8

FINANCIAL SECTOR PERFORMANCE AND SYSTEM STABILITY

The stability of the domestic financial system was maintained during the eight months ending August 2020 amidst the numerous uncertainties and unprecedented challenges posed by the COVID-19 pandemic. The banking sector assets exhibited relatively moderate expansion in loans and advances and investments while the increase in the asset base was mainly funded through the increase in deposits. The Central Bank introduced a number of regulatory forbearances with the view of managing the impact created through the COVID-19 pandemic, thereby enabling banks to maintain an adequate level of liquidity and capital. Despite the debt moratorium provided to COVID-19 affected businesses and individuals, the increasing number of Non-Performing Loans (NPL) has become a concern in credit risk management of the banking sector. The real impact of the pandemic on asset quality is expected to be realised upon the cessation of the moratorium. The Central Bank, having identified the importance of reviving adversely affected Micro, Small and Medium Enterprises (MSMEs), actively engaged in implementing extraordinary policy measures to provide concessionary loans to businesses and individuals affected by the COVID-19 pandemic through the banking sector during the period from January to August 2020. The Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) sector has become vulnerable with the contraction in asset base, credit and deposits as well as increasing NPLs and declining profitability during the period from January to August 2020. Nevertheless, capital and liquidity levels of the sector as a whole remained above the regulatory minimum requirements though a few individual LFCs have not complied with the stipulated minimum capital requirements. Other sectors in the financial system recorded a mixed performance. Sectors like primary dealers, unit trusts and stockbrokers have shown improved performance while the insurance sector slowed down during the period under consideration. Amidst unprecedented easing of monetary policy, a surplus liquidity was continuously observed in the interbank money market throughout the period from January to September 2020 driven by the reduction in the Statutory Reserve Requirement (SRR), primary market purchase of Treasury bills by the Central Bank and funds disbursed under special loan schemes. Lower level of export conversions and remittances as well as outflows of foreign investments from capital markets such as the government securities market and the equity market created pressure on the domestic foreign exchange market subsequent to the outbreak of COVID-19 in mid-March 2020. However, this pressure on the exchange rate eased after the imposition of temporary restrictions on non- essential imports and selected outward remittances, better than expected workers' remittances, and modest foreign exchange interventions by the Central Bank along with the introduction of Sell – Buy Forex SWAP auctions to the market. As a result, the Sri Lankan rupee recorded only a slight depreciation against the US dollar during the period from January to September 2020. The yield curve of government securities showed a downward movement mainly reflecting the excess liquidity in the market, strategic issuance arrangements put in place, announcing maximum yield rates to the market prior to auctions and due to primary market purchase of Treasury bills by the Central Bank. The Colombo Stock Exchange (CSE) recovered from the significant decline it witnessed in mid-March and early-May 2020 due to the COVID-19 pandemic. Domestic investors' preference shifting towards equity investments in a low interest rate regime helped market recovery though foreign outflows continued. Going forward, the Central Bank as a regulator of the financial sector would continue to be cautious about risks in individual institutions as well as systemwide risks and implement proactive measures to safeguard financial system stability.

Developments in Financial Institutions

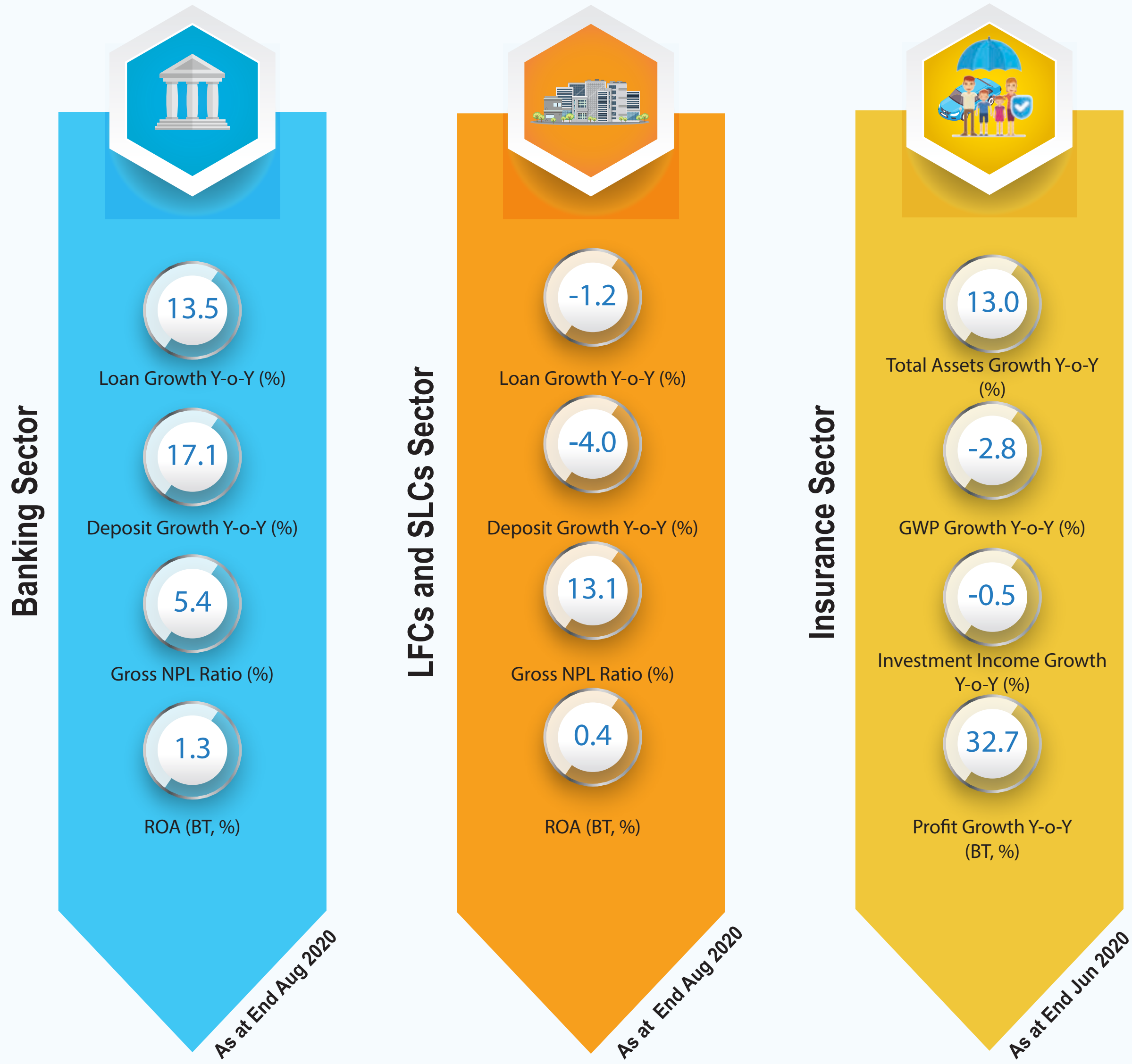
Banking Sector

- **The banking sector exhibited modest performance during the period under consideration amidst subdued economic activities in the global and domestic economy due to the spread of the COVID-19 pandemic**. Despite credit risk being on the increasing trend, the banking sector continued to operate with adequate capital, liquidity and provision coverage ratios during the period from January to August 2020. Further, capital ratios are expected to improve with the restrictions on dividend payments and profit repatriations. However, despite the freezing of classification on loans under moratorium, NPLs continued to increase. Although the granted moratorium for COVID-19 affected borrowers and related accounting treatment would help to maintain the NPL ratios during the moratorium period, the real impact on asset quality is expected to be realised upon cessation of the moratorium. Further, liquidity of banks need to be monitored closely as a significant portion of the credit portfolio is under moratorium. However, the relief measures provided for liquidity by expanding the definition of liquid assets through the Banking Act Direction No. 02 of 2020 and lowering of the SRR will help banks to remain compliant with the minimum Statutory Liquid Assets Ratio (SLAR). Subdued economic activities in the global and domestic economy resulting from the COVID-19 pandemic affected the performance of the banking sector. Therefore, the banking sector needs to be cautious of the direct and indirect impact of economic slowdown, together with the impact of the debt moratorium introduced.

- **The growth in assets of the banking sector improved during the first eight months ending August 2020 when compared with the same period of the last year**. Total assets of the sector expanded by 10.5 per cent (Rs. 1.3 trillion) to Rs. 13.8 trillion during the period concerned compared to a growth of 2.4 per cent (Rs. 277.8 billion) in the corresponding period of 2019. The increase in assets during the period was contributed by the increase in loans & advances (Rs. 725.6 billion) and investments (Rs. 598.3 billion). The asset base of the banking sector was funded primarily through deposits (Rs.10.3 trillion) and borrowings (Rs.1.7 trillion) as at end August 2020. The year-on-year growth in assets, which decreased to 6.2 per cent as at end 2019 from 14.6 per cent as at end 2018, gradually improved to reach 14.6 per cent as at end August 2020.

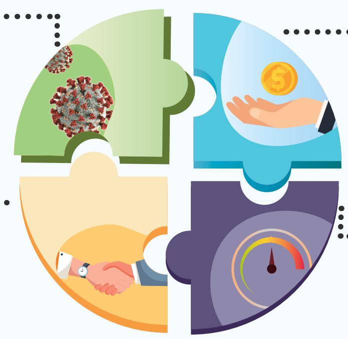
- **Year-on-year credit growth which reached 19.6 per cent as at end 2018, moderated thereafter to reach 5.6 per cent as at end 2019 and picked up during the period concerned to reach 13.5 per cent by end August 2020.** Total loans and advances reported an increase of Rs. 725.6 billion (8.9 per cent) during the period concerned to reach Rs 8.8 trillion as at end August 2020 when compared to an increase of Rs 102.7 billion (1.3 per cent) in the same period of 2019. Credit growth in 2020 was driven by an increase in rupee (LKR) loans, which accounted for 69.3 per cent of the total increase in loans and reported a growth of 7.7 per cent during the period. The loans provided to Government (Rs. 354.2 billion) and State-Owned Enterprises (Rs. 197.3 billion) accounted for 76.0 per cent of the increase in loans during the period concerned. In terms of products, except for credit cards and loans to banks and financial institutions which decreased by Rs. 4.2 billion and Rs. 7.3 billion, respectively, all other main loan products reported an increase during the period. As at end June 2020, banking sector credit was mainly extended to consumption (18.2 per cent), construction (15.6 per cent), wholesale and retail trade (13.2 per cent), manufacturing (10.6 per cent), infrastructure developments (9.1 per cent) and agriculture, forestry and fishing (8.1 per cent) sectors. Meanwhile, out of the main sectors, credit granted to financial services, trading and tourism reported a decline during the first half of 2020, while credit granted to other main sectors increased.

Figure 8.1
Highlights of Financial Institutions 2020



The Central Bank introduced a number of regulatory forbearances with the view of managing the impact of the COVID-19 pandemic.

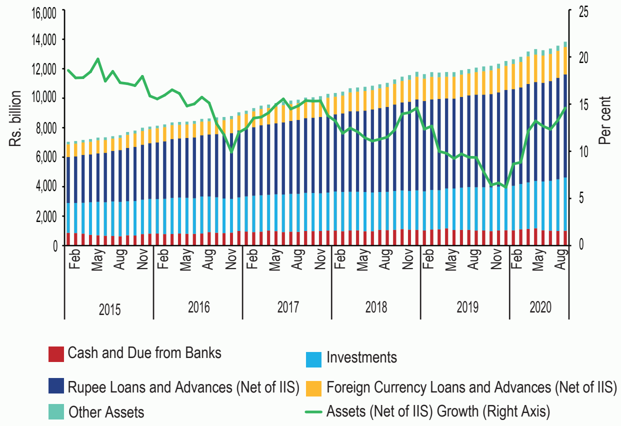
The Central Bank actively engaged in implementing extraordinary policy measures to provide concessionary loans to businesses and individuals affected by the COVID-19 pandemic through the banking sector during the first eight months of 2020.



The banking sector exhibited relatively moderate expansion in loans and advances and investments. Capital and liquidity levels of the LFCs and SLCs sector as a whole remained above the regulatory minimum requirements, though few individual LFCs have not complied with the stipulated minimum capital requirements.

Other sectors in the financial system recorded a mixed performance.

