



Completion Report

Project Number: 36357-01/03
Loan Number: 2138/2139
October 2011

Sri Lanka: Financial Markets Program for Private Sector Development

Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – Sri Lanka rupee/s (SLRe/SLRs)

		At Appraisal	At Program Completion
		3 November 2004	28 October 2010
SLRe1.00	=	\$0.0096	\$0.0090
\$1.00	=	SLRs104.13	SLRs111.54

ABBREVIATIONS

ABS	–	asset-backed security
ADB	–	Asian Development Bank
AFS	–	agency financial statement
AML	–	anti-money laundering (law)
APA	–	audited project account
ASPI	–	All Share Price Index
BOC	–	Bank of Ceylon
CBSL	–	Central Bank of Sri Lanka
CFT	–	combating the financing of terrorism
CRIB	–	Credit Information Bureau
CSE	–	Colombo Stock Exchange
CSP	–	Country Strategy and Program
DEX	–	debt securities trading system
FATF	–	financial action task force
GDP	–	gross domestic product
IBSL	–	Insurance Board of Sri Lanka
IMF	–	International Monetary Fund
IPO	–	initial public offering
LIBOR	–	London interbank offered rate
MOFP	–	Ministry of Finance and Planning
MPI	–	Milanka Price Index
PDD	–	public debt department
PSDP	–	private sector development program
ROA	–	return on assets
PPTA	–	project preparatory technical assistance
RRP	–	report and recommendation of the President
SEC	–	Securities and Exchange Commission
SEMA	–	Strategic Enterprise Management Authority
SOCB	–	state-owned commercial bank
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the government and its agencies ends on 31 December. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2009 ends on 31 December 2009.
- (ii) In this report, “\$” refers to US dollars.

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BASIC DATA

A. Loan Identification

1.	Country	Sri Lanka
2.	Loan Number	2138 and 2139
3.	Program Title	Financial Markets Program for Private Sector Development
4.	Borrower	Democratic Socialist Republic of Sri Lanka
5.	Executing Agency	Ministry of Finance and Planning
6.	Amount of Loan	\$60 million and \$5 million
7.	Program Completion Report Number	1271

B. Loan Data

1.	Appraisal	
	– Date Started	23 October 2004
	– Date Completed	3 November 2004
2.	Loan Negotiations	
	– Date Started	15 November 2004
	– Date Completed	16 November 2004
3.	Date of Board Approval	15 December 2004
4.	Date of Loan Agreement	20 December 2004
5.	Date of Loan Effectiveness	
	– In Loan Agreement	20 March 2005
	– Actual	20 March 2005
	– Number of Extensions	None
6.	Closing Date	
	– In Loan Agreement	Loan 2138: 31 December 2007; Loan 2139: 1 December 2007
	– Actual	Loan 2138: 28 October 2010; Loan 2139: 13 September 2011
	– Number of Extensions	Loan 2138: 3; Loan 2139: 3
7.	Terms of Loan	Loan 2138 Loan 2139
	– Interest Rate	LIBOR + 0.4% and 0.6% 1.5%
	– Maturity (number of years)	15 32
	– Grace Period (number of years)	3 8
8.	Terms of Relending (if any)	None None
	– Interest Rate	
	– Maturity (number of years)	
	– Grace Period (number of years)	
	– Second-Step Borrower	

9. Disbursements
a. Dates

Initial Disbursement	Final Disbursement	Time Interval
2138: 22 Mar 2005 2139: 11 Apr 2007	28 Oct 2010	60 months
Effective Date	Original Closing Date	Time Interval
21 Mar 2005	31 Dec 2007	33 months

b. Program (Loan 2138) Amount (\$ million)

Category	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
Tranche 1	20.0	0	0	20.0	20.0	0
Tranche 2	20.0	0	0	20.0	20.0	0
Tranche 3	20.0	0	0	20.0	20.0	0
Total	60.0	0	0	60.0	60.0	0

c. Project (Loan 2139) Amount (\$)

Category	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
Equipment	130,000	133,853	91,973	41,880	41,880	0
Training	365,000	383,050	383,050	0	0	0
Consulting Services	3,606,500	3,752,055	3,364,045	388,010	388,010	0
Documentation	71,200	74,199	72,089	2,110	2,110	0
Interest/Commitment Charge	309,183	323,784	302,664	21,120	21,120	0
Unallocated	518,117	544,501	544,501	0	0	0
Imprest Fund	0	0	0	0	0	0
Total	5,000,000	5,211,442	4,758,322	453,120	453,120	0

10. Local Costs under Loan 2139 (Financed)
- Amount (\$) 94,263
 - Percentage of Total Cost 1.99%

C. Program and Project Data

1. Program Cost, Loan 2138 (\$)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost	60,000,000	60,000,000
Local Currency Cost	0	0
Total	60,000,000	60,000,000

D. Project Data

2. Project Cost, Loan 2139 (\$)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost	4,527,240	358,856
Local Currency Cost	1,472,760	94,264
Total	6,000,000	453,120

3. Program Financing Plan, Loan 2138 (\$)

Cost	Appraisal Estimate	Actual
Implementation Costs		
Borrower-Financed	0	0
ADB-Financed	60,000,000	60,000,000
Other External Financing	30,000,000	30,000,000
Total	90,000,000	90,000,000

ADB = Asian Development Bank.

