8

FINANCIAL SECTOR PERFORMANCE AND SYSTEM STABILITY

The financial sector continued to expand and remained stable during the first half of 2017. The expansion of the asset base of the banking sector, which comprised credit and investment portfolios, was largely funded through deposits. Liquidity and capital ratios of the banking sector were maintained at levels that were well above the statutory requirements. The bank branch network expanded, contributing to improved financial inclusion in the country. The expansion of the licensed finance companies (LFCs) and specialised leasing companies (SLCs) sectors which slowed down with macroprudential policy measures implemented to curtail unhealthy developments in the market, showed signs of gradual rebounding with secured lending activities. Although the asset quality of LFC and SLC sectors deteriorated, it was at manageable levels in comparison to the expansion of the loan portfolio. Performance of primary dealers showed signs of some moderation. The insurance sector and superannuation funds recorded positive performance while the unit trust sector recorded a contraction. Amidst strengthened capital regulations, the stock broker sector recorded a mixed performance during the period under consideration. In the domestic money market, rupee liquidity remained mostly at deficit levels during the year, before turning to an excess from mid-July 2017. Accordingly, the interbank call money market rate, which remained close to the upper bound of the standing rate corridor, receded gradually since early August 2017. The yield rates of government securities across all maturities in the secondary market, which increased somewhat during the first four months of the year, declined substantially thereafter, particularly in view of improved domestic market conditions underpinned by foreign currency inflows to the government. The domestic foreign exchange market remained under pressure during the first seven months of the year on account of the tightening of global financial conditions and outflows resulting from import bills. However, with the receipt of the third tranche of the Extended Fund Facility (EFF) from the International Monetary Fund (IMF) along with notable conversions by exporters eased the pressure on the exchange rate. Reflecting these developments, the Sri Lankan rupee depreciated at a moderate level against the US dollar by 2.15 per cent during the first nine months of the year. Activities in the corporate debt securities market moderated, while the equity market performance remained subdued, reflecting volatile market behaviour and lower level of investor confidence. Nevertheless, share price indices and market capitalisation have recorded improvements, where foreigners remained net buyers in the equity market thus far during the year. Meanwhile, the national payment systems of the country operated smoothly without major disruptions or systemic risk concerns. Several initiatives were undertaken during the period to improve payment and settlement infrastructure to facilitate growing and changing payment needs of the financial sector.

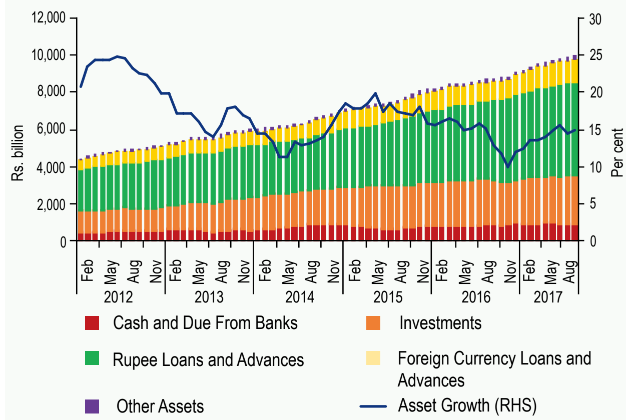
Developments in Financial Institutions

Banking Sector

- **The asset base of the banking sector expanded further during the first eight months of 2017 reflecting a growth in credit and investment portfolios of banks**. The increase in the asset base was funded mainly through deposits. Profitability of the banking sector improved due to higher net interest income, significant revaluation gains and lower operating expenses. Liquidity was maintained at comfortable levels and the banks maintained sufficient levels of capital to absorb adverse shocks. The banking sector continued to establish its presence by expanding its branch and Automated Teller Machine (ATM) networks.

- **Total assets of the banking sector stood at Rs. 9.9 trillion by end August 2017 recording an increase of 9.4 per cent during the first 8 months of 2017 compared to a growth of 6.8 per cent during the reference period of 2016.** The asset base increased by Rs. 854.9 billion resulting from an increase in net loans and advances by Rs. 599.4 billion and investments by Rs. 296.2 billion. This expansion was largely financed through the increase in deposits. The investments in government securities and Sri Lanka Development Bonds (SLDBs) contributed to around 97 per cent of the investment portfolio.

Chart 8.1
Assets of the Banking Sector



Source: Central Bank of Sri Lanka

- **Total loans and advances increased by 10.8 per cent during the first eight months of 2017 and stood at Rs. 6.1 trillion by end August 2017.** Despite higher market interest rates, lending to all economic sectors increased during the first half of 2017 with large disbursements towards transport, trading, tourism and manufacturing sectors. Credit was mainly concentrated in the construction (17.7 per cent), trading (14.3 per cent), manufacturing (10.8 per cent) and other (16.5 per cent) sectors as at end June 2017. During the first eight months of 2017, overdrafts (18.4 per cent), term loans (10.3 per cent) and pawning (8.7 per cent) reported significant increases. However, the leasing portfolio recorded only a marginal increase of 3.1 per cent due to the introduction of the loan to value ratio, as a macroprudential measure, in January 2017.

Table 8.1
Banking Sector - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (a)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets (Rs.billion)	7,491	8,624	9,047	9,901	15.1	14.8
Loans & Advances (Rs.billion)	4,338	5,092	5,541	6,140	17.4	20.6
Investments (Rs.billion)	2,345	2,428	2,291	2,588	3.6	6.6
Deposits (Rs.billion)	5,067	5,855	6,296	7,063	15.6	20.6
Borrowings (Rs.billion)	1,520	1,758	1,696	1,604	15.7	-8.8
Capital Funds (Rs.billion)	613	683	707	823	11.4	20.5
Tier 1 Capital Adequacy Ratio (%) (b)	13.5	12.2	12.5	12.2		
Total Capital Adequacy Ratio (%) (b)	16.0	14.7	15.6	15.0		
Gross Non-performing Loans Ratio (%)	4.2	3.0	2.6	2.8		
Net Non-performing Loans Ratio (%)	2.2	1.1	0.7	0.9		
Return on Assets (Before Tax) (%)	1.8	1.9	1.9	2.0		
Return on Equity (After Tax) (%)	15.5	16.9	17.3	17.6		
Statutory Liquid Assets Ratio (DBU) (%)	35.4	31.4	30.0	31.2		
Liquid Assets to Total Assets (%)	30.6	29.2	27.3	29.0		

(a) Provisional
(b) As at end June

Source: Central Bank of Sri Lanka

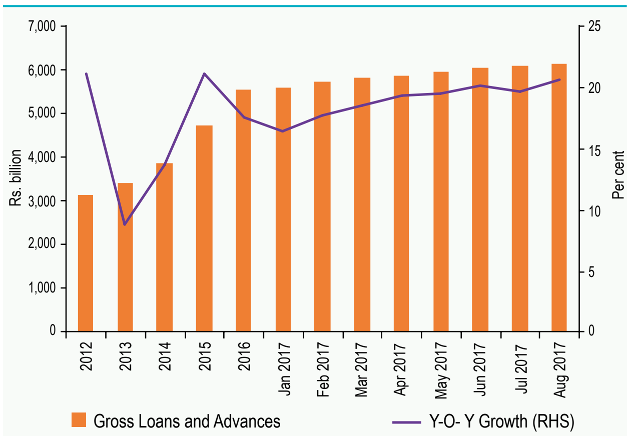
Foreign currency loans and advances increased by 13.4 per cent during the first eight months of 2017 while its share in total loans and advances increased to 19 per cent by end August 2017 from 18 per cent at end December 2016.

- **There was a shift in the composition of investment portfolio during the first eight months of 2017**. As at end August 2017, the held to maturity investment portfolio was 73.8 per cent of the total investment portfolio compared to 79.5 per cent as at end 2016. Share of trading portfolio increased to 25.9 per cent from 20.5 per cent as at end 2016. Year-to-date growth in the trading investment portfolio was 43.3 per cent.

- **Deposits, which were the main source of funding, represented 71.3 per cent of the total assets of the banking sector, surpassing Rs. 7 trillion by end August 2017.** The deposit base of the banking sector grew by Rs. 767.9 billion (12.2 per cent), of which 84 per cent consisted of rupee deposits. The increase in deposits was mainly from term deposits, which recorded an increase of 19.1 per cent. However, demand deposits decreased by 8.9 per cent, while savings deposits increased by 3.9 per cent during this period. The current and savings deposits to total deposits (CASA) ratio declined to 33.5 per cent at end August 2017 from 37.1 per cent at end 2016.

Chart 8.2

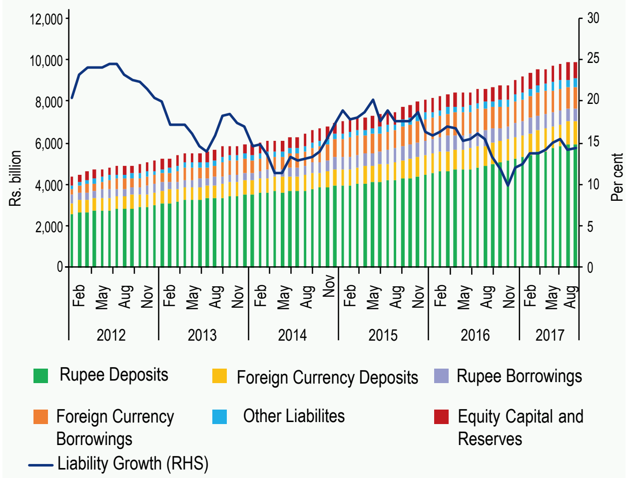
Loans and Advances of the Banking Sector



Source: Central Bank of Sri Lanka

Chart 8.3

Sources of Funding of the Banking Sector

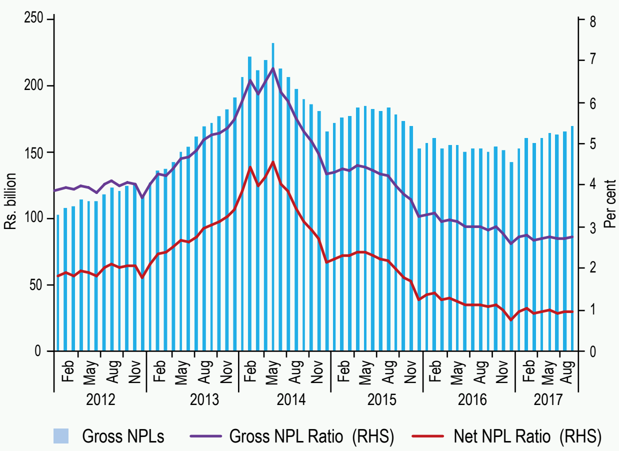


Source: Central Bank of Sri Lanka

- **Borrowings of the banking sector decreased by Rs. 92.2 billion (5.4 per cent) during the first eight months of 2017 due to a decline in rupee borrowings by Rs. 100.3 billion (15.1 per cent).** In contrast, foreign currency borrowings increased by Rs. 8.1 billion (US dollars 52.9 million), increasing its share to 65 per cent by end August 2017 from 61 per cent at end 2016. Foreign currency borrowings from domestic sources increased by Rs. 14.5 billion or US dollars 95.2 million (18.4 per cent) while borrowings from foreign sources decreased by Rs. 6.5 billion or US dollars 42.2 million (0.7 per cent).