Figure 8.2
Assets of the Banking Sector



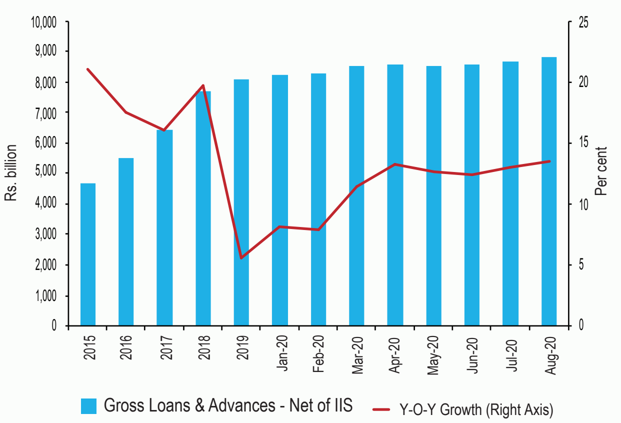
Source: Central Bank of Sri Lanka

Meanwhile, as at end August 2020, 25 per cent of the performing loans and 20 per cent of the non-performing loans had obtained moratoriums.

- **During the period concerned, investments by the banking sector was Rs. 598.3 billion (19.8 per cent) compared to that of Rs. 254.3 billion (9.4 per cent) during the corresponding period of 2019.**

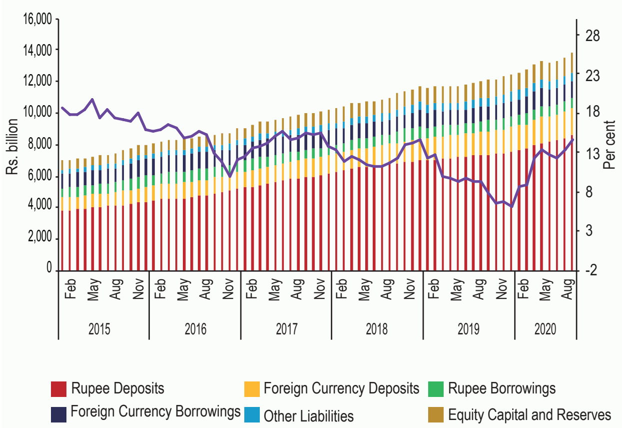
- **The banking sector expansion was largely funded through deposits which contributed towards 74.8 per cent of the total assets as at end August 2020.** The deposit base of the banking sector grew by Rs. 1.2 trillion with a 12.9 per cent growth and primarily consisted of rupee

Figure 8.3
Loans and Advances of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 8.4
Sources of Funding of the Banking Sector

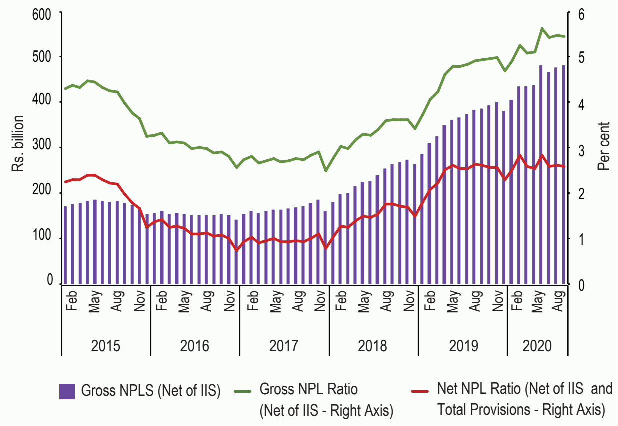


Source: Central Bank of Sri Lanka

deposits. Term deposits attracted more funds (Rs. 596.2 billion), while current and savings deposits in total increased by Rs. 531.7 billion during the period from January to August 2020. However, the current and savings deposits to total deposits (CASA) ratio increased from 31.4 per cent as at end 2019 to 32.9 per cent as at end August 2020, due to the lower base of CASA deposits. Total borrowings amounted to Rs. 1.7 trillion as at end August 2020. Borrowings of the banking sector reported an increase of Rs. 57.1 billion during the period from January to August 2020 compared to the decrease of Rs. 142.0 billion during the corresponding period of 2019. As a consequence, y-o-y growth in borrowings increased from a negative growth of 4.8 per cent as at end December 2019 to a growth of 7.1 per cent as at end August 2020. Rupee borrowings reported a decrease of Rs. 29.1 billion during the period concerned, while Foreign Currency borrowings reported an increase of US dollar 331.6 million (Rs. 86.2 billion).

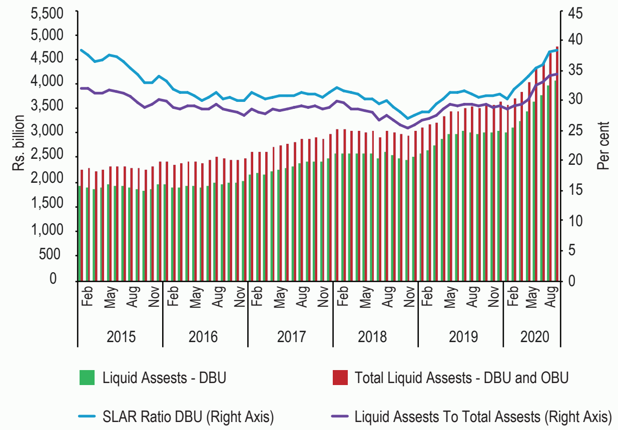
- **Asset quality of the sector showed a deterioration, but remained manageable.** Non-performing loans increased by Rs. 99.6 billion (26.1 per cent) to Rs. 481.3 billion as at end August 2020 from Rs. 381.7 billion as at end 2019, resulting in NPL ratio increasing to 5.4 per cent by end August 2020 from 4.7 per cent as at end December 2019. Except for the agriculture

Figure 8.5
Non-performing Loans of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 8.6
Liquidity Position of the Banking Sector



Source: Central Bank of Sri Lanka

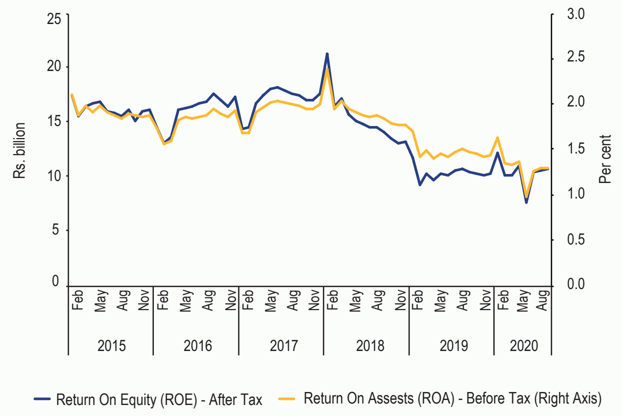
sector, a rise in NPLs was observed across all main economic sectors in the first half of 2020. However, the provision coverage ratio improved from 52.6 per cent by end 2019 to 53.8 per cent by end August 2020, with the downward migration of NPLs from the special mentioned and substandard categories requiring lower provisioning to the doubtful and loss categories which require higher provisioning.

- **The banking sector operated with an adequate liquidity buffer above the minimum regulatory requirement**. As at end August 2020, with the additional liquid assets resulting from the expansion of definition, the SLAR of the Domestic Banking Units (DBU) and the Off-shore Banking Units (OBU) were at 38.5 per cent and 44.4 per cent, respectively, which are well above the minimum statutory requirement of 20 per cent. Meanwhile, the ratio of liquid assets to total assets stood at 34.5 per cent at end August 2020. The loans to deposits ratio slightly decreased to 85.5 per cent at end August 2020 from 88.2 per cent as at end August 2019. The Rupee and All Currency Liquidity Coverage Ratios of the banking industry stood at 272.7 per cent and 206.7 per cent, respectively, as at end August 2020, well above the regulatory minimum of 90 per cent. The net Stable Funding Ratio was at 132.0 per cent as at end June 2020 above the minimum requirement of 90.0 per cent.

- **The net long position of foreign currency exposure of the banking sector decreased by US dollars 8.1 million as at end June 2020 compared to end June 2019, due to the increase in foreign currency liabilities higher than the increase in foreign currency assets.** During the first half of 2020, on-balance sheet assets denominated in foreign currency increased mainly due to increases in placements with banks and investments, while on-balance sheet foreign currency liabilities increased mainly due to foreign currency deposits. The net foreign currency exposure as a percentage of banks' regulatory capital and on-balance sheet foreign currency assets both stood at 0.5 per cent, as at end June 2020. The banking sector reported a long foreign currency position of rupee equivalent of Rs. 6.3 billion as at end June 2020 in comparison to a long position of rupee equivalent of Rs. 7.4 billion as at end June 2019. There was a net gain of Rs. 14.1 billion on foreign currency revaluation during the period from January to August 2020.

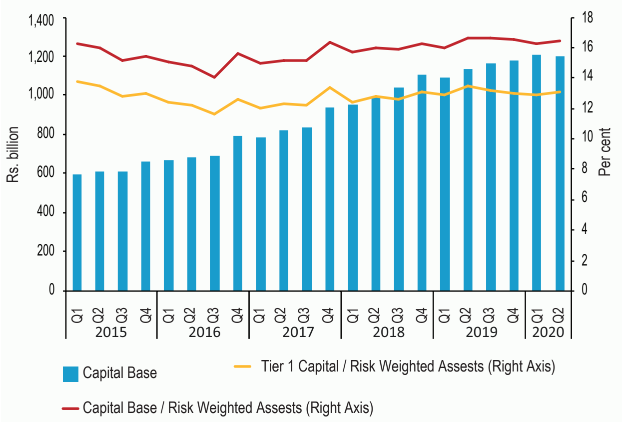
- **The downward movement in market interest rates during the period concerned resulted in an increase in capital gains in Treasury bonds to Rs 7.7 billion from Rs 3.4 billion reported during the corresponding period in 2019.** This was due to the increase in investments in government securities during the period concerned compared to the corresponding

Figure 8.7
ROA and ROE 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

period in 2019. Equity risk of the banking sector was minimal as exposure to the equity market of banks' trading portfolio was Rs.10.4 billion and was only 0.1 per cent and 1.4 per cent, respectively, of total assets and investments held for trading of the banking sector as at end August 2020.

- **Profits before taxes of the banking sector was Rs. 111.7 billion for the period concerned which is a Rs 5.8 billion decrease when compared to the profits of Rs. 117.5 billion during the corresponding period of 2019.** Profits decreased during this period when compared with the corresponding period of last year due to the decrease in net interest income (Rs. 9.0 billion) and increase in loan loss provisions (Rs. 27.8 billion). However, there was an increase in non-interest income (Rs. 7.0 billion) and decrease in non-interest expenses (Rs. 6.1 billion) during the period from January to August 2020 compared to the corresponding period of 2019, which contributed positively towards profits. Despite the profits before tax being lower compared to the corresponding period of the previous year, profits after tax of the banking sector increased by Rs. 6.9 billion to Rs. 81.6 billion during the period concerned compared to Rs. 74.8 billion of the corresponding period of 2019 due to changes in tax policies.

- **Decrease in profits before taxes was reflected in profitability ratios**. Return on Assets (ROA) before tax and Return on Equity (ROE) dropped to 1.3 per cent and 10.6 per cent, respectively, in August 2020 from 1.5 per cent and 10.8 per cent, respectively, in August 2019. Further, the net interest margin decreased to 3.2 per cent from 3.6 per cent during this period. Increase in operating cost resulted an increase of the efficiency ratio to 53.8 per cent in August 2020 from 51.6 per cent in August 2019.

- **The banking sector maintained adequate capital during the first half of 2020 in order to absorb any adverse shocks**. By end June 2020, the banking sector operated with a common equity ratio of 13.1 per cent and a total capital ratio of 16.4 per cent, well above the Basel III requirements. However, in the medium term, banks may face challenges in raising funds to meet the enhanced capital requirements for business growth. The leverage ratio (i.e. Capital as a percentage of total on and off-balance sheet exposures) of the banking sector was at 6.6 per cent as at end June 2020.

