8

FINANCIAL SECTOR DEVELOPMENTS AND STABILITY

The financial sector expanded and remained resilient supporting the growth momentum of the economy. With adequate capital and liquidity levels, an enhanced regulatory and risk management framework, and sustained improvements in the governance practices adopted, the overall soundness of financial institutions improved. A major policy initiative taken during the year was the implementation of the financial sector consolidation programme aimed at further strengthening the domestic financial system. Enhanced stability, dynamism and competitiveness of the financial sector following the consolidation of financial institutions will enable the financial sector to meet the growing financing needs of the domestic economy and support future economic growth. Commendable progress has been made as targeted in the master plan for financial sector consolidation which was announced in January 2014. Following the decline in pawning advances and the subdued performance of the Agriculture sector, credit granted to the private sector by licensed banks and finance companies decelerated while their investments increased. The overall non-performing loan (NPL) level of financial institutions increased mainly due to the rise in NPLs in respect of pawning advances during the first seven months of 2014, although there has been a moderation in NPLs since August, as interest rates have declined and financial institutions have adopted appropriate measures to improve their asset quality. Going forward, credit growth is expected to pick up in view of the easing of monetary policy and the prevailing conducive macroeconomic environment. In the money market, liquidity increased due to purchases of sovereign bond proceeds and foreign currency from the market as well as purchases of foreign currency loan proceeds to the government. Market interest rates adjusted downwards in view of the easing of the monetary policy stance and the enhanced level of market liquidity. The stock market has shown significant improvement as a result of improved macroeconomic fundamentals, strengthening of corporate sector performance, and increased domestic and foreign investor participation. Consequently, the market capitalisation of the Colombo Stock Exchange surpassed the Rs. 3 trillion mark by September 2014. The corporate debt securities market continued its improving trend owing mainly to the recent tax incentive provided by the government, becoming an alternative source for corporates to raise funding. In the domestic foreign exchange market, the rupee appreciated against the US dollar and several other major currencies whilst depreciating against the Indian rupee, during the period. The payment and settlement system, which operated with a high degree of availability and safety, supported the smooth functioning of domestic financial markets.

Developments in Financial Institutions

Banking Sector

- **The banking sector remained sound and resilient supported by the timely policy initiatives as well as the regulatory and supervisory measures in place**. The master plan on consolidation is envisaged to bring more dynamism and robustness to the banking sector thereby aligning business strategies to facilitate the envisioned economic goals.

- **The growth of total assets moderated during the first eight months of 2014, due to moderation in credit growth**. The total assets of the banking sector increased by 13.1 per cent, year-on-year, to Rs. 6.4 trillion. In comparison, total assets of the banking sector grew by 15.7 per cent in 2013. The asset growth during this period was largely supported by the increase in deposits by Rs. 262.7 billion (6.3 per cent). Meanwhile, borrowings increased by Rs. 148.9 billion (14.7 per cent). The funds mobilised were largely utilised in investment activities resulting in an increase in investments by Rs. 117.8 billion (6.9 per cent). Increased investments were mainly in respect of Government Securities.

- **Credit growth moderated largely due to the decline in pawning advances.** As a result of the decline in pawning, year-on-year growth of loans and advances declined to 5.1 per cent in August 2014 compared to 8.8 per cent in December 2013. The loan portfolio expanded by Rs. 79.3 billion during first eight months of 2014. Lowering loan to value ratio of key loan products such as pawning, the Government's commitment to fiscal consolidation and alternative funding sources for corporates in domestic and foreign capital markets largely contributed to the moderation in credit. Amidst these developments, the banking sector marked an increase in loans excluding pawning advances amounting to Rs. 250.7 billion during the first eight months of 2014.

- **Proactive measures have been taken by licensed banks to improve asset quality by recovering non-performing loans (NPLs), particularly the non-performing pawning advances**. The asset quality measured by the ratio of non-performing loans to total loans has remained steady at 5.6 per cent in both December 2013 and August 2014. The provisions (specific) coverage ratio marginally declined from 32.5 per cent as at end 2013 to 32.3 per cent as at end August 2014.

- **Liquidity position of banks remained healthy**. Statutory Liquid Asset Ratios (SLAR) for Domestic Banking Units and Off-shore Banking Units as at August 2014 stood at 40.6 per cent and 35.1 per cent, respectively, which were well above the minimum statutory requirement of 20 per cent. Further, as at end August 2014, liquid assets to total assets ratio was 34.2 per cent. Loan to deposit ratio of the banking sector improved from 82.2 per cent as at end 2013 to 79.1 per cent as at end August 2014.

- **Profits of the banking sector increased, but profitability decreased marginally**. During the first eight months of 2014, the banking sector recorded a profit after tax of Rs. 53.9 billion compared to Rs. 50.7 billion recorded during the corresponding period in 2013. Marginal increase of net interest income by Rs. 2.5 billion (1.9 per cent) is due to lower yields resulting from changes in the asset structure and the downward adjustment of interest rates which off-set to some extent the decline in the cost of deposits. Other operating income increased by Rs. 5.0 billion compared to the corresponding period of previous year, largely due to the increase in commissions, fees and charges on off-balance sheet items. Profitability ratios decreased during the first eight months of 2014. Return on Assets (ROA) (before tax), Return on Assets (after tax) and Return on Equity (ROE) decreased to 1.9 per cent, 1.3 per cent and 16.0 per cent, respectively while cost to income ratio, measured as total operating expenses to total operating income, decreased from 79.0 per cent in August 2013 to 78.7 per cent in August 2014.

- **Banking sector remained well capitalised to withstand any adverse shocks**. The regulatory Capital Adequacy Ratio (CAR) requirement under Basel II was maintained well above the required level of 10 per cent during the first eight months of 2014. The CAR of the banking sector stood at 16.9 per cent in June 2014.

- **Branch network expanded further improving financial accessibility**. The number of banking outlets increased during the first eight months of the year. Number of new outlets opened amounted to 9 during the first half of 2013 and 25 during the first eight months of 2014, increasing the total banking outlets operating in the country to 6,514 by end August 2014.

- **Regular assessments of the banking system were conducted to identify potential risks and vulnerabilities and to review the ability of the system to withstand potential shocks**. Over the past year, the Central Bank made further progress in strengthening banking sector stability by implementing a range of regulations to address potential risks. During the period under review, a regulatory framework on valuation of immovable property of licensed banks was specified, with a view to streamlining practices of valuation of immovable properties and establishing uniformity and a level playing field across the banking sector. An addendum to Directions on Integrated Risk Management framework was issued on baseline security standard for information security management, with a view to establishing minimum acceptable security standards and standardising information security policies of banks.