- **Asset quality of the banking sector deteriorated marginally during the year by end August 2017**. Total Non-Performing Loans (NPLs) increased by Rs. 26.8 billion to Rs. 169 billion. However, the NPL ratio increased marginally from 2.6 per cent at end 2016 to 2.8 per cent in August 2017 due to recovery measures adopted by banks and higher growth in the credit portfolio. Higher NPL ratios were reported in tourism (4.7 per cent), agriculture and fishing (4.1 per cent), manufacturing (3.8 per cent), traders (3.6 per cent), information and communication technology (3.2 percent) and construction (3.0 per cent) sectors as at end June 2017. Although specific provisions were 72.5 per cent of total provisions as at end August 2017, specific provision coverage ratio decreased to 48.0 per cent by end August 2017 from 52.1 per cent as at end December 2016.

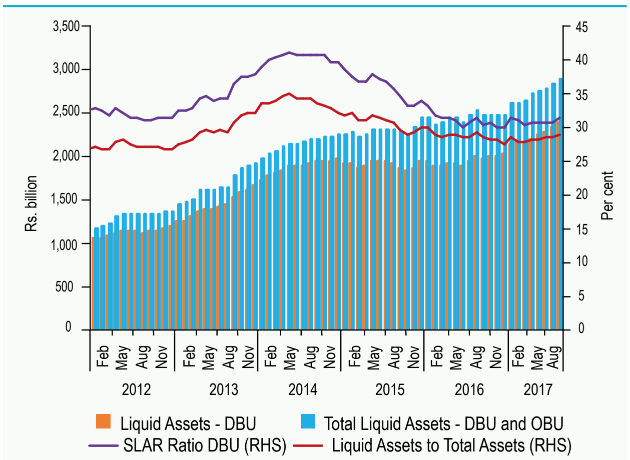
Chart 8.4
Non-performing Loans of the Banking Sector



Source: Central Bank of Sri Lanka

- **The banking sector maintained liquidity at a comfortable level during the first eight months of 2017**. The Statutory Liquid Assets Ratios (SLAR) of Domestic Banking Units (DBUs) and Offshore Banking Units (OBUs) were well above the minimum statutory requirement of 20.0 per cent, recording 31.2 per cent and 35.4 per cent, respectively. The ratio of liquid assets to total assets stood at 29.0 per cent. Loans to deposits ratio decreased from 88.0 per cent as at end 2016 to 86.9 per cent at end August 2017 due to relatively higher increase in deposit mobilisation. Rupee and all currency liquidity coverage ratios, which were introduced under Basel III liquidity standards, stood at 205.3 per cent and 176.2 per cent, respectively, remaining well above the regulatory minimum of 80 per cent.

Chart 8.5
Liquidity Position of the Banking Sector



Source: Central Bank of Sri Lanka

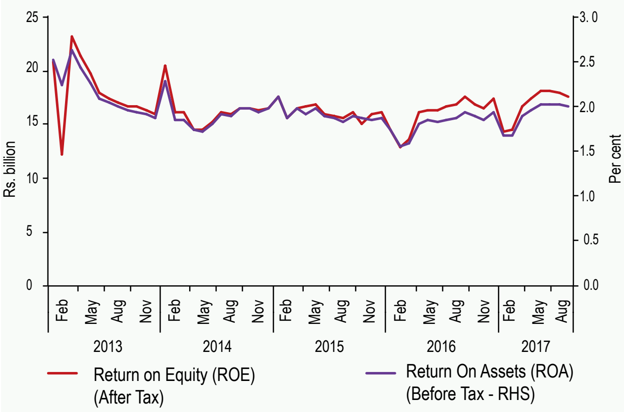
- **The foreign currency exposure of DBUs in the banking sector increased during the first six months of 2017 due to increase in the rupee value of foreign currency borrowings**. Net foreign currency exposure of DBUs as a percentage of banks' regulatory capital and on-balance sheet foreign currency assets stood at 1.9 per cent and 1.5 per cent, respectively. The banking sector reported a long foreign currency position of Rs. 15.6 billion at end June 2017 compared to a long position of Rs. 16.4 billion at end 2016.

- **Capital gains on treasury bonds for the first eight months of 2017 increased to Rs. 3.4 billion compared to Rs. 2.3 billion reported during the corresponding period of 2016 due to the downward trend that prevailed in yield rates of government securities.** Equity risk of the banking sector was minimal as exposure to the equity market of Rs. 42.1 billion was only 0.4 per cent and 3.1 per cent, respectively, of total assets and investments held for trading of the banking sector.

- **The banking sector reported a profit (after tax) of Rs. 86.6 billion during the first eight months of 2017, which is an increase of 18.2 per cent when compared with the corresponding period of 2016.** The increased profitability was due to higher net interest income, which increased by Rs. 24.9 billion. Non-interest income also increased by Rs. 18.3 billion during this period as a result of significant capital gains and an increase in other sources of income. Operating expenses increased by Rs. 5.1 billion while losses on trading and investment securities declined during this period. Staff costs increased by Rs. 3.3 billion reporting an increase of 5.7 per cent over the corresponding period of last year.

- **Profitability ratios as measured by the Return on Assets (ROA) before tax and Return on Equity (ROE) improved to 2.0 per cent and 17.6 per cent, respectively, during the first eight months of 2017 compared to 1.9 per cent and 16.9 per cent, respectively, in the corresponding period of 2016.** The efficiency

Chart 8.6
ROA and ROE of the Banking Sector



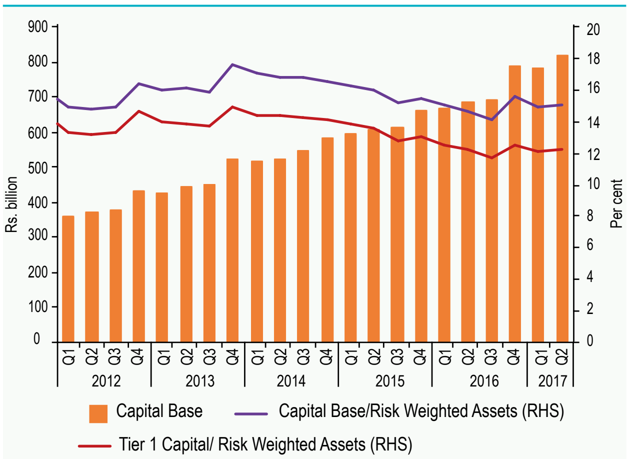
Source: Central Bank of Sri Lanka

ratio, which stood at 46.2 per cent has improved by 300 basis points when compared with end 2016. Net interest margin has remained unchanged year-on-year and stood at 3.5 per cent by end August 2017.

- **The banking sector maintained sufficient capital levels in order to absorb any adverse shocks**. The Core Capital Adequacy Ratio (CAR) and total CAR as at end June 2017 were 12.2 per cent and 15 per cent, respectively, and were maintained at healthy levels, well above the regulatory minimum of 5 per cent and 10 per cent, respectively.

- **The branch network expanded further during the first half of 2017 improving financial accessibility**. Accordingly, there were 3,543 bank branches, 3,045 student savings units and 4,148 ATMs installed by end June 2017. During this period, 19 new branches were opened and one branch was closed. Meanwhile, 335 ATMs were opened during this period.

Chart 8.7
Capital Adequacy of the Banking Sector



Source: Central Bank of Sri Lanka

- **With a view to enhancing the presence of foreign banks in Sri Lanka, a Letter of Provisional Approval was issued to the Bank of China in July 2017 to establish a branch in Sri Lanka.**

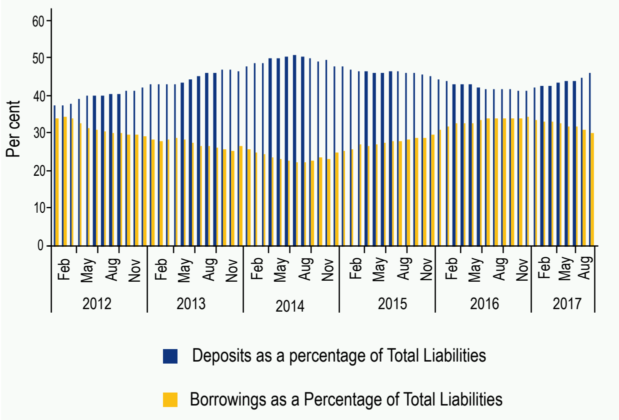
Non-Bank Financial Institutions (NBFIs) Sector

- **The performance of Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) showed signs of slowing down during the first eight months of 2017**. The fiscal and macroprudential policy measures taken to curtail the imports and lending for motor vehicle purchases and the increasing trend of lending rates that prevailed in the second quarter negatively affected the demand for core lending products of the sector. However, it is observed that LFCs and SLCs are gradually moving from core business of vehicle financing to other secured lending activities. LFC and SLC sectors represent 7.8 per cent of assets of the financial system of Sri Lanka and consist of 45 LFCs and 6 SLCs with a network of 1,344 branches.

- **Expansion of NBFI Sector has slowed down noticeably**. Total assets of the sector expanded by 7.8 per cent (Rs. 94.9 billion) to Rs. 1,306.8 billion in the first eight months of 2017 compared to a growth of 14.4 per cent (Rs. 143.5 billion) in the corresponding period of 2016. The slow growth in credit hindered the expansion of the asset base of the LFCs and SLCs sector.

