8

FINANCIAL SECTOR DEVELOPMENTS AND STABILITY

The financial sector remained stable amidst uncertainties in the global financial markets and continued to facilitate the growth momentum in the economy supported by continued soundness and stability of the key financial institutions, healthy levels of liquidity in financial markets and orderly functioning of payment and settlement infrastructure. In spite of slower loan growth, the banking and licensed finance company sectors maintained their soundness at healthy levels. The outreach of the financial sector has improved further with the expansion of the branch network of banks and licensed finance companies. Financial markets have remained liquid. The money market had excess liquidity during much of the nine-month period up to September 2013, which together with the easing of monetary policy by the Central Bank during this period resulted in interest rates in the money market declining. Interest rates pertaining to longer-term financial instruments were also seen declining, but at a slower pace. In the domestic foreign exchange market, the rupee depreciated marginally vis-à-vis the US dollar, the pound sterling and the euro, over the nine-month period ending September 2013, but appreciated against the Japanese yen, the Australian dollar and the Indian rupee. Activity at the Colombo Stock Exchange remained buoyant and the ASPI and the S&P SL 20 Index increased over the nine-month period ending September 2013 while net foreign inflows into the equity market continued for the second consecutive year. Trading activities in corporate debt securities were significantly high during the first nine months of 2013, specifically with respect to debentures, while issues of commercial paper, in value terms, have been sustained at around the same level in comparison to the corresponding period of last year. Payment systems operated efficiently and system availability remained at almost 100 per cent, contributing to the smooth settlement of transactions at both retail and wholesale levels.

Developments in Financial Institutions

Banking Sector

- **The banking sector expanded and remained stable during the first eight months of 2013 providing a supportive environment for continued growth in economic activities.** Diversifying the sources of funding in the banking sector, several banks successfully raised foreign debt capital in international markets.

- **Total assets of the banking sector expanded during the first eight months of 2013, albeit at a slower pace when compared with the corresponding period last year as growth in private sector credit moderated.** The sharp drop in international gold prices and the decline in external trade too contributed to the subdued loan growth during this period. Therefore, the funds mobilised were largely utilised in investments.

- **Overall asset quality deteriorated marginally, largely due to the increase in non-performing loans (NPLs) of pawning portfolios with the significant decline in international gold prices.** However, additional measures were introduced by banks to recover outstanding pawning advances, while the imposition of import duty on gold by the government also limited the decline in gold prices in the local market and the NPLs in the pawning portfolios. Asset quality measured by the ratio of NPLs to total loans increased from 3.7 per cent in December 2012 to 5.1 per cent in August 2013. The current level of NPLs is unlikely to have an adverse impact on banking sector stability, given the availability of adequate resources in the form of capital. The provision (specific) coverage ratio declined from 41.4 per cent as at end 2012 to 34.1 per cent as at end August 2013 as there was no requirement to make provisions for pawning related NPLs as they were backed by gold where the residual risk was low.

- **The liquidity position of banks remained healthy.** While the liquid assets to total assets ratio was at 29.1 per cent as at end August 2013, the Statutory Liquid Asset Ratios for Domestic Banking Units and Off-shore Banking Units stood at 34.1 per cent and 30.3 per cent, respectively by end August 2013, which were well above the statutory minimum of 20 per cent. The LKR loan to deposit ratio of the banking sector meanwhile improved from 86.9 per cent as at end 2012 to 81.7 per cent as at end August 2013.

Table 8.1 Banking Sector - Selected Indicators

Item	End Aug 2011	End Aug 2012	Change (%)	End Aug 2013 (a)	Change (%)
Total Assets (net) (Rs. billion)	3,960.4	4,881.1	23.2	5,648.0	15.7
Loans & Advances (net) (Rs. billion)	2,283.5	3,017.0	32.1	3,335.3	10.6
Investments (Rs. billion)	1,155.9	1,162.6	0.6	1,568.1	34.9
Deposits (Rs. billion)	2,857.7	3,436.4	20.3	3,970.8	15.6
Borrowings (Rs. billion)	577.9	805.1	39.3	938.3	16.5
Capital Funds (Rs. billion)	337.0	414.5	23.0	471.4	13.7
Tier 1 Capital Adequacy Ratio (%) (b)	13.4	13.1		13.9	
Total Capital Adequacy Ratio (%) (b)	14.8	14.8		16.1	
Gross Non-Performing Accommodations Ratio (%)	4.8	4.1		5.1	
Net Non-Performing Loans Ratio (%)	2.8	2.5		3.4	
Return on Assets (Before Tax) (%)	2.3	2.5		2.0	
Return on Equity (After Tax) (%)	19.3	20.0		17.0	
Statutory Liquid Assets Ratio (DBU) (%)	35.2	30.8		34.1	
Liquid Assets to Total Assets (%)	30.4	27.2		29.1	

(a) Provisional
(b) As at end June

Source: Central Bank of Sri Lanka

- **Profits declined marginally**. For the first eight months of 2013, the banking sector recorded a profit after tax of Rs. 50.8 billion compared to a profit after tax of Rs. 52.9 billion recorded for the corresponding period in 2012. Net interest income increased by Rs. 2.2 billion and non-interest income increased by Rs. 0.8 billion during the first eight months of 2013. Non-interest expenses and provisions and write offs increased by Rs. 2.4 billion and Rs. 6.9 billion, respectively, during the same period. Profitability ratios decreased marginally during the first eight months of 2013 due to the decline in the interest margin and the increase in provisions and write offs. Return on Assets (ROA) before tax and after tax decreased from 2.5 per cent and 1.7 per cent in August 2012 to 2.0 per cent and 1.4 per cent, respectively, in August 2013. The Return on Equity (ROE) also decreased from 20.0 per cent to 17.0 per cent during this period. In terms of cost efficiencies, the efficiency ratio, measured as total operating expenses to total operating income, deteriorated to 79.0 per cent in August 2013 from 75.2 per cent in December 2012, indicating a reduction in operating efficiency.

- **Adequate capital was maintained**. The regulatory Capital Adequacy Ratio (CAR) under Basel II has been maintained well above the required ratio of 10 per cent during the first six months of 2013. The CAR increased marginally to 16.1 per cent in June 2013 from 16.0 per cent in December 2012.

- **Branch network expanded improving delivery of financial services**. The number of banking outlets increased during the first eight months of the year. A total of 62 new outlets were opened during the first eight months of 2013 with 16 in the Western Province and 46 in other provinces. The total banking outlets operating in the country stood at 6,452 by end August 2013.

- **The Central Bank continued to implement prudential measures to strengthen risk management by banks**. Regular assessments of the banking system were made to identify potential risks and vulnerabilities as well as the ability of the system to withstand potential shocks. During the period, the Central Bank made further progress in strengthening banking sector stability by implementing a range of regulations aimed at alleviating potential risks. These regulations were implemented with a view to improving the standard of business conduct and good market practices for the effective and efficient functioning of foreign exchange trading activities, promoting the adoption of appropriate risk management standards by banks to mitigate plausible risks arising from their exposure to the stock market to prudent levels, regularising and streamlining outsourcing of business operations of banks, and strengthening the governance and risk management policies pertaining to the same.