- **Disclosure requirements were strengthened**. Banks were required to publish financial statements and other relevant disclosure requirements on their web sites and in the press in order to enhance uniformity in reporting and promoting healthy competition among banks. Further, banks were also required to refrain from publishing misleading and unethical advertisements, and to ensure that all important information is highlighted in a visible manner. Two new web reporting formats for Statement of Financial Position and Statement of Comprehensive Income were developed with the intention of enabling banks to submit their financial statements in accordance with the newly adopted Sri Lanka Accounting Standards.

Table 8.1 **Banking Sector - Selected Indicators**

Item	End Aug 2012	End Aug 2013	End Dec 2013	End Aug 2014 (a)	Y-O-Y Change (%)	
					Aug 2013	Aug 2014 (a)
Total Assets (Rs.billion)	4,881.1	5,646.4	5,941.5	6,388.2	15.7	13.1
Loans & Advances (Rs.billion)	3,017.0	3,335.3	3,426.6	3,505.8	10.6	5.1
Investments (Rs.billion)	1,162.6	1,568.1	1,719.2	1,812.2	34.9	15.6
Deposits (Rs.billion)	3,436.4	3,970.8	4,169.5	4,432.2	15.5	11.6
Borrowings (Rs.billion)	805.1	938.3	1,015.4	1,164.4	16.5	24.1
Capital Funds (Rs.billion)	414.5	471.4	489.6	534.6	13.7	13.4
Tier 1 Capital Adequacy Ratio (%) (b)	13.1	13.9	14.9	14.4		
Total Capital Adequacy Ratio (%) (b)	14.8	16.1	17.6	16.9		
Gross Non-Performing Loans Ratio (%)	4.1	5.1	5.6	5.6		
Net Non-Performing Loans Ratio (%)	2.5	3.4	3.8	3.9		
Return on Assets (Before Tax) (%)	2.5	2.0	1.9	1.9		
Return on Equity (After Tax) (%)	20.0	17.0	16.0	16.0		
Statutory Liquid Assets Ratio (DBU) (%)	30.8	34.1	37.7	40.6		
Liquid Assets to Total Assets (%)	27.2	29.1	31.9	34.2		

(a) Provisional
(b) As at end June

Source: Central Bank of Sri Lanka

- **Several new policy initiatives were taken to broaden the coverage of liquid assets in the computation of liquid asset ratio and to provide greater flexibility for banks to grant accommodations to large projects**. Licensed commercial banks were permitted to invest in international bond issues of Government of Sri Lanka through off-shore banking units, in the secondary market. Definition of liquid assets was broadened to accommodate investment in sovereign bonds issued by the Government of Sri Lanka and standing deposit balances held by commercial banks with the Central Bank. Accommodation granted by licensed commercial banks outside Sri Lanka was exempted from the requirement of Maximum Amount of Accommodation where such accommodation has been financed directly through foreign sources as the emanating risk to local banking sector is minimal. With the view of promoting banks in financing large projects with national interest, accommodations granted with the approval of the Monetary Board have been excluded from the computation of aggregate limit of large accommodation. A credit guarantee scheme for pawning advances for banks engaged in pawning activities was introduced to facilitate banks to provide an enhanced level of credit to their customers.

- **Several policy measures were taken, giving effect to relevant Government policies**. Guidelines on discontinuation of operations of the Investment Fund Account as introduced in the fiscal budget for 2011 were issued. The Central Bank unveiled the financial sector consolidation plan as proposed by the Fiscal Budget 2014 with the objective of reaping synergies and thereby strengthening the financial sector. Banks were also requested to facilitate implementation of the official language policy in accordance with the Official Language Commission Act No. 18 of 1991.

- **The capital adequacy framework was further strengthened.** In line with the commitment to move to advanced approaches of Basel II capital framework, the Standardised Approach and Alternative Standardised Approach for computing Operational Risk Capital Charge were introduced. Banks are encouraged to move to advanced approaches as they develop more sophisticated operational risk measurement systems and practices. Furthermore, pursuant to the issuance of the Directions on Implementation of Pillar 2 – Supervisory Review Process of Basel II framework in July 2013, banks were required to submit their Capital Adequacy Assessments every year. It is envisaged to issue guidelines on parallel computation of the capital adequacy ratio under revised Basel III capital standards and to issue a consultation paper on the liquidity coverage ratio (LCR) under Basel III liquidity standards.

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

- **The LFC and SLC sector performance remained moderate during the first eight months of 2014**. The LFC and SLC sector represented 7 per cent of assets of the Sri Lanka's financial system and consists of 48 LFCs and 9 SLCs with a branch network of 1,085. This sector also experienced a lower credit growth. Total assets of the sector therefore, expanded by 9 per cent (Rs. 64 billion) to Rs. 781.1 billion in the first eight months of 2014 compared to the growth of 14 per cent (Rs. 84 billion) in the corresponding period of 2013, mainly due to low demand for credit. The sector non-performing loans continued to show an increasing trend during 2014. During the period under review, profits have shown a moderate increase. The proposed consolidation process discussed under the master plan 2014 is expected to contribute positively in building a more resilient LFC and SLC sector. The capital and asset base would increase as a result of this process, enabling LFCs and SLCs to mobilise low cost, long term funds. As at end September 2014, the progress

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

Item	End Aug 2012	End Aug 2013	End Dec 2013	End Aug 2014 (a)	Y-O-Y Change (%)	
					Aug 2013	Aug 2014 (a)
Total Assets (Rs.billion)	553.4	680.3	717.6	781.1	22.9	14.8
Loans & Advances (Rs.billion)	442.8	531.1	553.1	594.2	19.9	11.9
Deposits (Rs.billion)	228.0	315.9	337.3	397.4	38.6	25.8
Borrowings (Rs.billion)	169.7	184.4	192.3	177.6	8.7	(3.7)
Capital Funds (Rs.billion)	83.0	95.9	94.7	108.6	15.5	13.2
Tier 1 Capital Adequacy Ratio (%)	17.2	15.2	13.5	13.7		
Total Capital Adequacy Ratio (%)	17.8	15.8	14.8	14.5		
Gross Non-Performing Accommodations Ratio (%)	5.2	6.0	6.7	7.6		
Net Non-Performing Accommodations Ratio (%)	1.8	2.3	2.5	2.9		
Return on Assets (Before Tax) (%) - Annualised	3.0	2.2	2.1	2.5		
Return on Equity (After Tax) (%) - Annualised	21.0	8.7	8.2	10.2		
Liquid Assets to Total Assets (%)	5.6	6.2	8.0	9.4		

(a) Provisional

Source: Central Bank of Sri Lanka

of implementation of consolidation process was satisfactory and was in line with the original time plan. Accordingly, 29 LFCs and SLCs have confirmed their mergers and acquisitions under the consolidation programme while a few cash-strapped LFCs and SLCs are progressing under the restructuring process. In addition, 4 LFCs and SLCs are in the process of finalising their consolidation plans.