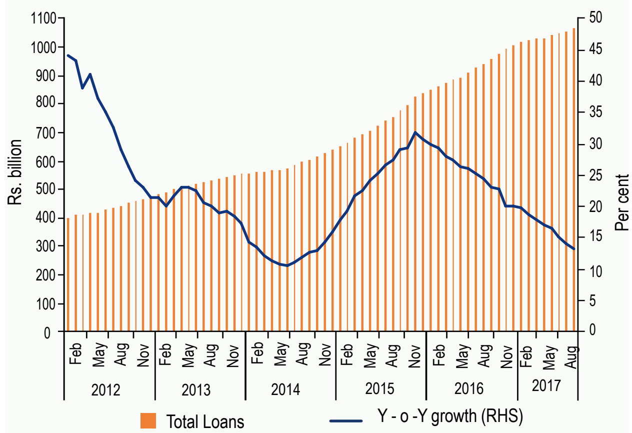
- **The sector expansion was largely funded through deposits**. During the past two years, the sector growth was propelled by the funds raised through borrowings. Nevertheless, sector borrowings declined by 5.8 per cent

Chart 8.8
Total Deposits and Borrowings of NBFIs



Source: Central Bank of Sri Lanka

Chart 8.9
Total Loans and Advances of NBFIs



Source: Central Bank of Sri Lanka

(Rs. 25.5 billion) to Rs. 413.2 billion in the first eight months of 2017 compared to the growth of 29.9 per cent in the corresponding period of 2016. In contrast, the deposits grew by 19.8 per cent (Rs. 104.9 billion) to Rs. 635.6 billion in the first eight months of 2017 compared to the growth of 5.3 per cent (Rs. 25.6 billion) in the corresponding period of 2016.

- **Credit growth responded to the macroprudential policy measures introduced by the CBSL**. Lending activities of the sector showed signs of slowing down in response to macroprudential policies implemented on vehicle loans as well as the increasing trend observed in lending rates, which affected the demand side. Credit extended by LFCs and SLCs grew by 6 per cent (Rs. 57.5 billion) to Rs. 1,020.2 billion in the first eight months of 2017 compared to the growth of 13.0 per cent in the corresponding period of 2016.

- **Asset quality showed signs of stress, but remained manageable**. Non-Performing Accommodations (NPAs) increased by 11.5 per cent to Rs. 59.0 billion during 2017. However, the NPA ratio remained at 5.5 per cent by end August 2017, which is a marginal increase from 5.3 per cent recorded at end 2016. When the loan loss provision is considered, the net NPA ratio increased marginally to 1.3 per cent by end August 2017 from 1.2 per cent at end 2016.

- **The overall liquidity position of NBFIs recorded a surplus**. The sector reported total liquid assets of Rs.115.6 billion with a surplus

Table 8.2
NBFIs (a) - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (b)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets - Net (Rs.billion)	924.8	1,139.7	1,211.9	1,306.8	23.2	14.7
Loans & Advances - Net (Rs.billion)	715.2	899.5	962.7	1,020.2	25.8	13.4
Deposits (Rs.billion)	454.5	506.2	530.7	635.6	11.4	25.6
Borrowings (Rs.billion)	272.8	408.3	438.7	413.2	49.7	1.2
Capital Funds (Rs.billion)	127.0	142.4	144.1	167.4	12.2	17.6
Tier 1 Capital Adequacy Ratio (%)	13.0	12.0	11.3	12.5		
Total Capital Adequacy Ratio (%)	13.6	12.6	11.7	13.3		
Gross Non-performing Accommodations Ratio (%)	6.3	5.5	5.3	5.5		
Net Non-performing Accommodations Ratio (%)	1.8	1.3	1.2	1.3		
Return on Assets (Before Tax) (%) - Annualised	4.2	3.7	3.6	3.0		
Return on Equity (After Tax) (%) - Annualised	20.8	20.0	19.8	14.9		
Liquid Assets to Total Assets (%)	8.2	7.0	7.1	8.5		

(a) NBFIs sector represents licensed finance companies and specialised leasing companies
(b) Provisional

Source: Central Bank of Sri Lanka

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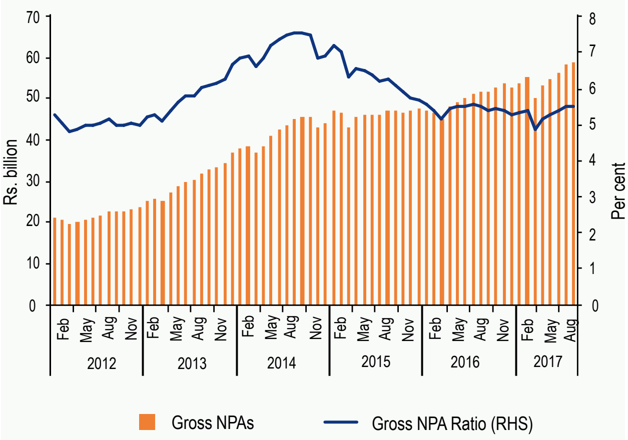
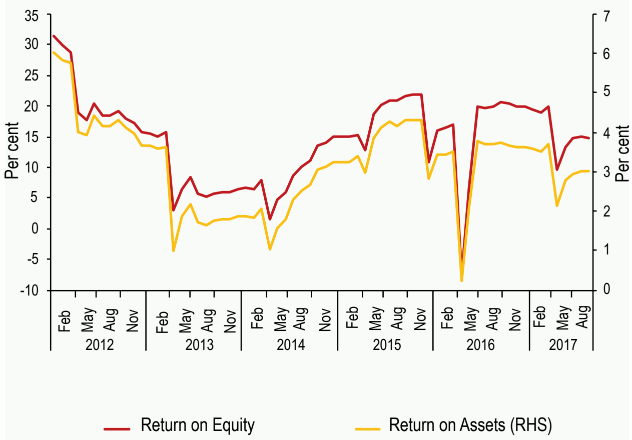
Chart 8.10
Non-performing Accommodations of NBFIs



Source: Central Bank of Sri Lanka

Chart 8.12
ROA and ROE of NBFIs



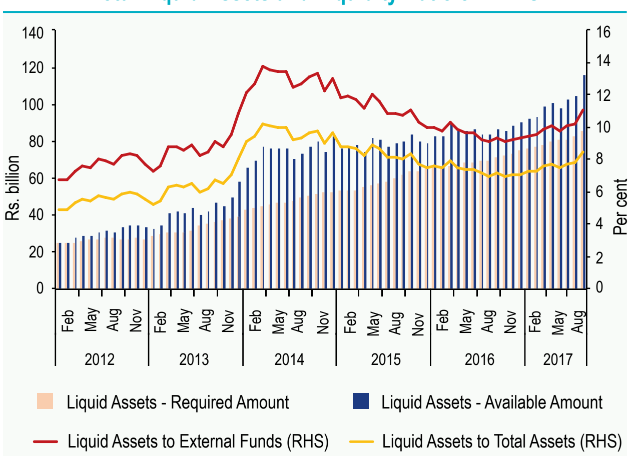
Source: Central Bank of Sri Lanka

liquidity of Rs. 30.5 billion against the stipulated minimum requirement of Rs. 85.2 billion. This surplus was mainly due to companies preferring to maintain liquid assets while funding the regular business operations with borrowings. The liquidity ratio (liquid assets to deposits and borrowings) improved to 11.0 per cent by end August 2017 compared to 9.3 per cent recorded at end 2016 due to reduced borrowings.

- **Sustained profitability**. Profit of the LFC and SLC sector was Rs.17.6 billion during the first eight months of 2017 compared to Rs. 22.1 billion in the corresponding period of 2016. Relatively high margins enabled the sector to sustain profits as net interest income grew by 11.4 per cent to Rs. 67.2 billion. The annualised ROA and ROE ratios were at 3.0 per cent and 14.9 per cent, respectively, by end August 2017 compared to 3.7 per cent and 20.0 per cent, respectively, in the corresponding period of the previous year.

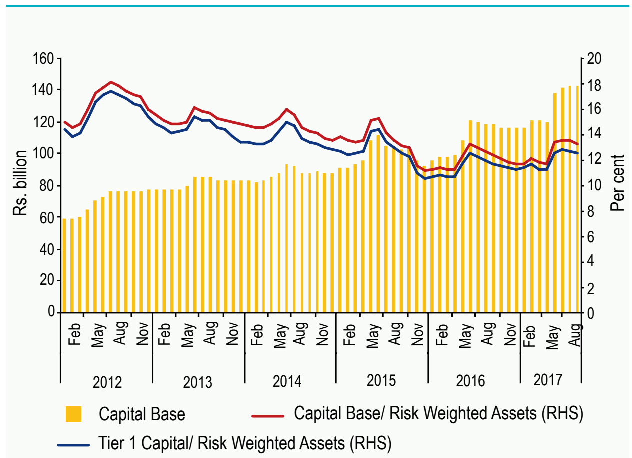
- **Improved capital position.** Capital elements increased by 10.8 per cent in the first eight months of 2017 to Rs.161.9 billion mainly due to retained profits**.** The regulatory Capital Adequacy Ratio (CAR) of the LFC/SLC sector has been maintained above the minimum requirement with CAR increasing to 13.3 per cent in August 2017 from 11.7 per cent at end 2016.

Chart 8.11
Total Liquid Assets and Liquidity Ratio of NBFIs



Source: Central Bank of Sri Lanka

Chart 8.13
Capital Position of NBFIs



Source: Central Bank of Sri Lanka

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Microfinance Institutions

- **During 2017, the Department of Supervision of Microfinance Institutions (DSMI) of the Central Bank continued exercising its duties as stipulated by the Microfinance Act No.6 of 2016.** DSMI issued two directions approved by the Monetary Board, namely, Opening, Closure and Relocation of Business Places and the Structural Changes, regulating Licensed Microfinance Companies (LMFCs). Further, DSMI issued Principles, Standards and Guidelines, approved by the Monetary Board under Section 28(1) of the Microfinance Act, to the Registrar of Voluntary Social Service Organisations, for rules to be made to give effect to the same. DSMI received several applications for licence under the Microfinance Act and is in the process of evaluating those applications.