- **The branch network expanded further during the first half of 2020 facilitating financial inclusion of the country**. Accordingly, 150 automated teller machines (ATMs) were installed and 9 branches were opened, while 7 ATMs and one branch were closed during the first half of

Table 8.1
Banking Sector - Selected Indicators

Item	End Aug 2018	End Aug 2019	End Dec 2019	End Aug 2020 (a)	Y-O-Y Change (%)	
					Aug 2019	Aug 2020 (a)
Total Assets (Rs. billion)	11,040	12,072	12,523	13,834	9.3	14.6
Loans & Advances (Rs. billion)	7,104	7,796	8,122	8,848	9.7	13.5
Investments (Rs. billion)	2,608	2,952	3,027	3,625	13.2	22.8
Deposits (Rs. billion)	8,089	8,836	9,162	10,344	9.2	17.1
Borrowings (Rs. billion)	1,548	1,621	1,679	1,737	4.7	7.1
Capital Funds (Rs. billion)	959	1,096	1,130	1,206	14.3	10.0
Tier 1 Capital Adequacy Ratio (%) (b)	12.8	13.5	13.0	13.1		
Total Capital Adequacy Ratio (%) (b)	16.0	16.7	16.5	16.4		
Gross Non-performing Loans Ratio (%)	3.6	4.9	4.7	5.4		
Net Non-performing Loans Ratio (%)	1.7	2.6	2.3	2.6		
Return on Assets (Before Tax) (%)	1.9	1.5	1.4	1.3		
Return on Equity (After Tax) (%)	14.6	10.8	10.3	10.6		
Statutory Liquid Assets Ratio (DBU) (%)	30.0	31.2	31.0	38.5		
Liquid Assets to Total Assets (%)	27.4	29.3	28.9	34.5		

(a) Provisional
(b) As at end of June

Source: Central Bank of Sri Lanka

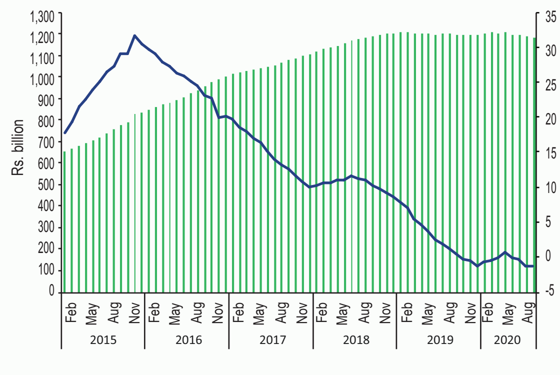
2020. Further, with the situation prevailing in the country with the COVID-19 outbreak, demand driven expansion in digitalized banking solutions and mobile payment systems were observed during the first half of 2020.

LFCs and SLCs Sector

- **The LFCs and SLCs sector performance weakened during the period from January to August 2020 recording a negative credit growth, declining profitability and increase in non-performing loans**. Restrictions on vehicle imports and subdued economic activities due to the COVID-19 pandemic, which resulted in low income levels and reduction in debt repayment capacity, contributed to the slowdown in the sector. The sector consists of LFCs with regulatory concerns[1] which represents 11.1 per cent and 16.0 per cent in terms of the market share of total net assets and total deposits, respectively. The Central Bank continued to monitor key prudential indicators of such LFCs with weak financial positions, with a view to reviving them. Accordingly, necessary actions have been taken to cease or limit finance business operations of weak finance companies to safeguard depositors and to ensure the long-term stability of the financial sector. Further, a number of measures were introduced providing flexibility to LFCs and SLCs facilitating them to support businesses and individuals affected by the COVID-19 pandemic. As at end August 2020, there were 41 LFCs (including 2 LFCs of which business operations were suspended) and 3 SLCs representing 7.6 per cent of the financial system assets. Branch network of LFCs and SLCs stood at 1,426 by end June 2020. The top 14 LFCs which have an asset base over Rs. 25 billion represent 80.1 per cent of the LFCs and SLCs sector.

- **The sector showed a negative asset growth during the eight months ending in August 2020 when compared to the corresponding period of 2019**. The net assets of the sector

Figure 8.9
Total Loans and Advances of LFCs and SLCs Sector



Source: Central Bank of Sri Lanka

1 LFCs which did not comply with the minimum prudential requirements on minimum core capital and minimum capital adequacy ratios.

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Table 8.2
LFCs and SLCs Sector - Selected Indicators

Item	End Aug 2018	End Aug 2019 (a)	End Dec 2019 (b)	End Aug 2020 (b)	Y-O-Y Change (%)	
					Aug 2019 (a)	Aug 2020 (b)
Total Assets - Gross (Rs. billion)	1,469.6	1,531.2	1,528.3	1,502.6	4.2	- 1.9
Total Assets - Net (Rs. billion)	1,406.4	1,442.4	1,432.7	1,388.7	2.6	- 3.7
Loans & Advances - Gross (Rs. billion)	1,184.6	1,200.3	1,194.7	1,186.2	1.3	- 1.2
Loans & Advances - Net (Rs. billion)	1,125.1	1,115.2	1,102.7	1,075.4	-0.9	- 3.6
Deposits (Rs. billion)	718.0	764.6	756.7	734.0	6.5	- 4.0
Borrowings (Rs. billion)	440.7	406.9	405.6	355.9	-7.7	- 12.5
Capital Funds (Rs.billion)	184.1	204.8	203.5	239.0	11.2	16.7
Tier 1 Capital Adequacy Ratio (%)	9.8	11.2	11.1	13.4		
Total Capital Adequacy Ratio (%)	11.1	12.5	12.5	14.6		
Gross Non-performing Accommodations Ratio (%)	6.9	9.6	10.6	13.1		
Net Non-performing Accommodations Ratio (%)	2.2	3.1	3.4	4.3		
Return on Assets (Before Tax) (%) - Annualised	2.8	1.6	1.8	0.4		
Return on Equity (After Tax) (%) - Annualised	12.9	4.3	5.6	- 2.5		
Liquid Assets to Total Assets (%)	7.5	8.3	8.6	8.3		

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

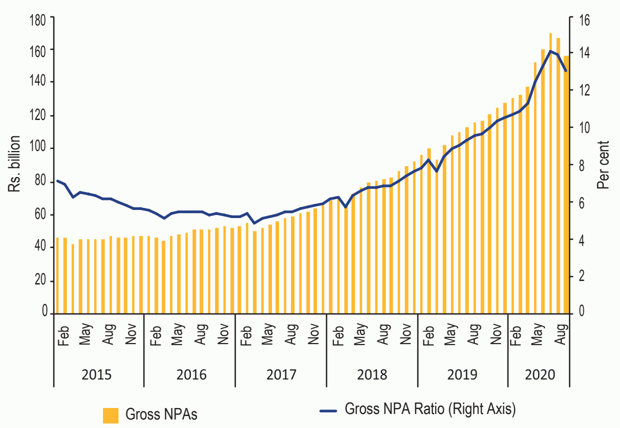
contracted by 3.1 per cent (Rs. 44.0 billion) reaching Rs.1,388.7 billion at the end of August 2020. Deterioration of assets was mainly due to reduced loans and advances. The Loans and Advances portfolio reduced by 2.5 per cent (Rs. 27.3 billion) at end August 2020 due to economic slowdown and restrictions on vehicle imports.

- **Asset quality of the sector deteriorated during the period under consideration**. The NPL ratio increased to 13.1 per cent from 9.6 per cent reported in the corresponding period, while the provision coverage ratio increased slightly to 57.2 per cent by end August 2020 compared to the corresponding period of the previous year.

- **The liabilities of the sector contracted during the reference period**. The deposit-base contracted by 3.0 per cent (Rs. 22.7 billion) during the period from January to August 2020, compared to the growth of 6.7 per cent recorded in the corresponding period of 2019. Borrowings of the sector also showed a negative growth of 12.2 per cent (Rs. 49.6 billion) during this period.

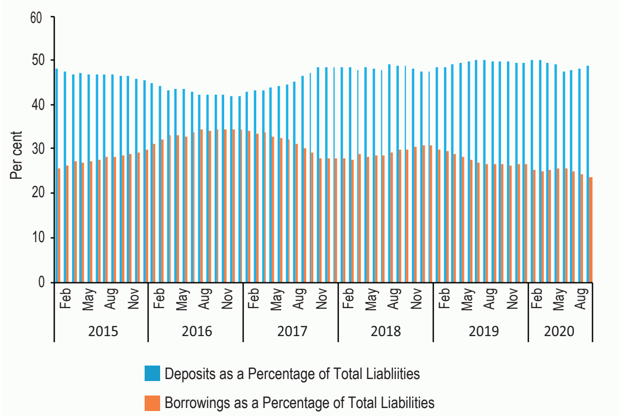
- **The overall liquidity position of the LFCs and SLCs sector recorded a surplus**. The overall statutory liquid assets available in the sector at end August 2020 showed a surplus of Rs. 73.1 billion as against the stipulated minimum requirement of Rs. 51.8 billion. Based on the

Figure 8.10
Non-performing Accomodations of LFCs and SLCs Sector



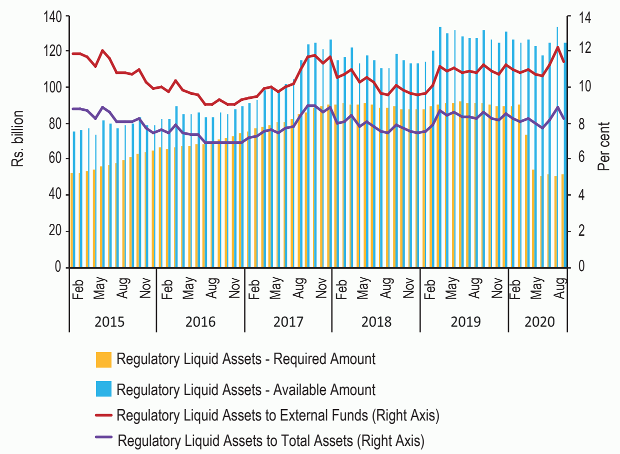
Source: Central Bank of Sri Lanka

Figure 8.11
Total Deposits and Borrowings of LFCs and SLCs Sector



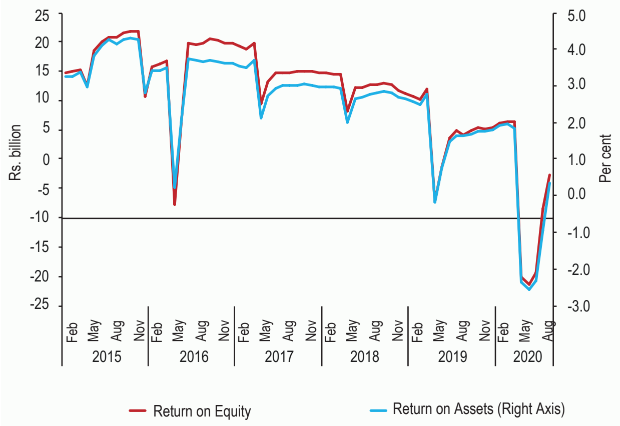
Source: Central Bank of Sri Lanka

Figure 8.12
Total Liquid Assets and liquidity Ratio of LFCs and SLCs Sector



Source: Central Bank of Sri Lanka

Figure 8.14
ROA and ROE of LFCs and SLCs Sector

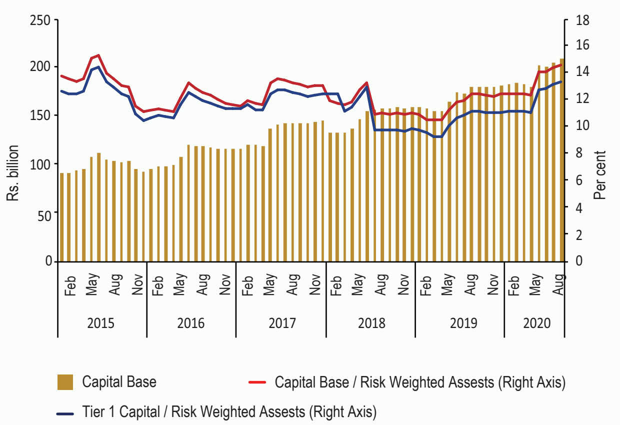


Source: Central Bank of Sri Lanka

predictions of possible future liquidity shortfalls, few companies have requested for liquidity support from the Sri Lanka Deposit Insurance and Liquidity Support Scheme (SLDILSS) of the Central Bank.

- **Capital funds of the sector improved due to the initial requirement of enhancement of regulatory capital requirements to Rs. 2 billion by January 2021 and Rs. 2.5 billion by January 2022.** The sector core capital level increased to Rs. 212.7 billion by end August 2020 due to regulatory requirements and the cancellation of the licence of a distressed finance company. Sector core capital ratio and total risk weighted capital ratio increased to 13.4 per cent and 14.6 per cent, respectively, by end August 2020. However, there are a few LFCs which do not comply with the stipulated minimum capital requirements.

Figure 8.13
Capital Position of LFCs and SLCs Sector



Source: Central Bank of Sri Lanka

- **Profitability of the sector declined compared to the corresponding period.** Net profit of the sector deteriorated and the industry recorded a profit after tax of Rs. 3.0 billion during the period from January to August 2020, mainly due to reduced net interest income and higher loan loss provisions. By end August 2020, the efficiency ratio increased to 93.2 per cent due to high loan loss provisions. Profitability of the sector as indicated by annualized ROA and ROE were at 0.4 per cent and negative 2.5 per cent, respectively, by end August 2020.