- **Deposits continued to be the major source of funding for LFCs.** Deposits grew by 18 per cent (Rs. 60 billion) to Rs. 397 billion in the first eight months of 2014 compared with the growth of 24 per cent (Rs. 62 billion) in the corresponding period of 2013. The borrowings decreased notably by 8 per cent (Rs. 15 billion) to Rs. 178 billion in the first eight months of 2014 as low credit growth resulted in less funding requirements.

- **The deceleration in credit growth continued to hamper the sector's performance.** Credit provided by the LFCs and SLCs increased by a moderate 7 per cent (Rs. 41 billion) to Rs. 594 billion in the first eight months of 2014 compared to the growth of 13 per cent in the corresponding period of 2013. The core businesses of the sector, namely, finance leases and hire purchase portfolio grew only by 2.2 per cent in the first eight months of 2014, compared to 7 per cent growth in the corresponding period of 2013. However, the secured loan category recorded a growth of 19 per cent in the first eight months of 2014.

- **Asset quality deteriorated.** High lending interest rate scenario that prevailed during 2013 and gold price fluctuations that affected the business of pawning resulted in asset quality deteriorating with the gross NPL ratio increasing to 7.6 per cent as at end August 2014 from 6.7 per cent as at end December 2013. However, when the loan loss provisions are considered, the net NPL ratio rose only by 0.5 per cent to 3.0 per cent as at end August 2014 from 2.5 per cent as at end December 2013. The main products that contributed to the increase in NPL ratio were finance leasing (31 per cent), and hire purchases (21 per cent).

- **The overall liquidity position of the LFC and SLC sector improved amidst lower credit growth.** The overall liquid assets of the sector recorded an increase of 27 per cent to Rs. 73 billion during the first eight months of 2014. Compared to the minimum statutory liquid assets requirement of Rs. 50 billion, LFCs and SLCs carried a surplus of Rs. 23 billion as at end August 2014. This is directly attributed to steady growth in sector deposits despite slowing down of overall credit growth.

- **Profitability increased with the decline in interest costs**. Profit of the sector was Rs. 6.8 billion during the first eight months of 2014 compared to a profit of Rs. 5.3 billion in the corresponding period of 2013. Accordingly, the annualised ROA and ROE ratios were at 2.5 per cent and 10.2 per cent, respectively, for the eight months period ending August 2014, compared to 2.2 per cent and 8.7 per cent as at end August 2013.

- **The capital position of the sector deteriorated marginally**. Capital funds increased by 15 per cent in the first eight months of 2014 and the capital adequacy ratios of the LFCs and SLCs sector exceeded the minimum regulatory requirement despite a marginal deterioration. As at end August 2014, the core capital ratio was 13.7 per cent and the total capital ratio was 14.5 per cent, well above the minimum statutory requirement of 5 per cent and 10 per cent, respectively.

Insurance Companies

- **The insurance sector recorded a growth in terms of total assets and premium income**. Total assets of the insurance sector recorded a growth of 13.0 per cent on a year-on-year basis, by end June 2014, in comparison to the growth of 23.9 per cent recorded at end June 2013. The gross written premiums (GWP) of the insurance sector grew moderately by 3.1 per cent in the first half of 2014, indicating a continuous moderation when compared to the increase of 9.1 per cent in the corresponding period of 2013. The intense price competition in the industry, coupled with the marginally increased management expenses, has affected the moderate growth of GWP, particularly, the general insurance sector. The premium income from motor insurance, which constitutes around 61 per cent of the general insurance premium, grew at a moderate pace of 3.7 per cent in the first half of 2014, compared to the increase of 8.0 per cent in the corresponding period of 2013. Premium income from fire and miscellaneous insurance declined by 2.0 per cent and 0.6 per cent, respectively, year-on-year, in the first half of 2014.

- **Profit before tax of the insurance sector declined in the first half of 2014**. This decline could be attributed mainly to the moderation in premium income growth and moderation of investment income from around mid-2013. The aggregate profit before tax declined by 16.8 per cent in the first half of 2014 compared to the decline of 16.5 per cent in the corresponding period of 2013. Investment income of insurance companies increased by 4.3 per cent in the first half of 2014, compared to the 34.2 per cent increase in 2013. However, the claims of the insurance sector increased by 2.8 per cent during the period under consideration compared to the increase of 15.9 per cent in the corresponding period of 2013. In the current declining interest rate scenario, low interest rates have adversely impacted on the interest income of the insurance companies as investments in government securities remained the main investment category of the insurance sector, representing 34.5 per cent of the total assets.

- **Insurance companies maintained their soundness.** The solvency ratios for long-term and general insurance were 8.7 per cent and 2.2 per cent, respectively, at end June 2014. Moreover, 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, was complied with as at end June 2014. Accordingly, investments in government securities by the long-term and general insurance sectors accounted for 44.7 per cent and 18.6 per cent, respectively, of their total assets.

Table 8.3 **Insurance Sector - Selected Indicators**

Item	End Jun 2012	End Jun 2013	End Dec 2013	End Jun 2014 (a)	Y-O-Y Change (%)	
					Jun 2013	Jun 2014 (a)
Total Assets (Rs. billion)	279.1	345.9	363.8	390.9	23.9	13.0
Total Income (Rs. billion) (b)	**54.9**	**62.6**	**123.5**	**64.8**	**14.1**	**3.4**
Gross Premium Income (Rs. billion) (b)	43.8	47.7	94.5	49.2	9.1	3.2
Investment Income (Rs. billion) (b)	11.1	14.9	29.0	15.6	34.2	4.3
Profit Before Tax (Rs. billion) (b)	7.0	5.9	13.5	4.9	(16.6)	(16.8)
Solvency Margin Ratio (Times)						
Long - term Insurance	5.8	7.2	8.9	8.7		
General Insurance	2.3	2.2	2.6	2.2		
Retention Ratio (%)						
Long - term Insurance	96.3	96.0	96.0	96.3		
General Insurance	78.3	78.5	83.5	78.5		
Claims Ratio (%)						
Long - term Insurance	33.1	41.9	46.2	42.4		
General Insurance	64.8	62.0	58.7	59.2		
Combined Operating Ratio (%)						
Long - term Insurance	78.9	89.5	93.7	89.7		
General Insurance	103.5	105.4	101.7	105.1		
Return on Assets (ROA) (%)						
Long - term Insurance	2.0	3.4	3.1	2.0		
General Insurance	10.3	4.1	5.1	3.5		
Return on Equity (ROE) (%) - General Insurance	19.4	7.2	9.1	6.0		
Underwriting Ratio (%) - General Insurance	16.1	15.7	20.8	18.1		

(a) Provisional
(b) During the period

Source: Insurance Board of Sri Lanka

Primary Dealers in Government Securities

- **Profitability of the Primary Dealer (PD) Industry increased during the first eight months of 2014.** The downward shift in the yield curve during the period under review enabled PDs to make higher profits. Total profits of the PDs for the first eight months of the year were higher than that recorded for the corresponding period of last year. The annualised ROE and ROA of PDs increased further during the first eight months of 2014. Increased profitability of the PDs during this period could be attributed mainly to the substantial increase in total realised and unrealised gains.