Insurance Sector

- **The insurance sector continued to grow in terms of total assets and premium income.** Total assets of the sector improved by 11.4 per cent, on a year-on-year basis, by end June 2017, compared to a growth of 9.9 per cent reported at end June 2016. Gross Written Premiums (GWP) grew by 13.9 per cent in the first half of 2017 compared to a growth of 17.2 per cent in the corresponding period of 2016. The general insurance premium grew by 16.2 per cent, largely underpinned the growth in GWP during the first half of 2017. Meanwhile, growth in premium income of long-term insurance decelerated to 11.1 per cent by end June 2017 compared to the growth of 21.3 per cent at end June 2016. Motor insurance, the largest contributor to the general insurance business, representing a share of 63.3 per cent, recorded a growth in premium income of 15.8 per cent in the first half of 2017, compared to the increase of 14.5 per cent in the corresponding period of 2016. Further, premium income from fire insurance (share of 9.4 per cent) and marine insurance (share of 2.6 per cent) also recorded growth rates of 11.0 per cent and 7.3 per cent, respectively, compared to the negative growth of 18.3 per cent and 0.1 per cent, respectively, in the first half of 2016.

Table 8.3
Insurance Sector - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%) Jun 2016	Y-O-Y Change (%) Jun 2017 (a)
Total Assets (Rs.billion)	**435.4**	**478.4**	**503.1**	**533.1**	**9.9**	**11.4**
Total Income (Rs.billion) (b)	**71.2**	**82.2**	**181.0**	**96.6**	**15.5**	**17.6**
Gross Premium Income (Rs.billion) (b)	57.1	66.9	140.3	76.2	17.2	13.9
Investment Income (Rs.billion) (b)	14.1	15.3	40.7	20.5	8.7	33.9
Profit Before Tax (Rs.billion) (b)	**3.9**	**5.2**	**21.6**	**4.7**	**32.7**	**-10.0**
Solvency Margin Ratio (Times)						
Long-term Insurance	9.3	n.a.	n.a.	n.a.		
General Insurance	2.2	n.a.	n.a.	n.a.		
Capital Adequacy Ratio (CAR) (%) (c)						
Long-term Insurance	n.a.	296	317	358		
General Insurance	n.a.	166	192	117		
Retention Ratio (%)						
Long-term Insurance	96.1	96.2	96.6	95.9		
General Insurance	161.2	159.1	80.1	78.5		
Claims Ratio (%)						
Long-term Insurance	40.3	37.1	37.5	36.9		
General Insurance	63.0	55.7	65.9	63.9		
Combined Operating Ratio (%)						
Long-term Insurance	87.0	85.1	84.2	86.2		
General Insurance	107.6	97.2	105.2	102.9		
Return on Assets (ROA) (%)						
Long-term Insurance	2.0	2.2	2.9	1.8		
General Insurance	1.8	2.4	7.3	8.9		
Return on Equity (ROE) (%) - General Insurance	**2.9**	**4.5**	**14.5**	**18.8**		
Underwriting Ratio (%) - General Insurance	**14.6**	**15.7**	**17.8**	**17.1**		

(a) Provisional
(b) During the period
(c) Introduced in lieu of the solvency margin ratio since 2016

Source: Insurance Board of Sri Lanka

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- **Insurance sector recorded a decline in overall profits**. The aggregate profit before tax dropped by 11.4 per cent in the first half of 2017 compared to a growth of 34.9 per cent in the corresponding period of 2016, largely due to weak performance in long-term insurance business, whose profits declined by 78.5 per cent in first half of 2017 compared to a growth of 34.1 per cent during the reference period of 2016. The claims of general insurance and long-term insurance sectors increased by 11.9 per cent and 8.3 per cent, respectively, during the period under consideration. Investment income of insurance companies increased by 33.9 per cent in the first half of 2017 compared to the 8.7 per cent growth in 2016. The investments in government securities by the long-term and general insurance sectors accounted for 51.3 per cent and 30.3 per cent, respectively, of their total investment portfolio.

Primary Dealers

- **The Primary Dealer (PD) sector expanded during the first eight months of 2017**. Total assets increased by 34.2 per cent to Rs. 418.3 billion and the total portfolio of government securities increased by 53.8 per cent to Rs. 393.8 billion, largely underpinned by the increase in investment portfolio. Meanwhile, borrowings under repo agreements decreased by 12.3 per cent to Rs. 149.9 billion.

- **Profitability decreased**. The sector recorded a profit of Rs. 10.3 billion over the period ending August 2017 compared to a profit of Rs. 11.1 billion in the corresponding period of 2016. Total capital gains (realised and unrealised) marked Rs. 3.0 billion compared to Rs. 6.9 billion in 2016. Profitability measured in terms of return on assets and return on equity of standalone PDs stood at 4.6 per cent and 14.1 per cent, respectively, as at end August 2017.

Table 8.4

Primary Dealers - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (a)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets (Rs.billion)	**235.8**	**311.8**	**260.0**	**418.3**	**32.2**	**34.2**
Standalone PDs	54.0	87.5	77.1	67.6	62.0	-22.7
Bank PDs	181.9	224.4	183.0	350.7	23.4	56.3
Total Portfolio (Rs.billion)	**217.1**	**256.0**	**222.7**	**393.8**	**17.9**	**53.8**
Standalone PDs	42.8	41.3	46.9	50.6	-3.5	22.4
Bank PDs	174.3	214.6	175.9	343.2	23.2	59.9
Total Capital (Rs.billion) (b)	9.3	19.5	21.5	23.2	108.6	19.3
Profit before Tax (Rs.billion) (c)	3.8	11.1	15.2	10.3	193.7	-7.3
Standalone PDs	1.5	7.4	8.7	2.4	392.9	-68.3
Bank PDs	2.3	3.7	6.5	8.0	62.3	114.8
Tier 1 Capital Adequacy Ratio (%) (b)	18.0	33.7	59.9	57.4	15.7	23.7
Total Capital Adequacy Ratio (%) (b)	19.1	35.0	61.5	58.8	15.9	23.8
Return on Assets (%)	2.8	5.8	5.8	4.6	3.0	-1.2
Standalone PDs	4.1	15.0	12.6	4.9	10.9	-10.1
Bank PDs	2.3	2.6	3.3	4.5	0.3	1.9
Return on Equity (%) (b)	25.1	70.8	52.1	14.1	45.6	-56.7
Leverage Times (b)	5.0	3.5	2.6	1.9	-29.0	-46.0
Operating Expenses to Total Income (%) (c)	6.2	3.1	3.5	3.0	-3.1	-0.1
Standalone PDs	14.0	5.6	7.1	12.1	-8.4	6.5
Bank PDs	1.8	0.8	0.8	0.5	-1.0	-0.3
Total Cost to Total Income (%) (c)	66.3	52.7	57.9	66.2	-13.6	13.4
Standalone PDs	63.2	34.0	43.9	64.0	-29.2	30.0
Bank PDs	68.1	69.8	68.4	66.7	1.7	-3.1
Duration of Assets and Liabilities (years)	1.2	1.3	1.2	1.0	7.9	-25.9
Standalone PDs	2.6	3.0	2.1	2.4	16.6	-21.7
Bank PDs	0.6	0.6	0.6	0.4	-6.1	-33.2

(a) Provisional
(b) Standalone PDs only
(c) During the period
Note: Above data excludes financials of Entrust Securities PLC.

Source: Central Bank of Sri Lanka

- **Capital was maintained at healthy levels**. All standalone PDs except one maintained their core capital above the minimum requirement of Rs. 1 billion by end August 2017. The risk weighted capital adequacy ratio of the sector was above the minimum of 10 per cent and the ratio increased to 58.8 per cent by end August 2017 from 35.0 per cent at end August 2016.

- **Risk profile improved**. The share of trading portfolio in total investment portfolio decreased from 52.1 per cent at end August 2016 to 34.5 per cent at end August 2017. As a result, the exposure of the sector to market risk decreased. In view of the large holding of risk-free government securities and its ability to be used as collateral for obtaining funds to bridge unforeseen liquidity gaps, the liquidity risk profile of PDs remained low. Further, most PDs had stand-by contingency funding arrangements to bridge liquidity gaps, if emerged.

Unit Trust Sector

- **The Unit Trust (UT) sector recorded a contraction in terms of number of units in issue and net asset value**. Despite the dismal performance of the sector, the total number of unit holders marginally increased by 2.3 per cent on year-on-year basis while total number of UTs managed by 14 unit trust management companies remained constant. The Net Asset Value (NAV) of the UT sector marked a decrease of 18.5 per cent, on a year-on-year basis, to Rs.103.3 billion by end June 2017. Meanwhile, the share of equities in investment portfolios of UTs increased to 13.9 per cent as at end June 2017 from 9.9 per cent as at end June 2016.

Stock Broking Companies Sector

- **Stock broking companies sector showed a positive performance with further strengthening of capital regulations**. The income of stock brokers showed a moderate decline during the first half of 2017 recording Rs. 406 million compared to Rs. 447 million in the first half of 2016. However, net profit before taxes improved during this period to Rs. 35 million from the recorded loss of Rs. 121 million at end June 2016. In addition, net capital of the stock broking companies sector increased by 22.6 per cent to Rs. 5.6 billion during the period under consideration from Rs. 4.5 billion in the previous year, while total assets increased marginally.

