

# A GUIDE TO FINANCIAL SERVICES IN SRI LANKA

DECEMBER 2004



Central Bank of Sri Lanka

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## PREFACE

**F**rom time to time, the Central Bank receives numerous inquiries from the public with regard to institutions that are authorised to accept deposits and other investments from the public, the type of deposits that they could accept and the types of loans and financial services that they would provide and on what terms. The public also wish to have an indication of the safety in dealing with other financial institutions that engage in trading in securities, foreign exchange, etc. **Most are concerned with the safety of their money and the adequacy of the return they receive by way of interest, etc.**

While there is no easy way by which one can answer all these questions, it is important to bear in mind that **there are always risks inherent in all investment decisions whether they are deposits or other funds.** It should be clearly understood that **these risks must be borne by depositors, lenders and other investors** and that the return on a deposit or a loan or a transaction will reflect the degree of risk, among other things. It is believed that **higher the risk, higher is likely to be the return on the investment or transaction, and that the opposite also holds is valid.** Therefore, when the return is high, the public should be mindful of the fact that the underlying risk too can be high.

**The Central Bank regulates and supervises only the banks and other financial institutions licensed or approved by it. The fact that these institutions are regulated, supervised or approved by the Central Bank does not involve a guarantee of the deposit, the investment or the transaction, whatsoever.** However, the Central Bank regulates and supervises the institutions to encourage them to act in a prudent manner, which will protect the public interest. **No institution is legally permitted to use the word "Bank", "Banker" or "Banking" in its name or to carry on the business of banking or finance without the written approval or licence of the Central Bank.** By granting the approval or licence to a particular institution, it only authorises the institution to carry on the business in compliance with the requirements of the relevant statutes. **The approval or licence does not mean a guarantee of deposits or other transactions that the public have with the institution or the safety or the soundness of the institution. The publication of the names of the institutions licensed or approved by the Central Bank should not in any way be construed as a recommendation by the Central Bank to the public to deposit or invest their money in any one of those institutions or to assume that those institutions are always safe and sound.** The safety of an institution and thereby the safety of deposits or other investments made by the public with an institution depends on the extent of efficiency of the risk management of the business of the institution by its managers and the Board of Directors. **Therefore, it is the responsibility of the depositors or other investors to exercise due care and vigilance over the institutions they deal with.** In this regard, the Central Bank presents the following information in the public interest, with a view to enhancing the awareness of the public about the financial system.



## Overview of Financial System

**I**nstitutions operating in Sri Lanka's financial system consist mainly of the following;

- Central Bank of Sri Lanka;
- 22 licensed commercial banks, of which, 11 are locally incorporated banks while the other 11 are local branches of foreign banks. They all have a total of 1,711 branches and other service outlets spread throughout the country;
- 14 licensed specialised banks, which consist of long-term lending/development banks, savings banks, regional development banks, etc.;
- 27 registered finance companies which engage primarily in hire purchase, leasing and real estate business;
- 12 primary dealers which engage in dealing in government securities;
- 11 leasing establishments; In addition, several other banks and financial institutions also engage in leasing business.
- 11 merchant banks and investment banks which engage in a variety of financial services;
- Savings and loan associations such as 1,594 co-operative rural banks functioning as banking arms of Multi-purpose Co-operative Societies, 8,450 thrift and credit co-operative societies and other registered co-operative and credit societies. They collect savings from members and non-members and lend exclusively to the members;
- Contractual savings institutions functioning in the forms of insurance establishments, Employees' Provident Fund, Employees' Trust Fund and other provident funds;

Assets of the Financial Institutions (End June 2004)		
Institution	Rs. Bn.	%
Central Bank of Sri Lanka	358	14.2
<b>Institutions Supervised by the Central Bank</b>		
Deposit-Taking Institutions	1,490	59.0
Licensed Commercial Banks	1,133	44.9
State Banks	510	20.2
Domestic Private Banks	471	18.7
Local Branches of Foreign Banks	152	6.0
Licensed Specialised Banks	299	11.8
Registered Finance Companies	58	2.3
Other Institutions	416	16.5
Employees' Provident Fund	341	13.5
Primary Dealers	50	2.0
Leasing Establishments	25	1.0
Group Total	1,905	75.5
<b>Institutions not Supervised by the Central Bank</b>		
Deposit-Taking Institutions	30	1.2
Co-operative Rural Banks	25	1.0
Thrift and Credit Co-operative Societies	6	0.2
Contractual Savings Institutions	201	7.9
Approved Private Provident Funds	87	3.5
Employees' Trust Fund	50	2.0
Insurance Institutions	63	2.5
Other Specialised Financial Institutions	30	1.2
Merchant Banks	22	0.9
Unit Trusts	4	0.2
Venture Capital Companies	4	0.2
Group Total	261	10.3
Total Assets	2,524	100.0

- Other specialised financial institutions which include 6 venture capital companies and 12 unit trusts.
- In addition, there is a large number of individual money lenders in the informal sector.

*Of the above, the institutions regulated and supervised by the Central Bank are licensed commercial banks, licensed specialised banks, registered finance companies and primary dealers. Leasing establishments should register themselves with the Central Bank. Meanwhile, the Central Bank undertakes only the function of the fund management of the Employees' Provident Fund which is administered under the Employees' Provident Fund Act. Accordingly, as in other countries this leaves out a large number of other institutions dealing*



*with funds or investments of money raised from the public which are almost impossible to be regulated and supervised by the Central Bank alone because of their size, nature, diversity and wide dispersal.*

### **\* Investments in Financial Institutions**

The types of investments that the public can make in the financial institutions fall mainly into three categories **shares, debt instruments and deposits.**

- **Shares:** By investing in shares of an institution, one receives an ownership in the institution proportionate to his/her share holding. Money invested in shares is not repayable, but the investor may recover it by selling such shares to other willing investors. The return on investment in shares comprises of dividend (if the institution pays out of profit) and capital gain (*i.e.* profit made if shares are sold at a higher price than the purchased price).
- **Debt Instruments:** Debts are the funds raised by way of debentures, bonds, privately arranged loans, *etc.* They are usually repayable only on the due date agreed in the debt contract or promissory note between the borrowing institution and the lender/investor. The return on a debt investment is the interest paid/received on the agreed dates or discount offered on the value of the debt by the borrower. In respect of investments in marketable debts, the capital gain, if any, is also a part of the return.
- **Deposits:** A deposit means a sum of money accepted, having the following terms and characteristics.
  - Money is repaid either on demand or at other time or in other circumstance

agreed by the receiver and the depositor.