Table 8.4 **Primary Dealers - Selected Indicators**

Item	End Aug 2012	End Aug 2013	End Dec 2013	End Aug 2014 (a)	Y-O-Y Change (%)	
					Aug 2013	Aug 2014 (a)
Total Assets (Rs.billion)	129.0	215.4	212.8	194.4	67.0	(9.7)
Total Portfolio (Rs.billion)	126.7	211.9	211.0	189.5	67.3	(10.6)
Total Capital (Rs.billion) (b)	4.5	5.7	6.6	9.5	24.7	67.3
Profit before Tax (Rs.billion) (c)	0.8	4.5	8.6	6.3	463.8	40.9
Tier 1 Capital Adequacy Ratio (RWCAR) (%) (b)	21.0	22.3	18.4	13.9		
Total Capital Adequacy Ratio (%) (b)	21.0	22.3	18.4	13.9		
Return on Assets (%)	0.6	3.1	4.0	4.5		
Return on Equity (%) (b)	(0.7)	23.8	28.4	56.9		
Leverage Times (b)	9.1	8.6	7.4	7.1		
Operating Expenses to Total Income (%)	4.7	2.8	3.2	5.8		
Total Cost to Total Income (%) (c)	94.1	74.4	64.8	60.2		
Duration of Assets and Liabilities (years)	0.8	1.1	0.9	1.7		

(a) Provisional
(b) Standalone PDs only
(c) During the period

Source: Central Bank of Sri Lanka

- **All standalone PDs maintained their capital base above the minimum requirement of Rs. 300 million as at end August 2014.** Risk Weighted 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 decreased by 10.6 per cent at the end of August 2014 to Rs. 189.5 billion.** This decrease could be attributed to the decrease in the size of the investment portfolio, which decreased by 58.5 per cent compared to the corresponding period of 2013. PDs' borrowings under repo agreements meanwhile, decreased by 20.3 per cent from end August 2013 to Rs. 119.6 billion by end August 2014.

- **The PD sector expanded with the appointment of a new PD.** Union Bank of Colombo PLC was appointed as a Primary Dealer in government securities.

Unit Trusts

- **The unit trust (UT) sector showed accelerated growth in terms of the net asset value (NAV) against the backdrop of concessions and incentives provided as per the Budget 2014, the setting up of a number of new funds with more investments in government securities and corporate securities and the sustained performance of the equity market.** As at end June 2014, there were 51 funds in operation, managed by 14 unit trust management companies registered with the Securities and Exchange Commission of Sri Lanka (SEC). The net asset value (NAV) of the UT sector increased significantly by 128 per cent to Rs. 75.4 billion as at end June 2014 from Rs. 33.1 billion as at end June 2013. As at end June 2014, the share of equities in investment portfolios of unit trusts declined to 15.5 per cent from 27.7 per cent as at end June 2013, while the share of government securities in investment portfolios increased to 31.2 per cent from 27.9 per cent despite lower interest rates in the market. However, the share of other investments (such as commercial paper, debentures, trust certificates and bank deposits) in the investments portfolio has increased significantly to 54.1 per cent, reflecting portfolio management with diversification.

- **The country's first ever dollar bond fund was introduced in July 2014 by a unit trust management company under the approval of the SEC.** This is an open-ended fund that offers US dollar returns by investing in Sri Lanka sovereign bonds, banks and corporate dollar bonds. The fund is rated by an international rating agency and is listed on a recognised global stock exchange.

Table 8.5 Unit Trust Sector - Selected Indicators

Item	End Jun 2012	End Jun 2013	End Dec 2013	End Jun 2014 (a)	Y-O-Y Change (%) Jun 2013	Y-O-Y Change (%) Jun 2014 (a)
Total Assets (Rs.million)	20,308	33,298	54,323	75,906	64.0	128.0
Net Asset Value - NAV (Rs.million)	20,069	33,101	54,448	75,383	64.9	127.7
Investments (Rs.million)	**20,124**	**33,165**	**54,159**	**75,944**	**64.8**	**129.0**
Equity	7,732	9,174	9,486	11,695	18.6	27.5
Government Securities	5,639	9,229	17,363	23,443	63.7	154.0
Other (e.g.Commercial Paper, Debentures, Trust Certificates & Bank Deposits)	6,753	14,762	27,310	40,806	118.6	176.4
Investments in Equity as a % of NAV	39.0	28.0	17.0	16.0		
Investments in Government Securities as a % of NAV	28.1	27.9	31.8	31.1		
Other Investments as a % of NAV	33.6	44.6	50.2	54.1		
Total No. of Unit Holders	27,042	28,168	29,940	29,797		
No. of Units in Issue (million)	1,327	2,362	4,103	5,516		
No. of Unit Trusts	34	44	53	51		

(a) Provisional

Source: Unit Trust Association of Sri Lanka

Table 8.6 Stock Broker Companies - Selected Indicators

Item	End Jun 2012	End Jun 2013	End Dec 2013	End Jun 2014 (a)	Y-O-Y Change (%)	
					Jun 2013	Jun 2014 (a)
Total Assets (Rs. million)	10,885	12,370	10,266	11,040	13.6	(10.8)
Total Liabilities (Rs. million)	4,130	6,213	4,463	5,073	50.4	(18.4)
Net Capital (Rs. million)	3,918	5,050	4,742	4,550	28.9	(9.9)
Income (Rs. million) (b)	994	1,034	2,552	1,231	4.1	19.0
Net profit/(Loss) before tax (Rs. million) (b)	(443)	(273)	(711)	(590)	(38.4)	116.3

(a) Provisional
(b) During the period

Source: Securities and Exchange Commission of Sri Lanka

Stock Brokers

- **In line with increased activity levels in the equity market, the performance of stock broker companies recovered in the first half of 2014.** With the increase in income of stock brokers, the extent of losses before tax of these companies declined during the period under consideration. However, the total assets and net capital of the stock brokers deteriorated during the period under consideration.

- **Continuous supervision was carried out on the stock brokers.** In order to strengthen market oversight and to ensure operational viability of the companies, the SEC continues on-site and off-site supervision of stock brokers taking a risk based approach, focusing on different risk categories.