- **Capital requirements of the stock brokers were upgraded to risk based capital adequacy ratio and minimum liquid capital in March 2017 from the previous requirement of minimum net capital**. All stock broking companies have met the net capital requirement in the first two months of 2017. Two companies failed to comply with the new requirement of risk, based capital adequacy ratio and minimum liquid capital introduced in March 2017. However, only one company failed

Table 8.5
Unit Trust Sector - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%)	
					Jun 2016	Jun 2017 (a)
Total Assets (Rs.billion)	133.8	127.7	103.1	104.4	-4.6	-18.3
Net Asset Value - NAV (Rs.billion)	133.1	126.8	103.1	103.3	-4.7	-18.5
Investments (Rs.billion)	133.6	122.8	102.9	102.3	-8.1	-16.7
Equity	13.5	12.6	13.9	14.4	-6.6	13.9
Government Securities	55.4	55.9	49.6	42.8	0.8	-23.4
Other (E.g.,Commercial Papers, Debentures, Trust Certificates & Bank Deposits)	64.7	54.4	39.3	45.2	-16.0	-16.8
Investments in Equity as a % of NAV	10.1	9.9	13.5	13.9		
Investments in Government Securities as a % of NAV	41.6	43.7	48.1	41.0		
Other Investments as a % of NAV	48.6	42.9	38.1	43.8		
Total No. of Unit Holders	35,660	39,707	41,249	40,651		
No. of Units in Issue (billion)	9.6	8.9	7.2	6.7		
No. of Unit Trusts	70	76	77	76		

(a) Provisional

Source: Unit Trust Association of Sri Lanka

Table 8.6
Stock Broking Companies - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%)	
					Jun 2016	Jun 2017 (a)
Total Assets (Rs. billion)	10.9	9.5	10.1	12.8	-12.2	34.4
Total Liabilities (Rs. billion)	4.8	3.9	4.5	7.3	-18.7	87.5
Net Capital (Rs. billion)	4.7	4.5	4.6	5.6	-2.8	22.6
Income (Rs. billion) (b)	0.6	0.4	0.3	0.4	-26.7	10.1
Net profit/(Loss) before tax (Rs. million) (b)	19.2	-121.0	-460.0	35.0	-729.4	128.9

(a) Provisional
(b) During the period

Source: Securities and Exchange Commission of Sri Lanka

to comply with the new regulatory requirement as at 30 June 2017.

Superannuation Funds

- **The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka with an asset base of over Rs. 1.9 trillion as at end June 2017.** The total number of member accounts of the EPF reached 17.5 million mark in December 2016, recording an increase of 3.6 per cent when compared with the previous year. Total member contributions during the first six months of 2017 increased by 16.0 per cent to Rs. 65.3 billion while refund payments increased by 14.9 per cent to Rs. 63.1 billion when compared with the corresponding period of the previous year. During the period under review, the net contribution (contributions minus refunds) stood at Rs. 2.2 billion, which is an increase of 57.1 per cent compared to the corresponding period of 2016. During the 12 month period ending 30 June 2017, total assets of the EPF increased by 11.9 per cent to Rs. 1,948 billion whereas the total investment of EPF also grew by 11.9 per cent to Rs. 1,873 billion. The investments of EPF consist of government securities (91.6 per cent), equity (4.5 per cent), corporate debt, trust certificates and reverse repo (2.1 per cent) and fixed deposits (1.8 per cent). The Fund reported a gross investment income of Rs. 107.0 billion during the first half of 2017, which is an increase of 11.5 per cent compared to the corresponding period of 2016.

- **The Employees' Trust Fund (ETF) has about 12.5 million accounts, of which about 2.6 million are active accounts.** Total contributions received and benefits paid to members during the first six months of 2017 increased to Rs. 11.1 billion (13.7 per cent) and Rs. 9.4 billion (27.9 per cent), respectively, from Rs. 9.8 billion and Rs. 7.3 billion, respectively, during the corresponding period of 2016. With the high growth in the disbursement of benefits, net contributions of the ETF decreased by 35.3 per cent in the first half of 2017. Meanwhile, total assets of the ETF increased by 12.1 per cent to Rs. 263.2 billion by end June 2017. The investment portfolio of

Table 8.7
Superannuation Funds - Selected Indicators

Item	Employees' Provident Fund (EPF)			Employees' Trust Fund (ETF)		
	End Jun 2016	End Jun 2017 (a)	Change (%) (a)	End Jun 2016	End Jun 2017 (a)	Change (%) (a)
Total Contributions (Rs. billion) (b)	56.3	65.3	16.0	9.8	11.1	13.7
Total Refunds (Rs. billion) (b)	54.9	63.1	14.9	7.3	9.4	27.9
Total Assets (Rs. billion)	1,741	1,948	11.9	234.7	263.2	12.1
Total Investment Portfolio (Rs. billion)	1,674	1,873	11.9	221.0	247.6	12.1
o/w, Government Securities (%)	93.2	91.6	-1.7	91.7	84.1	-8.3
Gross Income (Rs. billion) (b)	96.0	107.2	11.7	11.5	13.6	18.8

(a) Provisional
(b) During the period

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

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the ETF remained concentrated in government securities. However, the share of government securities declined to 84.1 per cent as at end June 2017 from 91.7 per cent as at end June 2016. Investments in equity stood at 4.9 per cent by end June 2017.

- **The Public Service Provident Fund (PSPF) had 229,951 members as at end June 2017**. Total assets of the PSPF amounted to Rs. 49.9 billion as at end June 2017 compared to Rs. 47.7 billion as at end June 2016. Total contributions and refunds of the PSPF during the first six months of 2017 amounted to Rs. 897.0 million and Rs. 256.8 million, respectively.

- **There were 151 privately managed approved provident funds (APFs) with around 169,281 members as at end June 2017**. The total assets of APFs stood at Rs. 434.3 billion while total investments stood at Rs. 264.5 billion at the end June 2017.

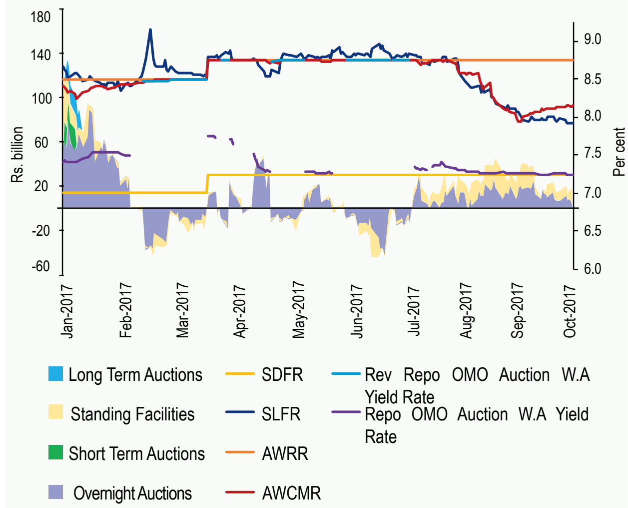
Developments in Financial Markets

Inter-Bank Call Money Market

- **The Average Weighted Call Money Rate (AWCMR), which moved closer to the upper bound of the Standing Rate Corridor (SRC), formed by the Standing Lending Facility Rate (SLFR) and the Standing Deposit Facility Rate (SDFR) till early August, moved downwards thereafter and has hovered at levels around the middle of the SRC since early September**. The AWCMR, which was at 8.42 per cent by end 2016, increased towards the upper bound of the SRC with the decline in excess money market liquidity, which reached deficit levels by around mid-February. Central Bank tightened its monetary policy stance in March 2017 by increasing the SDFR and the SLFR by 25 basis points each to 7.25 per cent and 8.75 per cent, respectively. Consequently, the AWCMR increased further and continued to hover at rates close to the upper bound of the SRC up until early August 2017. While the money market has

Chart 8.14

Standing Rate Corridor, OMO Auction Yield Rates, AWCMR and Absorption of the Market Liquidity

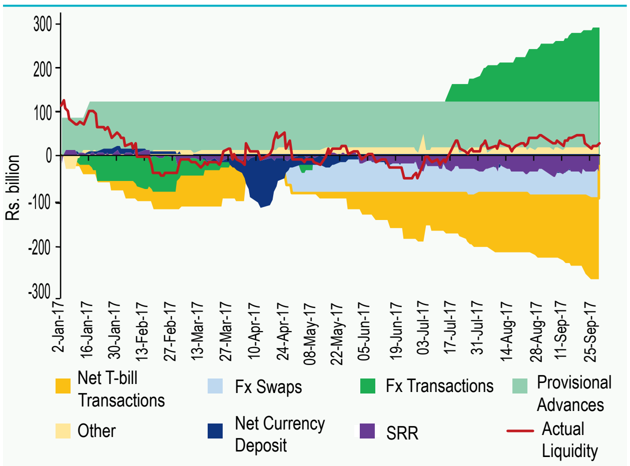


Source: Central Bank of Sri Lanka

continued to have surplus levels of liquidity since around mid-July 2017, the weighted average yield rate at the daily overnight repo auctions conducted by the Central Bank has declined since around mid-August, recording 7.25 per cent by end September 2017. Following this trend, the AWCMR also declined to around 8.00 per cent by mid-September 2017 and increased marginally to 8.11 per cent by end September 2017. With market repo rates following the movements of call money rates, the Average Weighted Repo Rate (AWRR) recorded at end September 2017 was 8.01 per cent, having declined in recently along with the decline in call money market rates.

- **Excess rupee liquidity in the domestic money market increased sharply at the beginning of 2017**. Whilst declining to deficit levels by early February, market liquidity fluctuated thereafter till mid-July, moving between deficit and surplus levels. Since mid-July, the domestic money market has continued to have excess rupee liquidity. The sharp increase in money market liquidity from a surplus of Rs. 39.2 billion at end 2016 to over Rs. 100 billion at the beginning of the year 2017 was mainly due to the provisional advances extended to the Government by the Central Bank. However, money market liquidity declined thereafter with the market experiencing deficits in liquidity from time to time from around mid-February until

Chart 8.15
Changes in the Central Bank's Balance Sheet driving Money Market Liquidity



Source: Central Bank of Sri Lanka

mid-July, primarily as a result of the Central Bank allowing its Treasury bill holdings to mature as well as outright sales of Treasury bills by way of conducting OMO. Seasonal withdrawals of currency was an additional factor that drove down money market liquidity during the month of April. Foreign exchange related transactions of the Central Bank including foreign exchange purchases and foreign exchange swaps have had a positive impact, on money market liquidity on a net basis during the first nine months of 2017. Conversion of a part of the proceeds from the International Sovereign Bond (ISB) to rupees by the government to settle its dues was another factor that led to an increase in market liquidity to surplus levels since around mid-July 2017. However, measures adopted by the Central Bank to reduce its holdings of Treasury bills by way of allowing its Treasury bill holdings to mature and outright sales of Treasury bills through OMO, have resulted in a decline in excess money market liquidity from the beginning of September. By end September 2017, excess money market liquidity amounted to Rs. 20.96 billion.