Primary Dealer Companies

- **Total assets and total portfolio of Primary Dealer Companies (PDCs) increased during the eight months ending in August 2020.** Total assets of the PDC industry increased by 17.1 per cent to Rs. 90.8 billion and the total portfolio of government securities held by PDCs increased by 15.0 per cent to Rs. 79.7 billion during the period from January to August 2020. This increase was mainly caused by the increase in the investment portfolio. Borrowings under

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Table 8.3
Primary Dealer Companies - Selected Indicators

Item	End Aug 2018	End Aug 2019	End Dec 2019 (a)	End Aug 2020 (a)	Y-O-Y Change (%)	
					Aug 2019	Aug 2020 (a)
Total Assets (Rs. billion)	**73.9**	**79.8**	**77.5**	**90.8**	**8.0**	**13.8**
Total Portfolio (Rs. billion)	67.3	73.7	69.3	79.7	9.4	8.2
Total Capital (Rs. billion)	11.9	14.4	15.2	18.0	20.6	24.8
Profit before Tax (Rs. billion)	**1.3**	**3.7**	**4.8**	**6.3**	**180.2**	**69.6**
Risk Weighted Capital Adequacy Ratio (%)	22.3	23.0	27.6	26.9	0.7	3.9
Return on Assets (%)	2.8	6.9	5.9	10.5	4.1	3.6
Return on Equity (%)	**13.9**	**33.1**	**27.3**	**41.9**	**19.2**	**8.8**
Leverage Times	**5.1**	**4.4**	**4.0**	**3.8**	**- 12.5**	**- 13.2**
Operating Expenses to Total Income (%)	11.6	7.0	8.1	11.0	- 4.6	4.0
Total Cost to Total Income (%)	31.8	13.4	16.2	15.9	- 18.3	2.4
Duration of Assets and Liabilities (years)	**2.5**	**2.5**	**3.0**	**2.6**	**2.7**	**0.9**

(a) Provisional

Note: 1. Excludes financials of Entrust Securities PLC and Perpetual Treasuries Ltd.

Source: Central Bank of Sri Lanka

repo agreements also unveiled an increase by 14.6 per cent to Rs. 69.1 billion by the end of August 2020.

- **Profitability of PDCs increased during the period from January to August 2020**. Profitability of PDCs measured in terms of ROA and ROE stood at 4.6 per cent and 14.6 per cent, respectively, during the eight months ending in August 2020. Overall, PDCs recorded a profit of Rs. 6.3 billion over the first eight months of 2020 compared to the profit of Rs. 3.7 billion reported in the corresponding period in 2019. PDCs recorded total gains (realised and unrealised) of Rs. 6.1 billion for the period concerned which has increased significantly compared to Rs. 3.1 billion recorded in the corresponding period in 2019. This significant increase in profitability of PDCs is attributable to the downward trend in the yield curve.

- **Capital was maintained at healthy levels**. All PDCs[2] maintained their core capital above the minimum requirement of Rs. 1.0 billion at end August 2020. The Risk Weighted Capital Adequacy Ratio (RWCAR) of PDCs was above the minimum requirement of 10 per cent and the ratio increased to 26.9 per cent by end August 2020 from 23.0 per cent at the end August 2019.

- **The risk profile of PDCs improved**. As the proportion of trading portfolio to total portfolio marginally increased from 83.3 per cent at end August 2019 to 83.6 per cent at end August 2020, the exposure of the industry to market risk remained stable during the period concerned in view of the large proportion of risk free government securities holdings of PDCs and also the ability of PDCs to use such government securities as collateral for obtaining funds to bridge unforeseen liquidity gaps, the liquidity risk profile of PDCs remained low. Further, most PDCs had stand-by contingency funding arrangements to bridge liquidity gaps, in case any liquidity shortage was materialised.

Insurance Sector

- **The overall performance of the insurance sector was sluggish during the period under consideration**. The total assets of the insurance sector grew year on year by 13.0 per cent at end June 2020 which is a slight decline from the growth in assets of 14.9 per cent reported during the corresponding period of year 2019. The growth of the Gross Written Premium (GWP) was negative 2.8 per cent at end June 2020 which is a significant decrease from the 14.1 per cent growth reported at end June 2019. The GWP of the long-term insurance sector increased by 3.8 per cent while the GWP of the general insurance sector declined by 7.7 per cent at end June 2020.

2 PDCs excluding Perpetual Treasuries Limited and Entrust Securities PLC

Table 8.4
Insurance - Selected Indicators

Item	End Jun 2018	End Jun 2019	End Dec 2019	End Jun 2020 (a)	Y-O-Y Change (%)	
					Jun 2019	Jun 2020 (a)
Total Assets (Rs. billion)	**581.8**	**668.3**	**691.4**	**755.2**	**14.9**	**13.0**
Total Income (Rs. billion) (b)	**108.1**	**123.8**	**251.8**	**120.8**	**14.5**	**- 2.3**
Gross Writtendown Premium Income (Rs. billion) (b)	85.8	97.9	196.7	95.1	14.1	- 2.8
Investments Income (Rs. billion) (b)	22.3	25.9	55.1	25.7	15.7	- 0.5
Profit Before Tax (Rs. billion) (b)	**21.7**	**13.7**	**27.7**	**18.2**	**- 36.8**	**32.7**
Capital Adequacy Ratio (CAR) (%)						
Long-term Insurance	310.3	293.0	298.0	308.0		
General Insuarance	179.5	203.0	231.0	238.0		
Retention Ratio (%)						
Long-term Insurance	96.0	96.1	95.8	95.1		
General Insuarance	76.1	78.5	83.0	75.9		
Claims Ratio (%)						
Long-term Insurance	44.2	42.0	45.6	40.6		
General Insuarance	63.7	64.6	67.4	47.2		
Combined Operating Ratio (%)						
Long-term Insurance	98.0	92.9	96.0	88.2		
General Insurance	101.4	101.4	105.3	87.3		
Return on Assets (ROA) (%)						
Long-term Insurance	8.5	2.6	3.9	3.2		
General Insurance	5.1	5.8	6.1	7.7		
Return on Equity (ROE) (%)- General Insurance	**10.4**	**12.0**	**12.3**	**16.2**		
Underwriting Ratio (%)- General Insurance	**18.0**	**17.9**	**14.7**	**33.3**		

(a) Provisional
(b) During the period

Source: Insurance Regulatory Commission of Sri Lanka

When considering sub-sectors of the general insurance sector, Health and Marine insurance both recorded a negative growth in GWP of 10.6 per cent as at end June 2020. Further, the GWP of the motor insurance and fire insurance sub-sectors reported a decline of 3.8 per cent and 1.0 per cent respectively, during the period under consideration.

- **The insurance sector profits increased during the period under consideration**. The total profit of the sector increased by 32.7 per cent by end June 2020. The profits of the long-term insurance sector which contributed to 61.2 per cent of the insurance sector profits, continued to decline during this period reporting a decline of 20.6 per cent at end June 2020. Meanwhile, general insurance sector profits increased significantly by 116.6 per cent during this period with a decline in claims in the second quarter of the year.

- **There was a drop of 28.2 per cent in the volume of claims made by the general insurance sector during this period, whereas the claims made by the long-term insurance sector also dropped marginally by 0.7 per cent.** The reduction of claims observed in the second quarter of 2020 may be attributable to the reduction of incidents covered by insurance as a result of the lockdown due to COVID-19 pandemic. The investment income of the sector marginally decreased by 0.5 per cent by end June 2020.

Unit Trusts

- **Performance of the unit trust sector indicated an overall improvement during the period under consideration**. The total number of unit holders increased to 47,903 by end June 2020 from 44,224 at end June 2019, even though the number of Unit Trusts declined by 3 by end June 2020. The net asset value of the unit trusts increased by 50.7 per cent from June 2019 to June 2020 and reported a net asset value of Rs. 113.4 billion at end June 2020. Investment in government securities has increased significantly by 115.1 per cent during the period under consideration, while investments in equity and other securities have increased by 0.7 per cent and 54.4 per cent, respectively.

Table 8.5
Unit Trust Sector - Selected Indicators

Item	End Jun 2018	End Jun 2019	End Dec 2019	End Jun 2020 (a)	Y-O-Y Change (%)	
					Jun 2019	Jun 2020 (a)
Total Assets (Rs. billion)	64.8	75.5	104.9	114.4	16.5	51.6
Net Asset Value - NAV (Rs. billion)	64.6	75.2	104.8	113.4	16.4	50.7
Investments (Rs. billion)	64.8	75.3	104.8	114.4	16.3	51.9
Equity	11.1	8.0	9.8	8.1	- 27.4	0.7
Government Securities	5.3	4.0	4.0	8.6	- 24.4	115.1
Other (e.g.,Commercial Papers, Debentures, Trust Certificates & Bank Deposits)	48.4	63.3	91.0	97.7	30.8	54.4
Investments in Equity as a % of NAV	17.2	10.7	9.4	7.2		
Investments in Government Securities as a % of NAV	8.2	5.3	3.8	7.5		
Other Investments as a % of NAV	74.9	84.1	86.9	86.1		
Total No. of Unit Holders	41,200	44,224	46,481	47,903		
No. of Units in Issue (billion)	2.0	3.6	4.8	5.4		
No. of Unit Trusts	79	75	71	72		

(a) Provisional

Source: Securities and Exchange Commission
Unit Trust Association of Sri Lanka

Stock Broker Companies Sector

- **The stock brokers sector indicated a significant improvement in its overall performance at end June 2020**. The income of the stock brokers increased by 84.9 per cent and recorded Rs. 443 million for the period ended June 2020. Thereby, the sector recorded a profit of Rs. 157.9 million during this period, recovering from the loss of Rs. 184.1 million recorded during the first half of 2019. Net capital of the sector slightly increased by 1.5 per cent during the period under consideration.

Superannuation Funds

- **The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka with an asset base of over Rs. 2.7 trillion as at end August 2020.** The total number of member accounts of the EPF reached 19.4 million in December 2019, recording an increase of 3.7 per cent when compared to the previous year.

- **Total member contributions during the period from January to August 2020 decreased by 4.9 per cent to Rs. 99.5 billion while refund payments decreased by 13.8 per cent to Rs. 73.8 billion when compared to the corresponding period of the previous year.** The said decline in contributions and refund payments may be the outcome of sluggish economic activities. Accordingly, the net contribution (net of contributions received and refunds paid) during the period under review stood at Rs. 25.7 billion.

- **During the 12 months period ending 31 August 2020, total assets of the EPF increased by 9.5 per cent to Rs. 2,714 billion whereas the total investment of the EPF also grew by 9.7 per cent to Rs. 2,712 billion.** The investment of the EPF consists of 93.8 per cent in government securities, 2.3 per cent in equity and 1.5 per cent in corporate debt, trust certificates and reverse repo and 2.4 per cent in fixed deposits. The Fund estimated a gross investment income of

Table 8.6
Stock Broking Industry - Selected Indicators

Item	End Jun 2018	End Jun 2019	End Dec 2019	End Jun 2020 (a)	Y-O-Y Change (%)	
					Jun 2019	Jun 2020 (a)
Total Assets (Rs. billion)	10.5	7.5	9.7	13.5	- 27.9	78.4
Total Liabilities (Rs. billion)	5.0	2.5	4.5	8.4	- 49.5	232.7
Net Capital (Rs. billion)	5.5	5.0	5.1	5.1	- 8.4	1.5
Income (Rs. million) (b)	384.6	239.6	574.0	443.0	- 37.7	84.9
Net Profit/(Loss) Before Tax (Rs. million) (b)	- 57.9	- 184.1	88.0	157.9	218.2	-185.8

(a) Provisional
(b) During the period

Source: Securities and Exchange Commission of Sri Lanka

Table 8.7

Employees' Provident Fund - Selected Indicators

Item	End Aug 2019	End Aug 2020 (a)	Change (%)
Total Contributions (Rs. billion) (b)	104.6	99.5	- 4.9
Total Refunds (Rs. billion) (b)	85.6	73.8	- 13.8
Total Assets (Rs. billion)	2,477.9	2,714.4	9.5
Total Investment Portfolio (Rs. billion)	2,471.9	2,711.9	9.7
o/w, Government Securities (%)	94.7	93.8	- 0.9
Gross Income (Rs. billion) (b)	159.4	172.6	8.3

(a) Provisional *Source:* Central Bank of Sri Lanka
(b) During the first eight months of the respective year

Table 8.8

Employees' Trust Fund - Selected Indicators

Item	End Jun 2019	End Jun 2020 (a)	Change (%)
Total Contributions (Rs. billion) (b)	13.4	13.2	- 1.5
Total Refunds (Rs. billion) (b)	10.4	8.5	- 18.3
Total Assets (Rs. billion)	327.7	362.7	10.7
Total Investment Portfolio (Rs. billion)	308.3	342.2	11.0
o/w, Government Securities (%)	77.8	81.8	5.1
Gross Income (Rs. billion) (b)	15.9	16.9	6.1

(a) Provisional *Source:* Employees' Trust Fund Board
(b) During the period

Rs. 172.6 billion during the period from January to August 2020, which is an increase of 8.3 per cent compared to the corresponding period of 2019.