Superannuation Funds

- **The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka with an asset base of over Rs. 1.3 trillion.** The EPF accounted for 12.5 per cent of the total financial sector in terms of assets. During 2014, EPF continued its growth momentum with the total number of member accounts reaching 15.0 million which is an increase of 4.1 per cent over the previous year. Total contributions during January to August 2014 increased by 13.1 per cent to Rs. 57.9 billion, while the refunds increased by 18.3 per cent, when compared to the corresponding period in the previous year, to Rs. 38.8 billion. Therefore, as at end August 2014, the net contributions (contributions minus refunds) stood at Rs. 19.1 billion, which is an increase of 3.8 per cent over the first eight months of last year. Total assets of the EPF increased by 14.6 per cent to Rs. 1,418 billion. At the end of August 2014, the total investment portfolio of the EPF amounted to Rs. 1,387 billion, with government securities accounting for 92 per cent of the investment portfolio. Equity accounted for 6.7 per cent of the EPF's investment portfolio by August 2014 while corporate debt and reverse repos accounted for 1.3 per cent. Investment income of the fund increased by 25.8 per cent to Rs. 104.2 billion by August 2014. The capital gains and dividends realised from the equity portfolio also increased significantly by 129.5 per cent to Rs. 6,904 million in the first eight months of 2014 from Rs. 3,008 million in the corresponding period of 2013.

- **The Employees' Trust Fund (ETF) accounted for 1.7 per cent of the assets in the superannuation sector by June 2014.** Total contributions and benefits paid to members during the first half of 2014 increased to Rs. 7.7 billion and Rs. 5.7 billion, respectively, from Rs. 7.1 billion and Rs. 4.7 billion during the corresponding period of 2013. However, the net contributions of the ETF declined by 16.7 per cent during the period under

Table 8.7 **Superannuation Funds - Selected Indicators**

Item	Employees' Provident Fund (EPF)			Employees' Trust Fund (ETF)		
	End Aug 2013	End Aug 2014 (a)	Change (%) (a)	End Jun 2013	End Jun 2014 (a)	Change (%) (a)
Total Contributions (Rs. billion)	51.2	57.9	13.1	7.1	7.7	8.5
Total Refunds (Rs. billion)	32.8	38.8	18.3	4.7	5.7	21.3
Total Assets (Rs. billion)	1,238	1,418	14.6	168.3	188.6	12.1
Total Investment Portfolio (Rs. billion)	1,207	1,387	14.9	158.6	177.4	11.8
o/w, Government Securities (%)	93.7	92.0	(1.8)	89.1	90.1	1.1
Gross Income (Rs. billion) (b)	82.8	104.2	25.8	8.2	8.8	7.3

(a) Provisional
(b) During the period

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

consideration against an increase of 12.2 per cent in the corresponding period of 2013. This can be attributed to the significant increase in superannuation benefits paid to members, which recorded an increase of 21.3 per cent in the first six months of 2014. The total assets of the ETF increased by 12.1 per cent to Rs. 188.6 billion as at end June 2014. As in the case of the EPF, the investment portfolio of the ETF is concentrated in government securities which account for 90 per cent of the total portfolio. Investments in equity and corporate debt securities accounted for 4.4 per cent and 0.5 per cent, respectively.

- **The Public Service Provident Fund (PSPF) had 232,685 members by end June 2014.** Total assets of the PSPF amounted to Rs. 38.4 billion as at end June 2014. Total contributions and refunds of the PSPF during the first six months of 2014 amounted to Rs. 531.6 million and Rs. 114 million, respectively.

Developments in Financial Markets

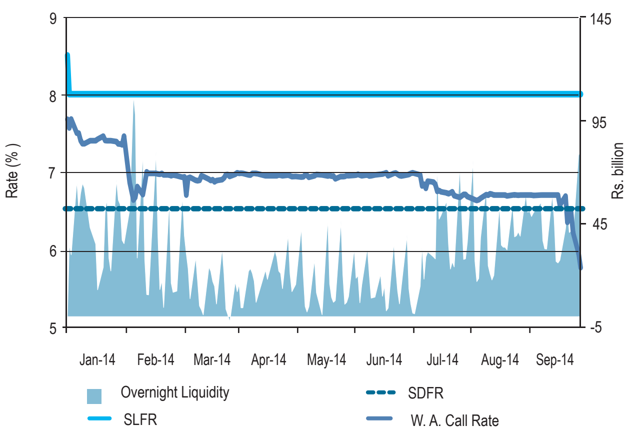
Inter-bank Call Money Market

- **A high level of excess liquidity was observed from end August 2013.** The main contributory factors for the increase in liquidity were foreign currency purchases by the Central Bank from the market, purchase of foreign loan receipts and proceeds of the international sovereign bond issued by the government and, FX-SWAP transactions entered into by the Central Bank.

- **The overall liquidity that prevailed around Rs. 71.67 billion by end 2013 increased further to Rs. 336.53 billion by end September 2014.** During the first nine months of 2014, the total outstanding liquidity varied in the range of Rs. 89.02 billion and Rs. 373.19 billion with an average of Rs. 236.86 billion. However, the overnight liquidity that was visible to the market remained around moderate Rs. 30 billion on average, due to continuous absorption of excess liquidity by the Central Bank on term basis through regular auctions of repurchase (repo) contracts.

- **The average weighted call money rate (AWCMR) which stood at 7.68 per cent in the beginning of the year, declined sharply by end January 2014 due to the conversion**

Chart 8.1 **Inter-bank Call Money Market (Interest Rate and Liquidity)**



of sovereign bond proceeds, and stabilised around 7.00 per cent until the first week of July 2014. Meanwhile, the AWCMR declined further on improved liquidity condition and hovered within a range of 6.35 – 6.96 per cent up to 24 September 2014. However, AWCMR declined sharply during the latter part of September 2014 with the introduction of limits on the availability of standing deposit facility since 23 September 2014. Accordingly, AWCMR hovered within a range of 5.77 - 7.68 per cent with an average of 6.90 per cent, during the first nine months of 2014.

- **During the first nine months of 2014 call market transactions were comparatively low as a result of high excess liquidity in the market.** The gross transaction volume of the call money market declined to Rs. 1,420.52 billion during this period compared to Rs. 1,642.87 billion in corresponding period of last year.

Domestic Foreign Exchange Market

- **The rupee appreciated marginally against the US dollar during the first nine months of 2014.** The Sri Lanka rupee appreciated marginally by 0.29 per cent to Rs. 130.37 as at end September 2014 with the increased inflows from the International Bond issues, foreign investments, worker remittances and tourism. During this period, the rupee depreciated slightly against the Indian rupee. However, the rupee appreciated against the sterling pound, the euro and the yen after European Central Bank introduced aggressive easing measures to the economy by cutting their deposit facility rate to negative territory.

- **The Central Bank intervened in the domestic foreign exchange market during the period under review by buying as well as selling US dollars with the intention of curbing the excess volatility.** Accordingly, the Central Bank purchased US dollars 1,371.7 million and sold US dollars 387.15 million resulting in a net purchase of US dollars 984.55 million.

