

**ASIAN DEVELOPMENT BANK**

**TAR: SRI 37280**

**PROPOSED**

**TECHNICAL ASSISTANCE CLUSTER**  
(Cofinanced by the Government of Sweden)

**TO THE**

**DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA**

**FOR**

**IMPLEMENTING PRODUCTS AND SERVICES FOR THE**

**DOMESTIC DEBT MARKET**

**September 2004**

## CURRENCY EQUIVALENTS

(as of 2 September 2004)

Currency Unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.0097
\$1.00	=	SLRs103.0750

## ABBREVIATIONS

ADB	–	Asian Development Bank
CBSL	–	Central Bank of Sri Lanka
CSP	–	country and strategy program
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
Sida	–	Swedish International Development Cooperation Agency
TA	–	technical assistance
TAC	–	technical assistance cluster

## TA CLASSIFICATION

<b>Poverty Classification</b>	Other
<b>Sector</b>	Finance
<b>Subsector</b>	Finance sector development and reforms
<b>Thematic</b>	Sustainable economic growth and private sector development

## NOTE

In this report, "\$" refers to US dollars

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## I. INTRODUCTION

1. In September 2003, the Asian Development Bank (ADB) approved the Country Strategy and Program (CSP) 2004–2008 for Sri Lanka. A technical assistance cluster (TAC), Financial Sector Development and Product Innovation, was included in the CSP. The TAC included cofinancing for \$1.2 million, of which \$700,000 would be provided in 2004, and \$500,000 in 2005. ADB will provide \$500,000 for the TAC in 2004.

2. The Swedish International Development Cooperation Agency (Sida) will provide cofinancing<sup>1</sup> for the TAC. A Fact-Finding Mission with Sida participation was fielded on 26–30 April 2004. The Government of Sri Lanka, ADB, and Sida agreed on the TAC's objectives and that the TAC should focus on implementing products and services for the domestic debt market. An ADB follow-up Mission visited Sri Lanka on 19–21 May to confirm with the Government and stakeholders the TAC's components and structure. The TAC<sup>2</sup> framework is in Appendix 1.

3. The Government has made significant strides in the overall framework supporting systemic development of the financial sector. Various donor organizations have helped draft laws and regulations for an effective regulatory framework. However, there is an urgent need to: (i) deepen the implementation of the financial reforms included in the policy and regulatory framework; and (ii) adapt relevant financial products and services necessary to adequately support the development of a stronger and more competitive financial (i.e., banking and capital) market that will enhance economic growth, create jobs, and reduce poverty.

4. The TAC will complement (i) Sida's ongoing technical assistance (TA) in collaboration with Riksbanken (Central Bank of Sweden) to the Central Bank of Sri Lanka; (ii) ADB's Private Sector Development Program approved in 2000,<sup>3</sup> Private Sector Development (Subprogram II),<sup>4</sup> and the Small and Medium Enterprise Sector Development Program<sup>5</sup> approved in 2001; (iii) International Monetary Fund (IMF) financial recommendations,<sup>6</sup> and (iv) the World Bank's ongoing work in restructuring contractual savings institutions, including pension and provident funds.

## II. ISSUES

5. Limited access to financing, particularly long-term financing for infrastructure, and the high cost of funds in the country hinder increased private sector activity. Much progress has been made, particularly with regard to the Government's fiscal consolidation of the historically large deficits, primarily financed through the short-term domestic debt market. Additionally, auctions of treasury bills and bonds in recent years have proved a better basis for Government borrowings and have improved the activity of the long-term debt market, but further progress still needs to be made. Moreover, there are a limited number of corporate bonds presently issued.

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<sup>1</sup> Sida has committed to provide cofinancing in the amount of SEK9,500,000. Based upon the exchange rate as of 25 August 2004 of \$1.00 = SEK7.57, Sida's (maximum) total commitment is approximately \$1,255,000.

<sup>2</sup> The TAC first appeared in *ADB Business Opportunities* (Internet edition) on 11 May 2004.

<sup>3</sup> ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for Private Sector Development Program*. Manila.

<sup>4</sup> TA 4248-SRI: Project preparatory work is ongoing for the \$65-million private sector development program (subprogram II) scheduled for ADB Board consideration by December 2004. Regulatory and policy reforms in the capital market, including the debt market, will be included in the program.

<sup>5</sup> ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for Small and Medium Enterprise Sector Development Program*. Manila.

<sup>6</sup> IMF Country Report No. 04/68.

Publicly traded bonds with an extended yield curve (i.e., 15–20 years) should also be made available in the capital market.

6. The financial system continues to be dominated by the banking sector and state-owned institutions. The latter has a large presence in banking, insurance, and provident funds; controls over 60% of the total assets of financial institutions; and utilizes over 50% of the country's financial resources. Assets of institutional investors amount to approximately one third of the total assets of banks. Despite their large size, their impact on financial market development and products and services offered have been negligible, mainly because they have been used as a captive source of funding Government debt, which has primarily issued short-term paper.

