

# SOME ASPECTS OF DEPOSIT BANKING IN CEYLON

*(with special reference to Bank of Ceylon)*

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by

**C. LOGANATHAN**

General Manager, Bank of Ceylon

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The Institute of Chartered  
Accountants of Ceylon

**LECTURE**

ON

**“SOME ASPECTS OF DEPOSIT BANKING  
IN CEYLON”**

*(with Special Reference to Bank of Ceylon)*

BY

Mr. C. LOGANATHAN,  
*General Manager, Bank of Ceylon*

*On Wednesday, 20th February, 1963  
at 6.30 p. m.*

**Brains Trust :**

Mr. Jack Bennett, Director, U.S. Aid Mission to Ceylon  
and former Governor, State Bank of  
Ethiopia.

Mr. H. A. J. Hulugalle, Former Editor, “Ceylon Daily  
News.”

Dr. W. M. Tilakaratne, Ph.D., Deputy Controller of  
Exchange.

**Chairman :**

Mr. L. A. Weerasinghe, F.C.A., President, Institute of  
Chartered Accountants.

AT THE HALL OF THE  
INSTITUTE OF CHARTERED ACCOUNTANTS  
30 A, Longden Place, Colombo 7.



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INTRODUCTORY COMMENTS OF

Mr. C. LOGANATHAN

Mr. Chairman, Ladies and Gentlemen,

I wish to explain to you in the first instance the thinking behind my various proposals:—

1. Our economy is generally speaking, underdeveloped. Only certain sectors are fairly developed with adequate know-how and resources; and banking is one of them. It is the duty of the banking system therefore to give a lead in the development of the economy.
2. It is the policy of the government and the wish of the people of this country that its nationals should progressively take a leading part in the business and industrial life of the community. It is not in the interests of a country like Ceylon which depends to a large extent for her living on foreign markets for her exports to Ceylonise trade by legislation at the risk of losing valuable foreign capital and exchange. Ceylonisation through competitive means, if feasible, should be the correct approach.
3. There is an urgent necessity for a greater emphasis to be placed on production than on distribution.
4. Deposit banks have large resources and personal contacts with prospective seekers of credit and are also eminently suited to service the loans granted.
5. The Ceylonese in general lack business experience and are not industrious, and the banking system must therefore provide them with the necessary experience and initiative. This would also involve the provision of adequate safeguards to protect the interests of banks.
6. The private sector must develop into a live force in the development of the economy. Otherwise the result would be a fully State-owned economy, which will not be in the interests of democracy.



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ASIA SECTION

7. Last, but most important, is the duty cast on the managements of deposit banks to give top priority to the interests of their depositors. Deposit banks are in the nature of trustees for their depositors, who are not risk bearers like lenders or shareholders. There is however an urgent necessity for the deposit banking system in Ceylon to engage in mixed banking provided however the capital structure is adequate to absorb the risks inherent in mixed banking. Adequate know-how is of course essential.

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## GENERAL

I shall deal mainly with some of the unsatisfied demands of the country's economy for bank finance and shall at the same time suggest solutions which being unorthodox must necessarily be treated in some detail.

In the old days when money consisted entirely of coins and uncoined precious metals it was only natural that private persons entrusted them for safekeeping with wealthy merchants. In course of time the owner of the coins found it convenient to transfer the ownership of his money to whomsoever he liked by the simple process of instructing by letter the merchant with whom he kept his money. The written letter is the father of the modern cheque and the merchant the father of the modern banker who pays out deposits against cheques. Deposits being not all claimed by the owners at the same time formed a profitable source for the business of money lending. In advanced countries cheques are now by far the most frequently used method of transferring money; and by far the greatest part of the supply of money consists of bank deposits. The majority of institutions that hold themselves out to be banks take money on deposit payable on demand, and this is generally considered to be the essential feature of commercial banking.

The modern banker, in addition to performing this essential function of banking, performs *inter alia* the function of money lending, including the financing of foreign trade. The ancestry

of the modern banker can be traced therefore to the merchant of the old days who made a specialty of financing foreign trade, and to the money lender who collected the savings of one set of persons and lent them to another, some deposits being withdrawable after a fixed term and others repayable on demand.

The function of accepting deposits withdrawable on demand by cheque and the function of making advances out of deposits make the modern commercial banks not only purveyors of money but also manufacturers of money. Deposits, as already stated, are generally of two kinds, those which are repayable on demand and those which are not. Those which are not repayable on demand are normally repayable at the end of a fixed term and not withdrawable by cheque. These deposits are clearly not circulating money. Those which are repayable on demand are withdrawable by cheque and are circulating money.

**In providing the cheque mechanism the banker also provides, or creates, money itself.** To understand this aspect of banking let us imagine that we have only one deposit bank in this country with a highly developed banking habit and with an extensive network of branches. When an advance is granted the bank either credits the current account of the borrower with the amount of the advance or gives him an overdraft limit up to the amount agreed to be advanced. The cheques drawn on the account will either be collected for the credit of some customer of the bank or will be paid in cash at the counter, which will again reappear at least partly as cash deposits. Thus most of the money advanced will under normal circumstances return to the bank in the form of deposits. The increased deposits will form the base for further advances. You will see, therefore, that the general tendency of an expansion of advances will be to increase deposits. But the expansion cannot go on indefinitely as an expansion of advances does not increase the bank's cash reserves which must always be adequate as will be explained later. The necessity of maintaining adequate cash reserves sets a limit to the expansion of advances and therefore of deposits.

In practice, the whole of the advances will not return as deposits. Some of the cheques drawn by the borrower may be



deposited back in payment of outstanding advances made to other customers. In this case, the total advances of the bank would not increase and, therefore, there is no change in the total deposits. Another reason is that some of the money received over the counter may be held by the public in the form of cash, thereby increasing the cash in circulation. There is yet another possibility. The money borrowed may be used by some party or other to pay for imports, in which case the bank's foreign cash balances are reduced. As foreign cash balances form a part of the bank's cash reserves, any advance used to buy foreign exchange will not create a deposit. You will observe, therefore, that no particular advance should necessarily affect deposits. One can safely say, however, that under normal circumstances an expansion of advances will result in an expansion of deposits.

The converse of this process of expansion is the contraction of deposits with a repayment of advances. Here again every repayment need not necessarily decrease deposits. The advance may have been made out of cash previously held by the public, or it may have been paid back from an advance made to a different customer, or it may have been paid back in foreign exchange, being proceeds of an export, in which case the foreign cash balance of the bank increases.

What applies in the case of the only bank of a country should apply to a banking system consisting of several banks, with one important difference. In the latter case, an advance made by an individual bank may not reappear as a deposit of one of its constituents, and advances made by other units of the banking system may not reappear even in part as deposits of the individual bank in question. It will be noted, therefore, that the cash reserves of an individual bank in a banking system consisting of several banks should, under normal circumstances, be necessarily larger than the total cash reserves of a banking system comprising only one bank.

You will realise, therefore, what a powerful credit making machine is a bank and more so a banking system, whether it consists of only one bank or several banks. No wonder, therefore, that with credit playing a predomi-

nant part in the settlement of monetary and business transactions of all kinds some control is found necessary to regulate the credit creating function of banks to the best possible advantage to the community. It is now accepted the world over that the institution that can most effectively exercise this control is a Central Bank with special powers and privileges.

Our Central Bank of Ceylon, which is one of the youngest Central Banks, was established in August, 1950. It is principally a bank of issue, a bankers' bank, and banker to the Government. It was established under Monetary Law Act, No. 58 of 1949, which endows the bank with a wide array of sanctions for regulating *inter alia* the country's credit supply and commercial banking operations.

The only credit agencies available before the establishment of the Bank of Ceylon were the foreign operated ones. The extent of their contribution towards promoting the development of the Island's economy is brought to light by the Pochkhanawala Banking Commission in their report on the establishment of a "State Aided Bank."

In their report the Commissioners pointedly observed that not only were the banks in Ceylon non-indigenous, but so also was their management. In the words of the Commissioners "The European Officials of the banks lacked that intimate touch with local enterprise and the local population, which is generated only by a free and unfettered intercourse of daily life." Their activities were generally confined to the financing of foreign trade which consisted largely of exports of plantation crops, such as Tea and Rubber and imports of food and clothing. Almost all the exporters and importers were then British and Indian.

These were some of the findings of the Commissioners based on the evidence placed before them and the figures supplied in confidence by the commercial banks.



## BANK OF CEYLON

The Bank of Ceylon was the result of the findings and recommendations of the Pochkhanawala Commission with certain amendments.

The history of deposit banking in Ceylon after the establishment of the Bank of Ceylon is intimately connected with the development of the Bank of Ceylon itself. The foreign banks are still mainly connected with the export and import trade of the country, although during the last few years, since the Bank of Ceylon started encroaching on their preserves, they are definitely playing a significant role in the financing of domestic business also, at least to maintain a satisfactory level of earnings.

What will be stated hereafter will generally be of a controversial nature and will be an outline of the role the Bank of Ceylon is playing, and could play, under certain circumstances, in the financing of the development of the country's economy. What should be the future role of banking in Ceylon cannot be discussed in terms of foreign banks. It will be the Bank of Ceylon and the People's Bank that will have to spell out the future role of banking in Ceylon, with the Government playing its role as the policy maker at least in the final analysis.