- **Trading volumes in the domestic foreign exchange market increased by 19.01 per cent up to end September 2014 compared with the corresponding period of the previous year.** Accordingly, the total volume of inter-bank foreign exchange transactions during the period under consideration in 2014 stood at US dollars 12.27 billion against US dollars 10.31 billion in the corresponding period of 2013. Similarly, the total volume of forward transactions up to end September 2014 was US dollars 4.94 billion compared to US dollar 4.0 billion recorded in the corresponding period of 2013. The daily average turnover in the inter-bank foreign exchange market including the forward market too had increased and stood at US dollars 67.76 million against US dollars 56.94 million in the corresponding period of 2013.

Government Securities Market

- **A declining trend in the government securities yield rates continued during the first nine months of 2014 driven by stable macro economic environment and prudent implementation of government borrowing programme.** The favourable market liquidity conditions also contributed to increase the secondary market activities in a declining interest rate environment. The benchmark yield rate on 364 day Treasury bills recorded a decrease of around 240 basis points to 5.89 per cent by end September 2014 from end 2013. In line with the downward movement in short-term interest rates and increase in market activities, the Treasury bond yield rates also adjusted downward during this period. Accordingly, the Treasury bond yields in the secondary market decreased by around 232 basis points to 374 basis points across the yield curve (2–30 years) by end September 2014. The foreign investor preference for government securities declined towards the latter part of the third quarter of 2014 owing to reduction in interest rates, strengthening of US dollar in the foreign exchange market and reduction in exposure levels by institutional investors to emerging and frontier markets. The foreign investments in government securities stood at Rs. 485.3 billion by end September 2014.

- **Treasury bonds continued to remain the foremost medium to long-term investment instrument during the first nine months of 2014.** During the period, five primary auctions were conducted for Treasury bonds with maturities of 5 to 30 years. Accordingly, the medium to long-term benchmark yield curve remained active up to 30 years with both new issuances and re-opening strategies adopted by the Public Debt Department to issue Treasury bonds.

Corporate Debt Securities Market

- **The commercial paper market was sluggish in the first half of 2014 in view of the excess liquidity in the banking sector**. The value of commercial paper (CP) issued with the support of banks amounted to Rs. 5.4 billion in the first six months of 2014 in comparison to Rs. 17.1 billion in the same period in 2013. The interest rates on CPs reduced to a range of 8.0 per cent to 12.5 per cent in 2014 from a range of 8.5 per cent to 22.0 per cent in 2013. CPs with a maturity of up to 3 months accounted for 63.1 per cent of the market, while the shares of CPs with 6 months and 12 months maturities were 22.6 per cent and 13.3 per cent, respectively. The total outstanding value of CPs amounted to Rs. 4.8 billion as at end June 2014 compared to Rs. 11.5 billion by June 2013.

- **The corporate debt market has been showing signs of continuous improvement, becoming an alternative source of finance by complementing the available sources for raising funds for corporates.** The recent policy measures taken by the government such as the removal of income tax and withholding tax on interest earned on new listed debt have triggered a surge in the issuance of listed corporate debt. During the first seven months of 2014, there were fourteen listings of corporate debentures by five corporate institutions, amounting to Rs. 6.5 billion, compared with eighty three issues (by twenty four companies) totalling Rs. 69.1 billion in 2013.

- **The maturity periods of these debentures varied from 3 years to 7 years, while the interest rates pertaining to these debentures varied in a range of 10.75-15.50 per cent during the period under consideration.** A number of debenture issues by corporate entities are in the pipeline and these will be listed during the balance period of 2014. The trading turnover of debentures listed on the Debt Securities Trading System (DEX) of the Colombo Stock Exchange (CSE) was comparatively high at Rs. 4.6 billion in the first seven months of 2014 compared to Rs. 0.3 billion in the corresponding period in 2013.

Equity Market

- **The equity market recorded improved performance for the first nine months of 2014.** The price indices, namely, the ASPI and the

Chart 8.2 Movements of Share Price Indices

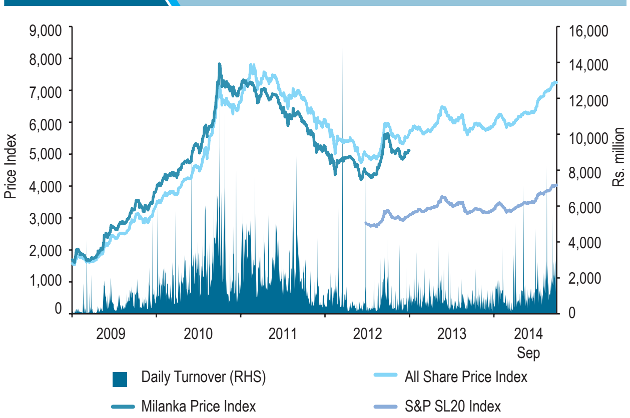


Table 8.8 Equity Market - Selected Indicators

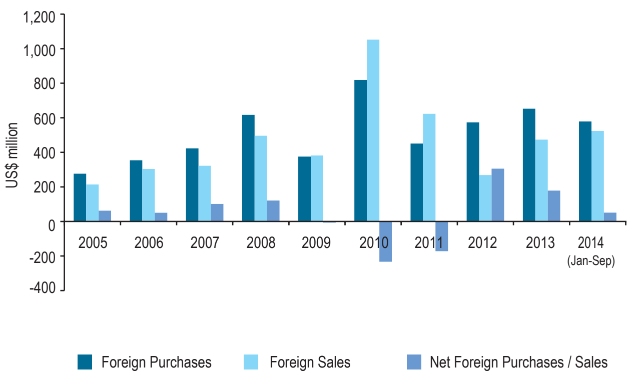
Item	End 2012	End Sep 2013	End 2013	End Sep 2014
All Share Price Index	5,643.0	5,803.3	5,912.8	7,252.1
Year to date change (%)	(7.0)	2.8	4.8	22.7
S&P SL 20 Index (From 26 June 2012)	3,085.3	3,214.4	3,263.9	4,038.3
June to date change (%)	8.0	4.2	5.8	23.7
Market Capitalisation (Rs.billion)	2,167.6	2,390.2	2,459.9	3,066.3
As a Percentage of GDP (%)	28.9	27.7*	28.4*	35.3*
Market Price Earning Ratio	15.9	16.5	15.9	19.7
Average Daily Turnover (Rs.million)	884.0	874.0	828.0	1,315.8
Net Cumulative Foreign Purchases (USD million)	305.3	156.0	178.7	53.5
Number of Companies Listed	287	288	289	293
Number of Right Issues	19	4	9	6
Amount raised through Right Issues (Rs.billion)	11.7	1.4	25.6	5.1
Initial Public Offers	6	1	1	4
Amount raised through IPOs (Rs.billion)	1.7	0.5	0.5	2.9

*Based on actual GDP for 2013 (Rs.8,631 billion)

Source: Colombo Stock Exchange

S&P SL20, daily turnover as well as net foreign investment inflows increased during this period. The downward trend in domestic interest rates, sustained foreign investor participation, and expectations of better corporate earnings, were supportive of stock market activity. As a result, the All Share Price Index (ASPI) increased by 22.7 per cent surpassing the 7,000 mark during the period under review. The S&P SL20 index increased by 23.7 per cent in the first nine months of 2014. The price indices of all the sub-sectors recorded gains during the period under consideration. The market price earnings ratio (PER) stood at 19.7 as at end September 2014, which is relatively higher than the PER of other Asian Stock exchanges.