- **Financial reporting and disclosure requirements were strengthened**. Taking into account the changes in international accounting standards as well as the suggestions and comments provided by the licensed banks and the Institute of Chartered Accountants of Sri Lanka, new formats for the preparation of annual audited financial statements and the publication of quarterly financial statements in the press, were issued. The new reporting formats will facilitate banks to be on par with other international financial institutions, by adopting international accounting standards and improving disclosures as well as transparency. Banks were required to publish financial statements and other disclosure requirements on their web sites in order to enhance uniformity in reporting and promote healthy competition among them.

- **Policy measures were taken to support lending to major sectors of the economy, with emphasis on the agriculture sector.** The list of loan categories that could be included under mandatory lending to the agriculture sector was extended to include loans and advances granted for growing, processing and trading of domestic agriculture products while banks were permitted to categorise their loans granted to other banks and finance companies for on-lending to the agriculture sector under mandatory lending to the agriculture sector. Ceilings were imposed on penal rates of interest pertaining to advances, in line with the declining interest rate structure of the economy. Moreover, the definition of liquid assets was broadened to include investments in Gilt Unit Trusts, which are open ended mutual funds.

- **Several changes were made to regulations to facilitate ease of business operations in the banking sector.** The limitations on licensed commercial banks, preventing them from providing financial accommodation to licensed finance companies against government securities, Central Bank securities and fixed deposits, without prior approval of the Director of Bank Supervision were withdrawn. The existing direction was amended to permit banks to sell, transfer, assign or dispose of immovable assets with the prior approval of the Director of Bank Supervision. Restriction, in the corporate governance direction, on holding directorships in more than 10 specified business entities, under the eligibility criteria for a person to be a director of a licensed bank, was withdrawn.

- **Initiatives were introduced to streamline the expansion of the branch network while improving customer awareness.** Banks were required to classify existing banking outlets into two categories, namely, branches and student savings units. All existing banking outlets, except student savings units, were required to be upgraded as branches with effect from 01 January 2013. Licensed banks were required to conspicuously display the list of activities for the information of customers in the premises of a branch, when such a branch is extending only selected banking services. Further, ICRA Lanka Limited was recognised as an approved external credit rating institution for the purposes of all regulatory requirements applicable to licensed banks.

- **As per budget 2013, new categories were added as permissible sectors for lending under the Investment Fund Account.** Lending for women entrepreneurship ventures, low cost housing development projects and sustainable energy source projects were identified as permitted sectors for utilising funds in the Investment Fund Account.

- **Capital Planning Process was strengthened.** Following the issue of the consultation paper on the implementation of pillar 2 – supervisory review process under the Basel II capital adequacy framework, documents submitted by banks on the Internal Capital Adequacy Assessment Process (ICAAP) have been reviewed and discussions have been held with the management of respective banks. A direction was issued to facilitate the full implementation of pillar 2 of Basel II.

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

- **During the first eight months of 2013, LFCs and SLCs expanded in terms of both assets and the branch network.** There were 47 LFCs and 12 SLCs by end September 2013. The expansion of the sector was supported primarily through increased deposit mobilisation. One SLC obtained LFC status while two LFCs within the same group were merged. The branch network

Table 8.2 **LFCs and SLCs - Selected Indicators**

Item	End Aug 2011	End Aug 2012	Change (%)	End Aug 2013 (a)	Change (%)
Total Assets (Rs. billion)	444.3	553.6	24.6	680.4	22.9
Loans & Advances (Rs. billion)	343.4	442.8	28.9	531.1	19.9
Deposits (Rs. billion)	176.2	227.3	29.0	315.9	39.0
Borrowings (Rs. billion)	152.9	169.7	11.0	184.4	8.7
Capital Funds (Rs. billion)	56.5	83.0	46.9	95.9	15.5
Tier 1 Capital Adequacy Ratio (%)	13.9	17.2		15.1	
Total Capital Adequacy Ratio (%)	13.7	17.8		15.7	
Gross Non-Performing Accommodations Ratio (%)	5.7	5.2		6.0	
Net Non-Performing Accommodations Ratio (%)	1.9	1.8		2.3	
Return on Assets (Before Tax) (%)	4.5	4.8		2.6	
Return on Equity (After Tax) (%)	23.5	24.6		11.0	
Liquid Assets to Total Assets (%)	4.2	5.6		6.2	

Source: Central Bank of Sri Lanka

(a) Provisional

of the sector expanded by 41 to 1,013 branches during this period.

- **Credit growth of LFCs and SLCs sustained amidst competition in the financial sector.** Credit provided by them increased by 13 per cent (Rs. 59 billion) to Rs. 531 billion in the first eight months of 2013 compared to 14 per cent in the corresponding period of 2012. Factoring, which grew by 56 per cent, and other secured loans, which increased by 47 per cent, recorded the highest growth rates during the period. However, the core businesses of the LFCs and SLCs, namely, finance leases, grew by only 12 per cent while hire purchases recorded a marginal negative growth of 1 per cent for the first eight months of 2013, compared with 20 per cent and 3 per cent, respectively, in the corresponding period of 2012. The increase of import duty on vehicles and high lending rates pertaining to accommodations that prevailed during the last 12 months largely contributed to the moderation of growth in leasing and hire purchases in 2013.

- **Asset quality of LFCs and SLCs deteriorated as indicated by the increase in the gross non-performing loan (NPL) ratio to 6.0 per cent by end August 2013 from 5.0 per cent at end December 2012.** The main products that contributed to the increase in the NPL ratio were finance leasing (26 per cent) and hire purchases (18 per cent).

- **The liquidity position of LFCs and SLCs improved.** Liquid assets of this sector increased by 27 per cent during the first eight months of 2013 to Rs. 42 billion. Compared with the minimum statutory liquid assets requirement of Rs. 36 billion, LFCs carried a surplus of Rs. 6 billion as at end August 2013. This could be attributed to several distressed companies which faced severe liquidity constraints being turned around with the support of revival plans, recording increased earnings and growth in funding channels.

- **The capital position of LFCs and SLCs strengthened further.** Capital funds increased by 11 per cent in the first eight months of 2013 and the aggregate Capital Adequacy Ratio of LFCs and SLCs exceeded the regulatory minimum requirement. Sustained profitability bolstered their capital position during 2013. Hence, both the core capital ratio and the total capital ratio were well above the statutory minimum of 5 per cent and 10 per cent, respectively.

- **Profitability declined as interest margins declined and operating expenses increased.** Profits of the sector declined in the first eight months of 2013 to Rs. 5.3 billion from Rs. 10.1 billion in the corresponding period of 2012. Accordingly, the annualised ROA and ROE were lower for the eight month period ending August 2013 when compared with the position as at end August 2012.