- Payment of interest or premium or provision of other benefits as return to the depositor on such money accepted by the receiver.
- Making available the use of the benefit of such money accepted to third parties by way of lending or other ways in the usual course of business of the receiver.

***In terms of current regulatory laws on banking and finance business, carrying on deposit-taking business without permission obtained under the relevant statute is an offence. The general public may come across instances where certain institutions canvas funds from the public by way of differently named investments without using the term "deposit", but such investments may well carry some or all of the above-mentioned characteristics of deposits. Therefore, the general public is advised to make their own assessment of the risks involved in investing their moneys in deposits or otherwise when they make investment decisions.***

### **Central Bank of Sri Lanka**

**T**he Central Bank is the institution that has been established under the ***Monetary Law Act as the authority responsible for the administration, supervision and regulation of the monetary, financial and payments system of Sri Lanka.*** Its operations and functions are geared to securing two objectives, *i.e.*, ***economic and price stability and financial system stability*** of the country with a view to encouraging and promoting the development of productive resources of



Sri Lanka. The Central Bank primarily conducts the monetary policy in order to secure the objective of economic and price stability. Meanwhile, in order to ensure a stable and sound financial system which will secure the financial system stability in the country, the Central Bank has been empowered to license, regulate and supervise the banks and other major institutions canvassing deposits and other investments of funds from the public. In addition, the Banking Act and the Finance Companies Act specifically empower the Central Bank to regulate and supervise the banks and finance companies in order to ensure the soundness of those institutions.

The Central Bank also carries out a number of other statutory functions relating to the Government, banks and the general public. Some of them are the banker to commercial banks, the banker to the Government and agent of the Government in the form of financial adviser, fiscal agent, Controller of Exchange and administration of the Employees' Provident Fund.

## Institutions Legally Permitted to Accept Deposits

### ★ **Institutions Permitted by the Central Bank**

There are three major categories of institutions that are subject to licensing, regulation and supervision by the Central Bank in the public interest because they accept deposits from the general public. ***They are licensed commercial banks, licensed specialised banks and registered finance companies.***

These financial institutions which account for about 59% of the formal market on the basis of assets are

supervised and regulated by the Central Bank by means of monthly and quarterly information received from them, regular inspections of their books and records and advice which encourages these institutions to act in a prudent manner in order to safeguard the interests of depositors and other creditors.

Regulation and supervision are governed by several laws, mainly the Monetary Law Act, the Banking Act and the Finance Companies Act. A complete set of laws and regulations relating to the banking and financial sector is available in 7 volumes for purchase at the Central Bank (Rs. 1,000 for each volume).

### ● **Licensed Commercial Banks**

A commercial bank is a banking institution issued with a licence by the Central Bank to carry on, among other

#### Licensed Commercial Banks

(in Alphabetical Order)

Domestic Banks	Telephone
1. Bank of Ceylon	2446790
2. Commercial Bank of Ceylon Ltd.	2328193-5
3. DFCC Vardhana Bank Ltd.	2371371-2
4. Hatton National Bank Ltd.	2660660
5. Nations Trust Bank Ltd.	4313131
6. NDB Bank Ltd.	2448448
7. Pan Asia Banking Corporation Ltd.	2565570
8. People's Bank	2327841-9
9. Sampath Bank Ltd.	2300260
10. Seylan Bank Ltd.	4701777
11. Union Bank of Colombo Ltd.	2370971
<b>Branches of Foreign Banks</b>	
1. Citibank, N.A.	2447316
2. Deutsche Bank AG	2447062
3. Habib Bank Ltd.	2447827
4. Indian Bank	2323402-3
5. Indian Overseas Bank	2324422-4
6. Muslim Commercial Bank Ltd.	2448765-6
7. Public Bank Berhad	2576289-92
8. Standard Chartered Bank	2480000
9. State Bank of India	2326133-5
10. The Hongkong & Shanghai Banking Corporation Ltd.	2447536
11. Union Bank Ltd. (Incorporated in Pakistan)	2679000-6



things, maintaining current accounts for customers, where money could be transferred by cheque and withdrawn on demand. They also maintain savings and time deposits for customers on which interest is paid and some minimum notice has to be given for withdrawal. In addition, they undertake a wide range of financial services and, on appointment by the Hon. Minister of Finance, deal in foreign currency as "authorised dealer".

The 22 licensed commercial banks, which currently operate through a total of 1,711 branches and other banking outlets in the country, generally depend on short-term deposits from the public for their funding requirements and are best suited to grant short-term loans. These banks are regulated and supervised by the Central Bank under the Monetary Law Act and the Banking Act.