7. As a result of limited long-term financing products available in the debt market, insurance companies face significant risks in managing their portfolios and are unable to match the maturities of their investment with the liabilities in the portfolio (e.g., investments, on average, have maturities of 3-5 years while liabilities have maturities of 20–30 years). Additionally, mortgage companies have difficulty raising long-term financing, resulting in limited financing for home mortgages. The mortgage financing that is available is too expensive.

8. Sri Lanka has few long-term savings institutions and institutional investors. Long-term savings are primarily held in State-operated Employee Provident Funds and the State-owned National Savings Bank. These institutions could reduce their portfolio risks and improve their investment yields if proper asset management techniques were employed. There is a need to strengthen the network of financial intermediaries and financial institutions in the debt market.

9. The absence of a well-functioning financial market has led to insufficient risk pooling and risk sharing, thereby limiting the scope for high-risk/high-return projects necessary to increase economic growth. The number of products and services offered is limited, especially to manage investment risk for issuers and investors. If investor confidence and knowledge improved, interest rate spreads would narrow.

### **III. THE PROPOSED TECHNICAL ASSISTANCE**

#### **A. Purpose and Output**

10. The TAC's purpose is to further strengthen the domestic debt market (and, thus, the financial system) on the basis of identified needs, as outlined in the previous section. The TAC will support implementation of some of the necessary financial reforms for long-term sustainability by providing awareness campaigns, capacity building, and on-site training through "learning by doing" from international institutions. Priority for improving skill development will be given to the Ministry of Finance (MOF) and the Public Debt Department.

11. The expected results and deliverables of the TAC include (i) introduction of relevant products and services for the debt market that should attract more domestic and international investment capital to Sri Lanka; (ii) stimulation of economic growth by providing additional financial products and services; (iii) reduction of overall capital cost and financial risk to the Government and private sector; (iv) improvement and strengthening of financial institutions; (v) diversification of investment opportunities for asset managers, pension funds, and insurance companies; (vi) improvement of liquidity, market efficiency, and transparency in the capital market; (vii) provision of alternative savings products; and (viii) improvement of the management and financial performance of pension and provident funds.

12. As a collaborative effort, the TAC will be implemented in close consultation with stakeholders. IMF, World Bank, Japan Bank for International Cooperation (JBIC), and United States Agency for International Development (USAID) support an enabling environment for business development.

## **B. Methodology and Key Activities**

13. The TAC has six components:

### **1. Component 1: Asset and Risk Management**

14. The TAC will provide support to the bond market in the areas of (i) credit, (ii) interest rate, and (iii) currency risk management. The TAC will also provide skill development for asset managers to understand and better manage financial risks in investment portfolios. The TAC will expose issuers and investors to alternative hedging and debt-financing products.

### **2. Component 2: Publicly Traded Securitized Bonds**

15. Appropriate awareness campaigns and capacity building will be provided to introduce publicly traded securitized bonds, which will improve liquidity in the debt market; improve the balance sheets of financial institutions; provide less expensive sources for funding; develop a longer term yield curve in the bond market; and provide critically needed financing alternatives to various industries, particularly the home mortgage market.

### **3. Component 3: Bond Derivatives**

16. Awareness campaigns will be conducted on the use of derivatives, in general, and bond derivatives, in particular, with the goal of developing a bond derivatives market<sup>7</sup> in Sri Lanka. Capacity building for users, investors, regulators, and other pertinent stakeholders will be conducted. Bond derivatives should help portfolio managers reduce risks associated with asset and liability management, as well as improve the rates of returns on investment portfolios, thereby stimulating savings and development of additional savings products.

### **4. Component 4: Infrastructure Bonds with Credit Insurance Guarantee**

17. The feasibility of providing a credit insurance guarantee for issuance of long-term (e.g., 10–15 years) Sri Lankan rupee-denominated bonds to be listed on the domestic bond market to finance a pilot infrastructure project will be assessed. The credit insurance guarantee would guarantee timely payments of principal and interest on the bond, and through the guarantee, the bond would be “AAA” rated, thus eliminating the need for a Government guarantee. The TAC will identify potential donor organizations to provide a credit insurance guarantee<sup>8</sup> in local currency. Funding in domestic currency could facilitate the financing of certain infrastructure projects that are not possible or appropriate to finance through dollar financing (i.e., avoiding currency mismatch by matching a project's costs, including debt service, with the project's revenue flows). By providing funds in local currency, local institutions (e.g., banks) could also

<sup>7</sup> The repurchase agreement (REPO) market in Sri Lanka is very active. As a result, bond derivatives will be the first derivative product to be introduced into the capital market.

<sup>8</sup> ADB; Sida; and/or GuarantCo, a group of bilateral donors within the Private Infrastructure Development Group (including the development aid authorities of the Netherlands, Sweden, Switzerland, and United Kingdom).

provide additional credit for the project. The availability of long-term instruments, if openly traded, should further develop the local debt market. The choice of the pilot case would depend upon, among other things, (i) the project's probability of success, (ii) size of the issue, and (iii) potential demand for the investment. MOF staff will be assigned to work on the pilot project with the consultants, thereby enhancing financial skills within the MOF.