- **Business revival plans of distressed companies continued to be in operation.** Under the business revival plans approved by the Monetary Board, managing agents were appointed, balance sheets were restructured by converting a portion of deposits to non-voting shares and fresh capital was infused by new investors, in majority of the distressed companies. The Central Bank continued to closely monitor the performance of the eight distressed companies through off-site and on-site supervision and regular meetings held with Boards of Directors and the senior management.

- **Measures were introduced to streamline the business operations of LFCs.** The Finance Companies (Structural Changes) Direction No.1 of 2013 was issued in June 2013 to replace the previous direction, as it was limited in scope and needed revision to be in line with current financial sector developments. The new direction specifies structural changes of LFCs (e.g., form a subsidiary or associate of a subsidiary or associate company; restructure the management of the company; enhance or reduce share capital) that require the prior approval of the Monetary Board or the Director of Supervision of Non-Bank Financial Institutions (D/SNBFI). Further, provisions in the Transfer of Assets Direction have been incorporated into the new Structural Changes Direction.

- **Guidelines were issued to ensure prudent profit distribution.** In view of the adoption of Sri Lanka Accounting Standards (LKAS) 32 and 39, and Sri Lanka Financial Reporting Standard (SLFRS) 7 by LFC and SLC sector, guidelines were issued to LFCs under which they were required to obtain prior approval of D/SNBFI for the distribution of dividends. From 2012 onwards, audited profits of LFCs and SLCs are dependent on the impairment and the provisions determined in accordance with the judgements and assumptions of the management of LFCs and SLCs as per LKAS/SLFRS. Requiring prior approval of D/SNBFI for the distribution of dividends is expected to prevent LFCs and SLCs from distributing profits imprudently.

Insurance Companies

- **The insurance sector experienced growth in total assets and premium income, although its profits declined.** Total assets of the insurance sector increased significantly by 23.9 per cent during the first half of 2013. Total gross written premiums (GWP), which grew at an accelerating pace up to mid-2011, continued to moderate thereafter, recording a growth of 8.9 per cent for the first half of 2013. The reduction of the registration of motor vehicles due to the imposition of higher excise duty on motor vehicle imports affected general insurance, of which the motor insurance business represents 60 per cent. The premium income for motor insurance grew only by 8.0 per cent in the first half of 2013 compared to an increase of 24.9 per cent in the corresponding period in 2012.

- **Profits of the sector declined due to high operational costs and declined investment income in the general insurance sector.** Despite an increase in total investment income contributed by a 92 per cent increase in investment income in the long term insurance sector, investment income in the general insurance sector declined by a significant 37.4 per cent due to marked to market losses in

Table 8.3 **Insurance Sector - Selected Indicators**

Item	End Jun 2011	End Jun 2012	Change (%)	End Jun 2013 (a)	Change (%)
Total Assets (Rs. billion)	241.9	279.1	15.4	345.9	23.9
Total Income (Rs. billion) (b)	**50.7**	**54.9**	**8.2**	**62.7**	**14.2**
Gross Premium Income (Rs. billion) (b)	38.6	43.8	13.5	47.7	8.9
Investment Income (Rs. billion) (b)	12.2	11.1	(8.7)	14.9	34.2
Profit Before Tax (Rs. billion) (b)	5.5	7.0	27.0	5.9	(15.7)
Solvency Margin Ratio (Times)					
Long term Insurance	8.2	5.8		7.2	
General Insurance	1.7	2.3		2.2	
Retention Ratio (%)					
Long term Insurance	96.6	96.3		96.0	
General Insurance	76.9	78.3		78.5	
Claims Ratio (%)					
Long term Insurance	36.2	33.1		41.9	
General Insurance	61.0	64.8		62.0	
Combined Operating Ratio (%)					
Long term Insurance	78.9	78.9		89.5	
General Insurance	99.5	103.5		105.4	
Return on Assets (ROA) (%)					
Long term Insurance	2.7	2.0		3.3	
General Insurance	2.0	10.3		4.1	
Return on Equity (ROE) (%) - General Insurance	4.3	19.4		7.2	
Underwriting Ratio (%) - General Insurance	23.2	16.1		15.7	

Source: Insurance Board of Sri Lanka

(a) Provisional
(b) During the period up to end June

equity investments. The significant growth in investment income in the long term insurance sector was due to the increased growth of investments in government securities which earned sizeable capital gains as interest rates declined. However, due to the decline in profits in the general insurance sector, the overall profits of the insurance sector declined.

- **Insurance companies maintained their soundness**. Insurance companies carrying on long term insurance business as well as those insurance companies carrying on general insurance business met the statutory solvency margin requirement by end June 2013. Moreover, all insurance companies complied with the requirement of investing 20 per cent of the technical reserves in respect of general insurance and 30 per cent of the long term funds in government securities as at end June 2013. Accordingly, investments in government securities by long term and general insurance accounted for 46 per cent and 20 per cent, respectively, of their total assets.

- **The Insurance Board of Sri Lanka (IBSL) took measures to strengthen the valuation process in the industry**. IBSL issued guidelines and instructions to insurance companies specifying eligibility criteria that a valuer should meet in order to be able to value land and buildings in Sri Lanka for the purpose of solvency margin rules for long term and general insurance business.

- **The minimum capital requirement pertaining to insurance companies and insurance brokering companies would be increased by 2015 and 2014, respectively, with a view to promoting their financial soundness**. Accordingly, all insurance companies registered on or before 30 June 2011 are required to increase their minimum paid up share capital up to Rs. 500 million for each class of insurance business on or before 11 February 2015. All registered insurance brokering companies are required to increase their minimum paid up share capital up to Rs. 2.5 million on or before 31 December 2014.

Primary Dealers in Government Securities

- **Performance of the Primary Dealer (PD) sector improved during the first nine months of 2013.** By end September 2013, the total assets of PDs increased, when compared with the level a year ago. Total profits of PDs for the first nine months of the year 2013 were higher than that of the corresponding period last year. Hence, the annualised ROE and ROA of PDs increased further during the first nine months of 2013. Increased profitability of PDs during this period could be attributed mainly to the substantial increase in revaluation gains and capital gains.

- **All standalone PDs maintained their capital base above the minimum requirement of Rs. 300 million as at end September 2013.** Tier 1 Capital Adequacy Ratio (RWCAR) of standalone PDs was also well above the minimum regulatory requirement of 8 per cent.

- **PDs' total portfolio of government securities increased by 56.4 per cent during the first nine months of the year to Rs. 200.7 billion.** This increase could be attributed to the increase in the size of both the trading portfolio and the investment portfolio, which increased by 40.1 per cent and 155.7 per cent, respectively, during this period. PDs' borrowings under repo agreements meanwhile, increased by 57.3 per cent from end September 2012 to Rs. 134.4 billion by end September 2013.