### ● *Licensed Specialised Banks*

Licensed specialised banks are the financial institutions which have obtained a licence from the Central Bank to conduct specialised banking business under the Banking Act. ***These banks are different from commercial banks in that they are not authorised to accept demand deposits from the public and, therefore, do not maintain current accounts for customers.*** However, they are authorised to accept savings and time deposits on which interest is paid. Also, they are not authorised to deal in foreign currency. At present, there are 14 licensed specialised banks operating with 404 banking outlets in the country. Of these, 8 are national level banks, while the remaining 6 are regional development banks whose operational area is limited to a specified region. The institutions operating at national level engage mainly in long-term lending for development projects while regional banks undertake

### Licensed Specialised Banks

(in Alphabetical Order)

<i>National Level Banks</i>	<i>Telephone</i>
1. Ceylinco Savings Bank Ltd.	2372720
2. DFCC Bank	2440376
3. Housing Development Finance Corporation Bank of Sri Lanka	2446241
4. National Development Bank of Sri Lanka	2437701 / 10
5. NDB Housing Bank Ltd.	2552552
6. National Savings Bank	2573008 / 15
7. Sanasa Development Bank Ltd.	5376686
8. State Mortgage and Investment Bank	2573561
<i>Regional Development Banks</i>	
1. Kandurata Development Bank	081-2214115 / 7
2. Rajarata Development Bank	025-2223080
3. Ruhuna Development Bank	041-2226208 / 9
4. Sabaragamuwa Development Bank	045-2224566
5. Uva Development Bank	055-2222849
6. Wayamba Development Bank	037-2227428 / 9

mainly short-term and medium-term lending out of deposits mobilised from the public. Licensed specialised banks are regulated and supervised by the Central Bank under the Monetary Law Act and the Banking Act.

### ● *Registered Finance Companies*

A registered finance company is a company registered and licensed by the Central Bank to accept time deposits and lend and invest such moneys. They do not maintain current and savings accounts. At present, there are only 27 finance companies registered with the Central Bank and they operate with a total of 78 branches and other service outlets in the country. Most of them engage in hire-purchase, leasing and real estate business. Finance companies are registered, regulated and supervised by the Central Bank under the Finance Companies Act. The other companies which call themselves as finance companies or investment companies are not authorised to accept deposits or to carry on the



## Registered Finance Companies

(in Alphabetical Order)

	Telephone
1. Alliance Finance Co. Ltd.	2673673
2. Arpico Finance Co. Ltd.	2553663
3. Asian Finance Ltd.	2438141
4. Associated Motor Finance Co. Ltd.	2687265
5. Bartleet Financial Services Ltd.	2326495
6. Central Finance Co. Ltd.	08-22227000
7. Central Investments & Finance Ltd.	2694753
8. Ceylinco Investment & Reality Ltd.	4719999
9. Chilaw Finance Ltd.	032-2222055
10. Commercial Credit Ltd.	08-12234963
11. Edirisinghe Trust Investments Ltd.	2694822
12. Finance & Land Sales Ltd.	2573660
13. Industrial Finance Ltd.	2314466
14. Janashakthi Finance & Investments Ltd.	2441930
15. L B Finance Ltd.	2508507
16. Lanka ORIX Finance Co. Ltd.	2665780
17. Mercantile Investments Ltd.	2343720
18. Merchant Credit of Sri Lanka Ltd.	2301501
19. Nanda Investments Ltd.	2686523
20. Senkadagala Finance Co. Ltd.	081-2201201
21. Silverreen Finance Co. Ltd.	081-2224619
22. Sinhaputra Finance Ltd.	081-2223235
23. The Finance & Guarantee Co. Ltd.	2672029
24. The Finance Co. Ltd.	2595210
25. The Multi Finance Co. Ltd.	081-2225130
26. The Rupee Finance Co. Ltd.	2694026
27. Trade Finance & Investments Ltd.	2688421

business of finance that requires approval under the Finance Companies Act.

## ★ Types of Deposit Accounts

Above institutions are permitted to accept several types of deposits from the public.

- Licensed Commercial Banks      All categories of deposit accounts including current accounts, savings accounts and time deposit accounts.
- Licensed Specialised Banks      Savings and time deposit accounts only.
- Registered Finance Companies      Time deposit accounts for a period of not less than 1 month and not more than 60 months.

## ★ Interest Payments on Deposits

● Commercial banks do not pay interest on balances in current accounts which can be withdrawn on demand. Regarding other deposits, it has been the practice of the deposit-taking institutions soliciting deposits to disclose, in their advertisements, interest rates payable on such deposits. In addition, the Central Bank has requested all licensed banks to display their interest rates in all branches. Interest rates so announced could be the annual rates applicable to interest payment on a daily, monthly or quarterly basis. Since such disclosure is inadequate and even could mislead the public (for instance, if interest is paid at a given rate monthly, the annual effective rate would be higher than the same rate payable at maturity because interest is paid monthly on the deposit balance inclusive of interest paid for the preceding months), the Central Bank has instructed the commercial banks, specialised banks and registered finance companies to publish **annual effective interest rates** in advertisements soliciting deposits. With this information, the depositors could compare the return on investment in deposits they place with different institutions.

● As in any other business, the income received by a depositor or an investor by way of interest is usually closely related with the risk taken by him/her. For instance, usually long-term deposits carry higher rates of interest as the risk associated with such deposits is also higher. **Therefore, if a deposit-taking institution offers a considerably higher rate of interest than others, a depositor may exercise a greater degree of caution in investing with such institution because, by and large, the risk too could be higher.**



### ★ **Other Institutions permitted to accept deposits**

Besides the above three categories of institutions, the co-operative societies registered under the Co-operative Societies Law No. 5 of 1972 and building societies incorporated under the National Housing Act (Chapter 401) are also authorised to accept deposits of money under the relevant law. Here too, current accounts are not permitted. They could, however, accept savings and time deposits on which interest is paid. ***These institutions which are not required to obtain the approval of the Central Bank to accept deposits are not regulated or supervised by the Central Bank.***

### ★ **Institutions that are not authorised to accept deposits**

Other institutions have not been permitted to accept deposits of money from the public, but they may accept other kinds of investments from the public by issuing various financial instruments such as shares, debentures and privately arranged loans and provide various financial services. These institutions include;