It will be embarrassing for me, as the Chief Executive of the Bank of Ceylon, to discuss what role the People's Bank is playing, and ought to play, in the country's economy. The subject of my talk could be more appropriately styled—“*The Bank of Ceylon—its role in the National Economy.*”

I wish to emphasise at this juncture that the views expressed by me are in my personal capacity and not as the General Manager of the Bank of Ceylon. The views I shall express need not necessarily be the views of the Bank or those of the Government. The proposals I shall discuss and the principles underlying these proposals are either under active consideration by the policy authorities concerned, or are in course of implementation.

## Capital

The Bank of Ceylon commenced business on August 1st, 1939, with an authorised capital of Rs. 7½ million, consisting of 120,000 ordinary shares of Rs. 50/- each and 30,000 6% preference shares of Rs. 50/- each. The entire preference capital was issued and taken up by the Government, and 30,000 ordinary shares were taken up by the public.

The ordinary share capital was later increased to Rs. 3 million by a further issue of 30,000 ordinary shares. Today the capital structure of the Bank is as follows:—

### AUTHORISED

30,000 6% Preference Shares of Rs. 50 each ... ..	Rs.	1,500,000
120,000 Ordinary Shares of Rs. 50 each ... ..	„	6,000,000
		<hr/>
	Rs.	7,500,000

### ISSUED

30,000 6% Preference Shares of Rs. 50 each, fully paid ... ..	Rs.	1,500,000
60,000 Ordinary Shares of Rs. 50 each, fully paid ... ..	„	3,000,000
Free Published Reserves ... ..	„	15,000,000
		<hr/>
Total ... ..	Rs.	19,500,000

In terms of the Finance Bill of 1961, which was introduced by the Minister of Finance in Parliament on 27th July, 1961 and which received the Governor-General's assent on 12th October, 1961, the Government became the sole owner of the Ordinary Shares of the Bank in addition to its holding of all the Preference Shares.

## Deposits

The deposits of a bank are its bread and butter. The extent and nature of its lending and foreign exchange operations depend very largely on the quantum and quality of its deposits.

The Bank of Ceylon's share of the entire banking deposits in this country stood, as at the end of September, 1961, at more



than 50%. The Bank also held, as at the end of September, 1961, more than 45% of the entire non-government banking deposits in the country.

The Bank has a network of twenty-five branches excluding its London Office. Plans for further extensions are under way and several branches in the suburbs of Colombo and in the outstations will be opened as early as possible.

### **Banking Habit**

In order to popularise the banking habit among persons of modest means the Bank introduced the Safety Cheque and Security Cheque, the basic principle underlying which is that funds to back these instruments are assured by the Bank.

Subsequent to the shares of the Bank being vested in Government in terms of the Finance Act, No. 65 of 1961, the Bank introduced two important innovations :-

- (1) All service charges for the maintenance of current accounts of customers who bank exclusively with the Bank were abolished.
- (2) All cheques drawn on any branch of the Bank or on any office of the clearing banks wherever situated in the Island were collected for a customer of the Bank free of any commission whatsoever.

The Bank will also introduce shortly the Bank of Ceylon Money Order and Credit Transfer Schemes which will enable a wider section of the public to use the Bank's services.

The Bank which already controls over 50% of the entire bank deposits of the country is now in a position to improve its share in this regard in view of the provision in the Finance Act which does not permit any new Ceylonese Account to be opened in a foreign bank. With the Bank enjoying a greater concentration of deposits in an environment in which the cheque using habit is well developed, a good percentage of the Bank's deposits and other financial resources could be considered as a permanent core of funds that will not be withdrawn, except under

abnormal circumstances arising, for example, from a severe adverse balance of payments or from an exceptional desire on the part of the public to hold cash. This would mean a less complicated short term liquidity problem than that obtaining in countries with a multiplicity of banks competing with one another for deposits.

The long term problem of liquidity which involves the question of the safety of the Bank's advances and investments will, however, be met by adequate safeguards aimed at a wise selection of investments and the necessary machinery to ensure the effective and efficient utilisation and recovery of the funds advanced to borrowers.

### **The Bank and the Small Businessman**

It is evident from the reports issued by the Bank from time to time that the Bank has been able to contribute most effectively towards the establishment of Ceylonese business houses in the fields of both foreign trade and domestic commerce. The Bank was mainly responsible for the emergence of many smaller businesses during the 'forties' and the 'fifties.' While this initial consolidation was being achieved, new avenues of service were being explored, and to this end two significant amendments to the Bank's Ordinance were sought and obtained.

- (a) The restriction whereby the Bank could not lend for a term longer than six months was withdrawn.
- (b) The limitation on the acceptance of land as primary security for an advance was rescinded.

### **Credit Guarantee Corporation**

In order to meet the reasonable demands of the small businessman for credit facilities the Bank, some years ago, placed before the Minister of Commerce and some of the chambers of commerce a scheme for the establishment of a "Credit Guarantee Corporation." The idea was for Chambers of Commerce of standing, or new Chambers of Commerce that may be established in different parts of the country and managed by businessmen of experience and integrity, to work in collaboration



with the Bank in the formation and management of a Credit Guarantee Corporation that would assist approved members of the Chambers in obtaining credit from the Bank. Such Chambers would have intimate knowledge of the business integrity and financial standing of their members and would bring to bear a certain degree of healthy influence over the business and financial transactions of their members. If this proposal is implemented it would go a long way to enable the Bank to give additional financial assistance to small businessmen in regard to their business transactions. A study of the draft Articles and Memorandum of Association of the proposed Credit Guarantee Corporation (Appendix A) would indicate what the Bank of Ceylon could do to assist the small businessman through the aid of various Chambers of Commerce.

### Bank Lending and Legal Handicaps

The Bank has for some years now been granting advances to individuals to meet their personal needs, the maximum period so far permitted for repayment being 36 months. The rate of interest applicable now is 5% or 4½% p.a. flat with attractive rebates for regular payments. The public will, however, appreciate that in a country which seeks to increase its productive capacity for the purpose of the country's rapid economic development, consumer finance must necessarily be regulated from time to time.

I shall now deal with certain legal handicaps to lending. I shall quote from the Bank of Ceylon 1960/61 report:—

“ A piece of legislation which hinders to a considerable degree the granting of credit facilities by the Bank is the **Public Servants' (Liabilities) Ordinance**. In terms of this enactment, no action can be maintained against a public servant who is in receipt of a salary of Rs. 520/- per month or below,

- (a) upon any promise, express or implied, to repay money paid or advanced to him or to another person at his request;
- (b) upon any promise, express or implied, to be answerable for the debt or default of another person; or

- (c) upon any bond, bill of exchange, promissory note, or other security made, drawn, accepted, endorsed, or given by him.

Protection is also afforded to a judgement debtor by **Section 218 of the Civil Procedure Code (Cap. 101) as amended by Act No. 20 of 1954**. By this provision, when a decree is not satisfied, a judgement creditor cannot seize *inter alia* the following :—

- (1) stipends of naval, military, air force and civil or political pensioners of the Government ;
- (2) salary and cost of living allowances of a public officer or servant ;
- (3) salary and allowance of an employee in a shop or office drawing in salary and allowance Rs. 500/- per mensem and below.

In enacting the provisions of law referred to above the legislature had in mind the need to protect the low-paid employee from the unscrupulous and rapacious private money lender but framed the legislation in general terms. No amount of legislation can prevent unscrupulous money lenders and financially embarrassed employees from acting in collusion and finding ways and means of circumventing the law. In the result the employee - borrower gets deeper and deeper into debt, for the cost to him will be greater when the lender's risks have not only to cover the ordinary risks of lending but also to compensate him for breaking the law. The safeguards provided by these enactments are not necessary in the case of reputable credit agencies such as the Bank and impede such agencies in the performance of their proper functions."

" Since the introduction of the Mortgage Act, No. 6 of 1949, the Bank has had to insist on a higher standard of title to immovable property offered as security. Sections 46 and 47 of the Mortgage Act read as follows :—

- ' 46. No decree in any hypothecary action upon any mortgage of land which is created after the



appointed date and no decree in any action for the recovery of any moneys due upon any such mortgage shall order any property whatsoever, other than the mortgaged land, to be sold for the recovery of any moneys found to be due under the mortgage, and no property whatsoever, other than the mortgaged land shall be sold or be liable to be sold in execution of any such decree. In this section "action for the recovery of moneys due upon a mortgage" includes any action for the recovery of any debt secured by a mortgage whether the cause of action sued upon arises by reason of the mortgage or otherwise.

- '47. The provisions of Section 46 shall have effect notwithstanding anything in any other law or in any mortgage bond or other instrument.'

"In other words when the Bank takes as security the mortgage of any land or immovable property it cannot have recourse to any other security or property of the debtor, if the security mortgaged does not realise the Bank's claim. This provision of law has restricted the Bank's opportunities of assisting borrowers more fully.

"Titles to land in our country are complicated, and for this reason the Bank has found it necessary very frequently to reject applications for advances against immovable property. Questions of title apart, even the valuation of property will necessarily have to be very conservative. Further, in the case of industrial property the law as it exists is not clear whether a particular item of plant or machinery of a factory offered as security is considered movable or immovable. This position is rendered more complicated when title to the site of the factory concerned is defective."