- **The PD sector expanded with the appointment of several new PDs and extension of their activities in to corporate debt.** Since 10 July 2013, all PDs were allowed to engage in trading activities in the corporate debt market as corporate debt dealers, in addition to their role as market makers for government securities. Further, three new PDs, namely, Perpetual Treasuries Ltd., Pan Asia Banking Corporation Ltd., and The Hong Kong and Shanghai Banking Corporation Ltd., were appointed during the year, to operate as PDs.

- **Measures were taken to strengthen and streamline the PD sector and improve the safety of investor funds.** A Direction on the Assessment of Fitness and Propriety of Directors and Officers Performing Executive Functions of Primary Dealer Companies was issued on 28 May 2013. In addition, another Direction on funds remaining unclaimed in the customer accounts maintained by the Dealer Direct Participants was issued on 02 September 2013.

Table 8.4 Primary Dealers - Selected Indicators

Item	End Sep 2011	End Sep 2012	Change (%)	End Sep 2013 (a)	Change (%)
Total Assets (Rs. billion)	149.6	130.4	(12.8)	204.6	56.9
Total Portfolio (Rs. billion)	148.1	128.3	(13.4)	200.7	56.4
Total Capital (Rs. billion) (b)	5.4	5.0	(7.4)	5.7	14.0
Profit before Tax (Rs. billion) (c)	2.4	1.4	(41.7)	4.5	221.4
Tier 1 Capital Adequacy Ratio (RWCAR) (%) (b)	15.7	19.7		22.2	
Total Capital Adequacy Ratio (%) (b)	15.7	19.7		22.2	
Return on Assets (%)	2.3	1.5		3.1	
Return on Equity (%) (b)	21.5	10.9		22.9	
Leverage Times (b)	7.7	8.4		8.0	
Operating Expenses to Total Income (%) (c)	2.9	3.9		2.5	
Total Cost to Total Income (%) (c)	75.4	84.4		73.4	
Duration of Assets and Liabilities (years)	1.2	1.1		1.1	

Source: Central Bank of Sri Lanka

(a) Provisional
(b) Standalone PDs only
(c) During the period up to end September

Table 8.5 Unit Trust Sector - Selected Indicators

Item	End Jun 2011	End Jun 2012	Change (%)	End Jun 2013 (a)	Change (%)
Total Assets (Rs. million)	27,286	20,308	(25.6)	33,298	64.0
Net Asset Value - NAV (Rs. million)	26,875	20,069	(25.3)	33,101	64.9
Investments (Rs. million)	**26,804**	**20,124**	**(24.9)**	**33,165**	**64.8**
Equity	11,211	7,732	(31.0)	9,174	18.6
Government Securities	13,438	5,639	(58.0)	9,229	63.7
Other (E.g., Commercial Paper, Debentures, Trust Certificates & Bank Deposits)	2,155	6,753	213.3	14,762	118.6
Investments in Equity as a % of NAV	41.7	38.5		27.7	
Investments in Government Securities as a % of NAV	50.0	28.1		27.9	
Other Investments as a % of NAV	8.0	33.6		44.6	
Total No. of Unit Holders	25,323	27,042		28,168	
No. of Units in Issue (million)	1,614	1,327		2,362	
No. of Unit Trusts	22	34		44	

Source: Unit Trust Association of Sri Lanka

(a) Provisional

Unit Trusts

- **The asset base of Unit Trust (UT) funds expanded with the establishment of seven new funds during the first six months of 2013.** As at end June 2013, there were 44 funds in operation, managed by 12 Unit Trust Management Companies (UTMC) registered with the Securities and Exchange Commission of Sri Lanka (SEC). While the net asset value (NAV) of the UT sector recorded a significant increase by end June 2013, the setting up of new funds with more investments in government securities and corporate debt securities contributed to this increase. By end June 2013, the share of equities in the investment portfolios of unit trusts recorded a decline when compared with end June 2012. In contrast, the share of other investments in the investment portfolio, particularly commercial paper and debentures, increased significantly during this period, reflecting a diversification of the investment portfolio.

- **Several policy initiatives were taken to encourage the development of the unit trust sector.** Lowering the income tax applicable to UTMCs to 10 per cent from 28 per cent and exempting services supplied by UTMCs to unit trusts from VAT will help expand the development of the unit trust sector. In addition, enabling investments in unit trusts to be executed directly in foreign currencies without having to channel funds through Securities Investment Accounts (SIA) will encourage investments in unit trusts by Sri Lankans working abroad. Further, as per the national budget for 2013, private pension funds and private provident funds were allowed to access capital market investments via unit trusts that invest exclusively in listed equities and listed corporate bonds, with a view to promoting investments in unit trusts by institutional investors.

Stock Brokers

- **Performance of stock brokers improved in the first half of 2013 compared to the first half of 2012.** The income of stock brokers improved marginally, while the extent of losses before tax declined in the first six months of 2013 compared to the corresponding period in 2012.

- **As per the national budget for 2013, stock broker companies were granted a 100 per cent depreciation allowance (lump sum depreciation) on IT infrastructure investments**

Table 8.6 Stock Broker Companies - Selected Indicators

Item	End Jun 2011	End Jun 2012	Change (%)	End Jun 2013 (a)	Change (%)
Total Assets	17,087	10,885	(36)	12,370	14
Total liabilities	11,069	4,130	(63)	6,213	50
Net capital	3,754	3,918	4	5,050	29
Income (b)	3,542	994	(72)	1,034	4
Net profit / (Loss) before tax (b)	1,649	(443)	(127)	(273)	38

(a) Provisional
(b) During the period up to end June

Source: Securities and Exchange Commission of Sri Lanka

and branch expansion. Facilitating the development of infrastructure in support of debt and equity market expansion will have a positive impact on the performance of the stock brokers in the years ahead.

Superannuation Funds

- **The Employees' Provident Fund (EPF), which is the largest systemically important superannuation fund in Sri Lanka, expanded further in terms of both net contributions and assets.** As total contributions during the period January to September 2013 increased at a faster pace than refunds, the net contributions (contributions minus refunds) of the EPF increased by 32.9 per cent over the corresponding period last year to Rs. 20.6 billion. The investment portfolio of the EPF consisted mainly of government securities which accounted for 93.4 per cent of its investments. The share of equity in the investment portfolio was 5.5 per cent while corporate debt and reverse repos had a share of 1.1 per cent.

- **The Employees' Trust Fund (ETF) expanded in terms of both net contributions and assets, during the first nine months of 2013.** The net contributions (contributions minus refunds) of the ETF increased by 20.6 per cent during the period under consideration to Rs. 3.5 billion. As in the case of EPF, the investment portfolio of the ETF is concentrated in government securities, which accounted for 88 per cent of the total portfolio by end September 2013. Investments in equity and corporate debt securities accounted for 4.7 per cent and 0.4 per cent, respectively, of the total investments.