Chart 8.3 Foreign Participation at the CSE



- **Liquidity levels in the market improved as reflected by the increased average daily turnover.** During the period under review, the total traded quantity amounted to 12,052 million, indicating an increase of 97 per cent, while the total number of trades stood at 1,438,326 recording a growth of 32 per cent when compared to the relevant values registered in the corresponding period of 2013. The turnover velocity ratio (anualised share turnover to average market capitalisation) also increased to 11.8 per cent during the first nine months of 2014 from 8.6 per cent in the whole year of 2013, indicating an improvement in liquidity at the CSE. During this period, domestic investors accounted for about 68 per cent of the turnover, compared with 56 per cent in 2013. Among the domestic investors, retail investors accounted for around 68 per cent of the turnover, while companies accounted for about 29 per cent.

- **In the background of tax exemptions being granted for new listings, four IPOs were made during the period from January- September 2014.** However, there were six rights issues of shares through which Rs. 5.1 billion was raised in the first nine months of 2014.

Development Finance and Access to Finance

- **With the aim of promoting regional development, the Central Bank continued its refinance schemes, interest subsidy schemes and credit supplementation schemes, which are operated through the Participating Financial Institutions (PFIs).** Through these schemes, the Central Bank channeled credit to agriculture, livestock, micro and small and medium enterprise (SMEs) sectors. These schemes are instrumental in increasing access to finance thereby helping achieve inclusive and balanced growth in the country.

- **The Central Bank continued to provide concessionary financing to the SME sector.** During the first nine months of 2014, the total loan disbursements to SMEs at concessionary interest rates amounted to Rs. 4,316 million. During this period, loans were granted to 21,388 beneficiaries engaged in manufacturing and service related activities. Such financing was released through four loan schemes, of which two loan schemes were implemented island-wide and the other two schemes targeted the Northern Province and Eastern Province.

- **Saubhagya loan scheme, the flagship scheme of Regional Development Department (RDD) of Central Bank for SMEs had disbursed Rs. 2,697 million among 10,880 beneficiaries during the first nine months of 2014.** Under the "Awakening North – Phase II", loan scheme, 5,274 loans amounting to Rs. 575 million has been disbursed, while 5,026 loans amounting to Rs. 1,000 million has been disbursed under the "Resumption of Economic Activities in the East – Phase III" loan scheme, during the period under review.

- **Several loan schemes were in operation to uplift the income level of low income earners during the period from January to September 2014.** The principal loan schemes designed to target this sector are Poverty Alleviation Micro-Finance Project – Revolving Fund (PAMP - RF) which continued to operate in 11 districts, Poverty Alleviation Micro-Finance Project II and Poverty Alleviation Micro-Finance Project II - Revolving Fund (PAMP II – RF), which continued to operate in 14 districts in the country. These schemes disbursed Rs. 2,039 million in total among 32,645 beneficiaries. Further, the other loan schemes implemented by the Central Bank, namely, Small Holder Plantation Entrepreneurship Development Programme (SPEnDP) and Dry Zone Livelihood Support and Partnership Programme – Revolving Fund (DZLiSPP – RF) Loan Scheme were also in operation successfully. The special loan scheme for Repair of Damaged Houses in the North and East was also disbursed Rs. 244 million to 2,423 borrowers during the period.

- **The Central Bank also continued to support the agriculture and animal husbandry sector by encouraging credit delivery through PFIs.** The Central Bank operates New Comprehensive Rural Credit Scheme (NCRCS), under which the PFIs are provided with interest subsidy for the loans granted to farmers for their working capital requirements for cultivation of 32 crops. NCRCS recorded a set back during the first nine months of 2014 due to the drought prevailed during the latter part of 2013 and the first half of 2014. NCRCS, disbursed Rs. 4,338 million among 54,527 farmers during the Maha season, a decline of 19.3 per cent, in terms of value of loans granted over the previous year Maha season. The amount of loans granted in 2014 Yala season was Rs. 2,411 million among 31,616 farmers also recorded a decrease of 13 per cent in terms of value of loans over the corresponding Yala season of 2013. Jaffna district continued to claim the highest share recording a share of 19 per cent of the NCRCS loan disbursements during the year, followed by Anuradhapura, Hambantota, Ampara and Polonnaruwa districts respectively. Of the NCRCS loans disbursed during two cultivation seasons of 2014, paddy represented 56 per cent of loans granted while onion and potato represented 21 per cent and 9 per cent, respectively. The balance was granted to cultivate maize, chilies, vegetables and other food crops.

- **Commercial Scale Dairy Development Loan Scheme (CSDDLS), a broad based loan scheme which provides medium to long term loan facilities to all activities in the dairy supply chain, was introduced by RDD in the second half of 2013**. Under this scheme, it is expected to support achieving the target of milk self-sufficiency in Sri Lanka by attracting entrepreneurs who can invest in hi-tech dairy farming. During the first nine months of 2014, Rs. 606 million was granted by PFIs among 234 dairy farmers and dairy entrepreneurs for activities covering dairy farm development, processing, transportation and storage facilities etc. However, the spread of foot-and-mouth disease among cattle in several districts since the beginning of 2014, resulted in a slowing down of the demand for credit for dairy related activities.

- **Promoting financial inclusiveness has also been given priority**. Formation of Self Help Groups, educating them about financial management and providing them loans to commence Income Generating Activities (IGAs) were continued with an aim of promoting financial inclusiveness. The RDD also continued to conduct programmes on financial literacy, entrepreneurship development, post-harvest technology, workshops for entrepreneurs and programmes for training of trainers (TOT) to educate beneficiaries and other stakeholders. Further, RDD disseminated information on the availability of concessionary credit facilities for the specific sectors, to the general public using the print and electronic media.

Developments in the Payment and Settlement Systems

- **The Central Bank continued the operations of the LankaSettle system, which is the systemically important electronic payment and settlement system for high value time critical inter-bank payments and government securities transactions**. The LankaSettle system recorded a system availability of 99.76 per cent during the first nine months of 2014. Further, in order to ensure readiness of the system to operate during contingency events, the Central Bank successfully conducted live operations from its disaster recovery site on 14 March 2014.