### The Bank's Advances and Safeguards

The Bank was established primarily for helping Ceylonese business, but the Ceylonese in general do not have the experi-

ence and know-how associated with their non-Ceylonese counterparts. The Bank cannot therefore adopt the same loaning procedure in regard to Ceylonese as the English banks do in granting advances to reputable European and other foreign business or estate companies. At the same time, the Bank cannot refuse to assist Ceylonese on the ground that the normal lending machinery in use in other banks cannot be adopted by it. What is required, therefore, is the provision of adequate machinery to safeguard the interests of the Bank in making advances to Ceylonese. The Bank has done much in the past to educate its customers to appreciate the dangers of speculative methods of business, the importance of high business integrity and the need to meet their obligations to the Bank promptly. But the time is not yet ripe for the Bank to discard the precautionary measures which it has adopted in the past to safeguard its larger advances.

### **Credit to Agriculture**

Such safeguards must all the more be necessary, particularly in regard to advances to Ceylonese for agricultural enterprises, in which direction this Bank's contribution has so far not been substantial. It is imperative that any expansion in this direction should be under a scheme or schemes that would automatically provide the necessary machinery to safeguard the moneys advanced by the Bank. There is an urgent need for the provision, of finance in a large way to Ceylonese for agricultural enterprises. For convenience and lucidity, reference will here be made to the problem of financing the Tea Industry. The operating principles, however, will be applicable to Rubber and Coconut as well.

Tea is all-important to the Ceylonese economy. Based on it is an industry which is practically the economic mainstay of the country. It provides over 25% of the country's gross national product and over 60% of its export income. The tea industry in Ceylon provides employment to several thousands of people, has about 575,000 acres under cultivation, and provides capital investment for many thousands of Pounds Sterling and lakhs of Rupees. It also contributes substantially to Government Revenue, earns valuable foreign exchange and, incidentally,



sets in motion many allied industries. Any assistance the Bank can give to the tea industry therefore is *ipso facto* an assistance to a large portion of the country's economy and also leads to an increase in the Bank's business.

Of the acreage under tea in Ceylon 41% is owned by Sterling Companies and Non-nationals and 21% by Rupee Companies. Ceylonese own 24% of the acreage under estate cultivation and the balance 14% is in small holdings which are also owned by Ceylonese. On this basis therefore well over 38% of the tea in Ceylon is produced by Ceylonese, and bank assistance, if availed of by all Ceylonese owners, will finance the production of over 173 million pounds of made tea.

At present the Bank has no regulated or organised plan for providing financial assistance to the Tea Industry in Ceylon. Some owners of tea estates have obtained short-term loans and overdraft facilities on the security of their estates. There are also some who enjoy overdraft facilities against stocks of teas in their stores. Tea estate pay requirements are prepared for delivery at the Bank or at the Post Office nearest the relative estate on encashment of cheques tendered by undoubted parties. A few others are allowed to utilise the financial assistance which Brokers could offer on account of the Bank undertaking to discount the pro-notes tendered by estate owners to the Brokers on the security of the stocks of tea held by the latter.

The above assistance is at present only available to a relatively small number of estate owners, while a large number, due to their inability to make available to the bank adequate security, are unable to obtain the required financial aid. Moreover, at present, in their cases the Bank is unable to extend its present scope of advances due to there being no machinery to exercise the control required in the case of advances against present and future crops.

In discussing a proposal for short-term finance to the Tea Industry no reference will here be made to capital expenditure for the construction of factories and buildings, the provision of machinery or for the clearing and replanting of tea. Medium-term finance for capital expenditure is available under the

Bank's medium-term deposit and loan scheme, while long-term finance can be had from the Agricultural and Industrial Credit Corporation, the Ceylon State Mortgage Bank or the Development Finance Corporation.

The proposed scheme for short-term finance would cover the cultivation, manufacture and marketing of Ceylon Tea.

### **Role of Managing Agency**

The first requirement of the scheme would be the setting up of one or more Managing Agency Houses sponsored by the Bank with a majority of Ceylonese on their Boards and with a shareholding interest of about 40% in its capital on the part of the Bank, and not more than 20% on the part of non-Ceylonese. If need be, an existing agency house or agency houses may be invited to participate in the proposed scheme. The agency house should have on its staff a few specialists experienced in the management of tea estates and, at least during the initial years, it may be advisable to employ a few non-Ceylonese with considerable experience in this type of work. The purpose of the Bank having a large interest in the agency house is that it would be in a position to exercise a certain degree of control over the agency house, and ensure its support and loyalty to the Bank for the reason that the extent of the success of the scheme would be dependent on the co-operation which the agency house would afford the Bank.

The Bank, in the first instance, would entertain proposals for financial assistance from tea estate owners. In the case of those offering their property as security, the Bank's advances would continue to be made against the primary mortgage of the estate as is being done now. With regard to those who cannot offer property as security, the Bank's assistance would be channelled through the agency house. Of course, the Bank would also advise those in a position to offer immovable property as security to make use of the proposed agency house if they are to receive extended facilities over and above the terms of advance allowable against immovable property.

The prospective applicant for an advance would be called upon to furnish his entire requirements in regard to cultivation,



manufacture and marketing of his tea on the understanding that he would appoint the agency house as his sole agent in all matters connected with management, cultivation, production and sale of teas manufactured on his estate, though arrangements could be made for the owner to continue in charge on the spot. His proposals will be examined by the Bank in regard to the location of the estate, average production, the prices fetched during the previous years, despatch facilities and other relevant matters. Should the Bank decide to entertain the proposal, the applicant will be required to appoint the agency house as his sole agent. The applicant's proposal will then be referred to the agency house which will be called upon by the Bank to examine in detail the applicant's books, crop figures, income, expenditure and general estate accounts and submit its recommendations to the Bank. The Bank will then examine the recommendations of the agency house and, if satisfied with the proposal, authorise the payment of the required funds to be made to the applicant through the agency house. From this stage onwards, it will be the duty of the agency house to make available to the applicant the Bank's funds in stages, *viz.*, a proportionate amount according to requirements for cultivation, plucking, manufacture and despatch until final sale of the manufactured tea. It will also be the duty of the agency house to call upon the estate owner to furnish regular returns. The agency house will thereafter be called upon by the Bank to exercise overall supervision at every stage in the cultivation, manufacture and marketing of tea, under the Bank's authority obtained in connection with the advances made through them to the estate from time to time. The close supervision exercised by the agency house will not only ensure that the Bank's funds will be utilised for the purpose for which they are sought, but will also safeguard the advances made by the Bank. A further function of the agency house will be the supervision of the transport of the manufactured tea to go-downs prior to marketing.

The scheme, if properly worked, would enable the agency house to supervise even small estates at reasonable cost. A unit for supervision by a representative of the agency house could consist of many estates, big and small, in a particular

area and belonging to many owners. The costs could be distributed equitably among the different estates.

### **Finance to the Ceylonese Exporter**

The export business of the country, particularly in regard to Tea, is largely in the hands of non-Ceylonese, and consequently the foreign exchange business of the banking system is to a very large extent in the hands of foreign banks. Exports of tea have been developed over a period of years through a very close link between the non-Ceylonese Estate Agency House, the non-Ceylonese Produce Broker, the non-Ceylonese Exporter of Tea and the Foreign Importer of Tea. Any attempt to nationalise or Ceylonise the export business in tea by legislation would necessarily break this close link and could jeopardise the foreign exchange earning capacity of the country, which depends to a large extent on Tea.

The Bank could however break this link by helping the Ceylonese Tea Producer through the lending scheme already referred to earlier, and the Ceylonese Tea Exporter by the liberalisation of credit not only in connection with his purchase and storage requirements but also in connection with his exchange transactions covering export documents. Liberalisation of credit would mean not only larger credit facilities but also better rates of interest and exchange that would enable the Ceylonese exporter, with the assistance of the Bank's foreign contacts, to wean the foreign importer away from the non-Ceylonese exporter through competitive means. The Bank has already formulated a scheme for this purpose which would involve the establishment of one or more large export corporations by Ceylonese producers of tea and businessmen already in the export trade. The scheme also envisages the provision of large go-downs and stores diffused throughout the City and the tea planting areas, and the employment of adequate know-how. The principle underlying the scheme involves what may be called "supervised credit" not only to the Tea Producer but also to the Tea Exporter. The agency house referred to earlier, with the assistance of one or more firms of produce brokers, will play an important role in regard to the export scheme also.



## The Bank as an Authorised Dealer in Foreign Exchange

The Bank along with other commercial banks is an authorised dealer in foreign exchange. As a national institution it has conscientiously carried out the implementation of all directives issued from time to time by the Controller of Exchange. Its adherence to these directives has been scrupulous. The present procedures laid down by the Exchange Control do in fact result in great inconveniences and even losses to the Bank's customers engaged in foreign trade.

Although the scope of foreign exchange operations is necessarily restricted by the present policy of Government, it is felt that the Bank can render its customers a more expeditious service if certain changes are made in existing procedures by a greater delegation of powers to the Bank. The Bank need not deal with applications for exchange relating to such matters as transfer of assets, and remittances for educational or travel purposes which call for individual assessment by the Exchange Controller. As regards day to day banking transactions, however, there are a large number of applications particularly in the import sector now being referred to the Exchange Controller, which could be handled by the Bank if it is advised by the Controller of the guiding principles which apply to their disposal.

