commercial banks and specialized banks is that the former is permitted to accept demand deposits from the public and maintain current accounts and engage in a full range of foreign currency activities, whereas the latter is not.

The regulation and supervision of banks by the CBSL is based on the internationally accepted standards set out by the Basel Committee on Banking Supervision. In this regard, banks in Sri Lanka migrated to the Basel II Capital Adequacy Framework under the Standardised Approach in 2008. In keeping with global trends, the CBSL is moving towards the risk-based supervision which focuses on identification of banking risks, management of risks and assessment of the ability in banks to mitigate such risks.

As a part of its regulatory and supervisory functions, the CBSL issues directives on the licensing, operations and closure of banks, the prudential requirements relating to banks, the resolution of weak banks and the enforcement of regulatory actions. The main techniques of supervision include continuous off-site monitoring and surveillance and periodic on-site examinations of banks, meetings with bank management and co-operation with external auditors.

The CBSL monitors the compliance of banks with a number of prudential requirements, including capital adequacy, liquidity, large exposures, asset quality, provisioning for non-performing loans, related party transactions, income recognition, share ownership, investments, fitness and propriety of directors and senior management and preparation and disclosure of financial statements. In addition, internal controls and standards of corporate governance and risk management in banks are also assessed. Further the CBSL has introduced a customer charter providing guidelines on the obligations of banks and customers. As at end 2013, there were 24 Licensed Commercial Banks (12 local and 12 foreign banks) and 9 Licensed Specialized Banks in operation in Sri Lanka.

The CBSL also regulates and supervises Non-bank Financial Institutions such as Licensed Finance Companies and Specialised Leasing Companies under the Finance Business Act and the Finance Leasing Act. As at end 2013, there were 48 Licensed Finance Companies and 10 Specialised Leasing Companies carrying on business under the purview of the CBSL.

In order to safeguard depositor funds, the CBSL operates the mandatory “Sri Lanka Deposit Insurance Scheme” for licensed banks and finance companies.

To increase public awareness, the CBSL periodically publishes press notices on “Financial Institutions Authorized to Accept Deposits from the Public”.

The CBSL regulates and supervises Primary Dealers under the Local Treasury Bills Ordinance and the Registered Stocks and Securities Ordinance. At the end of 2013, there were 15 primary dealers in operation, of which 8 are specialized primary dealer companies and 7 are Licensed Commercial Banks.

To improve the operational efficiency of the domestic money and foreign exchange market, the CBSL authorizes and supervises Money Brokers under the MLA.

The CBSL also has a lender of the last resort (LOLR) facility where funds may be lent to banks experiencing financial difficulties which are unable to obtain funds elsewhere. The main purpose of the LOLR facility is to preserve the stability of the banking and financial system by preventing panic ridden withdrawing of funds by depositors from banks with temporary liquidity problems.

4.1.6. Provision of Settlement Facilities and the Regulation of the Payment System

The maintenance of a well-functioning and secure payment and settlement system is an essential ingredient for a stable financial system. In terms of the Payment and Settlement Act, the CBSL is authorized to regulate and supervise payment, clearing and settlement systems. In addition, the CBSL is responsible for the preparation of a plan for the national payment system and for providing guidance and leadership for the establishment and development of the payment, clearing and settlement systems. Furthermore, the CBSL chairs the National Payments Council (NPC) which consists of the main stakeholders in the payment system. The NPC makes recommendations for the development of financial infrastructure in Sri Lanka.

Accordingly, the CBSL ensures the continuous operation of “Lanka Settle” which is the systematically important payment and settlement system. Lanka Settle comprises of two systems: the Real Time Gross Settlement (RTGS) system and “Lanka Secure”. The RTGS system is the fund settlement component of Lanka Settle which facilitates large value and time critical payments, in real time, eliminating settlement risks. Inter-bank call market transactions, government securities market transactions, open market operations, net cheque clearing transactions, inter-bank retail payment systems and the common ATM switch transactions are the main types of payments settled through the RTGS system. Lanka Secure is the security settlement component, which consists of the scripless security settlement system (SSSS) and the scripless securities depository system (SSDS) for government securities. The CBSL provides intra-day liquidity facilities on a collateralized basis, free of charge to participants of the Lanka Settle system to ensure its smooth functioning.

The CBSL is responsible for providing payment and settlement facilities for commercial banks and primary dealers. As the banker to the banks, the CBSL provides current account facilities to these institutions which are also participants in the Lanka Settle system.