#### **5. Component 5: Capacity Building for the Public Debt Department**

18. Capacity building will be provided to the Public Debt Department in debt management, risk analysis, and methods of adapting an efficient publicly traded Government bond market.

#### **6. Component 6: Capacity Building in the Debt Market for the Ministry of Finance**

19. The TAC will provide capacity building in the capital market, including the commercial debt market, for MOF staff. In order to further develop the skills needed at the External Resources and the Development Finance departments within the MOF, specific courses will be developed for each of the departments.

### **C. Cost and Financing**

20. The TAC's total cost is estimated at \$2,040,000 equivalent, comprising \$1,253,400 in foreign exchange, and \$786,600 equivalent in local currency costs. Sida will provide cofinancing of \$1,200,000 (footnote 1), of which \$700,000 will be funded in 2004, and the remaining \$500,000 in 2005. The ADB portion of the TAC will be financed on a grant basis from ADB's TA funding program. ADB will provide \$500,000 in 2004, of which \$368,647 will cover the foreign exchange cost and \$131,353 equivalent of the local currency cost. The Government will contribute \$340,000 equivalent to fund counterpart staff, office facilities, and administrative services. ADB will administer the TAC, including cofinancing provided by Sida. The cost estimates and financing plan are in Appendix 2.

### **D. Implementation Arrangements**

21. MOF will be the TAC's Executing Agency, as well as the Implementing Agency for Component 6. The Implementing Agency for Components 1–5 will be the Central Bank of Sri Lanka. MOF will appoint a qualified professional to manage the TAC. It will be implemented over 16 months, from December 2004 to March 2006. A team of eight international and four domestic consultants will provide 42 person-months of consulting services. An international consulting firm will provide a full technical proposal and will be recruited for Components 1–4 and Component 6 in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. The quality-based selection method will be used to select consultants because of the complexity of the TAC, which covers a number of subsectors, public and private debt markets, public and private institutional investors, retail investors, financial intermediaries, and capital market infrastructure. The issues are highly sensitive and will require high-level interaction with Government officials, Government agencies, regulators, and stakeholders. The consultants must have a high level of credibility and competence. Due to its knowledge and success in managing and issuing public debt, and prior experience in working on similar projects with the Central Bank of Sri Lanka, the National Debt Office of Sweden, a Swedish Government agency, will be chosen by direct selection to provide consultancy services for Component 5. The agency will complement the ongoing work of Riksbanken with the Central Bank of Sri Lanka. Outline terms of reference are in Appendix 3. A

number of activities will start simultaneously, and the sequencing in each sector will be carried out separately. An implementation schedule is provided in Appendix 4. The terms of reference for consultants and the implementation schedule are subject to change, depending on the output and/or recommendations of the other TAC components.

22. In support of the TA activities, the Executing and Implementing Agencies will provide (i) furnished office space for the consultants and access to a conference room, (ii) secretarial support, and (iii) local communication facilities for the consultants in Colombo. Staff from the Implementing Agencies will be made available on a part-time basis.

23. An inception report (with detailed work and implementation plans) will be submitted for each component by the consultants to the Executing, the respective Implementing Agencies, ADB, and Sida within 2 weeks from the start of work, an interim report halfway through the engagement, and a draft final report 2 weeks before the end of the engagement. The draft interim and final reports will be discussed at tripartite meetings involving the Executing, the respective Implementing Agencies, consultants, ADB, and Sida. The interim and final reports will incorporate results from the meetings and be made available 2 weeks from the date of the meetings.

#### **IV. THE PRESIDENT'S RECOMMENDATION AND DECISION**

24. The President recommends that the Board approve ADB administering a portion of technical assistance not exceeding the equivalent of \$1,200,000 to the Government of Sri Lanka for Implementing Products and Services for the Domestic Debt Market, to be financed on a grant basis by the Government of Sweden. If the Board approves ADB administering the technical assistance, the President, acting under the authority delegated by the Board, will approve ADB providing the balance of the technical assistance not exceeding the equivalent of \$500,000, for Implementing Products and Services for the Domestic Debt Market, and hereby reports this action to the Board.

## TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p><b>Goals</b></p> <p>1. Deepen the financial reforms included in the country's policy and regulatory framework</p> <p>2. Adapt relevant financial products and services to support the development of a stronger and more competitive financial market</p>	<p>Increase the amount of capital and number of investors in the bond market</p> <p>Increase products and services available to reduce investment risk</p> <p>Reduce the overall capital cost and financial risk to the Government and private sector</p>	<p>TA interim and final reports</p> <p>Available statistics from the public bond market</p> <p>Meeting with Executing and respective Implementing Agencies, consultants, ADB, and Sida</p> <p>TA interim and final reports</p> <p>Available reports from the Central Bank of Sri Lanka on interest rate spreads</p> <p>Annual reports of portfolio managers</p>	
<p><b>Purpose</b></p> <p>1. Support the bond market in asset and risk management</p> <p>2. Provide appropriate awareness campaigns and capacity building to introduce securitized bonds</p> <p>3. Conduct awareness campaigns for the use of derivatives and bond derivatives, and provide capacity building targeting users, investors, regulators, and other stakeholders</p> <p>4. Evaluate and design a publicly traded credit insurance guarantee bond in local currency</p>	<p>Improve financial performance of Employee Provident Funds, mutual funds, and portfolios of insurance companies</p> <p>Introduce use of financial hedging products</p> <p>Introduction of publicly traded securitized bonds</p> <p>Use derivatives and bond derivatives in investment portfolios</p> <p>Introduce a publicly traded credit insurance guarantee bond in local currency</p>	<p>TA interim and final reports</p> <p>Annual reports of portfolio managers</p> <p>Meeting with Executing and respective Implementing Agencies, consultants, ADB, and Sida</p> <p>TA interim and final reports</p> <p>Number and issue size of securitized bonds traded in the public bond market</p> <p>TA interim and final reports</p> <p>Annual reports of portfolio managers</p> <p>TA interim and final reports</p> <p>Trading of credit insurance</p>	<p>Portfolio managers have the needed capacity</p> <p>Portfolio managers have the needed capacity</p> <p>The Government is receptive to implementing financial reforms</p> <p>Consultants have the needed capacity</p> <p>Investors have the needed capacity</p> <p>Investors are interested in publicly traded credit insurance</p>

<b>Design Summary</b>	<b>Performance Indicators/Targets</b>	<b>Monitoring Mechanisms</b>	<b>Assumptions and Risks</b>
<p>to finance a pilot infrastructure project</p> <p>5. Provide capacity building for the Public Debt Department</p> <p>6. Provide capacity building for Ministry of Finance (MOF) employees</p> <p>7. Improve the awareness of the needs and use of debt market products and services</p>	<p>Trade Government bonds more efficiently</p> <p>Lower interest rates</p> <p>Involve MOF personnel with financial planning and reform</p> <p>Encourage use of new products and services in the local market</p>	<p>guarantee bond in the local bond market</p> <p>Reduced number of series of Government bonds outstanding</p> <p>Interest rates spreads</p> <p>TA interim and final reports</p> <p>Meeting with Executing and respective Implementing Agencies, consultants, ADB, and Sida</p> <p>TA interim and final reports</p>	<p>Government bonds.</p> <p>The Public Debt Department has the needed capacity</p> <p>MOF employees have the needed capacity</p> <p>Consultants have the needed capacity</p>
<p><b>Outputs</b></p> <p>1. Introduce relevant products and services for the debt market to attract more domestic and international investment capital</p> <p>2. Stimulate economic growth by introducing additional financial products and services</p> <p>3. Reduce the overall capital cost and financial risk to the Government and private sector</p> <p>4. Improve the performance of financial institutions</p> <p>5. Diversify investment opportunities for asset managers, pension funds, and insurance companies</p>	<p>Improve investment yields on portfolios</p> <p>Improve the functioning of the bond market through more investors; more liquidity; and diversified debt investment alternatives (e.g., availability of various bond maturities)</p> <p>Lower interest rates</p> <p>Make long-term maturities available for debt financing</p> <p>Improve yields on investment portfolios</p> <p>Increase debt products and services available in the domestic public debt, including increase in market share of issued corporate bonds and other nongovernment paper</p>	<p>TA interim and final reports</p> <p>Market capitalization of bond exchange before, during, and after TA completion</p> <p>Meeting with Executing and respective Implementing Agencies, consultants, ADB, and Sida</p> <p>Debt products and services offered before, during, and after TA completion</p> <p>TA interim and final reports</p> <p>Analysis of capital costs before, during, and after completion of TA</p> <p>Availability of products that help reduce financial risk</p> <p>TA interim and final reports</p> <p>Annual reports of portfolio managers before, during, and after TA completion</p> <p>TA interim and final reports</p> <p>Annual reports of portfolio managers before, during and after TA completion</p>	<p>Coverage of the consultants' inputs is complete</p> <p>The Government is receptive to implementing changes to stimulate capital market growth</p> <p>The Government is receptive to introducing change in the debt market</p> <p>Portfolio managers have the needed capacity</p> <p>Consultants have the needed capacity</p> <p>Investment managers have the needed capacity</p> <p>Consultants have the needed capacity</p>