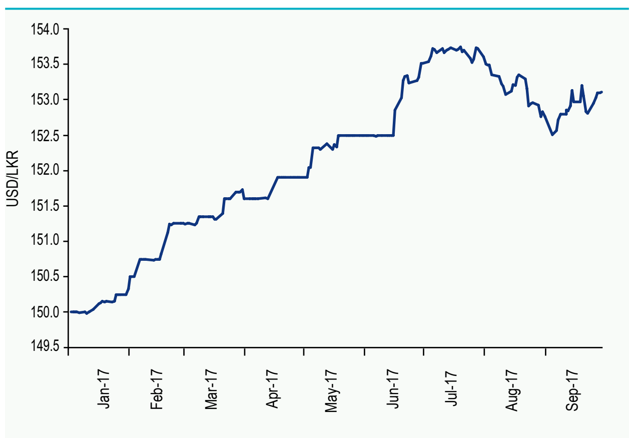
Domestic Foreign Exchange Market

- **The Sri Lankan rupee depreciated against US dollar by 2.15 per cent during the first nine months of 2017.** The pressure on the Sri Lankan rupee to depreciate surged in the first two quarters of 2017 due to the increased outflows of investments from government securities market with the interest rate hike by the Federal Reserve USA in March 2017 as well as due to the heightened import demand. This depreciating trend continued further until end July 2017 along with the second announcement by the Federal Reserve USA to raise interest rates in June 2017. However, with the positive sentiments created through the receipt of the third tranche of the EFF from the IMF, and the conversions of export proceeds, the pressure on the exchange rate eased towards end September 2017. During the period up to end September 2017, the Sri Lankan rupee depreciated against other major currencies such as the Japanese yen, the Indian rupee, the pound sterling and the euro.

- **Central Bank was a net buyer in the domestic foreign exchange market during the first nine months of 2017 with the intention of curbing excess volatility while engaging in foreign reserves accumulation**. Accordingly, during the period up to end September 2017, Central Bank absorbed US dollars 1,710.6 million from the market and supplied US dollars 549.8 million to the market resulting in a net purchase of US dollars 1,160.9 million.

- **During the period up to end September 2017, trading volumes in the domestic foreign exchange market increased by 13.54 per cent**

Chart 8.16
Movement of Rupee per US dollar

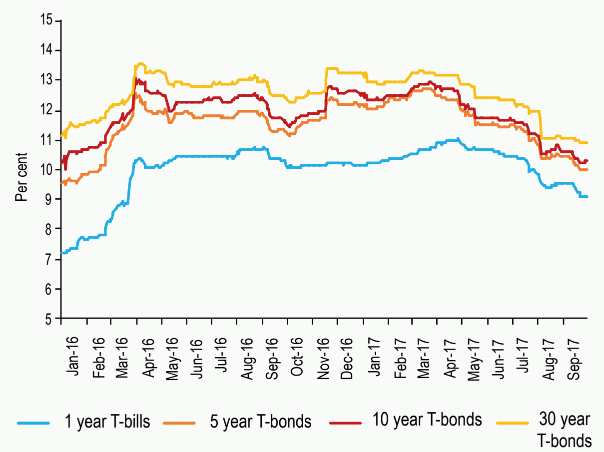


Source: Central Bank of Sri Lanka

compared to the corresponding period in 2016. The total volume of inter-bank foreign exchange transactions was US dollars 12.75 billion up to end September 2017 as against US dollars 11.23 billion in the corresponding period of 2016. The daily average volumes in the inter-bank foreign exchange market also increased by 11.43 per cent to US dollars 70.44 million during the reference period, from US dollars 62.39 million in the corresponding period of 2016. The total volume of forward transactions for the period up to end September 2017 also increased to US dollars 6.56 billion compared to US dollar 6.45 billion recorded during the first nine months of 2016.

Chart 8.17

Secondary Market Yield Curve of Government Securities



Source: Central Bank of Sri Lanka

Government Securities Market

- **In the first half of 2017, majority of borrowings were sourced from the domestic market**. With high interest rates and the liquidity shortage then prevailed in the market, the strategies adopted for debt issuance in the first half of 2017 included the issuance of Treasury bonds with shorter maturities and the issuance of Sri Lanka Development Bonds (SLDBs) amounting to US dollars 2,231.4 million. This was intended to offset any possibilities to crowd out the available domestic investible funds. However, with the relatively high volume of issuance of short and medium-term Treasury bonds in the first half of the year, the average time to maturity of government securities decreased.

- **The secondary market yield curve of government securities moderated during the first half of 2017, compared to first half of 2016**. The secondary market yield rates pertaining to 91-day and 182-day Treasury bills moved upward by 73 basis points and 51 basis points, respectively, while yield rates pertaining to 364-day Treasury bills decreased by around 3 basis points. Market yield rates of actively traded Treasury bonds with maturities of 2 to 10 years decreased by about 33 basis points, at the end of the first half of 2017 compared to the yield rates at end of the corresponding period. of 2016. The improved market conditions along with foreign inflows from International Sovereign Bonds, syndicated loans and increased foreign investments in Treasury bills and Treasury bonds combined with government strategy to settle only the principal amount of maturing Treasury bonds through domestic sources, contributed positively towards reducing the dependency in domestic funding. This has caused the secondary market yield rates to ease during the first seven months of 2017. The non-resident holdings of Treasury bills and Treasury bonds increased by 7.49 per cent to Rs. 254.44 billion by end July 2017 from Rs. 236.71 billion at end January 2017.

Corporate Debt Securities Market

- **Activities of the commercial paper market moderated during the first six months of 2017**. The value of Commercial Papers (CPs) issued during the period under review amounted to Rs. 3.6 billion in comparison to Rs. 4.8 billion during the same period of 2016. Continuing the upward trend observed in the previous year, interest rates appliable on CPs continued to increase to a range of 14.5-16.5 per cent in the first half of 2017 from the range of 8.7 - 13.0 per cent in the same period of 2016. The CPs issued during the period, had shorter maturities compared to the previous periods, reflecting somewhat unfavourable investor sentiments. The CPs with maturities up to 3 months accounted for 92.5 per cent of the market, while the share of CPs between 3 months

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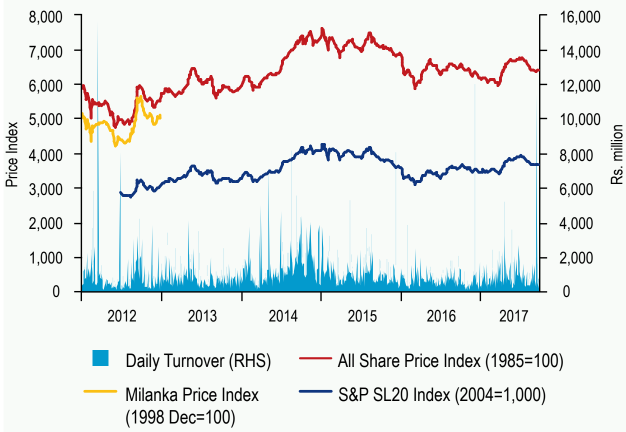
to 6 months maturity amounted to 7.5 per cent. There were no commercial papers issued for higher maturities than 6 months during the year. The total outstanding value of CPs amounted to Rs. 2.3 billion as at end June 2017 compared to Rs. 4.5 billion as at end June 2016.

- **The volumes in the corporate bond market contracted during the first half of 2017 compared to the corresponding period of the previous year**. During the first six months of 2017, there were seven listings of corporate debentures by two institutions, compared with 17 issues by nine institutions during the first six months of 2016. Consequently, the total value of the corporate bonds listed in the first six months of 2017, reduced to Rs. 10.0 billion compared to Rs. 34.4 billion in the corresponding period of the previous year. During the first six months of 2017, the two issuers were from the banking and finance sector, and the interest rates applicable to these bonds varied between 11.95 per cent and 15.00 per cent.

Equity Market

- **The Colombo Stock Exchange (CSE) could not sustain the positive performance it gained during the second quarter of the year, as reflected by the volatile movements in price indices during the last few months**. The sluggish behaviour of the equity market that prevailed at the end of 2016 continued in the first three months of 2017. This was largely due to expected policy rate hikes in advanced economies, uncertainty in the local policy direction and sustained pressure on the exchange rate. An upward trend was observed in early April as a result of the substantial net foreign investments. In addition, local institutional investors started to accumulate sound stocks at the prevailing lower prices while retail investors bounced back with regained confidence on the recovery of the CSE. However, starting from July 2017 onwards, performance of the equity market deteriorated diminishing the positive momentum prevailed in the preceding months. Although the momentum in the equity market diminished after the first half of 2017, an improvement in market activity was recorded during the first nine months of the year when compared to the performance in the corresponding period of the previous year. The All Share Price Index (ASPI) and S&P SL20 Index increased by 3.4 per cent and 5.5 per cent respectively, by September compared to end 2016.

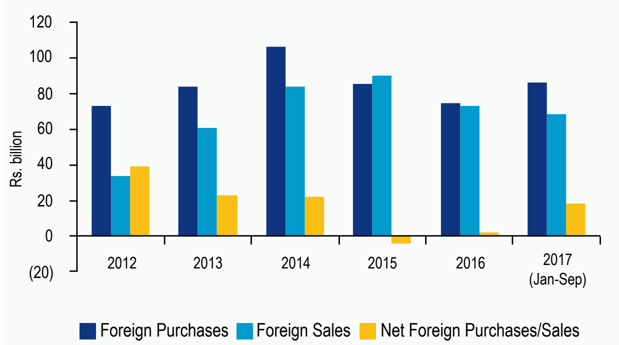
Chart 8.18
Movements of Share Price Indices



Source: Colombo Stock Exchange

- **Business involvement in the stock market as reflected by market capitalisation and turnover improved during the first nine month of 2017**. Market capitalisation increased to Rs. 2,919.7 billion at the end of September 2017, compared to Rs. 2,745 billion at end 2016. Further, total turnover for the first nine months of 2017 improved to Rs. 165.6 billion compared to Rs. 135.4 billion of the corresponding period of the

Chart 8.19
Foreign Participation at the CSE



Source: Colombo Stock Exchange

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Table 8.8
Equity Market - Selected Indicators