- **The Public Service Provident Fund (PSPF) had 239,001 active members while the 170 Approved Private Provident Funds (APPFs) had 155,096 active members as at end June 2013.** Total assets of the PSPF and APPFs amounted to Rs. 35.1 billion and Rs.122.4 billion, respectively by end June 2013. Total contributions and refunds of the PSPF during the first six months of 2013 amounted to Rs. 818 million and Rs. 194 million, respectively.

Table 8.7 Superannuation Funds - Selected Indicators

Item	Employees' Provident Fund (EPF)			Employees' Trust Fund (ETF)		
	End Sep 2012	End Sep 2013 (a)	Change (%)	End Sep 2012	End Sep 2013 (a)	Change (%)
Number of Accounts (million)	14.6 (b)	14.6 (b)	-	9.8	9.9	1.0
o/w, Active Accounts (million)	2.3 (b)	2.3 (b)	-	2.2	2.2	0.0
Total Contributions (Rs. billion)	52.0	57.6	10.8	9.4	10.7	13.1
Total Refunds (Rs. billion)	36.5	36.9	1.1	6.6	7.2	9.9
Total Assets (Rs. billion)	1,113	1,251	12.4	154.3	173.5	12.4
Total Investment Portfolio (Rs. billion)	1,083	1,217	12.4	145.7	162.9	11.8
o/w, Government Securities (%)	92.9	93.4		90.6	88.3	
Gross Income (Rs. billion) (c)	83.5	93.4	11.9	10.0	12.4	23.1

(a) Provisional
(b) As at end 2012
(c) During the period up to end September

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

Developments in Financial Markets

Inter-bank Call Money Market

- **During the first nine months of 2013, short-term interest rates in the inter-bank market declined responding to the easing of monetary policy by the Central Bank.** The Repurchase rate and the Reverse Repurchase rate of the Central Bank were revised downward on 10 May 2013 to 7.00 per cent and 9.00 per cent, respectively, from 7.50 per cent and 9.50 per cent. The Statutory Reserve Ratio (SRR) was reduced with effect from 1 July 2013 to 6 per cent from 8 per cent releasing funds of Rs. 48 billion to the market. Inflows of foreign funds to the banking sector meanwhile resulted in adding further liquidity to the money market. As a result, overnight market liquidity was in a surplus position about 93 per cent of the time during this period, despite varying between a deficit of Rs. 13.9 billion and a surplus of Rs. 88 billion.

- **In view of monetary policy easing and excess liquidity in the money market the average weighted call money rate (AWCMR) declined.** During much of the period from January to September 2013, AWCMR which was at 9.83 per cent at end 2012 declined to 8.44 per cent by end September 2013 and remained within the policy rate corridor since around mid-February 2013. The tax adjusted AWCMR prevailed within the policy rate corridor throughout this period, moving between a range of 8.86 per cent and 7.57 per cent.

- **The Central Bank took a number of measures during the year to improve liquidity management by banks whilst raising the effectiveness of its open market operations.** First, the reserve maintenance period was extended from one week to two weeks, to be effective from 01 June 2013. Second, short-term auctions (Repo and Reverse Repo) up to 7 days, on the same day settlement (T+0) basis, were introduced. Third, the Rs. 100 million limit on the use of the repo standing facility on days when the Central Bank offers a reverse repo auction, applicable to each bank, was withdrawn with effect from 01 June 2013. These measures helped banks utilise their liquid funds more efficiently, reducing the necessity for ad-hoc or unplanned market borrowings. The gradual narrowing down of the AWCMR spread after the implementation of these measures compared to the positions at the beginning of the year indicates that the short-term interest rates have started to respond to such measures in a favorable manner.

Domestic Foreign Exchange Market

- **The US dollar/LKR exchange rate depreciated marginally by 3.54 per cent over the first nine months of 2013, reaching Rs. 131.98 by 30 September 2013.** During the first five months, the exchange rate appreciated by 0.65 per cent with increased inflows by way of foreign investments, worker remittances and tourism. However, with expectations of the stimulus package in the US being tapered off earlier than expected, the currencies of many emerging economies depreciated and the appreciating trend of the US dollar/LKR exchange rate also gradually reversed commencing June 2013. In the government bond market, foreign investors were seen hedging their portfolios which, along with importer demand, exerted pressure on the US dollar/LKR exchange rate. The rupee depreciated slightly against the Euro but appreciated against the Sterling Pound, the Indian Rupee and the Japanese Yen.

- **The Central Bank intervened in the domestic foreign exchange market, buying as well as selling US dollars during the period under**

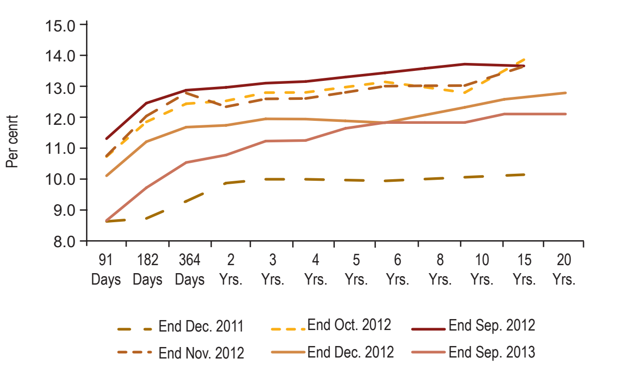
review with the intention of curbing excess volatility in the exchange rate. During the period, the Central Bank absorbed US dollars 715.2 million and supplied US dollars 628.7 million resulting in a net absorption of US dollars 86.6 million.

- **Trading volumes in the domestic foreign exchange market decreased marginally by 0.51 per cent up to 30 September 2013 compared with the corresponding period of the previous year due to the decline in international trade related payments.** The total volume of inter-bank foreign exchange transactions during the period under consideration in 2013 stood at US dollars 10.3 billion as against US dollars 10.4 billion in the corresponding period of 2012. The total volume of forward transactions up to 30 September 2013 was US dollars 4.0 billion compared to US dollars 3.2 billion recorded in the corresponding period of 2012. The daily average turnover in the inter-bank foreign exchange market including the forward market too decreased marginally and stood at US dollars 56.9 million as against US dollars 57.2 million in the corresponding period of 2012.

Government Securities Market

- **The yield rates in the government securities market declined gradually during the first nine months of 2013.** Yield rates throughout the yield curve pertaining to government securities (i.e. Treasury bills and Treasury bonds) of 3 months to 20 years declined in a range of 24 bps to 149 bps. The yield rate for the 6 month tenure declined the most by 149 bps. The decline in yield rates was a result of the easing of monetary policy by the Central Bank in view of the decline in inflation and inflation expectations. In addition, increased participation of foreign investors in the government securities market and the excess liquidity that prevailed in the money market during much of this period also contributed to the lower yields.