- **The Central Bank is facilitating the establishment of the Common Card and Payment Switch (CCAPS) with the objective of providing a nation-wide common platform for electronic retail payment systems in the country**. Accordingly, the Common ATM Switch (CAS), which is the first phase of CCAPS, started live operations in July 2013. At present, seven commercial banks are providing ATM services to their customers through CAS connecting about 2300 ATMs in the country. The Common Electronic Funds Transfer Switch (CEFTS), which is the second phase of CCAPS, is expected to be implemented before the end of 2014. CEFTS will provide common infrastructure to clear fund transfers made through multiple payment channels such as ATM, Internet Banking, Mobile Banking and Kiosks.

- **In terms of the provisions of the Payment Cards and Mobile Payment Systems Regulations No.1 of 2013, the Central Bank continued the regulation of the service providers of payment cards and mobile payment systems.** Accordingly, in 2014, the Central Bank issued licences to two licensed commercial banks and two finance companies to function as issuers of payment cards and a licence to a public company to function as a financial acquirer of payment cards. Approval was also granted to a licensed service provider to operate a stored value card system for fare collection in public transport. In addition, approval was granted to a licensed service provider operating a mobile phone based e-money system to extend e-money services to subscribers of other mobile phone operators. As a result, at present, 26 debit card issuers, 12 credit card issuers, 8 financial acquirers, 9 bank-led mobile payment system operators, and 2 custodian account based e-money system service providers, are offering financial services for the nation obtaining licences from the Central Bank.

Prospects for 2015

- **The financial system is expected to remain stable and resilient while the performance of financial institutions as well as markets is expected to improve, given the favourable outlook for macroeconomic performance**. The declining trend in interest rates, low inflation, stability of the rupee exchange rate, improved external sector performance and the projected higher economic growth would facilitate an expansion of financial sector activity. Capital levels of major financial institutions would increase in the ensuing period given the enhanced minimum capital requirements. Credit extended by financial institutions is expected to gradually pick up. The easing of monetary policy, the rebounding of pawning business of banks and finance companies with the introduction of the credit guarantee scheme and the stabilising of global prices of gold, the expected increase in investments with several large projects expected to be implemented, and the improvement in external sector performance with the gradual recovery of global economic activity would support a pick-up in credit. While investor risk appetite is expected to improve alongside these developments, domestic financial markets are expected to remain liquid whilst posting increased activity levels. The payment and settlement system will continue to operate with a high degree of reliability and safety.

- **The resilience of the banking sector will further improve in the short to medium-term with capital and liquidity being maintained well above requisite levels and prudent risk management and governance practices.** Capital levels of banks will remain at healthy levels with enhanced minimum capital requirements, whereby existing domestic licensed commercial banks will be required to maintain Rs. 10 billion while licensed specialised banks and foreign banks will be required to maintain Rs. 5 billion as core capital. Further, banks with comparatively low capital levels will raise new capital in line with broader strategic plans of such banks. The capital planning process and risk management practices of banks will improve further with the recent adoption of Internal Capital Adequacy Assessment Process under Pillar 2 of Basel II and advanced approaches for operational risk management under Basel II. In the medium-term, appropriate policy measures will be taken to adopt the capital and liquidity requirements stated in Basel III – International Regulatory Framework. In line with the above policy changes, banks are also expected to upgrade and strengthen their management information systems and related technological platforms in order to cater to the resulting information requirements.

- **Credit growth will gradually improve in the medium term due to the easing of the policy stance and the conducive macroeconomic environment**. Bank lending to sectors related to the 5 + 1 Hub activities will increase in line with the priority given to these sectors in the broader economic development plans of the Government. The low interest rate regime that will prevail in the medium-term will create a conducive environment for promoting entrepreneurship in areas such as Small and Medium enterprises and

Information Technology based ventures. Banks will engage in improving financial inclusion by focusing on areas such as improving financial literacy, developing mobile banking platforms, and community-based banking.

- **Banks will be encouraged to review their existing business models due to changes taking place in the financing and asset structures.** Dependency on deposits as a source of funding will gradually reduce due to enhanced access to international markets. Increasing foreign exchange exposure and the level of financial integration in the banking sector will be closely monitored to address potential risks that may adversely impact financial system stability. Banks will continue to maintain healthy liquidity positions, with an enhanced focus on maintaining a sound balance between liquidity and profitability. A consistent growth in sustainable earnings of banks is expected with the transformation of business strategies, especially in relation to core banking operations and the improvement of efficiency in line with innovations driven by information and communication technology.

- **Emphasis on group-wide risk management will increase as a result of the structural changes occurring in the banking sector, owing to the financial sector consolidation process.** Accordingly, supervisory intensity on banking groups will enhance commensurately, with the introduction of a consolidated supervision framework in the near future. The Central Bank will continue to conduct regular assessments of the banking sector to identify potential risks and vulnerabilities arising due to structural changes and will continuously take proactive measures to minimise the resulting impact on financial system stability. The supervisory framework will be further strengthened in line with Basel Core Principles on Effective Bank Supervision and other international and regional best practices, while closely interacting with other local and regional regulators.

- **Considering the proposed financial sector consolidation programme, the LFC and SLC sector is projected to expand to be a major player in the financial landscape.** In the new financial landscape banks may not be able to capture all market segments. There may be many new opportunities that could arise for this sector to capture new innovations and specialised skills. Further, the consolidation plan would fashion the existing LFC and SLC sector to a sector that comprises of around 20 institutions, each having a minimum asset base of over Rs.20 billion of which around 10 institutions are expected to be with asset bases of well over Rs. 30 billion by 2016. Increased capital will ensure that sufficient buffers are built during good times to meet unexpected losses and to strengthen resilience of the sector.

- **The segregation of long-term and general insurance from 2015 will promote greater transparency and policyholder protection in the insurance sector.** However, the sector will have some operational challenges of implementation due to factors such as increased cost in relation to duplication of some functions after the segregation and the long-drawn-out nature of legal procedures required in effecting the split. The capital position of the insurance companies is also expected to strengthen with the increase in the minimum capital requirement for new licensees. Further, the mandatory public listing by 2016 will promote greater transparency and encourage better governance in insurance companies.

- **A satisfactory growth in the equity market is anticipated during the balance period of 2014 and 2015 due to the downwards adjustment of interest rates, expected better corporate performance, increased foreign participation and the anticipated improvement in macroeconomic performance.** Foreign investor attraction will be strengthened due to periodical investor forum conducted by the CSE to promote and attract institutional investment funds, high net worth investors and top business corporates of other countries to the Sri Lankan capital market.

- **With the implementation of CCAPS and the strengthening of the regulatory framework, payment and settlement systems in the country will facilitate efficient and secure settlement of financial transactions.** CEFTS, which facilitate the timely settlement of inter-bank transactions, will encourage financial institutions to develop new products for making retail payments electronically. These new retail payments products will offer customer convenience at a relatively low cost. On the other hand, regulations, directions and guidelines on payment and settlement systems will ensure smooth operation of the payment and settlement system in the country.