- *Primary Dealers in Government Securities*
- *Merchant Banks / Investment Banks*
- *Leasing Establishments*
- *Venture Capital Companies*
- *Unit Trusts*
- *Insurance Institutions*
- *The societies or organisations (other than the registered co-operative societies and building societies) established or registered under any other written law*

*not being organisations established primarily for the purpose of making profit. They should not accept deposits from their members or any other parties unless the Central Bank's approval has been obtained to do so.*

***It should be clearly understood that the carrying on of business by an institution similar to the business of a bank or a finance company which has been specified in the Monetary Law Act, the Banking Act or the Finance Companies Act without the approval of the Central Bank is an offence under the law. The registration or incorporation of an institution under the Companies Act for the business of banking or finance does not mean that the institution is permitted to engage in the business of banking or finance, for which the approval of the Central Bank is required.***

The approval of the Central Bank is also required for the use of the word ***"Bank" or "Banker" or "Banking" or any derivative of those words*** in the name of an institution. The use of any of the above words in the name of an institution without approval is an offence under the Banking Act.

***Therefore, the general public is hereby informed that they should exercise utmost caution to ensure that they deposit or invest their money with legally permitted institutions. Risks associated with money invested in illegal institutions could be relatively greater because those institutions are not registered, authorised and supervised by the Central Bank or any other regulatory authority.***



## ★ Credit Rating

The credit rating of an institution is a vital piece of information that helps the public to assess the soundness of the institution.

***Credit rating is an assessment of the creditworthiness of an institution or a debt instrument such as debentures issued by institutions.*** Those who provide credit ratings to institutions on a charge of a service fee are the credit rating institutions.

Fitch Ratings Lanka Ltd., which is a joint venture between Fitch Inc. USA, the Central Bank and several other institutions, is the only credit rating institution operating in Sri Lanka at present. Fitch Inc. USA is one of the three largest rating institutions in the world. Ratings assigned by Fitch Ratings Lanka Ltd. are communicated by letters A, B, C and D, with the (sri) indicating that it is a Sri Lankan rating. AAA (sri) is the highest rating indicating the lowest risk and D (sri) will be the lowest with the highest default risk.

A number of banks and finance companies have already obtained a credit rating and published it for the information of the public. Considering the importance of credit rating, it has now been made mandatory for the following institutions to obtain a credit rating from a recognised credit rating institution before the stipulated date.

- Licensed commercial banks and licensed specialised banks - before June 30, 2004.
- Registered finance companies - before January 1, 2005.
- Leasing companies that raise funds by issuance of debt instruments to public - before January 1, 2005.

- Private companies that raise funds by issuance of debt instruments to public - before January 1, 2006.

More details could be obtained from Fitch Ratings Lanka Ltd., No. 15-4, World Trade Center, Colombo 1. Telephone 2541900.

## Regulation and Supervision by the Central Bank

**A**t present, deposit-taking institutions regulated and supervised by the Central Bank are licensed commercial banks, licensed specialised banks and registered finance companies. Regulation and supervision are carried out in terms of the provisions in the Monetary Law Act, the Banking Act and the Finance Companies Act.

### ★ The Nature of Regulation and Supervision

- The regulation involves laying down requirements that the institutions should comply with relating to their operations. ***The minimum ratio of capital to total value of risks in assets, minimum ratio of liquid assets to liabilities, limit on volume of lending to a single borrower, provision for bad and doubtful debts and submission of annual audited financial statements within a stipulated period are some of the major regulatory requirements.*** The regulatory requirements are intended to serve as prudential standards that help the institutions to mitigate some of the risks inherent in banking or finance business. Such regulations which are applied commonly to all institutions in the particular category of institutions (i.e., commercial banks, specialised banks



or finance companies) are determined in terms of the provisions of the relevant statutes, with a view to promote the safety and stability of the institutions as well as of the financial system as a whole.

- Supervision involves the oversight of the institutions through examinations carried out in two ways; off-site surveillance and on-site examinations. Off-site surveillance is the examination of information received periodically (monthly, quarterly, half-yearly, etc.) from the institutions relating to their performance and financial status with a view to revealing early warnings of impending problems which can be resolved by taking early remedial action. In on-site examinations, the Central Bank examiners periodically visit the institutions for examination of their books and accounts with a view to making an assessment of the operations of the institutions by (a) verifying compliance with prudential and regulatory requirements and (b) assessing the various risks, i.e., credit risk, liquidity risk, market risk and operational risk, and risk management capacity of the institutions. ***On the basis of the findings of these examinations, the Central Bank continuously communicates with the management of the institutions and requires them to initiate prompt corrective actions to solve the problems and weaknesses observed.***

### ★ The Objectives of Regulation and Supervision

- Through regulation and supervision, the Central Bank seeks to ensure that these institutions are careful in lending and managing the money of depositors and other investors and the institutions

are managed in a sound and prudent manner which will reasonably assure the safety of deposits and other funds placed with them by the public. However, the effectiveness of regulation and supervision ultimately rests on the co-operation extended by the management of the institutions by means of compliance with prudential requirements, providing accurate information for examination and undertaking strictly the corrective actions recommended by the Central Bank from time to time. Where an institution seeks to defy or evade the regulations and recommendations and engages in fraud, the regulatory and supervisory process loses its effectiveness.