<b>Design Summary</b>	<b>Performance Indicators/Targets</b>	<b>Monitoring Mechanisms</b>	<b>Assumptions and Risks</b>
6. Improve liquidity, market efficiency, and transparency in the debt market	Increase liquidity of the debt market  Extend the yield curve	TA interim and final reports	
7. Increase the institutional and retail investment base	Increase the market share of investments made by mutual funds, private sector pension/provident funds, and retail investors	TA interim and final reports  Analysis of trading statistics on the bond exchange before, during, and after TA completion	Consultants have the needed capacity
<b>Inputs</b> 1. Develop skills and training programs to strengthen and upgrade asset and risk management	Improve financial portfolio performance	TA interim and final reports	Consultants have the needed capacity
2. Develop skill programs to introduce home mortgage securitized bonds	Introduce publicly traded home mortgage bonds	TA interim and final reports	Proper legislation is in place
3. Conduct an awareness campaign and various skills development programs to develop a bond derivative market	Use bond derivatives widely	TA interim and final reports  Annual reports of portfolio managers	Proper legislation is in place
4. Create an infrastructure credit insurance guarantee bond to finance a pilot project	Issue publicly traded infrastructure credit insurance guarantee bonds	TA interim and final reports  Infrastructure bonds listed on the bond exchange	An appropriate pilot project is available  The project is economically successful  Credit insurance is available for a pilot project
5. Strengthen the capacity of the Public Debt Department	(i) Prepare debt management guidelines, (ii) prepare risk analysis models, (iii) conduct secondary market interventions, (iv) employ methods to reduce the number of and increase the size of Government bond issues, and (v) build capacity of primary dealers	TA interim and final reports	Appropriate time is given for employees to be trained
6. Implement skills enhancement programs and a training plan for MOF	Increase involvement by MOF employees on financial issues	TA interim and final reports	Appropriate time is given for employees to be trained

ADB = Asian Development Bank, MOF = Ministry of Finance, Sida = Swedish International Development Cooperation Agency, TA = technical assistance.

## COST ESTIMATES AND FINANCING PLANS

**Table A2.1 Cost Estimates and Financing Plan**  
(\$)

Item	Foreign Exchange	Local Currency	Total
<b>A. Asian Development Bank Financing<sup>a</sup></b>			
1. Consultants			
a. Remuneration			
i. International	189,706	0	189,706
ii. Domestic	0	14,118	14,118
b. Per Diem	0	0	0
i. International	29,118	0	29,118
ii. Domestic	0	0	0
c. Travel	0	0	0
i. International	22,059	7,353	29,412
ii. Domestic	0	3,824	3,824
2. Equipment	52,941	0	52,941
3. Course Documentation	0	0	0
a. Course Material, Production, and Shipment	22,941	0	22,941
b. Purchase of Reference Material	3,824	882	4,706
c. Information Dissemination	0	5,294	5,294
4. Workshops, Training, and Seminars	0	0	0
a. Training	0	35,294	35,294
b. Workshops and Seminars	0	46,176	46,176
5. Contract Negotiation	0	1,471	1,471
6. Contingencies	48,059	16,941	65,000
<b>Subtotal (A)</b>	<b>368,647</b>	<b>131,353</b>	<b>500,000</b>
<b>B. Sida Financing</b>			
1. Consultants			
a. Remuneration			
i. International	455,294	0	455,294
ii. Domestic	0	33,882	33,882
b. Per Diem	0	0	0
i. International	69,882	0	69,882
ii. Domestic	0	0	0
c. Travel	0	0	0
i. International	52,941	17,647	70,588
ii. Domestic	0	9,176	9,176
2. Equipment	127,059	0	127,059
3. Course Documentation	0	0	0
a. Course Material, Production, and Shipment	55,059	0	55,059
b. Purchase of Reference Material	9,176	2,118	11,294
c. Information Dissemination	0	12,706	12,706
4. Workshops, Training, and Seminars	0	0	0
a. Training	0	84,706	84,706
b. Workshops and Seminars	0	110,824	110,824
5. Contract Negotiation	0	3,529	3,529
6. Contingencies	115,341	40,659	156,000
<b>Subtotal (B)</b>	<b>884,753</b>	<b>315,247</b>	<b>1,200,000</b>
<b>C. Government Financing</b>			
1. Counterpart Staff	0	150,000	150,000
2. Office Facilities and Equipment	0	100,000	100,000
3. Supplies, Utilities, and Other Logistical Support	0	90,000	90,000
<b>Subtotal (C)</b>	<b>0</b>	<b>340,000</b>	<b>340,000</b>
<b>Total (A+B+C)</b>	<b>1,253,400</b>	<b>786,600</b>	<b>2,040,000</b>

Note: Figures may not add up to totals due to rounding.

Sida = Swedish International Development Cooperation Agency.

<sup>a</sup> Financed by Asian Development Bank's technical assistance funding program.

Source: Asian Development Bank estimates.