The CBSL is also responsible for providing facilities for the clearance of retail payments, such as cheques, bank drafts and off-line fund transfers. The clearing house function has been out-sourced to LankaClear (Pvt) Ltd, a company jointly owned by the CBSL and commercial banks. With the increased popularity of electronic payment instruments, such as payments cards, mobile and internet banking, the CBSL has introduced guidelines to ensure that such transactions are carried out in a secure manner.

4.1.7. Issue and Distribution of the National Currency

The CBSL has the exclusive right to issue currency notes and coins that are the legal tender in Sri Lanka. There is no maximum limit imposed on the issue of currency. The issue of currency is primarily based on the transaction demand for money.

The denomination, dimension and design of the notes and coins are decided by the Monetary Board. Currently, the CBSL circulates notes in nine denominations (Rupees 5000, 2000, 1000, 500, 200, 100, 50, 20 & 10) and coins in 10 denominations (Rupees 10, 5, 2 & 1, Cents 50, 25, 10, 5, 2 & 1). The larger denomination notes have enhanced security features to deter counterfeiting. A clean note initiative is being implemented to upgrade the quality of notes in circulation. The CBSL also issues commemorative notes and coins.

4.1.8. Compilation and Dissemination of Economic Data and Statistics

The CBSL compiles statistics required to formulate macro-economic policies and disseminates information on the economy to the public. This includes statistics on money, banking and the financial sector, balance of payments, national income, prices, wages and employment, agriculture, industry, trade and services, government finance and public debt. The CBSL also conducts economic, financial and business surveys.

4.1.9. Acting as the Banker and Financial Advisor to the Government

As banker to the Government, the CBSL maintains the accounts of and provides banking facilities to Government departments, agencies, institutions and certain statutory boards. The CBSL may give guarantees in favour of the Government. The CBSL also provides provisional advances to the Government.

As financial advisor to the Government, the CBSL may make recommendations to the Government on measures and policies that should be adopted for the purposes of coordinating its policies with the policies of the CBSL. In addition, the CBSL should submit to the Minister of Finance by 15 September each year, for use in the preparation of the Budget Speech, a confidential report describing and analyzing the monetary situation in Sri Lanka and the current monetary policy of the CBSL and examining the effect of the current fiscal policy of the Government on the ability of the CBSL to achieve its objectives.

4.2. Agency Functions

4.2.1. Management of the Public Debt

The CBSL is responsible for the issuance, servicing and management of public debt, as the fiscal agent of the Government in terms of the MLA. The main objective is to ensure that the Government's financing needs and payment obligations are met at the lowest possible cost, consistent with a prudent degree of risk, over the medium to long-term.

The Domestic Debt Management Committee, consisting of CBSL and Treasury officers decides on the Government's domestic borrowing programme, within the budgetary limits approved by the Parliament.

The CBSL raises funds from the public by issuing Government securities, such as short-term Treasury Bills and medium and long term Treasury Bonds of varying maturities. Treasury Bills are issued in terms of the Local Treasury Bills Ordinance while Treasury Bonds are issued under the Registered Stock and Securities Ordinance. The CBSL conducts regular auctions to issue Treasury Bills and Treasury Bonds, through Primary Dealers in Government securities. Other methods of issuance of Treasury securities are through private placement. Treasury Bills and Bonds are issued in scripless form and are accounted for in "LankaSecure" which is the central depository and title registry for Government securities.

The CBSL also issues dollar denominated Sri Lanka Development Bonds and funds have also been raised from the international capital market by issuing medium/long term fixed rate Sovereign Bonds.

4.2.2. Foreign Exchange Management

The CBSL carries out its duties and functions as an agent of the Government in managing foreign exchange transactions under the Exchange Control Act. The key functions include formulation of policies on foreign exchange transactions, granting permission and licences on specific foreign exchange transactions, monitoring of foreign exchange inflows and outflows on current account transactions and liberalized capital account transactions and advising Authorised Dealers on good practices.

At present, foreign exchange transactions relating to goods and services in trade (i.e. current account transactions) are freely permitted without restrictions through Authorised Dealers in foreign exchange (mainly banks) subject to their exercising due diligence to identify the bona fides of the transaction. In general, transactions relating to the acquisition of real or financial assets (i.e. capital account transactions) are partially liberalized and some may require CBSL approval unless allowed in terms of a general permission.

The current focus is for the further relaxation of foreign exchange transactions, particularly capital account transactions, in line with the macroeconomic policy stance to promote Sri Lanka in global business activities, with a view to enhancing investor confidence, strengthening foreign reserves and stabilizing the foreign exchange market.