### Credit to Contractors

The Bank is frequently called upon to finance the import of various commodities which are supplied under contract to Government and Public Corporations by Ceylonese importers not possessed of the necessary capital. In order to safeguard the Bank's position in these transactions it will be necessary to devise measures both documentary and otherwise to ensure that the goods delivered to the Government Department or Public Corporation concerned correspond in every detail to the requirements of the relevant tender. Since the entire transaction is financed by the Bank it is of paramount importance that the Bank should protect itself against any deflection on the part of the contractor by *inter alia* obtaining from the Government Department or Public Corporation concerned a firm assurance that payment for the goods imported under the Bank's

Letter of Credit would be made direct to the Bank provided that the goods comply with the specifications originally laid down by the Department or Corporation. In order that the Bank might be in a position to give the Department or Public Corporation concerned a proper and valid discharge for these payments, the Bank would also insist on the contractor executing an irrevocable power of attorney, coupled with an interest clause, in the Bank's favour to enable the Bank to take delivery of the goods, if necessary, and receive payment in terms of the contract. The principal purpose of this type of irrevocable power of attorney is to prevent importers from revoking their agreements with Government or Public Corporations and the Bank.

It is believed that if the Government and the Public Corporations would recognise and register such powers of attorney covering contracts for the supply of goods or the setting up of equipment and similar constructional works, it would promote competition to a greater degree. The Government would thereby be in a position to obtain their requirements on the cheapest possible terms. The greatest obstacle in the way of our Ceylonese businessmen entering into competition with their non-Ceylonese counterparts in Ceylon has been the inadequacy of their financial resources to handle large transactions and contracts. This, to a large extent, can be overcome by the provision of Bank facilities, provided adequate safeguards can be secured by the Bank to enable it to grant such facilities.

As indicated earlier, the principal security on which the Bank will have to rely in financing the execution of contracts adverted to will be an irrevocable power of attorney. In this regard certain laws may have to be amended, if necessary.

According to the present state of the law, the safeguards to the Bank and Government in obtaining from the borrower an irrevocable power of attorney come to an end on the death or disability of the borrower. Legislation should therefore be passed on lines similar to Sections 124, 126 and 127 in the English Law of Property Act 1925 (15 and 16 Geo. 5, C. 20) and Section 202 of the Indian Contract Act.



In the case of irrevocable powers of attorney granted by companies to the Bank, provision should also be made modifying the application of Section 78 of the Companies' Ordinance, Cap. 145, and permitting the registration of a charge, without reference to the amount of the charge or the property charged.

### **Rural Credit**

The bank has also been alive to the problem of rural indebtedness in the country. The principles formulated in the copy of memorandum (Appendix B) submitted by the Bank to the Minister of Agriculture and Food in 1955, with certain amendments in regard to detail, are still applicable in the present context provided the law as it exists today is amended to enable co-operative societies to transact business with the Bank of Ceylon as well.

Subsequent to the date of the memorandum referred to, the People's Bank has been established, and the Co-operative Federal Bank is no more, and so are most of the co-operative banks which have been absorbed by the People's Bank.

**The purposes of the People's Bank are circumscribed by Section 4 of the People's Bank Act. Section 4 of the Act states as follows :—**

“ The purposes of the Bank shall be to develop the co-operative movement of Ceylon, rural banking and agricultural credit, by furnishing financial and other assistance to co-operative societies, approved societies, Cultivation Committees and other persons.”

The People's Bank Act has earmarked a special field of activity to the People's Bank and it was for this reason that it was exempt from income tax and was also given certain other privileges not enjoyed by the Bank of Ceylon or any other bank. It is hoped that the People's Bank will play the role assigned to it effectively.

### **Need for Re-Orientation**

Ceylon's immediate banking problem is one of utilising excess bank liquidity in the best national interest and

**not solely for the purpose of obtaining maximum profits for the banking system.** The country's dependence on foreign sources for its essential imports and on foreign markets for its exports, the inadequacy of its money and security markets, the lack of business and industrial experience on the part of the indigenous people, the inadequacy of domestic capital and consequently the need for bank assistance to support new productive ventures, require a banking structure capable of granting all types of financial aid without endangering its stability. **A re-orientation of ideas about banking set-ups is, therefore, not only desirable but necessary.** What is needed is a **banking policy concerned primarily with the needs of the country in the field of finance and secondarily with determining the types of bank deposits and capital desirable for the purpose of meeting the country's needs.**

### **Medium-Term Deposits and Advances**

The Bank of Ceylon has evolved a scheme of accepting transferable medium-term deposits from the public to provide the base on which the structure of finance for industry could rest. It could be widened to meet any increase in the demand for longer-term credit for industry, subject, however, to adequate rates of interest being quoted to attract the required deposits and an adequate margin being maintained between these rates and the advance rates.

The Bank, for which a national role had been conceived at its founding, has always endeavoured to think in terms of the national good and to fit in with the changing economic pattern. It now desires to intensify its efforts in helping to achieve rapid industrialisation which the country so badly needs.

The Bank has made considerable loans to private enterprise for the provision of capital goods for both agriculture and industry. The Bank's Credit Investigation and Business Intelligence Departments, which have been functioning for the last ten years, assist the Management in the examination of applications for industrial loans. Bank forms reproduced in Appendix C set forth a summary of the main preliminary information normally required by the Bank to enable it to consider



proposals for advances either to an already *existing enterprise* or to a *new enterprise*.

In view of the fact that the Bank has provided accommodation to a wide range of industries over the last few years, it is in a position to claim a certain amount of experience not only in judging applications, but also in servicing the loans once they have been granted. In fact it is, in this respect, in a far better position than some of the State-established long-term lending institutions. It has branches in every important town in Ceylon. Practically every prospective long-term borrower is known at least to one of its branches either as a short-term borrower or as an account holder. His moral worth and business acumen have already been assessed, and will be reviewed from time to time. The same borrower is a complete stranger to a State-established long-term institution, where, if he is granted a loan, he is generally remembered only when his instalments are in arrears. A commercial bank making the same loan is in a better position to service and follow up the advances, as it is in continual contact with the borrower in connection with his other transactions as well. Continuing credit to the borrower can be regulated according to his needs and his changing financial position. In this respect, the Bank is superior to other long-term lending institutions. This is not to say that other long-term lending institutions are unnecessary or that the Bank can replace them. **On the contrary, the Bank has supported one such institution, the Development Finance Corporation, by purchasing Rs. 2,800,000 worth of its shares, in recognition of the important role this institution can play in the country's economy.**

### **Bank's New Role in Industrial Development**

The social and economic conditions of a community are not static. They constantly alter and develop, and the community must have a banking and credit system elastic enough to adjust itself to the changing conditions and needs. Any banking or credit system that is not adaptable to changing needs cannot be called satisfactory. The Bank is now a nationalised institution. Its future activities will be governed not by the interests of private shareholders but solely by the national

interest which transcends all sectional interests. It could now concentrate its efforts on performing its paramount function of promoting the development of the country's economy by providing not only medium and long-term finance to industry in the form of loan capital but also in the form of risk or equity capital.

The operations of a bank involve the maintenance of a balance between liquidity and profitability. When the bank is a State-owned institution, with only the interests of the country at heart, the word "profitability" does not connote merely benefits to the bank in the financial sense but benefits to the community as a whole. Liquidity may be viewed from two aspects — long-term and short-term. Short-term liquidity may again be sub-divided into normal and exceptional. The former implies ability to meet normal withdrawals of cash and the latter to meet sudden and exceptional demands for cash in an emergency. The problem of short-term liquidity is one that could be resolved particularly in so far as this bank is concerned. This bank is now a wholly State-owned institution, enjoying the prospects of increasingly larger deposits in view of the provision of the Finance Act already referred to, which does not permit the establishment of any more banks or the opening of any Ceylonese accounts in foreign banks. Further, the Bank being State-owned will be in a position to obtain, at all times, credit from the Central Bank to meet its reasonable short-term requirements.

The long-term liquidity problem however is one that cannot easily be resolved by orthodox means. Long-term liquidity relates to ultimate protection of the depositors in the event of the liquidation of the Bank. In view of the fact that the financial resources of the Bank are mainly its deposits, the capacity of the Bank to remain solvent will, in the ultimate analysis, be dependent on its ability to realise its advances, its investments and other assets without loss that cannot be absorbed by its capital and reserves. The Bank's capital and reserves, as they are, will be inadequate to meet the aggregate of the risks involved in any unduly extended advances to industry on a



medium or long-term basis. If the Bank is to play a more aggressive role in the country's industrial development by way of extended industrial loans or by participating in the capital issues of new industrial ventures, then the capital of the bank must necessarily be adequately increased.

The larger the fixed assets and equity investments of a bank are the larger should be its capital and free reserves. The more risky a bank's assets are the larger should be its capital and free reserves. To put these principles in a different way, the aggregate of the risk components of the assets of any financial institution must not be in excess of its capital and reserves, in the absence of any reliable and adequate insurance or guarantee cover to its creditors such as depositors.

The Government, as the sole owner of the Bank's share capital, may not find it feasible, in the present context of the country's economy, to add substantially to its shareholding in the Bank by way of new capital. If, however, the Government would increase adequately the authorised capital of the Bank and also its issued capital, but without having to add, for the present, to the paid-up capital of the Bank, then a capital structure could emerge under which the Government, as the sole owner of the issued capital, would be liable to meet any call by the Bank, particularly to meet the needs of its creditors, to the extent of the reserve liability of Government. A substantial reserve liability of Government will be adequate guarantee to the Bank's creditors, who will mainly be its depositors. The Bank at the moment has a very large quantum of its resources in a very liquid position. If the Bank's own resources from its deposits are inadequate to meet the demand for funds for long-term finance or equity investment, ways and means could be found for increasing its own deposits or for obtaining funds from the Central Bank.