Item	End Sep 2015	End Sep 2016	End 2016	End Sep 2017 (a)
All Share Price Index (1985 = 100)	7,050.9	6,534.8	6,228.3	6,438.2
Year-to-date change (%)	-3.4	-5.2	-9.7	3.4
S&P SL20 Index (2004 = 1,000)	3,826.2	3,617.3	3,496.4	3,688.0
Year-to-date change (%)	-0.1	-0.2	-3.6	5.5
Market Capitalisation (Rs.billion)	2,990.8	2,785.7	2,745.4	2,919.7
As a percentage of GDP* (%)	25.3	23.5	23.2	24.7
Market Price Earnings Ratio	18.4	13.4	12.4	10.7
Average Daily Turnover (Rs. million)	1,115.4	753.2	737.2	914.8
Net Cumulative Foreign Purchases in Secondary Market (USD million)	-23.4	-19.4	13.7	118.6
Number of Companies Listed	296	295	295	295
Number of Rights Issues (b)	12	6	6	14
Amount raised through Rights issues (Rs. billion) (b)	12.0	2.5	2.5	42.0
Initial Public Offering (b)	2	3	3	2
Amount raised through IPOs (Rs. billion) (b)	0.3	1.9	1.9	8.5

*Based on GDP for 2016 (Rs.11,839 billion)
(a) Provisional
(b) During the period

Source: Colombo Stock Exchange

previous year. The average daily turnover and the number of shares traded in the equity market also improved during the first nine months of the year. The net cumulative foreign purchases increased significantly by 711.3 per cent to US dollars 118.9 million in September 2017. However, the total number of trades declined to 727,064 compared to 882,201 in the corresponding period while market Price Earnings Ratio (PER) deteriorated to 10.7 times as at end September 2017 compared to 13.4 times prevailed at the end of 2016. During the period, there were 2 Initial Public offerings (IPO) at CSE which raised Rs. 8.5 billion while 14 right issues raised Rs. 42.0 billion.

Development Finance and Access to Finance

- **Central Bank continued to implement a number of development credit schemes with concessionary interest rates, terms and conditions through Participating Financial Institutions (PFIs) during the first eight months of 2017**. These schemes provided refinance facilities, interest subsidies and/or credit guarantees and credit supplementary services, targeting development of agriculture and livestock and Micro, Small and Medium Scale Enterprise (MSME) sectors. The primary objective of implementing these schemes was to assist farmers and entrepreneurs who are having limited or no access to the formal financial institutions and cannot afford high cost of financing to carry out their income generating activities. Broadly, these schemes are expected to promote access to finance and thereby improve the financial inclusion and balanced regional growth in the country. Overall, loans totalling to Rs. 11,562.3 million were disbursed among 78,740 beneficiaries through eleven credit Schemes by the Central Bank up to August 2017. The amount of funds released to the Agriculture and Livestock sector accounted for 50.2 per cent of the loans disbursed followed by 36.4 per cent and 13.4 per cent to the MSME sector and microfinance sector, respectively.

- **Central Bank provided concessionary credit to the MSME sector focusing on sustainable economic growth, employment generation, poverty eradication, etc. through five credit schemes.** These schemes, namely, the "Saubagya" Loan Scheme (SLS), "Swashakthi – Towards One Million Jobs" Loan Scheme, Dry Zone

Table 8.9
Sector-wise Loan Disbursements

Loan Scheme	Share (%)			
	2016 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
MSME	10	41	12	36
Microfinance	24	13	29	13
Agriculture and Livestock	66	46	60	50

Source: Central Bank of Sri Lanka

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Livelihood Support and Partnership Programme (DZLiSPP-RF), Second Phase of Self Employment Initiative Promotion Loan Scheme (SEPI Ph II) and Working Capital Loan Scheme for Tea Factories (WCLSTF), together, disbursed loans totalling Rs. 4,206.5 million among 9,393 beneficiaries. Of these schemes, SLS alone, which operates island-wide as the flagship loan scheme distributed Rs. 2,616.3 million which accounted for 62.2 per cent of total disbursements to the sector. New loan registrations under the WCLSTF declined during the first eight months of 2017, compared to the same period of 2016 as the scheme is nearing its completion as expected targets have been attained. The "Swashakthi - towards one million jobs" loan scheme that was introduced in March 2017 targeting the MSME sector development, and employment generation, disbursed loans totalling Rs. 930.4 million among 4,045 beneficiaries during the first eight months of the year.

- **Overall, the number and amount of loans disbursed to the MSME sector declined mainly due to limited availability of funds in the "Saubagya" loan scheme during the first eight months of 2017 compared to the corresponding period of the previous year since these schemes were nearing their completion**.

- **With a view to broadening the financial outreach among the masses and promoting poverty alleviation in the country, Central Bank**

Table 8.10

Loan Disbursements to the MSME Sector

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
Saubagya	9,776	3,574	5,141	2,616	-47.4	-26.8
Swashakthi*	-	-	4,045	930	-	-
SEPI Ph II*	-	-	190	82	-	-
SPEnDP**	198	25	-	-	-	-
DZLiSPP-RF	12	1	3	0	-75.0	-66.7
WCLSTF	108	3,450	14	577	-87.0	-83.3
Total	**10,094**	**7,050**	**9,393**	**4,207**	**-6.9**	**-40.3**

Source: Central Bank of Sri Lanka

* Loan Scheme has been commenced in 2017

** Loan scheme was concluded in December 2016

Table 8.11

Loan Disbursements under the Microfinance Loan Schemes

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
PAMP RF	3,747	183	6,174	307	64.8	67.7
PAMP II RF	15,283	1,247	10,468	889	-31.5	-28.7
SFLCP RF	1,219	67	328	22	-73.1	-67.2
NADeP	4,299	502	5,451	338	26.8	-32.7
Total	**24,548**	**1,999**	**22,421**	**1,556**	**-8.7**	**-22.2**

Source: Central Bank of Sri Lanka

provided financial support to the Microfinance sector through four microfinance loan schemes. These Schemes, which included, Poverty Alleviation Micro-Finance Project II-Revolving Fund (PAMP II–RF), Poverty Alleviation Micro-Finance Project–Revolving Fund (PAMP-RF), Small Farmers and Landless Credit Project–Revolving Fund (SFLCP-RF) and National Agribusiness Development Programme (NADeP) targeted the micro level entrepreneurs engaged in income generating activities in the agriculture and livestock, trade and other services, and fisheries sectors. Under these schemes, loans amounting to Rs. 1,555.9 million were disbursed among 22,421 beneficiaries, during the first eight months of the year. The amount of funds released to this sector accounted for 13.4 per cent of the total disbursements made by the Central Bank. Overall, the amount of loans disbursed under the microfinance loan schemes decreased by 22.2 per cent during the first eight months of 2017 compared to the corresponding period of the previous year, since PAMP II-RF and SFLCP-RF to be concluded shortly.

- **The agriculture and livestock sector continued its dominance in receiving concessionary credit facilities provided through the Central Bank operated loan schemes**. Funds amounting to Rs. 5,799.9 million released to this sector, accounted for 50.2 per cent of the total disbursements made through the credit schemes implemented by the Central Bank during the first eight months of 2017. Of the total disbursements, Rs. 4,959.5 million of loans or 85.5 per cent of loans granted to the sector, were delivered through the New Comprehensive Rural Credit

Scheme (NCRCS) which is the principal scheme that provides both interest subsidy and credit guarantee for loans granted for working capital requirements of small-scale farmers covering 33 short-term crop varieties. The amount of loans granted under NCRCS increased by 3.6 per cent in spite of the prevailed drought condition throughout the country. Among all the districts, the Monaragala District received the highest (14 per cent) amount of loan disbursements made under this scheme, followed by Anuradhapura (13 per cent), and Ampara (12 per cent) districts respectively. Paddy, being the major crop item, received the highest share of 59 per cent of total loan disbursements to the sector.

- **Commercial Scale Dairy Development Loan Scheme (CSDDLS) operated successfully during the first eight months of 2017, made disbursements to dairy farmers and entrepreneurs in the dairy related activities**. Compared to the first eight months of 2016, disbursements under CSDDLS decreased by 9 per cent during the corresponding period of 2017 due to limited availability of funds for the interest subsidy payments under this scheme. However, overall amount of loans granted under these two schemes to the agriculture and livestock sector increased by 1.6 per cent during the period under review.

- **The Central Bank continued to promote financial literacy and inclusiveness and helped entrepreneurship development through a number of programmes and workshops conducted during the reference period covering financial literacy, financial management, entrepreneurship development and Training of Trainers (TOT) and project appraisal workshops for entrepreneurs**. Formation of Self Help Groups and awareness of financial management were also given priority.

Table 8.12

Loan Disbursements to the Agriculture and Livestock Sector

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.
NCRCS	53,437	4,788	45,917	4,960	-14.1	3.6
CSDDLS	1,281	923	1,009	840	-21.2	-9.0
TDP RF	2	0	-	-	-	-
Total	**54,720**	**5,711**	**46,926**	**5,800**	**-14.2**	**1.6**

Source: Central Bank of Sri Lanka

- **Accordingly, Central Bank conducted 110 Skills Development programmes, 13 Capacity Building programmes and 56 programmes for beneficiaries of the PAMP II - RF project**. The number of programmes conducted under the category of awareness building in the reference period exceeded the targets given under the strategic goals. 30 societies of low income families under the Microfinance Credit Schemes too were formed during the reference period.

Developments in the Payment and Settlement Systems

- **Central Bank supervises and regulates payment and settlement systems in order to maintain a secure, reliable and efficient payment and settlement system in the country, which is a key requirement for achieving financial system stability**. In 2017, Central Bank continued to facilitate the national payment infrastructure to facilitate the economic activities of the country.

- **Central Bank continued to facilitate the establishment of Common Card and Payment Switch (CCAPS) operated by LankaClear (Pvt.) Ltd. (LCPL) under the brand name of 'LankaPay', which is a network of five interoperable switches. i.e. Common ATM Switch (CAS), Common Electronic Fund Transfer Switch (CEFTS), Shared ATM Switch (SAS), Common Point of Sale Switch (CPS) and Common Mobile Switch (CMobS).**

- **CAS, which is the first phase of CCAPS, started live operations in July 2013**. During first nine months of 2017, membership of CAS increased to 27. Within this period CAS settled 32.4 million transactions amounting to Rs. 189.2 billion. In order to enhance the security of card transactions carried through CAS network, CAS members were instructed by Central Bank to enable Europay, MasterCard and Visa (EMV) technology in ATM machines installed by all CAS members.