4.2.3. Fund Management and Custodian of the Employees' Provident Fund

The Employees' Provident Fund is the largest superannuation fund in Sri Lanka was established under the Employees' Provident Fund (EPF) Act. In terms of the provisions of the EPF Act, the CBSL is the custodian of the fund and responsible for fund management. The main activities carried out by the CBSL in this regard are the collection of member contributions and surcharges, maintenance of member accounts, investment of surplus funds, crediting of interest to member accounts and the payment of benefits to beneficiaries.

4.2.4. Facilitating Financial Inclusion

To promote financial inclusion and balanced growth in the country, the CBSL on behalf of the Government is engaged in regional development activities to increase access to finance and to build awareness. This is done by providing finance to needy sectors through Participating Financial Institutions (PFIs). The current focus is on granting credit under refinance and interest subsidy schemes to three broad sectors - agriculture and animal husbandry, small and medium enterprises and microfinance. In addition, skill development programmes on financial literacy, entrepreneur development and post-harvest technology are conducted. The credit schemes implemented by the CBSL are funded by the Government, CBSL, donor agencies and PFIs.

4.2.5. Financial Intelligence Services to Detect and Prevent Money Laundering and Terrorist Financing

The Financial Intelligence Unit (FIU) was established in terms of the provisions of the Financial Transactions Reporting Act (FTRA) and has been operating in the CBSL. The key functions of the FIU include the collection and receipt of information on financial transactions for the purpose of detecting possible links to money laundering, terrorist financing and other unlawful activities defined in the FTRA, investigations into suspicious financial transactions, the dissemination of information and investigations to relevant law enforcement agencies and regulatory authorities and the conduct of examinations of reporting institutions. The main reporting institutions are banks, finance companies, stock brokering companies, insurance companies and money changers.

5. ORGANIZATIONAL STRUCTURE AND DEPARTMENTS

5.1. Clusters and Departments

The organization structure of the CBSL is arranged on a function-oriented basis. There are four clusters - Economic and Price Stability Cluster, Financial System Stability Cluster, Agency Services Cluster and Corporate Services Cluster. Accordingly, departments have been categorized under the respective clusters, as shown below.

Economic and Price Stability Cluster

1. Domestic Operations Department
2. Economic Research Department
3. International Operations Department
4. Statistics Department

Financial System Stability Cluster

5. Bank Supervision Department
6. Currency Department
7. Department of Supervision of Non-Bank Financial Institutions
8. Financial Stability Studies Department
9. Payments and Settlements Department

Agency Services Cluster

10. Employees' Provident Fund Department
11. Exchange Control Department
12. Financial Intelligence Unit
13. Public Debt Department
14. Regional Development Department

Corporate Services Cluster

15. Centre for Banking Studies
16. Communications Department
17. Facilities Management Department
18. Finance Department
19. Governor's Secretariat Department
20. Human Resources Department
21. Information Technology Department
22. Internal Audit Department
23. Policy Review and Monitoring Department
24. Provincial Offices Monitoring Department
25. Secretariat Department
26. Security Services Department
27. Staff Services Management Department

The senior management of the CBSL consists of the Governor, Deputy Governors, Assistant Governors and Heads of Departments. At present, there are three Deputy Governors, with one in charge of the Price Stability Cluster and another in charge of the Financial System Stability Cluster. The supervision of departments under the other clusters are assigned among the Deputy Governors. There are also ten Assistant Governors and twenty seven Heads of Department.

The organizational structure and the main functions of the departments of the CBSL are given at Annex 1 and 2.

5.2. Regional Offices

The CBSL currently has five Provincial Offices which are located in Anuradhapura, Matale, Matara, Trincomalee and Jaffna. These Provincial Offices ensure that the functions of the CBSL are implemented in the region effectively through conducting awareness programmes, seminars, workshops and field visits. In addition, Provincial Offices are also involved in promoting access to finance, micro and small and medium enterprises, financial literacy and economic development activities in the regions.

5.3. Annual Accounts

The CBSL has adopted International Financial Reporting Standards in the preparation of its accounts, which are also audited in accordance with International Standards on Auditing. This audit complements the audit done by the Auditor General.

5.4. Profits

The CBSL's income is generated mainly from interest earned on the holdings of Government securities and investment income from international reserves. The profits of the CBSL are transferred to the General Treasury or used to settle Government obligations to the CBSL, following the guidelines given in the MLA.

5.5. Official Representation Abroad

The CBSL represents the Government of Sri Lanka at the International Monetary Fund (IMF) and may be authorized to represent the Government in dealings with the World Bank, Asian Development Bank,

foreign governments, institutions and agencies and regional financial institutions and agencies. The CBSL is also a member of regional central bank associations - SEACEN and SEANZA.