**Table A2.2 Financing Plan for the Equipment**

<b>Equipment Type<sup>a</sup></b>	<b>Quantity</b>	<b>Purpose</b>	<b>Cost (\$)</b>
1. Printer, fax, high-speed copy machine Desktop and laptop computers	1 each 3 each	To be provided to the External Resources Division of the MOF	30,000
2. Printer, fax, high-speed copy machine Desktop and laptop computers	1 each 3 each	To be provided to the National Planning Division of the MOF	30,000
3. Printer, fax, high-speed copy machine Desktop computer	1 each 1 unit	To be provided to the Budget Division of the MOF	10,000
4. Printer, fax, high-speed copy machine Desktop computer	1 each 1 unit	To be provided to the Treasury Division of the MOF	10,000
5. Printer, fax, high-speed copy machine, Desktop computer	1 each 1 unit	To be provided to the Public Enterprises Division of the MOF	10,000
6. Hardware equipment and data systems	1 system	To be provided for linkage of trading and clearing systems between the Central Bank of Sri Lanka and Colombo Stock Exchange	90,000

MOF = Ministry of Finance.

<sup>a</sup> Equipment will be procured by the consultants for Component 5 and Component 6 (as defined in the Terms of Reference) in accordance with the Asian Development Bank's *Guidelines for Procurement*. Ownership of the equipment will be transferred either to the Ministry of Finance or the Central Bank of Sri Lanka (based on where the equipment was installed) at the completion of technical assistance.

Source: Asian Development Bank estimates.

**Table A2.3: Summary of Cost Estimates and Financing Plan, By Cluster**  
(\$)

Item	Component 1			Component 2			Component 3			Component 4		
	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total
1. Consultants												
a. Remuneration												
i. International	86,000	0	86,000	86,000	0	86,000	64,500	0	64,500	86,000	0	86,000
ii. Domestic	0	8,000	8,000	0	8,000	8,000	0	0	0	0	8,000	8,000
b. Per Diem												
i. International	13,500	0	13,500	13,500	0	13,500	9,000	0	9,000	13,500	0	13,500
ii. Domestic	0	0	0	0	0	0	0	0	0	0	0	0
c. Travel												
i. International	10,000	3,000	13,000	10,000	3,000	13,000	5,000	2,000	7,000	10,000	3,000	13,000
ii. Domestic	0	2,000	2,000	0	2,000	2,000	0	0	0	0	2,000	2,000
2. Equipment	0	0	0	0	0	0	0	0	0	0	0	0
3. Course Documentation												
a. Course Material, Production, and Shipment	40,000	0	40,000	5,000	0	5,000	5,000	0	5,000	3,000	0	3,000
b. Purchase of Reference Material	4,000	0	4,000	1,500	0	1,500	1,500	0	1,500	1,000		1,000
c. Information Dissemination	0	5,000	5,000	0	2,000	2,000	0	2,000	2,000	0	5,000	5,000
4. Workshops, Training, and Seminars												
a. Training	0	30,000	30,000	0	30,000	30,000	0	20,000	20,000	0	20,000	20,000
b. Workshops and Seminars	0	42,000	42,000	0	35,000	35,000	0	30,000	30,000	0	30,000	30,000
5. Contract Negotiation	0	0	0	0	0	0	0	0	0	0	0	0
<b>Subtotal</b>	<b>153,500</b>	<b>90,000</b>	<b>243,500</b>	<b>116,000</b>	<b>80,000</b>	<b>196,000</b>	<b>85,000</b>	<b>54,000</b>	<b>139,000</b>	<b>113,500</b>	<b>68,000</b>	<b>181,500</b>
6. Contingencies	23,025	13,500	36,525	17,400	12,000	29,400	12,750	8,100	20,850	16,925	10,200	27,125
<b>Total (ADB + Sida)</b>	<b>176,525</b>	<b>103,500</b>	<b>280,025</b>	<b>133,400</b>	<b>92,000</b>	<b>225,400</b>	<b>97,750</b>	<b>62,100</b>	<b>159,850</b>	<b>130,425</b>	<b>78,200</b>	<b>208,625</b>

Table A2.3: — *Continued*

Item	Component 5			Component 6			All Components		
	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total
1. Consultants									
a. Remuneration									
i. International	107,500	0	107,500	215,000	0	215,000	645,000	0	645,000
ii. Domestic	0	0	0	0	24,000	24,000	0	48,000	48,000
b. Per Diem									
i. International	13,500	0	13,500	36,000	0	36,000	99,000	0	99,000
ii. Domestic	0	0	0	0	0	0	0	0	0
c. Travel									
i. International	20,000	4,000	24,000	20,000	10,000	30,000	75,000	25,000	100,000
ii. Domestic	0	0	0	0	7,000	7,000	0	13,000	13,000
2. Equipment	90,000	0	90,000	90,000	0	90,000	180,000	0	180,000
3. Course Documentation									
a. Course Material, Production, and Shipment	10,000	0	10,000	15,000	0	15,000	78,000	0	78,000
b. Purchase of Reference Material	2,000	2,000	4,000	3,000	1,000	4,000	13,000	3,000	16,000
c. Information Dissemination	0	3,000	3,000	0	1,000	1,000	0	18,000	18,000
4. Workshops, Training, and Seminars									
a. Training	0	10,000	10,000	0	10,000	10,000	0	120,000	120,000
b. Workshops and Seminars	0	10,000	10,000	0	10,000	10,000	0	157,000	157,000
5. Contract Negotiation	0	0	0	0	0	0	0	5,000	5,000
<b>Subtotal</b>	<b>243,000</b>	<b>29,000</b>	<b>272,000</b>	<b>379,000</b>	<b>63,000</b>	<b>442,000</b>	<b>1,090,000</b>	<b>389,000</b>	<b>1,479,000</b>
6. Contingencies	36,450	4,350	40,800	56,850	9,450	66,300	163,400	57,600	221,000
<b>Total (ADB + Sida)</b>	<b>279,450</b>	<b>33,350</b>	<b>312,800</b>	<b>435,850</b>	<b>72,450</b>	<b>508,300</b>	<b>1,253,400</b>	<b>446,600</b>	<b>1,700,000</b> <sup>a</sup>