- **The rate of return to members for 2019 was 9.25 per cent compared to the interest rate of 9.50 per cent given in 2018.** It is expected that it would be able to offer a similar or marginally lower rate for the year 2020 when compared to 2019 mainly due to the significant reduction of market interest rates during 2020. As more than 90 per cent of the fund investments consist of government securities, the decline in future market interest rates would definitely have a significant impact on the return on investment in the medium term.

- **The Employees' Trust Fund (ETF) expanded in terms of assets and contracted slightly in terms of contributions at end June 2020**. Total assets of the ETF grew by 10.7 per cent and reported Rs. 367.2 billion at end June 2020. Contributions declined slightly by 1.5 per cent and reached Rs. 13.2 billion during the period under consideration. With regard to the investment portfolio of the ETF, investment on government securities reported the highest contribution at 81.8 per cent of the total investment portfolio. Investments in fixed deposits and investments in equity accounted for 13.0 per cent and 3.3 per cent, respectively of the total investment portfolio at end June 2020.

- **The Public Service Provident Fund (PSPF) improved in terms of total assets and number of members while reporting a drop in net contributions at end June 2020**. The active members of the fund increased to 233,534 at end June 2020 compared to 230,414 recorded at end June 2019. Total assets of the fund improved by 14.6 per cent and recorded Rs. 71.8 billion at end June 2020 while investments of the fund increased by 14.0 per cent and recorded Rs. 67.0 billion. Investments in government securities amounted to 27.7 per cent of total investments. The net contribution of the fund decreased to Rs. 155.5 million by end June 2020, compared to Rs. 240.3 million by end June 2019. This was mainly as a result of the delay in receiving contribution proceeds due to the COVID-19 pandemic. The rate of return on member balances was 9.8 per cent during this period.

Developments in Financial Markets

Domestic Money Market

- **The surplus liquidity position, which prevailed since mid-September 2019, continued in 2020 as well, mainly due to the monetary operations of the Central Bank and range of other factors**. Other factors include reduction in the SRR, primary purchases of Treasury bills, foreign exchange related transactions and funds disbursed under special loan schemes introduced by the Central Bank in view of developments related to the COVID-19 pandemic. As the market was in surplus liquidity position, repurchase auctions were conducted during the first quarter of 2020 to absorb excess liquidity from the domestic market with a view to maintaining the AWCMR which is the operational target of the current monetary policy framework, at the middle of the Standing Rate Corridor (SRC). In early 2020, the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank which form lower and upper bounds of the SRC, respectively, were reduced by 50 basis points to 6.50 per cent and 7.50 per cent, respectively, to support the continued reduction in market lending rates.

- **Further, from mid-March 2020 onwards, several monetary policy relaxation measures were introduced by the Central Bank, to ensure certainty in the availability of market liquidity and to prevent undue pressure on short term interest rates during the COVID-19 pandemic**. Accordingly, the SDFR and the SLFR were further reduced by 25 basis points to 6.25 per cent and 7.25 per cent, respectively, with effect from 17 March 2020, while the SRR applicable for Licensed Commercial Banks (LCBs) was reduced by 1.00 percentage point to 4.00 per cent with effect from 16 March 2020 releasing about Rs. 65.0 billion worth of liquidity to the domestic money market. Although the market was in surplus levels during the period from end March to June 2020, the Central Bank conducted overnight, short-term and long term reverse repo auctions with a view to inducing a downward adjustment in the AWCMR considering the asymmetric distribution of liquidity among the money market participants as well as to ensure certainty of liquidity in the market. Further, the Central Bank provided long-term liquidity assistance to LCBs through the long term reverse repo auctions for an extended period of three months. In the meantime, long term liquidity assistance was also extended for a period up to 15 days to Standalone Primary Dealers (SPDs) as well, through the Liquidity Support Facility (LSF). With effect from the close of business on 03 April 2020, the SDFR and the SLFR were further reduced by 25 basis points to 6.00 per cent and 7.00 per cent, respectively, as a measure to provide further relief to businesses and individuals affected by the COVID-19 pandemic.

- **In addition, with the view of providing more flexibility in liquidity management, the minimum daily reserve requirement to be held by a LCB with the Central Bank was reduced from 90 per cent to 20 per cent of the required reserves on any given day with effect from 16 April 2020**. Further, the Bank Rate, which is an administratively determined rate that could be used by financial institutions in periods of imminent financial panic, has been effectively reduced by 500 basis points from 15.00 per cent to 10.00 per cent with effect from 16 April 2020, while allowing it to be automatically adjusted in line with the SLFR with a margin of +300 basis points. Considering the need for inducing a further downward trend in interest rates, thereby encouraging lending to needy sectors of the economy by the financial system, the SDFR and the SLFR were further reduced by 50 basis points to 5.50 per cent and 6.50 per cent, respectively, effective from the close of business on 06 May 2020, and further reduced by 100 basis points each, to 4.50 per cent and 5.50 per cent, respectively, with effect from 09 July 2020.

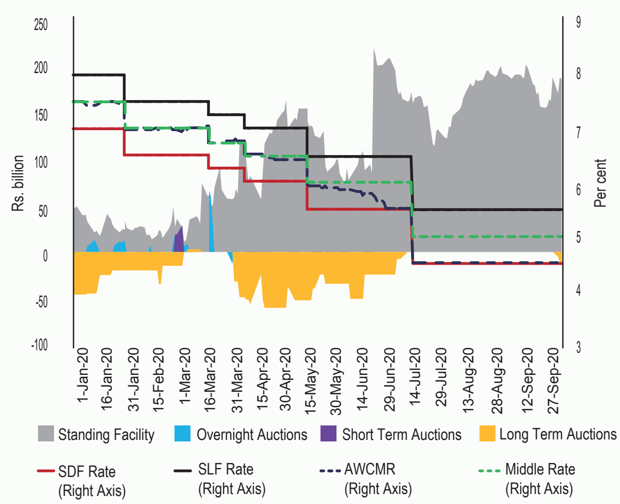
- **Moreover, releasing another Rs. 115 billion liquidity to the domestic money market, SRR was further reduced by 200 basis points to 2.00 per cent from 4.00 per cent with effect from 16 June 2020.** At the same time, the amount of till cash consisting of currency notes and coins which is considered for computation of SRR of LCBs was also reduced to 1 per cent from 2 per cent. With the prevailing surplus liquidity position in the domestic money market, auctions under Open Market Operations (OMOs) were not conducted during the period from 17 June 2020 to 24 September 2020. The Central Bank absorbed excess liquidity in the money market through the Standing Deposit Facility (SDF) on overnight basis as LCBs continued to park excess liquidity with the Central Bank. However, amidst the substantial surplus liquidity position in the domestic money market, considering the anticipated liquidity reduction due to foreign loan repayments, and hence recognizing the need for ensuring availability of adequate liquidity, auctions under OMOs were commenced since 25 September 2020. Accordingly, long term and short term reverse repo auctions for LCBs as well as long term liquidity support facility auctions for SPDs were conducted on a need basis.

- **Following the monetary policy relaxing measures of the Central Bank, the AWCMR which remained at the middle of the policy rate corridor until May 2020, declined gradually towards the lower bound of SRC**. The Central Bank was able to maintain the AWCMR around the middle rate of the interest rate corridor mostly during the first half of 2020. In line with the reduction in policy rates by a total of 100 basis points during the period from January to April 2020, the AWCMR also adjusted in a similar magnitude indicating a complete pass-through of the policy rate adjustments. With the prevalence of high liquidity surplus amidst continued accommodative monetary policy stance of the Central Bank, the AWCMR was allowed to move towards the floor rate of the SRC aiming to drive down market lending rates in a bid to bolster economic activities. Accordingly, by the end September 2020, the AWCMR remained at 4.53 per cent. The Average Weighted Repo Rate (AWRR) indicated some uptick in the months of September and early October 2020 mainly due to borrowings by few primary dealers in the repo market at relatively high interest rates, but remained broadly closer to the AWCMR. By end of September 2020, AWRR was 4.58 per cent.

- **Monetary policy implementation of the Central Bank during the period of COVID-19 pandemic was aimed at assuring the availability of adequate liquidity to induce low interest rates environment, while ensuring smooth operations of the financial system.** In order to provide credit to the sectors having special liquidity needs in the COVID-19 pandemic period, the Central Bank introduced new credit schemes under Section 83(1) of the Monetary Law Act, No. 58 to 1949. Accordingly, the Central Bank introduced a liquidity facility

Figure 8.15

Standing Rate Corridor, AWCMR and Market Liquidity



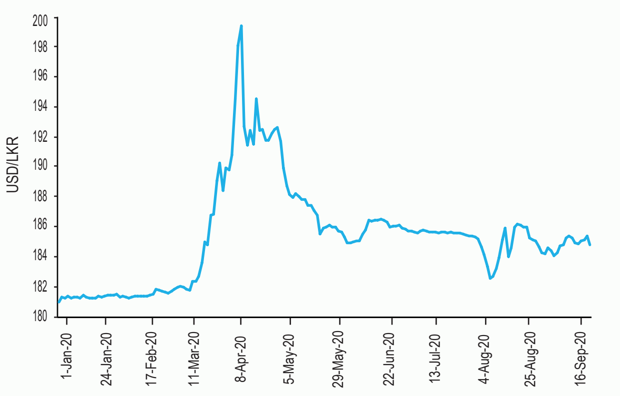
Source: Central Bank of Sri Lanka

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 at a rate not exceeding 4.00 per cent upon the receipt of promissory notes from such LCBs which have been secured by the Letter of Acceptance of Payment of Outstanding Bills due to Contractors and Suppliers issued by the Government. As at end September 2020, Rs. 4.5 billion was disbursed to LCBs under this loan scheme. In addition, the Central Bank provided funds to LCBs under the Saubagya Renaissance Loan Scheme Phase II at a concessionary rate of 1.00 per cent against the pledge of a broad spectrum of collateral, on the condition that LCBs in turn will on-lend to domestic businesses at a rate not exceeding 4.00 per cent. As of end September 2020, Rs. 51.0 billion has been disbursed to LCBs under Saubagya Loan Scheme Phase II.

Domestic Foreign Exchange Market

- **During the period from January to September 2020, the Sri Lankan rupee depreciated against the US dollar by 2.10 per cent from Rs. 181.63 as at end December 2019 to Rs. 185.52 as at end September 2020.** The year 2020 started with an enduring exchange rate that moved around Rs. 181 level, subsequent to the post-election economic stability, which continued till end February 2020. However, the perceived stability did not prevail for long and a significant pressure on the exchange rate was observed since mid-March 2020 leading the exchange rate to reach almost Rs. 200 levels in April 2020 with the lower levels of export conversions, tourism related inflows and remittances as well as increased repatriations of foreign investments from the government securities market and equity market following the global crisis of the COVID-19 pandemic. However, this pressure on the exchange rate was eased through modest FX interventions on Spot and Forward basis by the Central Bank along with the introduction of Sell – Buy Forex SWAP auctions to the market with a view to provide FX liquidity without depleting the foreign exchange reserves. Further, the policy directions taken by the Government and the Central Bank to impose temporary restrictions on non-essential imports and selected outward remittances, and better than expected remittance inflows too supported to reduce the pressure on the exchange rate. Accordingly, the depreciating trend observed in the exchange rate during the first half of 2020 gradually eased towards the end of September 2020. Meanwhile, during the period from January to September 2020, the Sri Lankan rupee marginally appreciated against the Indian rupee and the Sterling pound, and depreciated against Australian dollar, Euro and Japanese yen.

Figure 8.16
USD/LKR Exchange Rate Movement



Source: Central Bank of Sri Lanka

- **The Central Bank was a net buyer in the domestic foreign exchange market during the period ending 30 September 2020.** Despite the modest sales during the periods of excessive volatility, specifically from March to mid-May 2020, the Central Bank was able to resume purchasing foreign exchange from the market to build up foreign exchange reserves of the country since the end of May 2020 with the receipt of inflows into the domestic foreign exchange market and the condensed import demand. Accordingly, during the period up to end September 2020, the Central Bank absorbed US dollars 629.0 million and supplied US dollars 373.9 million resulting in a net purchase of US dollars 255.1 million.