The device suggested will enable the Bank to grant extended long-term finance to industry and also to take

part in underwriting new capital issues required by industry on the basis of its own deposits and the reserve liability of the Government. If the Bank is to engage in extending finance to industry as suggested, then it would be equipped with adequate know-how. The fact that the Bank is a fully State-owned institution does not necessarily mean that the industries which it is expected to finance and towards whose capital the Bank is expected to contribute should be in the Government sector. On the contrary it will be the function and duty of the Bank to assist the private sector industries. The Bank will be prepared, therefore, to sponsor and manage industries in collaboration with the domestic private sector.

It is a truism that the total investment of a country cannot exceed its total savings and the foreign capital it can attract. Any excess will be in the form of deficit financing. The nature of the deficit financing and the use to which it is put would spell out generally the degree and nature of inflation arising therefrom.

It is hoped, therefore, that the Government will make every endeavour to encourage, by adequate tax incentives and other means, not only the mobilisation, in a large measure, of domestic private savings and their investment in productive ventures, but also a greater inflow of foreign capital and know-how, in the development of the country's economy. The Bank could, from time to time, sell its equity holdings to the public, having in view the desirability of achieving as much diffusion as possible in the share ownership in the different enterprises of the country.

The Development Finance Corporation in which the Bank has a large stake may also be called upon to participate with the Bank in financing industry by way of loans and equity investment. The Ceylon Institute of Scientific and Industrial Research and the Development Division of the Ministry of Industries could also assist the Bank in making its new venture into industrial development a success.

There is yet another scheme which, if implemented, would go a long way in enabling the greater participation



by the Bank of Ceylon in the industrial growth of the country. The scheme falls briefly into two complementary parts as follows :—

- (1) The establishment by this Bank of a special department, styled the “Industrial Loans Department.”
- (2) The setting up of a special Insurance Fund, with contributions of Rs. 1 million each from the Bank and the Government (to be held in two accounts, styled Fund A and Fund B respectively) for the purpose of protecting some of the loans granted by the Industrial Loans Department.

The Industrial Loans Department will deal with loans in three categories :—

Category 1 — those loans which the Bank is prepared to grant at its own risk and responsibility, and without any protection from the proposed Insurance Fund. One-twelfth of the income derived by way of interest on these loans will be set aside for addition at the end of every financial year to Fund A (*i.e.* the Bank’s portion of the Insurance Fund) and a further one-twelfth to Fund B (*i.e.* the Government’s portion of the Insurance Fund).

Category 2 — those loan applications which the Bank will not normally grant at its own risk and responsibility, but which at the request of the applicant have been re-examined by a Committee (which may be styled the “Committee of Review”) appointed by the Minister of Finance and the Minister of Industries, and which are recommended by the Committee of Review to be granted by the Bank under the protection of the Insurance Fund. One-sixth of the income derived by way of interest on loans in this category will be set aside and added to Fund A and a further one-sixth to Fund B.

Category 3 — those loans which the Bank considers unsafe even after recommendation by the Committee of Review and for which the Bank is prepared to release funds only on a guarantee from the Government under the hand of the Minister of

Finance. One-third of the income derived by way of interest on loans in this category will be set aside and added to Fund B (*i.e.* the Government's portion of the Insurance Fund), provided, however, the residual interest earned by the Bank will not be less than  $\frac{1}{2}\%$  above Bank rate, with a minimum of 4%.

The Insurance Fund itself, as stated earlier, will initially have a capital of Rs. 2 million, of which Rs. 1 million (styled Fund A) will be furnished by the Bank out of its own resources, and Rs. 1 million (styled Fund B) by the Government. The moneys belonging to the Insurance Fund will be held in the Bank, and the Bank will allow the Government interest on the sum of Rs. 1 million in Fund B at the rate applicable to fixed deposits in the Bank for a period of one year.

The total volume of loans outstanding at any one time and protected by the insurance fund is not to exceed ten times the amount lying in the fund. It is thus envisaged that, whereas initially the Bank will be in a position to grant loans for industrial purposes under the protection of the fund to the extent of Rs. 20 million, in the course of 5 years if no losses have been incurred, loan outstandings could be increased to a much larger figure. All this will be in addition to whatever industrial loans the Bank grants under Category 1.

One may now turn to the question of additions to, and deductions from, the Insurance Fund after it has been established. It has already been explained how additions to the fund will be in the form of fractional portions of the interest earned on loans granted by the proposed Industrial Loans Department. To repeat them briefly, they are as follows :—

- (1) Loans in Category 1 — one-twelfth of the interest earned to Fund A, and one-twelfth to Fund B.
- (2) Loans in Category 2 — one-sixth of the interest earned to Fund A, and one-sixth to Fund B.
- (3) Loans in Category 3 — one-third of the interest earned to Fund B.

These additions to the Insurance Fund as well as the Bank's original contribution of Rs. 1 million should be treated as allowable expenses for purposes of income tax.



Deductions from the insurance fund will be on account of losses as follows :—

- (1) Losses on loans in Category 1 will be borne entirely by the Bank, and will not be chargeable to the Fund.
- (2) Losses on loans in Category 2 will be borne equally by Fund A and Fund B. Any losses over and above the amount available in the funds will be borne equally by the Government and the Bank.
- (3) Losses on loans in Category 3 will be borne in their entirety by Fund B. After any amounts have been charged to Fund B, the guarantee given by the Government for loans in Category 3 will be implemented immediately to restore the amount lying in Fund B to parity with the amount lying in Fund A.

Periodically, in June and December each year, the Central Bank will review loans granted in categories 2 and 3, and make an estimate of what amounts, if any, are to be considered bad and doubtful. If at any time the Central Bank considers that more than 10% of the amounts lent are bad and doubtful, it will be necessary for the Bank and the Committee of Review to reconsider the lending policy for industrial loans.

This is only a brief outline of the scheme in view. Matters of detail could be worked out between officials of the government and the Bank once broad agreement to the proposals has been reached.

Before I conclude, however, I would like to acquaint you with some of the thinking that lies behind these proposals. I cannot do better than quote two extracts from the booklet entitled "Investors' Guide" issued by the Development Division of the Ministry of Industries. The first extract is taken from the Introduction to the booklet by the Hon. Maithripala Senanayake, M.P., Minister of Industries, Home & Cultural Affairs, and reads as follows :—

"Rapid industrialisation is an essential condition for the development of socialism....."

It means not a limitation of private enterprise and initiative ; it means indeed a fuller and freer expression of it, so that society as a whole can benefit through our common endeavour."

"The task of industrialisation cannot be borne entirely by the State. The private sector has a vital role to play, this role must be clearly defined and it is the responsibility of the State to do that."

The second extract is to be found on page 7 of the booklet, and is as follows :—

"No Government which believes in private enterprise can direct private investment on a planned basis. All that it can endeavour to do, is to offer various inducements. Government has to manufacture manufacturers."

This Bank, for which a national role has been conceived at its founding, has always endeavoured to think in terms of the national good and to fit in with the changing economic pattern. It now desires earnestly to intensify its efforts in helping to achieve the rapid industrialisation of the country and in helping to "manufacture manufacturers," as stated by the Minister of Industries. Its resources, both financial and technical, are at the disposal of a government which desires to guide rather than to dictate their channelling, and it is in this context that the statements I have quoted above are particularly welcome. This attitude on the part of government coupled with the proposal for an Industrial Loans Department receiving protection from an insurance fund, offers the Bank the scope to perform its role on business lines and at the same time offers the government the opportunity of stepping in and satisfying the Bank in regard to marginal applications for industrial loans, or guaranteeing those loans which the Bank would ordinarily not grant, after examining the reasons why the applications were originally declined.

One could then look forward to a very fruitful intervention by Government in achieving benefits for society



as a whole. The Bank on its part can provide the necessary funds in accordance with its resources, and in addition, (and what is considered more important) a certain amount of know-how in dealing with industrial loans.

### Government Finance and Banks

Before concluding, I wish to refer to another aspect of deposit banking from the angle of government finance. It is customary for any government to have recourse to borrowings from commercial banks through government bonds to bridge a budget deficit. There should be a limit to such borrowings. A distinction should be drawn between bank lending to finance projects which would yield a return in the short-term — such as finance to private industry or to government industrial corporations run on business lines — and bank lending to government for the purpose of bridging a deficit arising from unrealistic expenditure incurred on consumption or on unduly long-term or infra-structure development.

# APPENDIX "A"

( EXTRACTS )

*Preliminary Draft*

## MEMORANDUM OF ASSOCIATION

OF

### THE CREDIT GUARANTEE CORPORATION LIMITED

1. The name of the Company is The Credit Guarantee Corporation Limited.
2. The registered office of the Company is situated in the District of Colombo.
3. The objects for which the Company is established are as follows :-

1. **To become sureties, guarantors or indemnitors** or in any manner become liable or answerable to the Bank of Ceylon for loans, overdrafts, credits, advances, trust receipt facilities, letters of credit facilities or other pecuniary aid, assistance or accommodation or banking facilities, present, future or contingent, made by the Bank of Ceylon, to any shareholder of the Company and for such purpose to enter into contracts of suretyship, guarantee, indemnity or any contracts of whatsoever kind or nature solely or jointly with any other person, firm or Company and in or in reference to all such contracts to waive all or any of the privileges to which such sureties, guarantors or contractors are by the law for the time being in force in Ceylon entitled to, and to give security, if and when called upon by the Bank of Ceylon so to do, in any form, for any such undertaking or liability and for such purpose to make, draw, accept, endorse, negotiate, discount, purchase, issue and execute promissory notes, bills of exchange and other negotiable and transferable instruments and to create, execute, grant or issue any mortgages, mortgage debentures, debenture stock, bonds or obligations of the Company whether at par, premium or at a discount and whether redeemable, irredeemable or perpetual, secured upon all or any part of the undertaking, revenue, rights and property of the Company, present and future, including



uncalled capital or unpaid calls of the Company, and to fulfil, pay off or redeem every such obligation, undertaking or security, and therefor to claim and receive any consideration, brokerage, premiums, commissions, remunerations, reward, compensation or advantage from any such shareholder aforesaid of the Company and to receive, obtain and take from all such shareholders aforementioned of the Company counter-guarantees, counter-indemnities or counter-securities in any form as may be expedient, whether in the form of mortgages or charges of or on movable or immovable property or otherwise, and to release such securities, and generally to assist or execute all such purposes.