ADB = Asian Development Bank, Sida = Swedish International Development Cooperation Agency.

<sup>a</sup> Total project cost is \$2,040,000 of which \$1,700,000 is being provided by ADB and Sida and \$340,000 is being contributed by the Government.

Source: Asian Development Bank estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

### A. **Component 1: Asset and Risk Management Experts** (1 international, 4 person-months; 1 domestic, 2 person-months)

1. The international and domestic experts must have extensive experience in the debt market and techniques used in asset/portfolio management. Complete familiarity with managing credit, interest rates and currency risks is a requirement. Experience in working with emerging markets is a necessity.

2. The experts will undertake the following tasks:

- (i) Review work already done by the Government, multilateral and bilateral aid agencies, and other consultants on asset and risk management.
- (ii) Prioritize capacity-building needs in upgrading asset and liability debt management techniques in portfolios related to debt instruments for (a) the Central Bank; (b) Treasurer's/portfolio managers of private and State-owned enterprises; (c) banks; (d) insurance industry; (e) mutual funds; (f) appropriate regulatory authorities; and (g) other groups (e.g., teacher associations, primary schools, and universities) that might need asset and risk management techniques.
- (iii) Develop skill development programs within the given budget to include (a) priorities of topics to be covered; and (b) methods for providing capacity building (e.g., courses, workshops, on-the-job training). Provide detailed costs, timetable, and work and implementation plans (e.g., pilot case) for each program. The programs could vary by user group, type of industry, etc. The subjects should include, but not be limited to (a) analysis of risk exposure structure; (b) liability management (e.g., forward interest rate swaps); (c) development of risk management policies and manuals; and (d) analytical tools and instruments for risk management. Course documentation and reference material will be provided (hard copy and electronic version).
- (iv) Develop a program to train local staff to become trainers in asset and risk management.
- (v) After obtaining approval from the Executing and respective Implementing Agencies, ADB, and Sida for the skill development and training-of-trainers program, implement the skill development and training-of-trainers programs.

### B. **Component 2: Home Mortgage Securitized Bond Experts** (1 international, 4 person-months; 1 domestic, 2 person-months)

3. The international expert must have extensive experience in publicly traded bonds, securitization, mortgage banks, mortgage companies, and the home mortgage market. Complete familiarity with structuring asset-backed and pass-through secured bonds, and the role of special-purpose vehicles, trustees, and credit ratings are requirements. Experience in working with emerging markets is a necessity. The domestic expert must have extensive experience in the home mortgage market, mortgage institutes, bond market, and local bond investors.

4. The experts will undertake the following tasks:

- (i) Review work already done by the Government, multilateral and bilateral donor agencies, and other consultants on introducing publicly traded securitized bonds for the home mortgage market.
- (ii) Develop detailed skill development programs to introduce publicly tradable bonds secured by home mortgages. The skill development programs should include, but not be limited to: (i) subjects to be covered, including course documentation and reference material to be provided (hard copy and electronic version); (ii) identification of the participants to attend the program (e.g., issuers, investors, bond traders, rating agencies etc); (iii) costs; (iv) timetable; (v) work plan; and (vi) implementation arrangements for each program.
- (iii) After obtaining approval from ADB, Sida, the Executing and respective Implementing Agencies for the skill development programs, implement them.

**C. Component 3: Bond Derivatives Expert** (1 international, 3 person-months)

5. The international expert must have extensive experience in the debt market, and in using and structuring bond derivatives. The experts must have significant pedagogical experience in training professionals, holding seminars, etc. Experience in working with emerging markets is a necessity.

6. The expert will undertake the following tasks:

- (i) Review work already done by the Government, multilateral and bilateral aid agencies, and other consultants on derivatives, bond derivatives, and trading of repurchase agreements (REPOs) in the Sri Lankan market.
- (ii) Develop awareness campaign and various skill development programs for potential users of bond derivatives.
- (iii) Prioritize the skill development programs to maximize the impact of introducing bond derivatives to the Sri Lankan market.
- (iv) Develop a work plan implementation program.
- (v) After obtaining approval from ADB, Sida, the Executing and respective Implementing Agencies for the awareness/skill development programs, implement them.