- It should be clearly understood that regulation and supervision do not mean that the Central Bank controls or manages the institutions soliciting deposits and other investments from the public or that the Central Bank stands to protect all such institutions from possible failures irrespective of their weak financial condition or mismanagement. All financial institutions, just like any other business organisation, stand to seek profit which is the reward for risk-taking in the business. It is the Board of Directors and managers who control and manage the institutions with desired levels of risk-taking. ***Financial institutions too can fail from time to time as they are in inherently risky business if their risk management is weak.*** In a competitive system, some banks or financial institutions will fail occasionally, just like other businesses. The Central Bank only regulates and supervises the institutions licensed by it to ensure that they are managed in a sound and prudent manner. Moreover, the Central Bank has the responsibility to ensure that the whole



financial system remains stable and sound. For this purpose, it is necessary that the major institutions in the financial system are sound and managed prudently. Institutions with weak financial condition or with weak risk management pose a threat to the stability of the financial system because a possible failure of one or a few such institutions is likely to weaken **the public trust in the system, the very essential precondition for the existence of financial institutions in the business**, and cause a contagion effect on even other well-run institutions unreasonably. In fact, the banking system is sound and stable to the extent that such weak institutions are removed from the system. **Therefore, the Central Bank is not expected to protect each and every weak or excessive risk-taking institution which will endanger the stability of the financial system.**

- For the purpose of protecting depositors from the risk of failure of depository institutions, countries implement Deposit Insurance Schemes. Under these schemes, depository institutions are expected or required to insure their deposit liabilities with the scheme by paying a periodical premium. In the event of failure of an insured depository institution, the deposit insurance will pay out deposits subject to a maximum limit. A Deposit Insurance Scheme has been in operations in Sri Lanka since 1987 and participation in the scheme is voluntary to licensed banks and registered co-operative societies carrying on banking business. As in some countries, the Government is now considering to formulate and implement a mandatory deposit insurance scheme with a view to provide specific protection to small depositors from the failure of institutions.

## ★ Some Misconceptions about Regulation and Supervision

- **A misconception exists that, as supervisor and regulator, the Central Bank guarantees the safety of all deposits and other investments of the public:**

While regulators seek to achieve the safety and soundness of the institutions regulated by them, yet the safety and soundness of the institutions depend largely on the management of the institutions by their Directors and Managers. **It is the Board of Directors who bear the ultimate duty and responsibility in guiding the institution to operate in a sound and prudent manner which will protect the interest of depositors and other stakeholders. Directors should serve as unbiased judges of the performances of the institution.** For this purpose, it is necessary that they have oversight on the affairs of the institution which include mainly compliance with regulatory requirements, adequacy of capital, quality of assets, earning capacity, adequacy of liquidity, exposure to various risks and risk management system. Accordingly, the Directors ought to be fit and proper persons who are capable of fulfilling such duties and responsibilities practically and effectively. **Therefore, it is the responsibility of the public to exercise utmost care and vigilance over the true affairs of the institutions in which they place deposits and other investments.**

In order to facilitate this, the Central Bank has required such institutions to disclose to the public, up-to-date financial information relating to their operations. Such disclosures are made by commercial banks and specialised banks periodically



in the newspapers. Further, licensed banks and registered finance companies have been required to display their annual audited financial statements at their Head Offices and branches for the information of the public. The public is expected to inform themselves of the safe and sound condition of the institutions from such disclosure of information and other comments or reviews appearing in the financial media from time to time.

● ***Another misconception is that, as the regulator and supervisor, it is the duty of the Central Bank to inform the public very early when an institution begins to face problems so that depositors are able to withdraw their money before the failure of the institution:***

It is argued that the public is first made aware of the problems in an institution only as a result of a drastic supervisory action for the suspension or liquidation of the institution. However, until such time, the Central Bank makes every endeavour through its regulatory and supervisory process to resolve the problems of an institution in order to protect the public interest. ***If the Central Bank pre-announces problems of an institution, there would be an immediate run on the institution by depositors and other creditors and it would collapse immediately, perhaps prematurely and unnecessarily.*** Hence, the Central Bank does not have the option to warn the public of problem institutions, but it will take steps, in terms of the statutory provisions applicable to encourage and require the management of such institutions to take remedial measures to resolve problems. If all such steps fail, the Central Bank has no option but to suspend the business of the

institution in order to protect the interest of the public through application of a more stringent course of action authorised. The liquidation of such institution is the last supervisory action available to safeguard the interest of depositors and other creditors to the extent laid down in the relevant statutes.

### ★ **An Expert's View on the Role of the Central Bank as the Bank Supervisor**

Professor Charles Goodhart, Professor of the London School of Economics and formerly a member of the Monetary Policy Committee of the Bank of England, clarified as follows the role of the Central Bank as the supervisor of banks in answering two questions raised by the audience during his Independence Commemorative Lecture delivered at the Central Bank on February 6, 2003.

● ***Question 1 : Can the systemic stability issues be separated from concerns about the possible failure of individual financial institutions?***

**Answer :** The answer is absolutely yes. A Central Bank neither can nor should guarantee the continuation of all financial intermediaries irrespective of how badly managed they are or how the management has been. Even in some cases, the management can act illegally, for example, BCCI did in the case of a failure in the UK. ***Although a Central Bank neither could nor should stop all individual failures, it has to be prepared and ready to stop an individual failure causing such concern and panic about the stability of the system as a whole.*** Let me give you a particular example and I take it from my own country, i.e. UK.



Barings bank failed in 1995 as a result of the fraudulent activities of a trader in Singapore. Now, one of the reasons why the Bank of England decided that Barings should be allowed to fail was that because that did not have any systemic implications for the rest of the banking system.

Moreover, one of the reasons why the trader had been able to get away with his activities was that the internal control mechanism in Barings has been pretty badly run, and ***those who saved Barings might have given the wrong kind of signal that it does not matter what the internal control mechanisms are like, the Central Bank will always save you.*** The failure of Barings was probably the strongest wake-up call that banks in the UK had almost for a century and made them realise that it was their responsibility to maintain internal control mechanisms. That said, the fact that Barings has failed meant that there were possibly people who might have doubted whether a similar kind of effect could have impacted on other equivalent types of merchant banks in the UK at that time because if a second bank had been allowed to fail when there was no particular reason for doubting its solvency, that would, because of run on it, have let to a generalised run and that would have let to a systemic failure.