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### Vote of Members

8. Regulation 54 of Table "A" shall be numbered 54 (2) and immediately before it the following new regulation shall be inserted :-

" 54 (1). Notwithstanding anything to the contrary herein contained the Bank of Ceylon while and only so long as it holds more than fifty per cent. of the issued capital of the Company shall not be entitled to exercise its votes as an ordinary shareholder except in regard to any amendment in the memorandum or articles of association or a winding up of the Company."

9. Where the Bank of Ceylon ceases to hold more than fifty per cent. of the issued share capital of the Company the preceding clause 8 hereof shall cease to have any effect.

### DIRECTORS

10. Regulation 64 of Table "A" shall be excluded and the following shall be substituted therefor :-

“ 64 (1) The number of Directors shall be five.

(2) The first Directors shall be selected and appointed by a Committee (hereinafter referred to as “ the First Committee of Selection ”) from a panel of ten members or shareholders of the Company nominated by Chambers of Commerce.

(3) If the First Committee of Selection for any reason is not satisfied with the panel nominated by such Chambers of Commerce then that Committee shall require the Chambers of Commerce to nominate *de novo* another panel of names.

(4) If the Chambers of Commerce do not furnish the First Committee of Selection with a panel of at least five names satisfactory to that Committee then it shall reject all such names submitted by the Chambers of Commerce and at its own choice and discretion make the appointments to the offices of Directors of the Company directly from the list of members or shareholders of the Company.

(5) The Chambers of Commerce shall always elect their nominees at a joint meeting of the duly accredited representatives or delegates of such Chambers of Commerce duly authorised thereto in writing under the hands of the President and Secretary of the respective Chambers of Commerce aforesaid and at every such election each of the Chambers of Commerce through its aforesaid representative or delegate shall have and exercise one nominating vote for every five shares subscribed by members or shareholders of the Company introduced to such membership by such of the Chambers of Commerce.

(6) The term “ Chambers of Commerce ” in these presents shall mean and include Chambers of Commerce and similar bodies and organisations in Ceylon duly approved for the purposes of these presents by the First Committee of Selection.



(7) The opinion or findings of the First Committee of Selection and those of the Alternate Committee of Selection referred to in Regulation 80 and expressed or made under this regulation shall respectively be final and conclusive and shall not in any manner be questioned in or outside any Court of Law.

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14. Regulation 69 of Table "A" shall be excluded and the following substituted therefor :-

" 69 (1) The aggregate maxima of the amounts of the guarantees for the time being in force and given by the Directors shall not at any time exceed the total of the issued and paid-up share capital and the free reserves of the Company.

(2) the maximum amount of any guarantee given by the Directors in the case of any one shareholder shall not exceed —

(i) Rs. 5,000/- in respect of loans or trust receipt facilities ;

(ii) Rs. 10,000/- in respect of letters of credit facilities.

(3) No guarantee shall be given by the Directors in respect of any transaction which is not directly or indirectly related to or connected with the trade, business or commerce of any shareholder of the Company without the previous consent of the Board of Directors of the Bank of Ceylon.

(4) the term "guarantee" in this regulation shall mean and include all contracts of suretyship, guarantee, indemnity and all other contracts referred

to in and within the meaning and intent of sub-clause (1) of clause 3 of the Memorandum of Association of the Company.

(5) the maxima specified in clauses (1) and (2) above may be exceeded by the Directors with the written consent of the Board of Directors of the Bank of Ceylon.

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17. Regulation 72 of Table "A" shall be modified :-

(a) by the substitution for paragraph (b) of the following :-

“(b) holds the office of or exercises the functions of a manager or executive or other place of profit in the Company.”

(b) by the addition immediately after paragraph (f) of the following :-

“(ff) is absent from the meetings of the Directors for a continuous period of six calendar months without special leave of absence from the Board of Directors and the Board resolves that his office be vacated ; or

“(fff) is a member of the Senate or House of Representatives or of any Municipal Council, Urban Council or Town Council or is nominated as a candidate for election to such membership.”



## Rotation of Directors

18. Regulations 73 to 80 of Table "A" shall be excluded and the following shall be substituted therefor :-

" 73 (1) At every ordinary General Meeting of the Company one Director shall retire.

(2) Unless the Directors agree among themselves, the respective Director who should retire at each ordinary General Meeting shall be determined by lot, at the first meeting of the Board of Directors.

(3) (a) A retiring Director shall be eligible for re-nomination or re-appointment.

(b) A Director retiring at a meeting shall retain office until the close or adjournment of the meeting.

(4) On re-nomination or re-appointment a retiring Director shall at once become a Director without any further formality.

" 74 (1) If any Director dies or vacates his office another person shall be nominated or appointed by the First Committee of Selection in place of the Director so dying or vacating his office.

(2) A Director so appointed shall be subject to retirement at the same time as the Director in whose place he has been nominated or appointed would have retired had he remained in office.

"75. If it appears to the First Committee of Selection that a Director is unlikely to be able to discharge the duties of his office for a period not less than six months by reason of, absence from Ceylon, illness, ill-health or any other cause whatsoever, the First Committee of Selection may appoint any person to act in the place of such Director for such period as it may deem fit.

“76. Every vacancy casual or otherwise in the office of a Director under Regulation 72 to 75 shall also be filled by appointment made by the First Committee of Selection from a panel prepared and nominated by the Chambers of Commerce and containing at least twice the number of persons to be appointed and all the provisions of Regulation 64 except sub-clause (1) thereof *mutatis mutandis* shall apply thereto.

“77. The Company may by extra-ordinary resolution remove any Director from office with the consent of the First Committee of Selection.

### Committees of Selection

19. Immediately after the new Regulation 77 inserted by clause 18 above the following shall be inserted :-

“78. The First Committee of Selection referred to in Regulations 64, 74, 75, 76 and 77 shall consist of :-

- (a) (i) the person for the time being holding or acting in the post or office of Governor of the Central Bank of Ceylon; or, in case he is unable or unwilling to act,
- (ii) the person for the time being holding or acting in the post or office of Senior Deputy Governor of the Central Bank of Ceylon; and
- (b) the person for the time being holding or acting in the post or office of Permanent Secretary to the Ministry of Commerce; and
- (c) the person for the time being holding or acting in the post or office of General Manager of the Bank of Ceylon.

“79(1). If and whenever the First Committee of Selection for any reason fails to function or cannot function then the Alternate Committee of Selection



shall have and be deemed to have and exercise all the rights, powers and privileges conferred on the First Committee of Selection by Regulations 64, 74, 75, 76 and 77 and every reference to the First Committee of Selection in such Regulations shall be deemed to be a reference to the Alternate Committee of Selection.

(2) Whenever it becomes necessary or expedient for the Alternate Committee of Selection to function under the preceding sub-clause then the Secretary of the Bank of Ceylon shall give notice in writing under his hand, delivered to the members of the Alternate Committee of Selection of the date on which the Alternate Committee of Selection shall exercise its functions.

(3) The Secretary of the Bank of Ceylon, shall before giving the written notice referred to in the preceding sub-clause (2), first give written notice under his hand to the members of the First Committee of Selection, of a final date before which, the First Committee of Selection should exercise its powers and authorities hereunder.

“80 (1) The Alternate Committee of Selection referred to in Regulations 64 (7) and 79 shall consist of :-

- (a) the persons for the time being respectively holding or acting in the posts or offices of Presidents of the respective Chambers of Commerce; and
- (b) the person for the time being holding or acting in the post or office of General Manager of the Bank of Ceylon.

(2) In the Alternate Committee of Selection each of the persons who are members of the Alternate Committee of Selection by virtue of the provision of paragraph (a) of the preceding sub-clause as Presidents of the respective Chambers of Commerce shall have and exercise in that Alternate Committee of

Selection one vote for every five shares subscribed by members or shareholders of the Company introduced to such membership by the respective Chambers of Commerce represented respectively by each or such persons aforesaid.

(3) The General Manager of the Bank of Ceylon shall in the Alternate Committee of Selection have and exercise such number of votes equivalent to the aggregate of the votes which are in fact exercised by the other members of the Alternate Committee of Selection.

(4) The quorum necessary for the transaction of the business of the Alternate Committee of Selection shall be a number not less than one-half of the total number of members of that Committee and shall always include the General Manager of the Bank of Ceylon.

(5) Where at any meeting of the Alternate Committee of Selection the votes of the members of that Committee present and voting are equally divided in regard to any question, the Chairman or other member presiding at such meeting shall, in addition to the vote or votes to which he is entitled as such member of that Committee, have a casting vote.