- **During the period ending 30 September 2020, trading volumes in the domestic foreign exchange market decreased.** Due to the impact of the COVID-19 pandemic during the period from January to September 2020, trading volumes in the domestic foreign exchange inter-bank market decreased by 6.0 per cent, to US dollars 13.97 billion compared to the same period in the previous year. Correspondingly, the daily average volumes in the inter-bank foreign exchange market during the period from January to September 2020 compared to the same period in 2019 decreased by 4.4 per cent to US dollars 79.37 million from US dollars 82.98 million.

Government Securities Market

- **Historically low yield rates were observed across the Treasury bills and Treasury bonds market during the period from January to September 2020.** Following the primary market downward adjustments in yield rates, a downward shift was observed in the secondary market yield curve for government securities throughout the nine months ending in September 2020, in comparison to the corresponding period in 2019. The decreasing trend witnessed in the secondary market yield rates was a result of strategic issuance arrangements in line with resource availability, the accommodative monetary policy stance adopted

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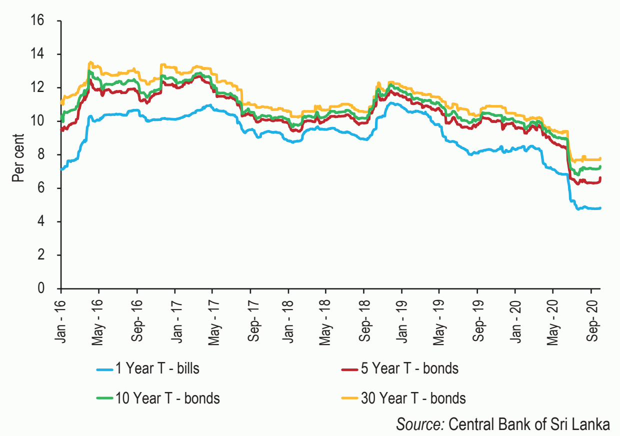
by the Central Bank and the policy direction of the government to facilitate low benchmark interest rates. Accordingly, by end September 2020, the secondary market yield rates of 91-day, 182-day and 364-day Treasury bills declined by 301 basis points, 324 basis points and 351 basis points, respectively, compared to the rates prevailed at end 2019. Meanwhile, the market yield rates of actively traded Treasury bonds with maturities ranging from 2 to 8 years declined in the range of 280 to 319 basis points during the period under review.

- **In order to facilitate the cash flow requirements of the General Treasury without compromising the effectiveness and transparency of the primary issuance process of Government securities, commencing from the COVID-19 pandemic period, several arrangements were initiated and continued in line with Government policy directions in the government securities market.** Accordingly, the maximum yield rate for acceptance for all maturities offered at Treasury bill and Treasury bond auctions was announced to the market participants prior to auctions with effect from 12 May 2020, to facilitate informed decision making while enhancing symmetry of information among auction participants. Further, the frequency of Treasury bond auctions was increased to two auctions a month deviating from the established practice of one auction a month to facilitate

Figure 8.17
Secondary Market Yeild Curve of Government Securities



Source: Central Bank of Sri Lanka

General Treasury's cash flow requirements during the period from May to July 2020. Meanwhile, the advance announcement of the auction calendar was maintained on shorter durations given Vote on Account based financing authorization.

- **A substantive volume of finances from Treasury bills and Treasury bonds was raised with over Rs. 141.6 billion savings during the period from January to September 2020.** In aggregate for the same period, Rs. 2,428.0 billion were raised by issuances of Treasury bills and Treasury bonds and enabled the government to accomplish substantial savings in its budgetary operations, including for 2020, in comparison to the weighted average cost of financing of the same instruments in 2019.

Corporate Debt Securities Market

- **The Commercial Paper (CP) market was relatively active during the period from January to August 2020 amidst the COVID-19 pandemic**. The value of commercial papers issued with the support of banks amounted to Rs 3.3 billion during the period from January to August 2020 in comparison to Rs. 2.4 billion recorded during the corresponding period of 2019. The interest rates on CPs lowered to a range of 9.00 per cent to 15.50 per cent during the eight months ending August 2020 from a range of 13.50 per cent to 16.25 per cent in the corresponding period of 2019. CPs with a maturity up to 3 months accounted for 69.2 per cent of the market, while remaining CPs were issued with a 6 month maturity period. The total outstanding value of CPs amounted to Rs. 2.1 billion at end August 2020 compared to Rs. 2.2 billion at end August 2019.

- **The activity observed within the corporate bond market remained low during the nine months ending September 2020 compared to the previous year**. Performance of the corporate bond market was affected by the COVID-19 pandemic and temporary closure of the Colombo

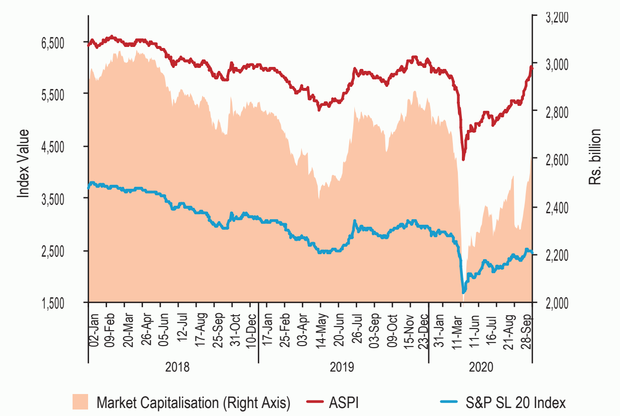
Stock Exchange (CSE) for a period of seven weeks. Twelve different types of debentures were issued by six institutions during the nine months ending September 2020 compared to seventeen types of debentures issued by nine institutions during the corresponding period of 2019. Total value of the corporate bonds listed during the period from January to September 2020, significantly decreased to Rs. 16.4 billion compared to the Rs. 35.6 billion recorded in the corresponding period of the previous year. Out of the twelve debentures issued during the period, only two debentures were issued with floating interest rates and the rest of the debentures were issued with fixed interest rates. The fixed interest rates of debentures ranged from 9.50 - 13.25 per cent during the period under review compared to the range of 12.88 - 15.50 per cent observed during the corresponding period of 2019.

Equity Market

- **Overall, the CSE reported a dismal performance during the period from January to September 2020 due to numerous uncertainties created by the COVID-19 pandemic though it showed signs of recovery in terms of share prices since mid-May 2020**. The bourse started to recover from its poor performance with domestic investors' preference shifting towards equity investments due to the low interest rate regime, an improved condition in handling COVID-19 in the country and increase in confidence with the renewed political stability. However, the CSE exhibited high sensitivity to the adverse news regarding the COVID -19 pandemic.

- **The volatility of the All Share Price Index (ASPI) and S&P SL 20 indices increased significantly during the period in an environment of market stress created by the COVID-19 pandemic**. With the start of the spread of COVID-19 in Sri Lanka, from 10 March to 20 March, the market was halted for 30 minutes in the days market was opened due to over 5 per cent decline recorded in S&P SL20 index.

Figure 8.18
Movements of Share Price Indices

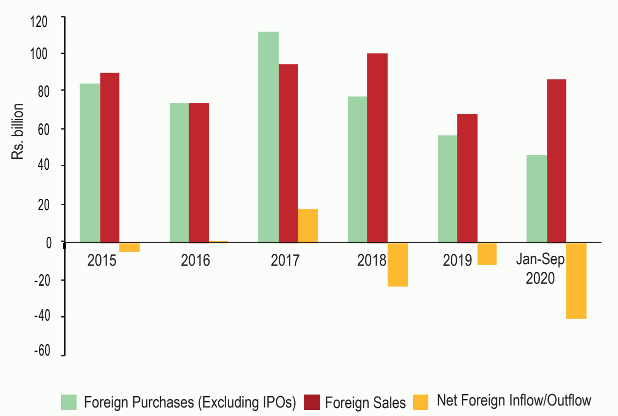


Source: Colombo Stock Exchange

The CSE was closed from 20 March 2020 until 11 May 2020 due to the lockdown imposed by the government to prevent the spread of COVID–19. Upon the reopening of the CSE after a seven week shutdown, the market was again halted on both 11 and 12 of May due to the decline in S&P SL20 index over 5 per cent. Since then, the market has shown signs of recovery. However, market indices plummeted on 13 July and 05 October following market panics immediately after identifying new COVID-19 clusters in the country.

- **Overall, the ASPI and S&P Sri Lanka 20 index decreased by 2.4 per cent and 16.1 per cent, respectively, by end September 2020 compared to end 2019.** Market capitalisation

Figure 8.19
Foreign Participation at the CSE



Source: Colombo Stock Exchange

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Table 8.9
Equity Market - Selected Indicators

Item	End 2018	2019 Sep	End 2019	2020 Sep
All Share Price Index (1985=100)	6,052.4	5,738.2	6,129.2	5,984.8
Year to date change (%)	- 5.0	- 5.2	1.3	- 2.4
S&P SL 20 Index (2004=1,000)	3,135.2	2,759.2	2,937.0	2,463.3
Year to date change (%)	- 14.6	-12.0	- 6.3	- 16.1
Market Capitalisation (Rs. billion)	2,839.5	2,709.2	2,851.3	2,595.8
As a Percentage of GDP (%)	19.7	18.7	19.0	17.3
Market Price Earning Ratio	9.7	10.2	10.8	10.1
Average Daily Turnover (Rs. million)	833.6	661.0	711.2	1,481.6
Net Cumulative Foreign Purchases (Rs. billion)	- 23,247.5	- 2,570.4	- 11,735.3	- 39,856.6
Number of Companies Listed	297	290	289	285
Initial Public Offers	2	0	0	1
Amount raised through IPOs (Rs. billion)	2.0	0	0	8.1

(a) Based on GDP for 2019 (Rs. 15,016 billion)

Source: Colombo Stock Exchange

decreased to Rs. 2,595.8 billion at end September 2020 from Rs. 2,851.3 billion at end 2019. Market price earnings ratio (PER) declined to 10.1 times at end September 2020 from 10.8 times at end 2019. Meanwhile, the average daily turnover during the period from January to September 2020 increased to Rs. 1,481.6 million compared to Rs. 661.0 million in the first nine months of the previous year. Even though, other indicators showed an improvement since mid-May 2020, foreign investors continued to move their investments from the CSE. In the secondary market, the cumulative foreign sales were Rs. 39.9 billion during the first nine months of 2020 compared to the cumulative foreign sales of Rs. 2.6 billion recorded during the corresponding period of 2019. There was only one Initial Public Offering (IPO) in the CSE during the nine months ending September 2020 which raised Rs. 8.1 billion.

Developments in Financial Infrastructure

Payment and Settlement Systems

- **The national payment infrastructure continued to facilitate economic activities of the country by effectively catering to the payment and settlement needs of individuals and institutions**. During the COVID-19 pandemic, uninterrupted operations were ensured in the Payment and Settlement Systems enabling the carrying out of urgent payments and other transactions.

- **The LankaSettle System comprises two closely integrated systems i.e. the Real Time Gross Settlement (RTGS) System and the LankaSecure System.** The RTGS System settles high value time critical customer and interbank transactions. In order to encourage usage of the RTGS System for high value transactions, the maximum per transaction fee was reduced to Rs. 400 from 01 October 2020 from Rs. 1,000. Further, the cut-off time for accepting customer transactions was extended to 12.30 p.m. allowing more time for customers to use the RTGS System.

- **ATM transactions of payment cards issued under the National Card Scheme are routed through the Common ATM Switch and in order to promote the usage of these cards, a reduced fee structure was introduced.** Accordingly, General Direction No. 1 of 2020 on fees chargeable on the transactions effected through the Common ATM Switch was issued replacing General Direction No. 1 of 2014 to include maximum fees that can be charged for ATM transactions carried out using payment cards issued under the National Card Scheme.

- **Several payment products were implemented using the Common Electronic Funds Transfer Switch (CEFTS), which provides a common infrastructure to clear payments effected through multiple payment channels such as ATMs, Internet Banking, Mobile Banking, Kiosks and over-the-counter, for routing and clearing of transactions**. JustPay, which is a Mobile App based payment solution for low value payments, facilitated payments up to the value of Rs. 10,000. In April 2020, the maximum per transaction value of JustPay was increased to Rs. 25,000. In addition, approval was granted to several government and private institutions to join the LankaPay Online Payment Platform (LPOPP), which facilitates online real time payments and as at end September 2020, three institutions, namely; the Sri Lanka Customs, the Board of Investment of Sri Lanka and the Sri Lanka Ports Authority provided real time payment facilities through LPOPP.