- **CEFTS, which is the second phase of CCAPS, was implemented on 21 August 2015**. CEFTS provides a common infrastructure to clear payments effected through multiple payment channels such as ATM, internet banking, mobile banking, kiosks and over-the-counter. During the first nine months of 2017, eight financial institutions integrated with CEFTS increasing the members of CEFTS, thereby to 30. CEFTS settled 2.1 million transactions amounting to Rs. 181.1 billion during the first nine months of 2017.

- **LankaPay Online Payment Platform (LPOPP) was launched on 20 July 2017 to facilitate real time payments to Sri Lanka Customs through CEFTS member financial institutions**. By end September 2017, six LCBs had connected to LPOPP. LPOPP can be extended to facilitate payments to other government institutions as well. Payment and Settlement Systems Circular No. 08 of 2017 on Maximum Limits on Transaction Value and Fees of CEFTS was issued replacing the Payment and Settlement Systems Circular No. 01 of 2015, in order to increase the maximum per transaction value limit for transactions carried out through a specific transaction code to facilitate real time payments to Sri Lanka Customs.

- **The Central Bank approved the request made by LCPL to implement a National Card Scheme in partnership with an international card scheme**. Accordingly, the National Card Scheme, which will be implemented in 2018, will facilitate the introduction of low cost products for national initiatives such as social benefit schemes and public transport. The CPS will commence live operations after implementation of the national card scheme.

- **The National Payment Council (NPC), which is the industry consultative and monitoring committee on payment systems commenced the consultative process for preparation of a Roadmap for medium-term development of payment systems covering application of new technology, new payment products and system stability and consumer protection focused regulation**. The draft Roadmap was finalised after incorporating the suggestions made by council members. In order to facilitate implementation of the action points of the Roadmap, the NPC appointed two committees to study the potential impact of FinTech and Blockchain and to make recommendations.

Expected Developments

- **The Credit growth is expected to gradually moderate to a sustainable rate in the medium term in line with the current monetary policy direction**. There has been an increase in the NPLs and banks will need to be cautious of further increase in NPLs associated with the increase in credit and ensure that proper risk management mechanisms are in place to mitigate such risks.

- **Capital levels of banks are expected to strengthen further, with the build-up of capital as a result of the enhanced capital requirements**. With the enhanced minimum capital levels and the implementation of Basel III Minimum Capital Requirements, banks are required to increase their high quality capital. Banks which are unable to comply, will be encouraged to consolidate on a voluntary basis. Further, with the adoption of Sri Lanka Financial Reporting Standard – 9, Financial Instruments (SLFRS 9) in January 2018, banks will be required to recognise loan losses under expected credit loss approach instead of the existing incurred loan loss approach. Accordingly, banks will be required to augment their capital levels further to be in line with the new accounting standard. This will improve the ability of the banking sector to absorb shocks arising from financial and economic stress, reducing the risks of spill over from the financial sector to the real economy in the coming years.

- **The liquidity positions of banks will continue to be maintained at healthy levels**. Banking Act Directions on Liquidity Coverage Ratio (LCR) under Basel III Liquidity Standards were issued in 2015 to be complied with on a staggered basis and the banks are required to maintain an LCR of 100 per cent by 2019. Also with the implementation of the Net Stable Funding Ratio (NSFR) in 2018, the liquidity risk profile of banks will be further strengthened.

- **With a view to strengthening the banking sector, the Central Bank issued a consultation paper on Basel III Leverage Ratio Framework for Licensed Banks**. Commencing 31 March 2017 banks were required to report Leverage Ratio for monitoring purposes within 30 days from the end of each quarter. Banking Act Directions on the Leverage ratio will be issued upon the issuance of final guidelines by the Basel Committee on Banking Supervision and with this, banks may need to reassess the balance sheet size and business expansion, as the leverage ratio restricts the assets expansion regardless of the relative risk of different assets classes.

- **Changes in macroeconomic variables will be closely monitored to identify and address any spillover risks arising from the real economy to the banking sector and appropriate macroprudential measures will be introduced to preempt any future risks to the stability of the financial system**. The regulatory and supervisory framework will be further strengthened in line with the Basel Core Principles on Effective Banking Supervision and other international and regional best practices. Examination methodology of banks will be enhanced focusing on the efficiency, effectiveness and sustainability of individual banks and the banking sector.

- **Changes are to be introduced to the regulatory and supervisory framework with respect to Cyber-Security and FINTECH, pertaining to banks in line with international standards and best practices**. This will prompt banks to upgrade and strengthen their management information systems and related technological platforms enabling the banks to cater to emerging information requirements. Digital initiatives such as mobile/phone banking and internet banking will be used to increase access for banking services, utilising Information Technology as a service delivery channel. This will require banks to take preventive measures to strengthen information security management of all systems related aspects.

- **The banking sector is expected to increase access to banking with a view to enhancing financial inclusion and supporting economic activities throughout the country**. With a view to achieving a balanced growth island-wide, banks will be expected to closely monitor and take steps to improve region-wise credit to deposit ratios to be able to utilize funds collected from a particular region to finance economic activities of the same region.

- **Large commercial banks will be encouraged to look into avenues of regional expansion, which will lead to an increase in the geographical reach of the banking sector**. Close interactions will be maintained with other regional regulators with a view to enhancing information sharing among regulators and cross-border supervision.

- **Direction on risk weighted capital adequacy ratio**. A new capital adequacy framework for LFCs and SLCs is proposed to be implemented during 2017 in view of fostering a strong emphasis on risk management and to encourage ongoing improvements in LFC and SLC's risk assessment capabilities. Therefore, the proposed capital adequacy framework provides for maintenance of capital adequacy ratios on a more risk sensitive focus covering credit risk and operational risks under the basic approach available in the Basel accord. Further, the above proposed new regulatory framework is expected to enforce a strict regulatory environment and a natural consolidation drive by pushing smaller, inefficient, weak LFCs/SLCs to consolidate with bigger players or to seek strategic investors with capital infusions.

- **The stability of the sector is expected to be reinforced further in the medium-term horizon with changes to the existing regulatory framework**. The changes are proposed to the existing risk management, liquidity and provisioning regulations, which will enable to establish an Integrated Risk Management Framework for LFCs and SLCs. New governance practices are also expected to be incorporated to the Corporate Governance Framework with a view to improving governance.

- **A positive outcome will be expected through the initiatives proposed on the resolution of some distressed finance companies**. Initiatives will be taken to resolve distressed finance companies, largely through mergers and recapitalisation through strategic investors. Further, options are being evaluated to settle the existing depositors of these institutions through the Sri Lanka Deposit Insurance and Liquidity Support Scheme and thereafter to liquidate those companies.

- **During 2018, DSMI expects to receive applications for licence under the Microfinance Act, which would be evaluated and suitable applicants will be licensed.** Action will be taken to include LMFCs under the Credit Information Bureau of Sri Lanka.

- **DSMI is in the process of reviewing the Microfinance Act to suggest amendments for more effective regulation of the microfinance sector**. DSMI has identified the need for provisions on regulation of non-deposit taking micro-credit institutions through an appropriate regulatory framework, and a unified customer protection framework for protection of microfinance customers. DSMI expects to issue a customer protection charter during 2018, With a view to protecting microfinance customers.

- **Regulation of the microfinance sector in a holistic manner has been difficult due to the fact that Microfinance Institutions (MFIs) are regulated by a number of other regulators apart from the Central Bank, such as Samurdhi Development Department and Co-operative Development Department, which are exempted from the purview of the Microfinance Act**. Therefore, DSMI expects to take mesures during 2018 to convene an inter-regulatory council comprising of all regulators of MFIs, which would meet at regular intervals. It is anticipated that Central Bank would entering into MOUs with other regulators of MFIs for sharing of information and regulatory knowledge during 2018.

- **It is expected that new and advanced electronic retail payment instruments such as payment cards, mobile and internet payments will become more popular as a means of settling transactions**. The increased use of these new electronic retail payment systems, has necessitated measures to minimise risks, and to increase efficiency levels and reduce costs. Accordingly, the Central Bank introduced policy measures to provide a safe and sound environment for easy adoption of electronic payment systems and to maintain public confidence in the electronic retail payment and settlement systems.

- **Central Bank is engaged in the preparation of guidelines for mobile applications used by institutions providing payment services for payment related mobile applications which is expected to be issued during the year**. These guidelines will lay down the minimum standards in relation to protection of customer information and transaction security and is expected to ensure availability of secure mobile applications to effect payments.

- **Central Bank is in the process of revising the Credit Card Operational Guidelines issued in 2010, in line with the new developments in the credit card industry**. It is expected to issue revised guidelines during the year after considering the suggestions made by relevant stakeholders.

- **Strengthening of the supervisory and regulatory framework governing the capital markets and the insurance sector continued during the year**. The Insurance Board of Sri Lanka (IBSL) has taken measures to streamline the provision of ancillary services by insurance brokering companies. In addition, IBSL intends to work with the World Bank for developing a Micro-Insurance Framework for Sri Lanka. This framework intends to promote micro-insurance as an effective poverty reduction tool. The development of the micro-insurance sector would improve the ability of risk mitigation and reduce the vulnerability of low-income households by facilitating them with access to affordable insurance products.

- **The Securities and Exchange Commission (SEC) introduced new risk based criteria on minimum capital requirements and minimum liquid capital of stock brokers while promotional activities of unit trust were streamlined**. Approval of a Small and Medium Enterprises Board and minimum public float enforcement rules by SEC in 2017 are considered to be a major step towards further expansion of capital market operations. Further, the SEC intends to facilitate the demutualisation of the CSE with technical assistance from Asian Development Bank. Demutualisation of the CSE is expected to yield a number of advantages including raising additional capital for expansion and innovation purposes, increasing the ability to operate in a more customer-focused and responding to changes in the dynamic business environment in speedily manner.

- **Central Bank has formulated new strategies expecting to promote access to finance, improve financial inclusion and balanced regional growth in the country**. Accordingly, the Central Bank facilitates all sectors by enhancing the flow of credit and credit plus services and provision of non-financial support to achieve sustainable development of the country and create a conducive financial environment to bring-in excluded segment to the formal financial sector by developing a National Financial Inclusion Strategy for the country.