5.6. Annual Report

The CBSL is required by the Monetary Law Act to submit an Annual Report to the Minister of Finance on the state of the economy, the condition of the CBSL and a review of the policies and measures adopted by the Monetary Board, within four (4) months after the end of each financial year.

5.7. Regular Press Releases

The CBSL disseminates information on a regular basis through press releases on the following subjects.

- Exchange Rates (daily)
- SLIBOR (daily)
- Open Market Operations (daily)
- Government Securities Market Weekly Summary of Primary and Secondary Market Transactions (weekly)
- Treasury Bill Auctions Announcement (weekly)
- Treasury Bill Auction Result (weekly)
- Economic Indicators (weekly and monthly)
- Colombo Consumers' Price Index (monthly)
- External Sector Performance (monthly)
- Monetary Policy Statement (monthly)

5.8. List of Main Publications

- Annual Report
- Recent Economic Developments (annually)
- Financial System Stability Review (annually)
- Public Debt Management (annually)
- Monthly Bulletin
- Economic and Social Statistics of Sri Lanka (annually)
- Sri Lanka Socio-Economic Data (annually)
- Staff Studies Series (annually)
- “Satahana” (once in two months)
- “Kurippedu” (once in two months)
- News Survey (quarterly)
- Payment Bulletin (quarterly)
- Occasional Papers
- A Step by Step Guide to Doing Business in Sri Lanka
- A Step by Step Guide to Foreign Exchange Transactions

A complete list of all publications and more detailed information about the CBSL is available on the website: **www.cbsl.gov.lk**

For additional information, please contact:

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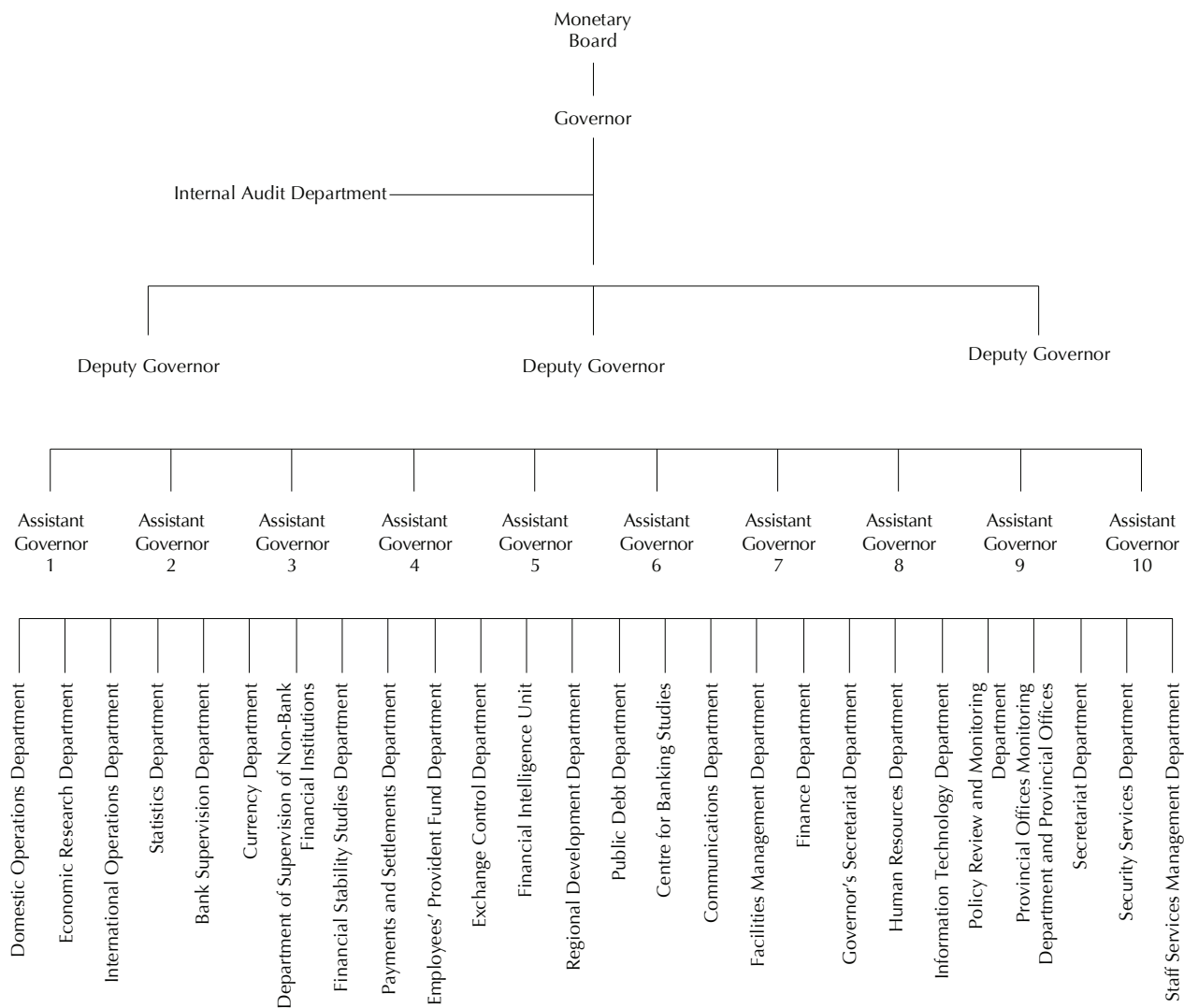
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Annex 1: Organizational Structure of the Central Bank of Sri Lanka