Chart 8.1 Government Securities Secondary Market Yield Curve



- **The management of the public debt was further strengthened while improving the risk profile of the public debt portfolio.** A Treasury bond with a maturity of 30 years was issued in June 2013 at a yield rate of 12.50 per cent. As a result of issuing a large volume of long dated Treasury bonds during the first nine months of 2013, the Average Time to Maturity (ATM) of the Treasury bond issuance increased to 9.81 years by end September 2013 from 6.27 years as at end September 2012. As a result, the ATM of the entire domestic debt portfolio increased to 5.98 years by end September 2013 from 3.83 years as at end September 2012.

Corporate Debt Securities Market

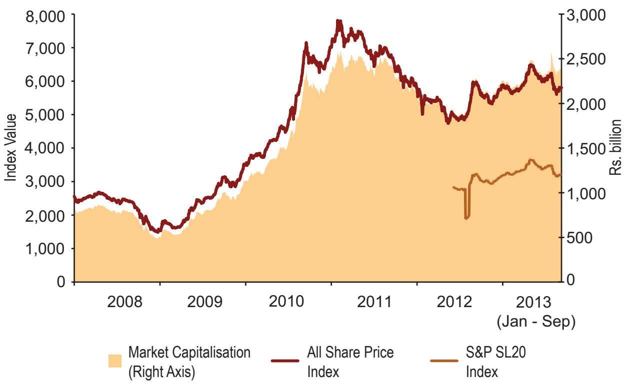
- **The commercial paper market has been relatively active in the first eight months of 2013.** The value of commercial paper (CP) issued with the support of banks amounted to Rs. 20.2 billion in the first eight months of 2013 in comparison with Rs. 21.4 billion in the same period in 2012. The interest rates on CPs increased to a range of 12.15 per cent to 22.00 per cent in 2013 from a range of 11.25 per cent to 18.50 per cent in 2012. CPs with a maturity of up to 3 months accounted for 81 per cent of the market, while the shares of CPs with 6 month and 12 month maturities were 9.9 per cent and 9.1 per cent, respectively. The total outstanding value of CPs amounted to Rs. 9.4 billion as at end August 2013 compared to Rs. 10.9 billion by August 2012.

- **The market for debentures posted improved performance for the first nine months of 2013**. Measures, taken by the government, such as the exemption of withholding tax on interest income earned from investments in listed debt have contributed towards increasing the popularity of corporate debt. There were thirty eight listings of corporate debentures (including one introduction) by fourteen corporate institutions during this period. The maturity periods of these debentures varied from 1 year to 10 years. The total funds mobilised through these debentures amounted to Rs. 28.2 billion and they carried both fixed and floating interest rates. The fixed rates of interest, payable monthly, quarterly, semi-annually and annually, pertaining to thirty two debentures were in the range of 13.50 – 20.00 per cent, while six debentures were issued with floating rates. Moreover, a number of debenture issues are in the pipeline and some debentures will be issued in the latter part of the year. The trading turnover of debentures listed on the Debt Securities Trading System (DEX) of the CSE was comparatively high at Rs. 407 million in the first nine months of 2013 compared to Rs. 39 million in the corresponding period in 2012.

Equity Market

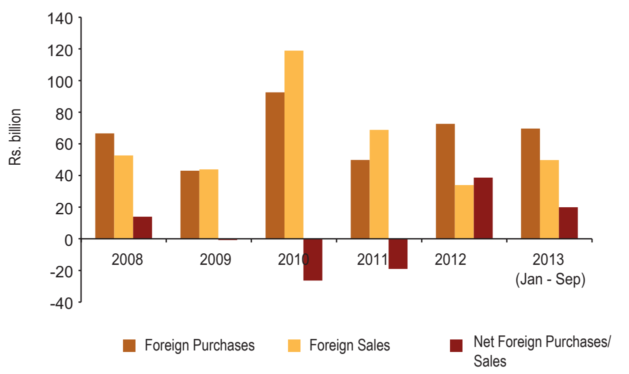
- **Key indicators of performance of the Colombo Stock Exchange such as the All Share Price Index (ASPI), the S&P SL 20 index, market capitalisation as well as the market price earnings ratio indicated an improvement in the nine-month period ending September 2013**. The downward trend in domestic interest rates, foreign investments and the healthy earnings posted by most listed companies primarily contributed towards this improvement. The ASPI and the S&P SL 20 index increased by 2.8 per cent and 4.2 per cent, respectively, during the period under review. The market price earnings ratio (PER) stood at 16.5 as at end September 2013, compared to 15.9 at end 2012. Market capitalisation increased to Rs. 2.4 trillion by 30 September 2013 from Rs. 2.2 trillion at end 2012. A total of Rs. 1.4 billion raised through four rights issues during this period also contributed towards the increase in market capitalisation.

Chart 8.2 Movements of Price Indices and Market Capitalisation of the CSE



- **Domestic investors continued to account for a large part of the turnover.** Domestic investors accounted for about 62 per cent of the turnover during the first nine months of the year, compared with 78 per cent during the corresponding period in 2012. Accordingly, an increase in turnover levels in relation to foreign investors has been recorded during this period. Among domestic investors, retail investors accounted for around 33 per cent of the turnover while domestic companies accounted for about 29 per cent. The average daily turnover during the first nine months of 2013 was Rs. 874 million compared to Rs. 884 million during the first nine months of 2012. The net

Chart 8.3 Foreign Participation at the CSE



inflow of foreign funds to the market during this period amounted to Rs. 19.9 billion, i.e., US dollars 151 million. Market capitalisation increased by 10.2 per cent (i.e., Rs. 222 billion), to Rs. 2.4 trillion by end September 2013, which is equivalent to 28 per cent of GDP.

- **Several policy initiatives were taken as per the national budget for 2013 to enhance the performance of the CSE.** A 3-year tax holiday was offered to new companies which would be listed on the CSE by offering 20 per cent of the shares to the public before December 2013. This is an encouraging initiative to enhance the depth of the stock market, which currently carries a market capitalisation to GDP ratio which is far behind the other regional markets. Moreover, this will enable companies with a relatively short operating history to speed up their shareholders' payback period by obtaining a listing on the CSE whilst accessing more equity capital for future expansion. In addition, the 0.1 per cent stamp duty charged on shares transferred to margin trading accounts was abolished to encourage margin trading on the Colombo Stock Exchange.

- **In order to enhance investor confidence and develop the capital market, the Securities and Exchange Commission of Sri Lanka (SEC) has initiated a consultative process with all key stakeholders.** The SEC has identified the following ten tasks/projects in its capital market road map to be implemented over the next three years: a) to expedite SEC Act amendments so as to be in line with the International Organization of Securities Commission (IOSCO) standards, b) encourage more public and private listings, c) attract new foreign and local funds, d) develop infrastructure such as trading, back-office system etc., e) develop the corporate debt market, f) intensify education and awareness, g) develop the unit trust industry, h) strengthen risk management, i) develop new products and j) demutualise the CSE from a member owned company to a company owned by shareholders.