This is a very difficult job for a Central Bank. You have got to, in order to ensure that management does manage itself properly and effectively, allow bad management to bear the cost and losses arising from their own poor handling of the system. But at the same time, you have got to ensure that the system as a whole remains stable. So then indeed it is the ultimate requirement of the Central Bank to separate systemic stability for which it has total responsibility from crime and it

has got to do that while at the same time ensuring that individual banks take the responsibility for their own actions.

● ***Question 2: A Central Bank dominates and controls all commercial banks. But, there have been frauds in some of the commercial banks which could not have been detected earlier until it was later found out. It affects the monetary system or the policy of the Central Bank. What steps is it taking now to prevent such frauds ?***

**Answer :** Fraud is extraordinarily difficult to detect and it is actually a matter for the law and the police rather than for the Central Bank. ***The Central Bank's role is to ensure that the overall system of banks and the financial system within the economy remains sound and stable. It is not the role of the Central Bank to have an official sitting in every banking office, looking over the shoulder of every trader or everybody who is organising a bank loan.*** That would be both impossible on resources and it would be undesirable in the degree of control that would be exerted. It is not a function of a Central Bank to second guess every activity that the commercial banks were undertaking. The commercial banks' management has got to manage.

One of the problems that I have actually seen or think I have seen in my relatively short time in this country is that ***there are many people who do not understand the role of the Central Bank in supervision and regulation.*** It is not to second guess every detail of every exercise of every bank. That would be very undesirable and impossibly constraining. Management has to manage.



Nevertheless, the Central Bank has got to ensure that management in general knows the kind of internal risk management mechanisms, the kind of requirements, the maintenance of capital, the maintenance of liquidity, and in aggregate that the system as a whole remains sound. There is virtually no country in the world which has not had a bank failure and, indeed, it would be undesirable to be in a country without ever having a bank failure because I would suggest that, that country has been so constraining its banking system that it will be inefficient, tied down and not working satisfactorily. You would not expect that every industrial company always remains in business. There are failures in industrial companies. There are failures in commercial companies. There are failures in hotels. You have got to allow managers to undertake some risks. Without undertaking risks, there is no growth and there is no development.

***The Central Bank sets the general conditions which will maintain the stability in the system as a whole.***

However, there will be occasionally bank failures. There have been bank failures in the UK. There are bank failures every year in the United States. The biggest bank in France, Credit Lyonnais, effectively failed. There are many bank failures and they are inevitable part of the risk-taking and the development of our economies. I admit that some of the bank failures are connected with fraud, but again fraud is something that you cannot expect an external supervisor to observe as a generality.

***Frauds occur. It is necessary to set the structure of the system so that frauds are unlikely to occur. It is***

***necessary to ensure that when fraud does occur, the management that allowed fraud to occur certainly suffers.*** But, you cannot prevent fraud occasionally occurring at times. I took the example of Barings. That was fraud of a major kind occurring in one of the oldest and highest reputed banks in the UK and it occurred and that sort of thing will occur again, it is bound to occur, unless you have a totally excessive degree of controls by the Central Bank which will be inappropriate.

## Dealings in Government Securities

**A**s the agent of the Government, the Central Bank is responsible for managing the Government debt. The Government of Sri Lanka, like any other institution, borrows money to finance its expenditure programmes. For this purpose, it issues various types of debt securities. The Central Bank undertakes the function of issuing these securities on behalf of the Government.

Government securities are currently in the form of Treasury bills, Treasury bonds, Sri Lanka Development Bonds and Rupee Securities, which are notes issued by the Government acknowledging a borrowing and promising to repay the holder in 91 days, 182 days, 364 days (Treasury bills) or more (Treasury bonds, Sri Lanka Development Bonds and Rupee Securities).

For the convenience of the public, the Central Bank has appointed 12 primary dealers to deal in Treasury bills and Treasury bonds. These dealers buy all the bills and bonds from the issues at the



auctions and sell them to the public. Also, they trade these bills and bonds in the secondary market. Thereby, they create a market by buying and selling. Licensed commercial banks and other institutions incorporated for the business of dealing in Government securities are eligible to apply to be considered for appointment as primary dealer.

### Primary Dealers in Government Securities

(in Alphabetical Order)

	Telephone
1. Bank of Ceylon	2541938
2. Capital Alliance Ltd.	2314700
3. Ceylinco Shriram Securities Ltd.	2564933
4. Commercial Bank Primary Dealer Ltd.	2332319
5. First Capital Treasuries Ltd.	2304430
6. HNB Securities Ltd.	2381696
7. Nat Wealth Securities Ltd.	4730000
8. NSB Fund Management Co. Ltd.	2564706
9. People's Bank	2304484
10. Sampath Surakum Ltd.	2305842
11. Seylan Bank Asset Management Ltd.	2456907
12. The Hongkong & Shanghai Banking Corporation Ltd.	2421697

Sri Lanka Development Bonds are denominated in US Dollars and issued through the designated agents which are primary dealers and authorised dealers in foreign currency. Non-resident Sri Lankans, foreign citizens and foreign companies are eligible to buy these bonds from the designated agents. Rupee Securities can be bought directly from the Central Bank.

As in other countries, Government securities are considered as the least risky types of investments and, therefore, the return would be generally lower than the return on other financial investments available in the market. However, on occasions where the Government is compelled to compete for raising funds

from the market, Government securities may carry higher rates of return than the return on other investments to attract investors.