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### B a n k e r s

25. Immediately after Regulation 102 of Table "A" there shall be inserted the following new regulation :-

" 102A. The sole and exclusive bankers of the Company shall at all times be the Bank of Ceylon."



26. By the insertion after Regulation 107 of Table "A" of the following :-

"108. Notwithstanding anything to the contrary in these presents contained, no provision either in the Memorandum or in the Articles of Association for the time being of the Company shall be added to, abrogated or modified without the prior approval of the Board of Directors of the Bank of Ceylon.

"109. The Company shall not be entitled to commence business until—

- (a) Two hundred and fifty shares have been subscribed by the Bank of Ceylon, and
- (b) at least two hundred and fifty shares have been subscribed by and allotted to and paid up by the public."

( **EXTRACTS** )

*Preliminary Draft*

**ARTICLES OF ASSOCIATION**  
OF  
**THE CREDIT GUARANTEE CORPORATION LIMITED**

**Preliminary**

1. The regulations contained in Table A in the first schedule to the Companies Ordinance No. 51 of 1938 (such Table being hereinafter called "Table A" shall apply to the Company save in so far as they are excluded, varied, modified or added to hereby expressly or by implication.

**S h a r e s**

2. Regulation 2 of Table A shall be numbered 2 (2) and the following new paragraph shall be inserted immediately before that regulation :-

" 2 (1) Out of the first issue of shares which shall comprise one thousand, Rs. 1,000/- each, shares shall be issued as follows :-

(a) To the Bank of Ceylon, 500 ordinary shares  
of Rs. 1,000/- each Rs. 500,000

(b) To the public, 500 ordinary shares  
of Rs. 1,000/- each Rs. 500,000

3. Immediately before Regulation 3 of Table A, there shall be inserted the following new regulation :-

" 2A (1) No share shall be allotted or issued to, held by or transferred to :-

(a) any person who is not a citizen of Ceylon,

(b) any firm in which the majority of members or partners are not citizens of Ceylon,



- (c) any company or corporation (i) incorporated outside Ceylon, or (ii) in which, shares representing at least 51% of the issued share capital of the company is not held by citizens of Ceylon in their own right.

(2) The term "Citizen of Ceylon" in sub-clause (1) of this regulation shall mean: Citizen of Ceylon by descent or registration — (a) within the meaning of the Citizenship Act, No. 18 of 1948, and all statutory modifications thereof, or (b) under the law for the time being in force in Ceylon.

(3) The Directors of the Company shall both be entitled to and bound to satisfy themselves that any allotment, issue or transfer of shares of the Company does not contravene the provisions of sub-clause (1) of this regulation and that any person, firm or company to whom shares are allotted, issued or transferred and who are not disqualified by virtue of sub-clause (1) of this regulation to hold shares *bona fide* intend to hold such shares in their or its own right and for their or its own benefit.

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4. The liability of the members is limited.
5. The share capital of the Company is Rupees Five Million (Rs. 5,000,000) divided into Five Thousand (5,000) shares of Rupees One Thousand (Rs. 1,000) each with power to increase or reduce the capital, to consolidate or sub-divide the same into shares of larger or smaller amounts, to issue any of the existing shares or any new shares from time to time to be created at a premium or divide the same into different classes with any such guaranteed, preference, deferred, qualified or other special privileges or advantage over any shares previously issued or thereby or thereafter issued or subject to such restrictions or limitations that may be prescribed by the Company's Articles of Association, or determined by resolution.

## APPENDIX B

*(Extract from a Memorandum to the Minister of Agriculture)*

Colombo,  
28th April, 1955.

THE HON. THE MINISTER OF AGRICULTURE & FOOD,  
COLOMBO.

Dear Sir,

### **The Bank of Ceylon and The Co-operative Movement**

I understand there is a proposal before you to reconstitute the Co-operative Federal Bank of Ceylon into a Commercial Bank with an emphasis placed on its special role in the co-operative field. I am sure you would give consideration to my views on the matter.

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I wish to place before you for your consideration a proposal in outline which if given effect to will go a long way towards the promotion of the Co-operative Movement and the development of the rural areas of the country and incidentally providing a solution to the liquidity problems of the Co-operative Federal Bank.

- (a) The Bank of Ceylon will take over all the assets and liabilities of the Co-operative Federal Bank. The Government will furnish a guarantee to the Bank of Ceylon in respect of those outstanding advances already granted and which the Bank of Ceylon does not find acceptable according to its own loaning standards. The Bank of Ceylon will, however, administer such unacceptable loans and will do its best to recover the amounts due. The other assets, such as Government



Bonds, will be taken over by the Bank at a reasonable valuation mutually agreed upon by the Bank of Ceylon and the Government. The amount due from the Co-operative Federal Bank to the Government of Ceylon will be paid by the Bank of Ceylon. All deposits held by the Co-operative Federal Bank will be accepted by the Bank of Ceylon subject to the approval of the depositors. The Paid-up share capital of the Co-operative Federal Bank may be redeemed by the Government at par, or on such other terms as the Government may deem fit. The members of the staff of the Co-operative Federal Bank of sufficient merit will be absorbed by the Bank of Ceylon.

- (b) A fund styled " Co-operative Advances Insurance Fund " will be created with a contribution of Rs. 1 million by the Bank of Ceylon out of its undistributed profits, and by another contribution of Rs. 5 million by the Government. This amount of Rs. 6 million will form the nucleus for larger funds accumulated from earnings under clause (c) below.

(c) The Bank of Ceylon will organise and maintain a Co-operative Loan Department which will receive and examine applications for credit from Co-operative Societies and Co-operative Provincial Banks. Where proposals are found unacceptable the applicant Societies and Co-operative Provincial Banks may apply to the undermentioned Advisory Committee 'A' which will examine the rejected proposals and make its own recommendations. Should the bank still decline to consider the application favourably and should the Advisory Committee 'A' disagree with the decision of the bank, the matter will be referred to the Commissioner of Co-operative Development, who if he disagrees with the bank, will place the proposal for the consideration and ruling of the following body called Committee 'B,' which will consist of :-

- (i) Chairman — Secretary to the Treasury or his deputy.
- (ii) Permanent Secretary to the Ministry of Agriculture & Food or his deputy.

- (iii) The Commissioner of Co-operative Development or his representative.

A representative of the Bank of Ceylon and, such others as may be required by the abovementioned body to be in attendance.

If this Committee desires the granting of the advances declined by the Bank, the Bank of Ceylon will grant the advances against the guarantee of the Government of Ceylon. The rate of interest chargeable to Co-operative Societies will be 6% and to Co-operative Provincial Banks 5%. The excess over 4% will be credited to the Government's share of the Insurance Fund. Any excess over 5% on loans granted by the Bank at its own risk will be credited to the Bank's share of the Insurance Fund. Interest rates will be reviewed from time to time.

I might mention here that the Insurance Fund would, if there are no inroads into its resources, assume larger proportions and serve as a base for expansion of credit facilities in the rural areas. Advisory Committee 'A' will consist of the following and will function in each of the provinces :-

In the Western Province —

Chairman — Deputy Commissioner of Co-operative Development.

Other Members — Representatives of Co-operative Provincial Banks in the Western Province and three others or more nominated by the Minister of Agriculture and Food, from the Co-operative Societies of the Western Province.

In other Provinces —

Chairman — Assistant Commissioner of Co-operative Development.

Other Members — Representatives of Co-operative Provincial Banks and three others or more nominated by the Minister of Agriculture from the Co-operative Societies in the area.



All losses arising from advances on instructions from Committee 'B' will be charged against the Insurance Fund, the Bank's share of the Fund absorbing one-sixth of the losses and the Government's share absorbing five-sixth. At the end of June and December each year the Central Bank will examine the advances made by the Bank of Ceylon to the Co-operative Societies and Provincial Banks, and will submit a statement showing details of loans considered bad and doubtful. If at any time the aggregate of bad and doubtful debts guaranteed by Government amount to 25% of the bank's share of the Insurance Fund or the Government's share of the Insurance Fund, whichever is lower, the matter will be brought to the attention of Committee 'B' and the lending policy reviewed. Any allowances payable to members of Committees will be for account of Government.

The Permanent Secretary to the Ministry of Agriculture and Food or his nominee will join the Board of Directors of the Bank of Ceylon without the power to vote but with the facility to place his views in regard to advances to the Co-operative Movement.

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The Bank will be prepared to open more branches at such centres as may be deemed expedient.

Co-operative Provincial Banks may continue their activities alongside the branches of the Bank of Ceylon and may, if they wish, obtain advances as mentioned earlier from the Bank of Ceylon on their own merits.

If the Bank is to play an aggressive role in the development of the Co-operative Movement as outlined under the above scheme, then the Bank is entitled to an assurance that the Government will not, at a later stage, subsidise or promote any other commercial bank and thereby weaken the Bank and place it in a vulnerable position.

A modification of the proposal set out earlier would be:—

The Co-operative Federal Bank will continue to function as hitherto but will cease to accept deposits from the public. As this will result in the Co-operative Federal Bank ceasing to be a member of the Clearing House, the Bank of Ceylon will grant credit to the Co-operative Federal Bank in such a way that funds will be available to it no later than if it had been a member of the Clearing House and had presented its cheques through the Clearing House. To enable the Bank of Ceylon to extend this measure of credit the Co-operative Federal Bank must be a solvent institution at all times or, in the alternative, the Government should agree to indemnify the Bank of Ceylon against losses that may be incurred by the inability of the Co-operative Federal Bank to repay credits extended by the Bank of Ceylon in respect of cheques subsequently dishonoured.