**D. Component 4: Infrastructure Bonds with Credit Insurance Guarantee** (1 international, 4 person-months; 1 domestic, 2 person-months)

7. The international experts must have extensive experience in the debt market, project financing and credit insurance guarantee bonds. Experience in working with emerging markets is a necessity.

8. The experts will undertake the following tasks:

- (i) Review work already done by the multilateral and bilateral aid agencies, and other consultants on infrastructure credit insurance guarantee bonds.
- (ii) Analyze the Government's pilot project from the standpoint of raising a portion of the funds for the project through an infrastructure credit insurance guarantee bond.

- (iii) Structure a long-term (e.g., 10–15 years) Sri Lankan rupee-denominated infrastructure credit insurance guarantee bond for the domestic market without a Government guarantee.
- (iv) Identify potential investors and issuers in the local market who would be interested in investing and/or issuing infrastructure credit insurance guarantee bonds.
- (v) Develop and conduct workshops for potential investors, issuers, etc. to introduce infrastructure credit insurance guarantee bonds in Sri Lanka. Provide documentation, and course and reference material (hard copy and electronic version).
- (vi) Evaluate the need to establish a local credit insurance company. The analysis should include, but not be limited to: (a) potential market size of issuers; (b) potential market size of investors; and (c) business case and next steps, if any, to establish a local credit insurance company.
- (vii) If the Executing Agency, Implementing Agency, ADB, and Sida agree that a local credit insurance company should be established in Sri Lanka, a business plan should be written.

**E. Component 5: Capacity Building for the Public Debt Department** (2 international, 5 person-months)

9. The international experts must have extensive experience in working with the Swedish National Debt Office, including experience in issuance of Government bonds, debt management and the primary and secondary Government bond market. The experts will provide appropriate documentation, course and reference material (hard copy and electronic version).

10. The experts will provide capacity building in the following areas:

- (i) Debt management guidelines, including governance systems and institutional relationships on debt management. Capacity building should also include preparation of guidelines and benchmarks used (e.g., duration of nominal debt, required amortization levels of foreign debt, etc.).
- (ii) Conduct strategic cost and risk analysis in the context of the guideline proposal discussed in (i). The various risks covered should include (a) refinancing risk, (b) refixing risk, (c) operational risk, (d) settlement risk, and (e) the trade-offs between hedging cost vs. the risk being hedged.
- (iii) Suggest ways to (a) reduce the number of series of Government bonds outstanding, and (b) resolve the resulting “bunching” problem.
- (iv) Develop a secondary market intervention mechanism.
- (v) Supervise primary dealers.
- (vi) Refine legal and institutional structures.

**F. Component 6: Capacity Building on the Debt Market for the Ministry of Finance** (2 international, 10 person-months; 1 domestic, 6 person-months)

11. The international and domestic experts must have extensive experience in the debt market, including all the analytical tools and instruments used in managing a debt portfolio. The experts must have significant pedagogical experience in training professionals, holding seminars, etc. Experience in working with emerging markets is a necessity for the international expert.

12. After reviewing the work being conducted in the other components in the technical assistance, the experts will undertake the following tasks:

- (i) identify and prioritize the capacity building needs for the employees of the MOF and the employees within the External Resources and Development Finance departments;
- (ii) Access the needs for capacity building in the capital market (debt and equity including venture capital), credit analysis, portfolio and risk management and the products and services available in the debt market;
- (iii) Develop and provide skills enhancement programs for (a) employees at the MOF; and (b) specific programs developed for the needs of the external Resource Department and the Development Finance Department.
- (iv) Course material, documentation and reference material shall be provided (hard copy and electronic version) for each of the participants; and
- (v) Develop a plan to train local staff to become trainers to MOF staff for products and services offered in the debt market.
- (vi) After obtaining approval from ADB, Sida and the MOF for the capacity building programs, implement the programs.

## SUMMARY OF IMPLEMENTATION ARRANGEMENTS

<b>Component</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	
Implementing Agency	CBSL	CBSL	CBSL	CBSL	CBSL	MOF	
<b>Schedule</b>							
Commencement	Dec 04	Jun 05	Jun 05	Feb 05	Dec 04	Dec 04	
Completion	Aug 05	Mar 06	Oct 05	Oct 05	Jun 05	Mar 06	
<b>Consulting Services</b>							<b>Total</b>
<b>(person-months)</b>							
International	4	4	3	4	5	10	30
Domestic	2	2	0	2	0	6	12
<b>Total</b>	<b>6</b>	<b>6</b>	<b>3</b>	<b>6</b>	<b>5</b>	<b>16</b>	<b>42</b>

CBSL=Central Bank of Sri Lanka, Dec = December, Aug = August, Jun = June, Mar = March, Oct = October, Feb = February, MOF=Ministry of Finance.

Source: Asian Development Bank estimates.