## Foreign Exchange Transactions

Under the Exchange Control Act, the Central Bank functions as the agent of the Government through the Controller of Exchange. Currently, the Controller regulates transactions in foreign currencies of a capital nature only, i.e. involving sale or purchase of a capital asset and cross-boarder lending and investments. Current or non-capital transactions which involve in export and import of goods and services and remittances are free of control. The Board of Investment too is authorised to grant exemption from exchange control to companies specifically approved by the Board of Investment.

The public could engage in foreign exchange transactions only with those institutions and persons who are authorised to deal in or accept foreign currency. The general public is cautioned that any transaction with institutions and persons other than those authorised by the Controller of Exchange is an offence under the Exchange Control Act.

### ★ Institutions and persons authorised for transactions in foreign currency

#### ● Authorised Dealers

All licensed commercial banks at present have been permitted to deal in foreign exchange as authorised dealers and they have the authority to enter into transactions of buying,



borrowing, accepting, selling and lending foreign currency with eligible parties.

- ***Travel Agents authorised to issue Traveller's Cheques***

<b>Authorised Travel Agents</b> (in Alphabetical Order)	
	Telephone
1. Air Global Ltd.	2544200
2. Aset Airways Ltd.	2300750
3. Ceylon Carriers (Travel Services) Ltd.	2325101
4. George Steuarts Travel International Ltd.	2326411
5. Hemas Travels (Pvt) Ltd.	2445177
6. Lewis Brown Air Services (Pvt) Ltd.	4525747
7. Mackinnons American Express Travel (Pvt) Ltd.	2448065
8. N-CAR Travels & Tours Ltd.	2564584
9. The Thomas Cook Overseas Ltd.	2440578

- ***Authorised Money Changers***

They have been permitted to buy foreign currency notes in exchange of Sri Lanka Rupees and to exchange designated foreign currencies. The money changers (list - page 19) are not permitted to sell foreign currency for Rupees or convert traveller's cheques and any other foreign currency instruments into Rupees.

- ***Other establishments authorised to accept payment in foreign currency***

Selected establishments in certain trades have been authorised by the Controller of Exchange to accept payments in foreign currency. Those are authorised hotels, gem and jewellery traders, travel agents, duty free shops, hospitals, agency post offices and harbour traders (who sell products to crew and passengers in transit).

- In addition to the above authorised institutions, the National Savings Bank

has also been authorised to limited transactions in foreign currency such as accepting deposits in form of Non-resident Foreign Currency Deposits and Resident Foreign Currency Deposits and purchase of foreign exchange tendered by its depositors in the form currency notes, traveller's cheques and bank drafts to the credit of their accounts at the bank.

## **Network Marketing Pyramids and Risks**

**T**he Central Bank receives public inquiries regarding the operations of ***Pyramid schemes and safety of transactions*** of the public with those schemes. Some pyramid schemes are ***disguised as multi-level or network marketing schemes***. Under such schemes, products such as gold coins which are of limited consumer value and utility and, therefore, do not have a regular market, are often sold. The participants in these schemes have to recruit others to participate and purchase the products and will receive commissions tied to such recruitments as benefits or return on their participation. Products are sold at an inflated price which includes a premium or a fee to join the scheme and earn commissions. The number of participants in the scheme expands in a pyramid form.

The general public is advised to ***be aware of the risks*** inherent in participation in such disguised pyramid schemes as highlighted below.

- The scheme has to expand in a geometric progression and it is bound to ***collapse sooner or later*** for want of new participants. If it is assumed



that in a given country a pyramid scheme expands without any impediments, it will collapse once the total population of that country is exhausted. This truth is not revealed by promoters of pyramid schemes. Therefore, such schemes are deceptive and fraudulent by nature.

- When the scheme collapses, the majority of participants, mostly new comers, would not only lose anticipated commission, but also be left with **substantially over-priced** products.
- Some participants have to make their credit cards available to remit payments to foreign marketing companies for purchase of products on behalf of new recruits. This is tantamount to **an unauthorised foreign currency transaction**, which is an offence under the Exchange Control Act.
- These are not schemes that are designed by genuine marketing companies who sell useful products to consumers through the building of a network of marketing representatives who will deliver the products to individual consumers on payment by credit cards or by other means.
- Because of such risks, these pyramid schemes have been made illegal in some countries including USA and legislation has been proposed to pronounce **these schemes as illegal in Sri Lanka** and, therefore, the

participants eventually will have to run the **legal risks**.

The public is advised to assess very logically the presentations made by the promoters of such pyramid schemes before they agree to part with their money. These promoters are masters of group psychology. At recruiting meetings in the atmosphere created by these promoters, the prospective participants will find it difficult to resist the temptation to earn easy money. The fact that the majority of the participants in a pyramid scheme will not get any return is not revealed by the promoters. Therefore, such schemes are fraudulent and deceptive.

For details of pyramid schemes which are disguised as multi-level or network marketing schemes, the readers are directed to visit the following websites.

- [www.mlmlegal.com](http://www.mlmlegal.com)
- [www.crimes-of-persuasion.com/](http://www.crimes-of-persuasion.com/)
- <http://www.ftc.gov/bcp/menu-fran.htm>
- <http://www.ftc.gov/speeches/other/dvimf16.htm>
- [http://www.iowaattorneygeneral.org/consumer/press\\_releases/pyramid-release.html](http://www.iowaattorneygeneral.org/consumer/press_releases/pyramid-release.html)
- <http://www.law.emory.edu/6circuit/may99/99a017op.o6.html>
- <http://www.mlmsurvivor.com>
- [http://www.mlmsurvivor.com/km\\_net.htm](http://www.mlmsurvivor.com/km_net.htm)
- <http://www.marketwaveinc.com/>



## Authorised Money Changers

(in Alphabetical Order)