It is my considered view that what the Bank of Ceylon cannot achieve for the Co-operative Movement will not be achieved by the Co-operative Federal Bank, however reconstituted. All that a reconstituted Co-operative Bank can achieve, having due regard to its own stability, can be achieved by the Bank of Ceylon under my scheme.

The Bank of Ceylon by reason of its size and strength is able to assume, with a Government guarantee (limited and "protected"), risks of a size and character which if assumed by the Co-operative Federal Bank would result in its liquidation or the assumption of its liabilities by the Government.

The above proposals may be amended after I have had full discussion with representatives of your Ministry, the Co-operative Department, the Central Bank and the Treasury.

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Should you consider my suggestions worthy of consideration I shall be pleased if you will arrange for a conference between your Permanent Secretary and myself in the first instance.

Yours faithfully,  
**C. LOGANATHAN**  
*General Manager, Bank of Ceylon.*



## APPENDIX " C "

### SCHEDULE ' A '

#### PRELIMINARY INFORMATION IN REGARD TO AN EXISTING COMPANY

#### 1. The Company to be accommodated

- (a) Describe the company, including name, address, place of business, place of incorporation, nature of business and capital structure.
- (b) Furnish names and brief biographical notes for principal stockholders, directors and officers or managers. Describe any special arrangements or plans for management.
- (c) If the company is one of a group of affiliated companies, give a brief description of the group and the company's relationship to it.

#### 2. Operations of the Company

- (a) Describe productive facilities of the company, including location, size of plant and nature of equipment.
- (b) Describe in general the operations of the company, including the products being and to be produced, together with relevant information regarding raw materials, markets, competition, tariffs, patent licences and special tax or other governmental concessions, if any. For each major product or class of product, state for each of last five years the number of units sold and gross income therefrom.
- (c) Furnish copies of annual reports (including balance sheets, profit and loss statements and any other financial statements) for the last five years; copies of any recent prospectuses or other descriptive material; copies of constituent corporate documents, such as charter, by-laws, articles of association.

#### 3. Purpose for which accommodation is sought

- (a) Describe the purpose to which the proposed accommodation is to be applied. If new construction or purchase

of equipment is involved, give (1) brief descriptions, (2) expenditures to date, (3) additional equipment required, (4) estimate of the time required for completion, and (5) the approximate amounts required in local or foreign currencies.

- (b) Furnish estimates of output, costs, revenues, and net profits for each of the first three years of operation after the proposed accommodation is completed, showing the major assumptions upon which such estimates are based.
- (c) Furnish copies of any reports or studies which may have been made by consultants or others, regarding engineering, costs, markets or other relevant matters. If such reports or studies have not been made, state what arrangements, if any, are contemplated for making them.

#### **4. Accommodation required**

- (a) Set forth in detail the amount of the accommodation required and the arrangements the company proposes to make in regard to its repayment.
- (b) Describe the nature and value of securities offered for the proposed accommodation.

#### **5. Miscellaneous**

- (a) State whether the information is being furnished by the company to be accommodated, if not, state in what capacity the person furnishing the information is acting, including the interest, if any, which he has in the proposal and the company.
- (b) Furnish any other material information and describe any other significant problems relating to the enterprise or the proposed accommodation.
- (c) Furnish bank references.



## **SCHEDULE ' B '**

### **PRELIMINARY INFORMATION IN REGARD TO A NEW COMPANY**

#### **1. The Company to be accommodated**

- (a) Describe the plans for the organisation and operations of the company to be financed, including place of business, place of incorporation, nature of business, and capital structure.
- (b) Furnish names and brief biographical notes for proposed principal stockholders, directors and officers or managers. Describe any special arrangements or plans for management.
- (c) If the company is to be one of a group of affiliated companies, give a brief description of the group and the company's relationship to it.
- (d) Furnish copies of prospectuses or other descriptive material; also, if available, copies of proposed constituent corporate documents, such as charter, by-laws, articles of association.

#### **2. Proposed operations of the Company**

- (a) Describe proposed productive facilities, including location, size of plant and nature of equipment.
- (b) Describe the proposed operations of the company, including the products to be produced, together with relevant information regarding raw materials, markets, competition tariffs, patent licences and special tax or other governmental concessions, if any.
- (c) Furnish estimates of output, costs, revenues, and net profits for each of the first three years of operation. The main cost items (such as raw materials, labour, power, sales expenses, administrative expenses, depreciation, interest and taxes) should be shown, together with the assumptions upon which they are based.

- (d) Furnish copies of any reports or studies which may have been made by consultants or others regarding engineering, costs, markets, or other relevant matters. If such reports or studies have not been made, state what arrangements, if any, are contemplated for making them.

### 3. Purpose for which accommodation is sought

Describe the purpose to which the proposed accommodation is to be applied. If new construction or purchase of equipment is involved, give (a) brief description, (b) estimate of the time required for completion of the work, and (c) the approximate amounts required in local or foreign currencies.

### 4. Accommodation required

- (a) Set forth in detail the amount of the accommodation required and the arrangements the company proposes to make in regard to its repayment.
- (b) Describe the nature and value of securities offered for the proposed accommodation.

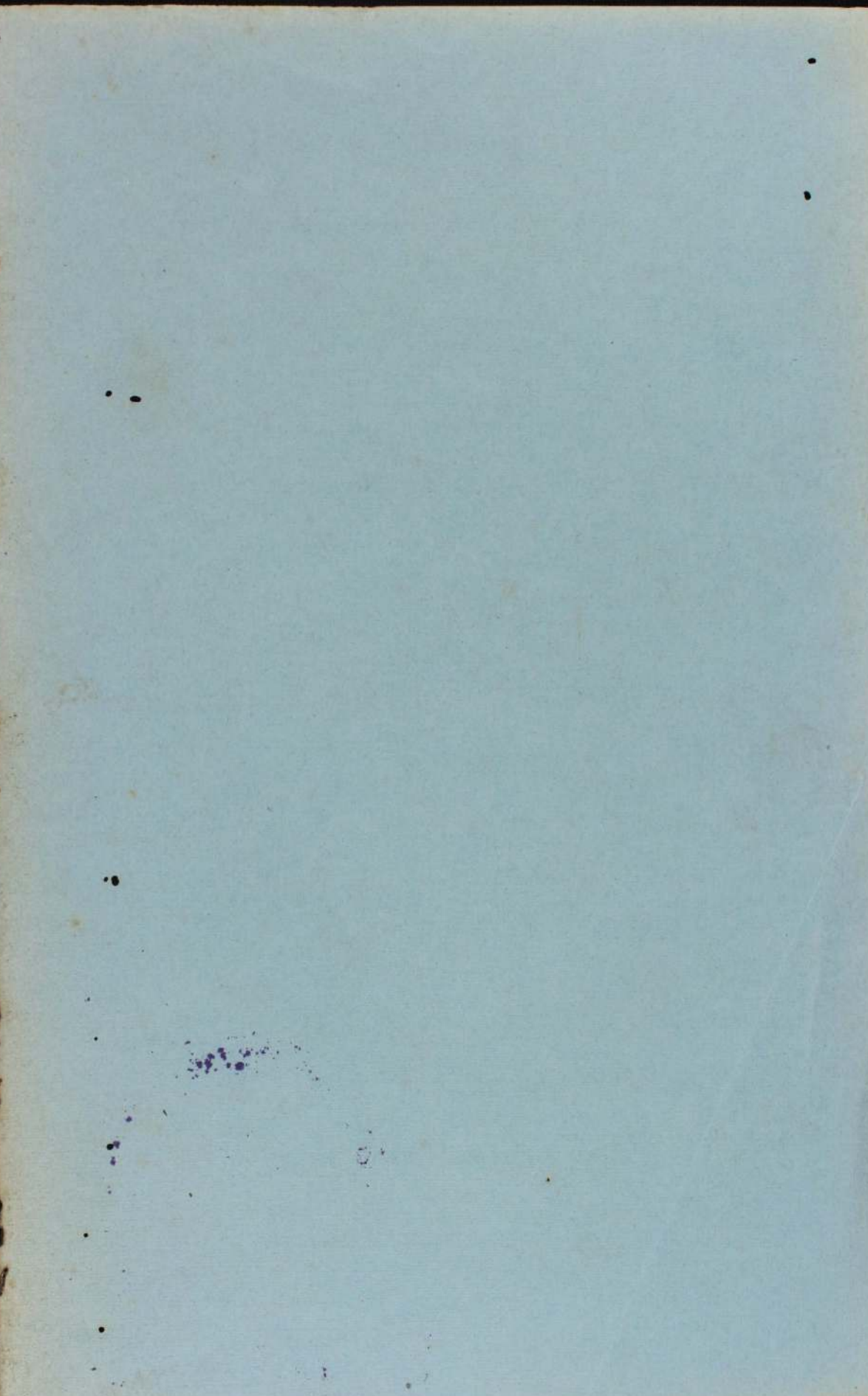
### 5. Miscellaneous

- (a) State whether the information is being furnished on behalf of the company to be accommodated, if not, state in what capacity the person furnishing the information is acting, including the interest, if any, which he has in the proposal and the company.
- (b) Furnish any other material information and describe any other significant problems relating to the enterprise or the proposed accommodation.
- (c) Furnish bank references.

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