Development Finance and Access to Finance

- **Several initiatives were taken to increase access to finance by the Small and Medium Enterprises (SMEs) sector considering its potential contribution to the development of the country.** As announced in the national budget for 2012, SME banking centres were opened by commercial banks, enhancing credit plus services to SME entrepreneurs. These centres provide facilities to entrepreneurs to obtain financial resources as well as advisory services. The incentives for SMEs announced in the government budget for 2013 including tax exemptions and the reduction of tax rates, expansion of financing facilities, and the introduction of further credit plus services are expected to enhance access to finance for the SME sector.

- **Measures were taken to enhance the provision of loanable funds to the microfinance sector.** In order to enhance access to finance for the sector, several budgetary concessions have been granted to the microfinance sector. The National Development Trust Fund, which merged with Sri Lanka Savings Bank (SLSB) in 2010 has provided Rs. 699 million for the microfinance sector through Partner Organisations (POs), during the first half of 2013. Most of these funds have been disbursed for the purposes of agriculture, cottage industry and small trading activities. SLSB intends providing Rs. 1,763 million as micro loans through POs during 2013. Meanwhile, a legal framework for the regulation of the microfinance sector will be established, which would facilitate prudential financial practices among microfinance institutions, streamline the financial services delivery mechanism in the microfinance sector and pave the way for new and dynamic players to enter the market.

- **During 2013, the Central Bank continued to engage in activities aimed at promoting regional development by coordinating and encouraging credit delivery to strategic sectors**. Through refinance schemes, interest subsidy schemes and credit supplementation schemes that were implemented with Participating Financial Institutions (PFIs), the Central Bank made available credit and credit plus facilities for ventures in the agriculture sector, the livestock sector and the micro, small and medium sector enterprises (MSMEs) sector. In total, loans amounting to Rs. 3,561 million were disbursed to 17,315 beneficiaries during the first eight months of 2013. Accordingly, the loans disbursed recorded an increase of 42 per cent while the number of beneficiaries increased by 63 per cent when compared with the corresponding period of 2012. The Central Bank intends disbursing Rs. 4,933 million among 20,275 beneficiaries during 2013, through the Central Bank coordinated schemes, for MSME development.

- **Under the Saubhagya Loan Scheme, which provides credit facilities to commence or uplift MSMEs or MSMEs affected by disasters, Rs. 2,319 million was disbursed among 5,167 beneficiaries during the first eight months of the year.** The Saubhagya Scheme is targeting to disburse Rs. 3,450 million during 2013 to 8,900 beneficiaries. Reflecting the expected boom in the leisure industry, most of the loans granted under the Saubhagya scheme were for the establishment or refurbishment of hotels and restaurants.

- **Under the loan scheme "Awakening North – Phase II", 6,014 loans amounting to Rs. 533 million were disbursed while under the loan scheme, "Resumption of Economic Activities in the East – Phase II", 4,728 loans amounting to Rs. 586 million, were disbursed during the first eight months of 2013.** Under these two schemes, it is expected to disburse Rs. 800 million and Rs. 1,000 million, respectively, during 2013. Increased investments in infrastructure development in the two regions has stimulated the start-up of new investment in SME enterprises and therefore, the performance of the two loan schemes is expected to improve further in 2014. Altogether, the demand for SME financing is expected to increase further in 2014 with the support of budgetary concessions announced for the SME sector as well as increased economic activities in this country.

- **Loans disbursed for Agriculture and related activities reflected the setback in the sector during the first eight months of 2013**. Prolonged drought conditions that prevailed during the previous year, and the floods experienced during the latter part of 2012 and the first half of 2013 adversely affected the performance of agriculture which resulted in a decline in the demand for loanable funds to agriculture. Under the New Comprehensive

Rural Credit Scheme (NCRCS), through which working capital requirements are provided to farmers in relation to 32 crops, Rs. 5,378 million was disbursed among 60,120 farmers during the Maha season, a decline of 10.4 per cent over the previous year's Maha season. The highest share of the NCRCS loans (38 per cent of the total amount and 23 per cent of the total number of loans) has been claimed by the Jaffna District, which reflects a revival of agricultural activities in the Jaffna peninsula. This was followed by Anuradhapura, Hambantota, Polonnaruwa and Ampara Districts. Of the NCRCS loans disbursed during the first half of 2013, paddy represents 51 per cent of the loans granted while onions and potato represent 21 per cent and 14 per cent, respectively. It is intended to provide Rs. 3,430 million among 40,950 beneficiaries during the Yala season of 2013. Further, under the Tea Development Project Revolving Fund Loan Scheme Rs. 56 million was disbursed among 233 beneficiaries during the first eight months of 2013.

- **Promoting financial inclusiveness has also been given priority**. Accordingly, the formation of Self Help Groups, educating them about financial management and providing them loans to commence Income Generating Activities (IGAs) have been given priority. The Central Bank coordinates six micro finance credit schemes, under which Rs. 1,315 million was disbursed among 23,804 beneficiaries during the first eight months of 2013. Under Poverty Alleviation Micro Finance - Revolving Fund Loan Scheme (PAMP RF) Rs. 540 million was disbursed among 11,702 beneficiaries in 14 Districts. Under the PAMP - RF and PAMP II - RF Loan Schemes, it is intended to provide microfinance loans amounting to Rs. 1,325 million during 2013, among 22,000 beneficiaries. Further, under the other microfinance schemes coordinated by the Central Bank, namely, the Small Farmers and Landless Credit Project - Revolving Fund (SFLCP-RF) Loan Scheme, the Small Holder Plantation Entrepreneurs Development Programme (SPEnDP), the Dry Zone Livelihood Support and Partnership Programme – Revolving Fund (DZLiSPP-RF) Loan Scheme and the National Agribusiness Development Programme (NADeP), Rs. 800 million is expected to be disbursed during 2013.

Payment and Settlement Systems

LankaSettle System

- **The Central Bank, as the operator of the LankaSettle System, continued to ensure a reliable and safe mechanism for the efficient settlement of transactions through the Real Time Gross Settlement (RTGS) system.** The LankaSettle System recorded a system availability of 99.87 per cent for the first eight months of 2013. The RTGS system which facilitates electronic payments accounted for 87 per cent of the total value of non-cash payments during the same period and continued to be the main inter-bank fund transfer system in the country. A total of 201,077 transactions with a value of Rs. 35,269 billion, were carried out through the RTGS System during the first eight months of the year. In order to ensure readiness of the system during contingency events, the Central Bank successfully conducted live operations from its disaster recovery site on 05 March 2013.