1. A O Lakshmi Jewels (Pvt) Ltd.	- 361, Main Street, Matale.	066-2230581
2. Abdeen Money Changers (Pvt) Ltd.	- 43, Hospital Street, Colombo 1.	2421612
3. Amani International (Pvt) Ltd.	- 180, 2nd Cross Street, Colombo 1.	2423590
4. Apollo Travels & Tours (Pvt) Ltd.	- 52, 53, Hospital Street, Colombo 1.	2433604
5. Ariyawansa Jewellers (Pvt) Ltd.	- 14, Kandy Road, Kiribathgoda.	4812015
6. Avin Money Exchange (Pvt) Ltd.	- 341/4, Galle Road, Hikkaduwa.	091-2277730
7. Citi Exchange (Pvt) Ltd.	- 92, York Street, Colombo 1.	2432322
8. Colombo Money Exchange (Pvt) Ltd.	- 96, Chatham Street, Colombo 1.	2438626
9. Crown Money Exchange (Pvt) Ltd.	- 56, 64, Mudalige Mawatha, Colombo 1.	2472957
10. Daya Authorised Money Changer (Pvt) Ltd.	- 112, Sea Street, Colombo 11.	2320345
11. Dedigama Jewellers (Pvt) Ltd.	- 65, Old Road, Maharagama.	2850785
12. Devi Forex (Pvt) Ltd.	- 131, Sea Street, Colombo 11.	2388757
13. Fathima Traders (Pvt) Ltd.	- 30A, Hospital Street, Colombo 1.	2449060
14. Golden Money Changer (Pvt) Ltd.	- 42, Mudalige Mawatha, Colombo 1.	2451070
15. International Exchange (Pvt) Ltd.	- 53 B, York Street, Colombo 1.	2437850
16. Intersun Travels (Pvt) Ltd.	- 90, York Street, Colombo 1.	2432555
17. Jewel Lanka Money Exchange (Pvt) Ltd.	- 192, Main Street, Negombo.	031-2224419
18. Lasantha Money Changer (Pvt) Ltd.	- 67, Bazaar Street, Chilaw.	032-2007516
19. M. M. B. L. Money Transfer (Pvt) Ltd.	- 300, Galle Road, Colombo 4.	2565526
20. Maruthi Money Exchange (Pvt) Ltd.	- 224 1/1, Galle Road, Colombo 6.	-
21. Mayurie Money Changers (Pvt) Ltd.	- 240, Main Street, Negombo.	031-2239389
22. Midna Mini Market (Pvt) Ltd.	- 12, Super Market Complex, Wennappuwa.	031-2255632
23. Montecarlo Exchange (Pvt) Ltd.	- 12, 1/1, Greens Road, Negombo.	031-2232020
24. MP Money Exchanger (Pvt) Ltd.	- 32B, Colombo Road, Gampaha.	033-2226018
25. New Regals Money Changer (Pvt) Ltd.	- 110, Main Street, Kurunegala.	037-2224447
26. Orient Gems (Pvt) Ltd.	- 87, Chatham Street, Colombo 1.	2325465
27. Prasanna Money Exchange (Pvt) Ltd.	- 42/A, Mudalige Mawatha, Colombo 1.	2422049
28. Pushpa Money Changer (Pvt) Ltd.	- 67, Greens Road, Negombo.	031-2236998
29. R. K. Niketh (Pvt) Ltd.	- 2-11, 1st Floor, Majestic City, Colombo 4.	4527244
30. Rab Money Trade & Investment (Pvt) Ltd.	- 192/12, Main Street, Colombo 11.	2343259
31. Rafeek Gems (Pvt) Ltd.	- 109, Chatham Street Colombo 1.	2341842
32. Ravi Forex (Pvt) Ltd.	- 115, Sea Street, Colombo 11.	2436358
33. Royal Money Exchange (Pvt) Ltd.	- 51/C, York Street, Colombo 1.	2331824
34. Royal Money Mart (Pvt) Ltd.	- 132/1, Galle Road, Aluthgama.	034-2275209
35. Salaka Trust Investments (Pvt) Ltd.	- 466, Union Place, Colombo 2.	4793000
36. Serandib Express (Pvt) Ltd.	- 500, Galle Road, Colombo 6.	-
37. Shifaz Money Exchange (Pvt) Ltd.	- 51, York Street, Colombo 1.	2344168
38. Sultans Money Exchange (Pvt) Ltd.	- 37, Hospital Street, Colombo 1.	2449671
39. Swiss Money Exchange (Pvt) Ltd.	- 51 B, York Street, Colombo 1.	2448615
40. Thomas Cook (India) Ltd.	- Arrival Post Custom Area, Bandaranaike International Airport, Katunayake	42252861
41. Travel Data Tours & Travels (Pvt) Ltd.	- 78/80, Bristol Building, Colombo 1.	2388241
42. Trust Lanka Money Changer (Pvt) Ltd.	- 342, Sea Street, Colombo 11.	2341250
43. Wall Street Exchange (Pvt) Ltd.	- Multi Plaza Building, 93/1/9, Main Street, Colombo 11.	2433680
44. Windsor Money Changer (Pvt) Ltd.	- 8/B/10, Bristol Street, Colombo 1.	4718390
45. Pearl Exci (Pvt) Ltd.	- 23, Fernando Avenue, Negombo.	031-2223160



## **For further inquiries, please contact**

- ☐ **Bank Supervision Department**  
(regarding Licensed Commercial Banks and Licensed Specialised Banks)  
☎ 2477100, 2477096      E-mail : [banksup@cbsl.lk](mailto:banksup@cbsl.lk)
- ☐ **Department of Supervision of Non-Bank Financial Institutions**  
(regarding Registered Finance Companies and Leasing Establishments)  
☎ 2477500, 2477480      E-mail : [snbfi@cbsl.lk](mailto:snbfi@cbsl.lk)
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