- **The National Quick Response (QR) Code specification branded as "LANKAQR" was issued to provide a low cost payment option and ensure interoperability of different payment mechanisms and instruments**. In addition, QR code based payment option provides convenience to the customer. The Central Bank officially launched LANKAQR with the participation of LANKAQR certified institutions during the year. The launch was followed by an island-wide promotional campaign on LANKAQR, which is carried out to enroll merchants and to increase customer awareness and adoption of this payment method.

- **Considering the economic benefits of using digital payment mechanisms by the general public, the year 2020 was designated as the Year of Digital Transactions**. Accordingly, many promotional activities were carried out throughout the year to increase awareness and encourage the general public to use digital payment mechanisms to complete day-to-day transactions. In March 2020, the Central Bank launched a digital campaign with the concept of "Cashwade", which highlighted the difficulties faced by the customers and merchants when using cash for their transactions. Further, under the Year of Digital Transactions programme, posters, banners and other reading materials were distributed to all stakeholders to educate their staff and customers on usage of digital payment mechanisms.

- **The FinTech Regulatory Sandbox was established in February 2020 with the objective of encouraging and enabling FinTech initiatives that promote efficiency and increase access to financial products and services**. Accordingly, this regulatory sandbox will provide a safe space in a controlled environment for innovators to test their products and services without infringing on regulatory requirements.

- **The National Payments Council (NPC), which is the industry consultative and monitoring committee on payment systems, finalised its Road Map for 2020-2022**. The Road Map broadly covers the areas of expanding interbank payment infrastructure, promoting e-payments, standardization and interoperability, innovations for payment systems, strengthening payment system security and public awareness. Further, the NPC appointed a committee on FinTech developments to focus on new innovative products and concepts such as digital payment platforms, open banking and virtual banking.

- **The Working Committee for Blockchain Technology studied the possibility of using Blockchain Technology to improve the safety and efficiency of financial services and recommended to initially facilitate a shared Know-Your-Customer (KYC) solution based on Blockchain Technology**. Accordingly, actions were initiated to develop a Proof of Concept (POC) to assess the capability of using Blockchain Technology for a shared KYC solution. Proposed initiatives considered by the FinTech Committee are expected to be implemented in order to promote the efficiency and security of digital transactions and thereby reduce the usage of physical cash and enable greater financial inclusion. In addition, by introducing new payment products and concepts, it is expected to facilitate the development of the financial sector and strengthen financial system stability.

Regulation and Supervision of Foreign Exchange

- **Regulations and Directions under the Foreign Exchange Act, No. 12 of 2017 (FEA) were revisited during the period under review in order to address the issues/concerns of various stakeholders and to further facilitate foreign exchange transactions.** Such proposed amendments were forwarded for the approval of the Minister of Finance and the Cabinet of Ministers. Further, proposed amendments to the FEA which were targeted at resolving certain issues in the provisions of the FEA and strengthening the regulatory aspects of foreign exchange transactions were also forwarded to the Minister of Finance for necessary action.

- **Several measures were taken during the year to ease the pressure on the exchange rate and improve the foreign reserve position**. Accordingly, Directions were issued instructing Authorized Dealers (ADs) to issue foreign currency notes up to a maximum of US dollars 5,000 (or its equivalent in other foreign currency) as travel allowance to persons resident in Sri Lanka travelling abroad for any purpose as against the previously permitted travel allowance of US dollars 10,000. Further, release of foreign exchange under the Documents Against Payments (D/P) and Open Account (O/A) payment terms were suspended with immediate effect for the importation of certain identified non-essential consumer goods, for a period of three months until 20 June 2020. In view of the difficulties faced by foreign exchange earners, Directions were issued to ADs informing them to recover foreign currency loans granted to holders of Business Foreign Currency Accounts (BFCAs) and to Sri Lankan expatriate employees who have either lost their employment or returned to Sri Lanka due to the same reason, in Sri Lankan rupees, when recovery of such loans in foreign currency is remote, as a last resort, where necessary, by converting such loans to Sri Lankan rupee denominated loans. In terms of an Order issued under Section 22 of the FEA, several measures were imposed on outward remittances of capital transactions for a period of three months including suspensions for overseas investments through the Outward Investment Accounts (OIAs) by persons resident in Sri Lanka subject to certain exclusions, outward remittances through BFCAs or Personal Foreign Currency Accounts (PFCAs) held by persons in, or resident in, Sri Lanka, other than for remittances on current transactions, repatriation of funds under migration allowance through Capital Transactions Rupee Accounts (CTRAs) by emigrants who have already claimed migration allowance and for limitations on the eligible migration allowance by emigrants who are claiming the migration allowance for the first time up to a maximum of US dollars 30,000.

- **On the lapse of this Order, a new Order was issued under the Section 22 of the FEA imposing measures on outward remittances on capital transactions for a further period of six months**. These measures included suspension of the general permission granted to make outward remittances for investments overseas through OIAs by persons resident in Sri Lanka subject to certain exclusions, suspension of any outward remittances through BFCAs or PFCAs held by persons resident in Sri Lanka other than outward remittances on current transactions up to any amount or outward remittances on capital transactions up to a maximum of US dollars 20,000 during the effective period of the Order. Further, repatriation of funds as migration allowance through CTRAs by the emigrants who have already claimed migration allowance or who are claiming the migration allowance for the first time were limited up to a maximum of US dollars 20,000 and US dollars 30,000, respectively, during the effective period of the Order.

- **In order to further encourage inward remittances, a foreign currency account named "Special Deposit Account (SDA)" was introduced through Regulations under FEA to be opened with fresh inward remittances until 2 October 2020 by any Sri Lankan individual resident in or outside Sri Lanka and any person resident outside Sri Lanka.** Directions were issued to ADs specifying the criteria for opening and maintaining SDAs and on permitted transactions thereof. These Directions enabled ADs to accept legitimately acquired foreign currency notes into SDAs in addition to inward remittances received through banking channels. With a view of attracting more SDA deposits in the form of foreign currency, a new Order under Section 8 of the FEA was issued repealing the existing Order under the same Section of the FEA increasing the amount of foreign currency that can be retained by a person in, or resident in Sri Lanka in his possession up to US dollars 15,000 from the previously permitted amount of US dollars 10,000.

- **Considering positive impacts to the foreign currency reserve position of the country, Regulations and Directions were issued under the FEA, permitting ADs to renew and continue SDAs beyond the maturity with interest rates applicable for normal term deposits.** These Regulations also allowed transfer of SDA maturity proceeds into an Inward Investment Account or a PFCA, if the SDA holder is eligible to open and maintain such accounts.

Financial Consumer Relations

- **The Financial Consumer Relations Department (FCRD) was established by the Central Bank in August 2020 under the provisions of Section 33 of the Monetary Law Act, No. 58 of 1949 (MLA), with a view to streamline handling of issues pertaining to financial consumer related concerns.** The Terms of Reference (TOR) along with the proposed Financial Consumer Protection Framework highlights several short- term and long- term policies to be implemented by the FCRD in the future. In the short term, FCRD will be serving as a single point of contact for receipt and dissemination of all external complaints and grievances directed to the Central Bank. The entities regulated by the Central Bank that comes under the purview of FCRD will be Licensed Commercial Banks, Licensed Specialised Banks, Licensed Finance Companies, Specialized Leasing Companies, Primary Dealers and Participants of Payments and Settlement Systems. Meanwhile, the FCRD is expected to focus on supervising standards of market conduct, formulating financial consumer protection policies in line with the local and international market developments and best practices, taking proactive and reactive measures with respect to malpractices, misconducts whilst identifying and monitoring emerging vulnerabilities in the financial consumer protection related issues in the medium term. Also, the FCRD is planning to introduce transitional legal arrangements under the existing legal framework until an act on financial consumer protection is enacted.

- **The FCRD continues to receive a significant amount of complaints, grievances and inquiries related to entities regulated by the Central Bank.** The total number of calls, faxes, emails and letters received up to 30 September 2020 is around 10,000 since its inception on 10 August 2020. The FCRD is planning to set up a state-of-the-art Contact Center at the Central Bank, which is expected to be operative by end 2020.

- **In the long term, the FCRD will be converted to a new Financial Consumer Protection Authority to systemize the financial consumer protection framework in Sri Lanka addressing issues relating to the fragmented financial consumer protection regulations where all regulated entities will be captured in the financial system in Sri Lanka.** The new authority will be constituted through a new statute, which will include among others imposing monetary penalties in relation to misconduct of a participating financial institution.

Anti-Money Laundering and Countering Financing of Terrorism

- **Sri Lanka was listed as a High Risk Third Country by the European Commission (EC) in February 2018, subsequent to Sri Lanka being identified by the Financial Action Task Force (FATF) as a jurisdiction with strategic Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) deficiencies in its Compliance Document a.k.a "the Grey List" in October 2017.** Upon listing, a time bound Action Plan to address the identified strategic deficiencies was assigned to Sri Lanka. Since the listing by the FATF, the Financial Intelligence Unit (FIU), together with other stakeholders, took a series of effective and tangible steps to implement the FATF Action Plan well within the given time frame and accordingly, the FATF de-listed Sri Lanka from the Grey List at its Plenary held during 13-18 October 2019 in Paris. Subsequent to the de-listing by the FATF, the EC de-listed Sri Lanka from its High Risk Third Countries published on 7 May 2020.

- **In order to strengthen the AML/CFT compliance, the FIU issued several circulars and guidelines during the period from January to September 2020 focusing on AML/CFT compliance obligations for Accountants and Trusts or Company Service Providers and, scenario based LankaFIN reporting for Licensed Finance Companies, Insurance Companies and Stock Brokers**. Further, with a view to foster a strong emphasis on financial system risks and vulnerabilities that arose with the global COVID-19 pandemic, the FIU issued a Circular to all the financial institutions of the country advising them to increase vigilance/ due diligence and take appropriate measures to protect the financial system from possible money laundering/terrorist financing risks arising during the global COVID-19 pandemic.

- **The FIU initiated a series of measures to further strengthen the Law Enforcement Agencies' (LEAs) effort in combatting money laundering (ML) related to illicit drug trade such as programmes to increase the awareness among investigating officers on ML investigations, continuous coordination with investigators, prosecutors and financial institutions, briefing the financial institutions on their responsibilities in ensuring institutional compliance and supporting LEA's efforts, etc**.

Legal Reforms Related to the Financial Sector

- **During 2020, several legal reforms were initiated**. Significant steps have been taken towards introducing a new Banking Act by repealing the existing Banking Act, No. 30 of 1988 to create a stronger legal foundation for supervision of banking system of the country and necessary actions have been initiated to carry out amendments to the Finance Business Act, No. 42 of 2011 in order to address the deficiencies identified therein. In addition, arrangements and discussions are in progress to facilitate required amendments to the Payments and Settlement Systems Act, No. 28 of 2005 and Registered Stock and Securities Ordinance, No. 07 of 1937 and discussions are underway to establish a legal framework for the purpose of implementing an International Transactions Reporting System.

Resolution and Enforcement Actions

- **The Resolution and Enforcement Department (RED) commenced compensation payments to the depositors of three (03) licence suspended/cancelled finance companies (The Finance Company PLC (TFC), ETI Finance Ltd. (ETI) and Swarnamahal Financial Services (SFS)).** Compensation payments were made through the SLDILSS while continuing compensation payments to the depositors of another three (03) licence cancelled finance companies (Central Investment and Finance PLC (CIFL), The Standard Credit and Finance Ltd. (TSCFL), TKS Finance Company PLC (TKSFL)). With a view to expediting the compensation payment procedure with regard to TFC, ETI and SFS, the RED introduced the Agent Bank

Concept in line with international best practices. Accordingly, the Monetary Board of the Central Bank appointed People's Bank as the Agent Bank for paying compensation to the aggrieved depositors of these three companies.

- **The RED conducted awareness programmes Island wide to educate the general public including students and government officials, on the repercussions of investing in unauthorized finance businesses and prohibited schemes**. Officials of the RED participated in electronic media programs to enhance awareness in the society regarding financial scams and frauds. At the same time, investigations into prohibited schemes were conducted in collaboration with the Sri Lanka Police and Attorney General's Department. New investigations based on the complaints received from the general public and various other parties were also commenced.