Annex 2: Functions of the Departments of the Central Bank of Sri Lanka

(At the end of June 2014)

Cluster	Department	Main Functions
Economic & Price Stability Cluster	Domestic Operations Department	Responsible for implementing monetary policy measures and the operation of current account facilities for the government, commercial banks and primary dealers.
	Economic Research Department	Responsible for compiling data and conducting research in money, banking and other economic subjects for the formulation and implementation of policies and measures and for the information of the public. Plays a key role in providing economic advice to the government.
	International Operations Department	Responsible for managing the official international reserves.
	Statistics Department	Responsible for compiling, analyzing and forecasting socio-economic statistics and conducting surveys.
Financial System Stability Cluster	Bank Supervision Department	Responsible for the regulation and supervision of licensed banks. Administers the Sri Lanka Deposit Insurance Scheme.
	Currency Department	Responsible for the issue and distribution of national currency notes and coins.
	Department of Supervision of Non-Bank Financial Institutions	Responsible for the regulation and supervision of licensed finance and specialized leasing companies.
	Financial Stability Studies Department	Responsible for monitoring the financial sector through macroprudential surveillance.
	Payments and Settlements Department	Responsible for operating the Lanka Settle System, regulating payment services and products and the oversight of the domestic payment and settlement system.
Agency Services Cluster	Employees' Provident Fund Department	Responsible for receiving member contributions, maintaining member accounts, investing funds and paying benefits to members of the Employees' Provident Fund.
	Exchange Control Department	Responsible for foreign exchange management under the Exchange Control Act.
	Financial Intelligence Unit	Responsible for implementation and administration of the Financial Transactions Reporting Act relating to money laundering and financing of terrorism.
	Public Debt Department	Responsible for the raising, servicing and managing of public debt, maintenance of central depository system for government securities and supervision of primary dealers.
	Regional Development Department	Responsible for promoting regional development through government, CBSL and donor assisted credit delivery programmes.

Cluster	Department	Main Functions
Corporate Services Cluster	Centre for Banking Studies	Responsible for conducting in-house training programmes for CBSL staff and financial sector personnel.
	Communications Department	Responsible for providing external and internal communication services, library services, printing services and managing the Economic History Museum.
	Facilities Management Department	Responsible for the maintenance of the premises and physical assets of the CBSL.
	Finance Department	Responsible for budgeting, budgetary control and financial statements/ reports of the CBSL.
	Governor's Secretariat Department	Responsible for managing Governor's office.
	Human Resources Department	Responsible for recruitment, placement, training , promotion and performance monitoring of staff.
	Information Technology Department	Responsible for providing information technology operations and systems for the CBSL.
	Internal Audit Department	Responsible for the internal audit function.
	Policy Review and Monitoring Department	Responsible for monitoring the implementation of the CBSL's Strategic Plan.
	Provincial Offices Monitoring Department	Responsible for facilitating and monitoring the activities of the Provincial Offices.
	Secretariat Department	Responsible for the general administration and procurement services of the CBSL.
	Security Services Department	Responsible for providing security for the CBSL.
	Staff Services Management Department	Responsible for providing welfare facilities to the CBSL staff.

NOTES

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ISBN - 978-955-575-297-8

Printed at the Central Bank Printing Press, 58, Sri Jayawardenepura Mawatha, Rajagiriya.
Published by the Central Bank of Sri Lanka, Janadhipathi Mawatha, Colombo 1, Sri Lanka.