LankaSecure System

- **The LankaSecure System consists of the Scripless Securities Settlement System (SSSS) and the Scripless Securities Depository System (SSDS) for government securities transactions on Delivery versus Payment basis.** The total value of scripless securities held by LankaSecure as at end September 2013 amounted to Rs. 3,698 billion, accounting for 99.9 per cent of the total value of Treasury bills and Treasury bonds outstanding. These scripless securities consisted of Treasury bills amounting to Rs. 796 billion and Treasury bonds amounting to Rs. 2,902 billion. LankaSecure maintained 82,611 accounts through dealer direct participants, covering corporate as well as individual customers.

Cheque Imaging and Truncation (CIT) System

- **The CIT system continued to ensure a safe and efficient retail payment system.** The CIT system, which was introduced in 2006 is operated by LankaClear (Pvt) Ltd. (LCPL), and has substantially improved the cheque clearing process reducing the island-wide cheque realisation time to one day (T+1). As at end August 2013, the CIT system has cleared 31,688,308 cheques to the value of Rs. 4.6 trillion.

Sri Lanka Inter-bank Payment System

- **The Sri Lanka Inter-bank Payment System (SLIPS) which was enhanced from an off-line mechanism to an on-line mechanism continued to facilitate pre-authorised low value payments on T+0 basis.** A total of 10,931,036 transactions valued at Rs. 448.3 billion were carried out through SLIPS during the first eight months of 2013.

Common ATM Switch

- **In order to provide a nation-wide common platform for electronic retail payment systems, the Central Bank continued its assistance to establish the Common Card and Payment Switch (CCAPS).** The Common ATM Switch (CAS) which is the first phase of CCAPS, started live operations in July 2013. It is expected to utilize the ATM network in the country more efficiently and effectively and thereby reduce transaction costs in the financial system. In order to ensure smooth operations of the CAS, the Central Bank issued the following directions to LankaClear (Pvt) Ltd. and Members of the CAS;

i. General Direction No. 1 of 2013 - Operations of the Common ATM Switch. This direction was issued to impose certain prudential and obligatory requirements to LankaClear (Pvt) Ltd. as well as member banks of CAS.

ii. General Direction No. 2 of 2013 - Fees Chargeable on the Transactions effected through the Common ATM Switch. This Direction was issued to impose upper limits for the fees that can be charged from customers by card issuers and the interchange fee that can be charged from card issuers by financial acquirers.

Payment Cards and Mobile Payment Systems

- **To facilitate new developments in the electronic retail payment systems, the Central Bank revised the direction issued on payment cards and mobile payments.** Service Providers of Payment Cards Regulation No. 01 of 2009 was rescinded and the Payment Card and Mobile Payment Systems Regulation No. 1 of 2013 was issued to regulate and supervise activities of service providers of payment cards and service providers of mobile phone based payment systems. During the first nine months of 2013, the Central Bank issued 3 new licences to service providers of payment cards enabling them to issue debit cards. Further, the Central Bank gave approval to a telecommunication network operator licensed by the central Bank to operate an E-money scheme to issue a store value card for the transport sector using near field communication technology. In order to ensure safe and secure payment card operations in Sri Lanka, the Central Bank mandated the adoption of the line encryption technology to institutions engaged in financial acquiring. Accordingly, on the instructions of the Central Bank, all acquirers upgraded their point-of-sale terminals with line encryption technology by 31 March 2013.

Prospects for 2014

- **The financial sector is expected to broaden and strengthen supported by conducive domestic macroeconomic conditions, overall soundness in the financial institutions and expected growth in the financial markets.** The business expansion expected in line with the projected growth for the economy would magnify the opportunities for further growth in the financial sector.

- **The soundness of the banking sector will be reinforced with enhanced capital and risk management.** Banks are expected to strengthen their capital further, in terms of quantity as well as quality, with the enhancement of minimum capital requirements for LCBs and LSBs by end 2013 and 2015. Moreover, appropriate measures would be implemented in line with the Basel III Capital Adequacy Framework. In addition, integrated risk management processes will also be strengthened with the implementation of Pillar 2 of Basel II – Supervisory Review Process.

- **The funding structure of the Sri Lankan banking sector is expected to be diversified further with the recent orientation towards local debt, equity markets and foreign borrowing.** A few banks have already capitalised on the tax concessions provided by the 2013 Budget to investors in corporate debt securities through the issuance of debentures and more are expected to follow this path in the near future. Moreover, it is expected that Sri Lankan banks will continue to explore the opportunities to raise funds from international markets. The banks have already raised a total of US dollar 973 million from foreign sources during 2012 and US dollar 1,414.3 million during the first nine months of 2013. It is anticipated that these borrowings would reduce banks' reliance on customer deposits as a source of funding, resulting in a reduction of the interest rate spread in the Sri Lankan banking sector.

- **Consolidation in the financial sector will increase efficiency and stability in the sector.** In general, large scale financial institutions enjoy economies of scale benefits, operational and cost efficiencies and thereby higher profitability. With the enhancement of the minimum capital levels of banks, LFCs and SLCs and the need to meet the minimum liquidity requirements, the smaller and weaker institutions would be encouraged to consolidate for survival as well as to enable them to compete with the large institutions. Already, several SLCs have migrated to LFC status in order to enhance their funding sources by way of deposits in addition to borrowings through debt instruments. In this context, it is expected that the remaining SLCs would also migrate to LFC status or be amalgamated with other financial institutions. The road ahead towards the US dollar 4,000 per capita era could pose challenges to small/weak institutions as competition for funding sources intensify. Therefore, such companies are expected to consolidate to bring stability and to derive the benefits from economies of scale and synergies.

- **Capital markets are expected to broaden in an environment of declining interest rates, targeted incentives and focussed market development plans.** In a scenario of low interest rates to boost economic growth, the capital markets would be in a position to attract investors away from traditional deposits. Further, several tax incentives granted to encourage investors in corporate debt securities have already seen a significant increase market activity in this sector. Several new corporate debenture issues have been lined up for issue in the next few months as well as next year, providing the much needed boost to the corporate debt market. In addition, the SEC and the CSE are working together to implement a capital market development master plan to make the regulatory system more proactive in line with international standards. This master plan will pursue 10 key strategies to further enhance investor confidence and develop the capital market in the country. The declining interest rates will also provide the ideal environment for the insurance sector to offer long-term pension products to the market.

- **Financial market infrastructure is to be expanded and strengthened using advanced technologies.** An e-trading platform is to be established to facilitate the secondary market activities of government and corporate debt securities. A Central Counterparty System is to be established to facilitate clearing and settlement of equity and debt securities while mitigating settlement risks. Payment and settlement infrastructure is expected to advance further towards an environment of digitalised transactions where electronic payment systems such as e-money, e-payments and mobile payments systems are introduced to a wider range of retail transactions. Arrangements will be made to establish a national platform for electronic retail payments where the final settlements will be effected through the Real Time Gross Settlement System. In addition, measures will be taken to ensure the security and reliability of financial market infrastructure by way of effective security measures and a strengthened regulatory framework.