Development Finance and Access to Finance

- **The Central Bank on behalf of the Government, implemented a working capital loan scheme to support COVID-19 affected MSMEs during 2020, in addition to the continuation of several refinance, interest subsidy and credit guarantee schemes**. The Central Bank, in consultation with the Government, implemented the Saubagya COVID-19 Renaissance Facility in three phases to provide working capital loans for COVID-19 affected MSMEs, including individuals and self-employed people. The first phase includes a refinance facility in terms of Section 88 of the MLA while the second phase was implemented to provide financing facilities in terms of Section 83 of the MLA. The third phase was executed to offer Credit Guarantee and Interest Subsidy facility in terms of Section 108 of the MLA. The total value of working capital loans approved by the Central Bank under the Saubagya COVID-19 Renaissance Facility stood at Rs.175 billion for 60,175 beneficiaries at the end of September 2020. About 50 per cent of the total working capital approved by the Central Bank was provided to MSMEs and individuals in the services sector, while about 34 per cent and 16 per cent were provided to the MSMEs and individuals in the industry sector and the agriculture sector respectively.

- **In addition, several other measures were taken to support MSMEs**. The Supply Chain Re-Energizing Loan Scheme (SCREL) was implemented in collaboration with the Ministry of Plantation in order to provide working capital loans for the Tea Sector. Further, a Credit Guarantee Scheme for working capital loans granted to MSMEs affected due to Easter Sunday attack was implemented in collaboration with the Ministry of Finance. Annual interest rate charged on loans granted under the New Comprehensive Rural Credit Scheme (NCRCS) was reduced from 7 per cent to 4 per cent while the interest rate applicable to the Saubagya Loan Scheme was reduced from 8 per cent to 6 per cent. More resources were allocated for the provision of loans under the Self Employment Promotion Initiative (SEPI) loan scheme while the maximum loan amount per borrower also increased from Rs. 500,000 to Rs.1 million. Moreover, the maximum loan amount granted to a new entrepreneur under the Swashakthi Loan Scheme was also increased to Rs. 450,000 from Rs. 250,000.

- **Further, the Central Bank took several measures during 2020 to promote financial inclusion and to improve financial literacy targeting those who have been excluded from the formal financial sector**.

Table 8.10
Saubagya Covid-19 Renaissance Facility
Details of Facilities Approved by the Central Bank as at end Sep 2020

Facility	No. of Loans Approved	Value of Loans Approved (Rs. billion)
Phase I (Refinance)	16,346	30.0
Phase II	26,540	92.0
Phase III (Credit Guarantee & Int. Subsidy)	17,289	53.0
Total	**60,175**	**175.0**

Source: Central Bank of Sri Lanka

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Expected Developments

- **Considering the need to maintain capital and liquidity buffers, which are important in maintaining the safety and soundness of the banking sector, the Central Bank introduced a range of regulatory measures to licensed banks with a view of supporting the businesses and individuals affected by the COVID-19 pandemic**. The impact of the COVID-19 pandemic on the banking sector as a result of measures adopted to provide relief to affected businesses/individuals and the impact of regulatory measures on licensed banks are yet to be assessed.

- **It is expected that the credit growth would pick up gradually in the short to medium-term in line with monetary policy measures introduced, and other extraordinary policy measures adopted by the Central Bank to enhance credit flows to the economy**. However, at present, a gradual increase in NPLs in the banking sector is observed due to challenges in the operating environment, and it is challenging to forecast the exact potential medium and long term adverse impact of the COVID-19 outbreak on NPLs at this juncture. Accordingly, monitoring has been intensified and licensed banks also need to be cautious of further increase in NPLs associated with the increase in credit and should ensure that proper risk management mechanisms are in place to mitigate all relevant risks.

- **Capital levels of banks remain above minimum statutory requirements and the deadline to achieve enhanced minimum capital levels were deferred by two years for licensed banks, from end 2020, to end 2022**. Since 2017, banks have been required to build-up capital which can be utilized in times of stress, and measures such as the adoption of Basel III Capital Adequacy Ratio, Basel III Leverage Ratio and new Accounting Standard SLFRS 9: Financial Instruments, have required banks to augment their capital levels. This has resulted in improving the ability of the banking sector to absorb shocks arising from financial and economic stresses reducing the probability of spill-over of risks from the financial sector to the real economy in the coming years. With these developments, small banks will also be incentivised to undergo business consolidation which will facilitate such banks to meet the proposed minimum capital requirement.

- **The liquidity positions of banks are expected to be maintained at healthy levels with the buffers maintained in excess of the required Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)**. However, in order to provide flexibility for licensed banks to face the extraordinary challenges posed by the COVID-19 pandemic, the regulatory minimum ratios of LCR and NSFR were reduced from 100 per cent to 90 per cent. Further, certain assets were determined as liquid assets for the purpose of computing SLAR. Licensed banks are expected to avail these relaxations in the best interest of supporting their customers and the economy at large, benefits of which would in return accrue to the banking sector to remain resilient. In the meantime, the Central Bank will closely monitor the liquidity position of banks, due to the potential changes to their liquidity risk profile considering the already announced debt moratorium and other measures.

- **Macro-economic developments will be monitored to identify any adverse scenarios arising in order to address any spill-over of risks arising from the real economy to the banking sector**. Appropriate macroprudential measures will be introduced, if necessary, to pre-empt any future risks to the stability of the banking system. The regulatory and supervisory framework pertaining to licensed banks will be further strengthened in line with the Basel Core Principles on Effective Banking Supervision and other international best practices.

- **The legal and regulatory framework of licensed banks will be further strengthened through the drafting of the new Banking Act**. The key areas to be considered in the proposed new Banking Act include an overall mandate for supervision and regulation, a differentiated regulatory framework to facilitate proportionality, strengthening corporate governance, consolidated supervision, resolution, imposing monetary penalties/fines, ring-fencing of banks to mitigate contagion risk, strengthening provisions for mergers, acquisitions and consolidation, subsidiarisation of large foreign banks if needed, and introducing financial holding company structure for banks, if deemed necessary.

- **The supervisory rating model (Bank Sustainability Rating Indicator-BSRI) is being reviewed and updated by the Central Bank**. This will strengthen the Central Bank's risk based supervision framework for banks to enhance efficiency, effectiveness and sustainability of individual banks and the banking sector, enabling early supervisory intervention and prompt corrective actions for banks.

- **Considering the need to protect banks from contagion risk, and to ensure the stability and the soundness of the banking sector and the financial system, consolidated supervision of banking groups will also be carried out**. Accordingly, a regulatory framework on consolidated supervision will be formulated and provisions in this regard will also be brought into the Banking Act.

- **Large commercial banks will be encouraged to continue to look into avenues of regional expansion and continuous close interactions will be maintained with other regional regulators with a view to enhancing information sharing among regulators and cross-border supervision**.

- **With the increased risk in cyber security, changes to the existing regulatory and supervisory framework will be introduced with the approval of the Monetary Board to enhance the cyber-security of banks in line with international standards and best practices**. The proposed regulations will prompt banks to upgrade and strengthen their information security and technology resilience capabilities.

- **The conventional business models of banks may undergo significant changes in the medium to long-term, due to FinTech driven highly efficient alternative banking products and services as well as challenges posed by the COVID-19 pandemic**. It is expected that banks will take measures to enhance access to banking services through initiatives such as mobile banking and internet banking with a view to enhancing financial inclusion and supporting economic activities given the pandemic situation, whilst taking proactive measures to further strengthen information security management in banks. Further, it is also essential that futuristic regulatory and supervisory approaches are adopted to ensure safety and soundness of the banking system while facilitating these emerging businesses and operational models.

- **Going forward, crisis preparedness and resilience of banks to face adverse scenarios will be further strengthened through the implementation of recovery plans for licensed banks**. Banks will be required to implement recovery plans in order to minimise the adverse impact on troubled banks and their spill-over effects to the financial sector. Two Consultation Papers were issued to banks in this regard for comments. Banking Act Directions providing guidelines for preparation of recovery plans by banks are expected to be issued in due course.

- **On 10 April 2019, the Central Bank launched the Roadmap for Sustainable Finance in Sri Lanka**. This roadmap provides a broad direction to financial regulators and financial institutions to effectively manage environmental, social and governance (ESG) risks associated with projects they finance and help increase assistance to businesses that are greener, climate-friendly and socially inclusive. Currently, the Central Bank is in the process of developing a Sustainable Finance Taxonomy and reporting requirements for financial institutes.

- **The stability of the banking sector will be maintained to support economic activities of the country**. Considering the regulatory efforts to strengthen the capital and liquidity levels of banks and extraordinary policies amidst the COVID-19 pandemic, expected improvements in risk management and corporate governance, enhanced supervision and monitoring of the licensed banks, it is expected that the resilience and stability of the banking sector will be maintained, to serve the real economy efficiently and effectively, in the future.

- **The Central Bank will continue to adapt its supervisory approaches to suit the new normal amidst the COVID-19 outbreak**. Accordingly, the Central Bank may carry out its on-site supervision activities remotely, when required, considering the health guidelines issued by the authorities. Therefore, off-site supervisory processes would be further strengthened which would help the Central Bank to identify and monitor emerging risks and remedy for any deficiencies of the risk management process of banks, if required. Hence, there may be an increased reliance on electronic submission of regulatory information and licensed banks will be required to ensure timely and accurate submission of data as per the requirements of the Central Bank. Further, going forward, more virtual meetings rather than in-person meetings would be conducted with banks' management, considering requirements for social distancing rules and travel restrictions, if any, that may prevail.

- **The stability of the LFCs and SLCs sector is expected to be reinforced further in the medium-term horizon with changes to the existing regulatory framework**. The changes are proposed to the FBA to strengthen the resolution framework of LFCs. Further, the existing regulatory framework of LFCs & SLCs and PDCs will be reviewed and streamlined with a holistic view, in line with current market developments.

- **Capital levels of the LFCs and SLCs sector are expected to strengthen further, with the build-up of capital as a result of the enhanced capital requirements**. With the enhancement of minimum capital levels and the implementation of new capital adequacy requirements, capital levels are expected to increase during the next few years. The enhanced capital levels of the sector will improve the shock absorbing capacity during the periods of stress.

- **Establishment of a proper resolution framework for LFCs and SLCs is also planned to be carried out in the near future**. Initiatives are currently being taken to resolve the distressed/high risk LFCs, as per the provisions of the FBA. The process of settling the depositors of the finance companies whose licences have been cancelled/ business suspended are being continued to be carried through SLDILSS. A Guideline will be issued on the Prompt Corrective Action plan to identify weaknesses of LFCs on a timely basis and facilitate decisive corrective action in order to strengthen depositor confidence and lessen the cost of a potential failure to the SLDILLS and the public.

- **A Master Plan is developed to establish 25 resilient and well performing LFCs which will be implemented in the medium term.** In order to address the weaknesses and risks in the LFCs and SLCs sector, the Central Bank has proposed a medium term consolidation plan for LFCs and SLCs sector to ensure strong and stable LFCs, each having the minimum prudential requirements well above the requirement after five years with diversified business models which can effectively contribute to the economic needs of the country.

- **Initiatives have already been taken to implement comprehensive cross border transactions and a foreign currency transactions monitoring system to collect data from ADs**. Upon implementation, this monitoring mechanism is expected to capture all data on foreign exchange sales and purchases and inflows and outflows to the domestic foreign exchange market and thereby to fill any data gaps affecting policy formulation.

- **It is envisaged to strengthen the regulatory framework applicable to SLDILSS in terms of the proposed Banking Act and international best practices**. Completing the ongoing compensation payments will also be given the priority during the first quarter of 2021. It is also expected to conduct on-site supervision of member institutions of SLDILSS with the assistance of the regulatory departments to ensure the maintenance of databases and other systems that are imperative for ensuring the effectiveness and efficiency of the scheme. It has also been planned to develop the resolution measures for licenced banks and LFCs under the existing legal framework.

- **Measures will be taken to strengthen the investigation unit of the Resolution and Enforcement Department to conduct more investigations into prohibited schemes and similar financial scams**. Awareness programmes regarding fraudulent schemes will also be conducted for the general public including school children, public officials and law enforcement authorities with a view to enhancing their knowledge on the importance of combating such financial scams.

- **The National Financial Inclusion Strategy (NFIS), developed with assistance of the International Finance Corporation (IFC) of the World Bank Group, is expected to be officially launched during the fourth quarter of 2020**. The key objective of the NFIS is to identify and promote a more effective and efficient process to improve financial inclusion across the country. The Central Bank will conduct the first ever Financial Literacy Survey for Sri Lanka during the fourth quarter of 2020 to understand the level of financial literacy in the country with the objective of using the findings as the baseline for developing strategies to enhance financial literacy in the country.