4. Cost Breakdown, by Program Component, Loan 2138 (\$)

Component	Appraisal Estimate	Actual
Recapitalization of People's Bank	82,000,000	56,000,000 ^a
Preparation of Acts and Administrative Cost to SEMA	3,000,000	0
Operationalization of Public Debt Office	5,000,000	0
Total	90,000,000	56,000,000

SEMA = Strategic Enterprise Management Authority.

^a The government provided a total of SLRs6.0 billion—SLRs2.0 billion in 2005, SLRs1.0 billion in 2006, SLRs1.5 billion in 2007, and SLRs1.5 billion in 2008—roughly equivalent to \$56 million at the average exchange rate of \$1:SLRs107 from 2005 to 2008. ADB released \$60 million in three tranches.

5. Cost Breakdown, by Project Component, Loan 2139 (\$)

Component	Appraisal Estimate	Actual
Contract for Derek Kelly, 1 Sep 2005	331,440	274,908
PriceWaterhouseCoopers Pvt Ltd, 24 Oct 2005	20,306	18,392
PriceWaterhouseCoopers Pvt Ltd, 24 Oct 2005	104,594	94,263
Total	456,340	387,566

6. Program Schedule, Loan 2138

Item	Appraisal Estimate	Actual
First Tranche Release	December 2004	22 March 2005
Second Tranche Release	June 2006	28 October 2010
Third Tranche Release	December 2007	28 October 2010

7. Program Performance Report Ratings, Loan 2138

Implementation Period	Rating	
	Development Objectives	Implementation Progress
22 Mar 2005–31 Dec 2005	Satisfactory	Satisfactory
31 Jan 2006–31 Dec 2006	Satisfactory	Satisfactory
31 Jan 2007–31 Aug 2007	Satisfactory	Satisfactory
30 Sep 2007–31 Dec 2007	Satisfactory	Partly Satisfactory
31 Jan 2008–31 Dec 2008	Satisfactory	Satisfactory
31 Jan 2009–31 Dec 2009	Satisfactory	Satisfactory
31 Jan 2010–31 Dec 2010	Satisfactory	Satisfactory

8. Project Performance Report Ratings, Loan 2139

Implementation Period	Rating	
	Development Objectives	Implementation Progress
31 Dec 2004–31 Dec 2005	Satisfactory	Satisfactory
31 Jan 2006–30 Dec 2006	Satisfactory	Satisfactory
31 Jan 2007–30 Jun 2007	Satisfactory	Satisfactory
30 Jun 2007–31 Jul 2007	Satisfactory	Unsatisfactory
31 Aug 2007–31 Dec 2007	Satisfactory	Satisfactory
31 Jan 2008–31 Dec 2008	Satisfactory	Satisfactory
31 Jan 2009–30 Jun 2009	Satisfactory	Satisfactory
31 Jul 2009–31 Dec 2009	Satisfactory	Unsatisfactory
31 Jan 2010–31 Dec 2010	Satisfactory	Satisfactory

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members ^a
Fact-Finding	26–30 Apr 2004	3	15	a, b, b
Review (PPTA)	17–28 May 2004	3	9	a, b, b
Appraisal ^b	27–29 Oct 2004			c
Consultation	31 Jan–11 Feb 2005	2	12	a, b
Consultation	10–14 Mar 2005	1	3	a
Program Inception	4–16 May 2005	3	9	a, c, d
Review 1	20–24 Jun 2005	1	2	a
Review 2	25–26 Oct 2005	2	4	a, b
Review 3	12–16 Dec 2005	2	4	a, b
Review 4	27 Feb–2 Mar 2006	1	1	a
Consultation	24–28 Mar 2006	1	1	a
Review 5	5–14 Dec 2006	2	16	a, e
Review 6	14–28 Mar 2007	4	24	a, b, d, f
Review 7	7–9 Dec 2007	2	6	a, a
Review 8	22–24 Jan 2008	2	6	a, a
Review 9	12–14 May 2008	3	9	a, b, d
Review 10	15–17 Dec 2008	2	6	p, e
Review 11	16–23 Mar 2009	1	6	p
Program completion review	2–4 Aug 2010	2	6	d, p

^a Back-to-office report does not indicate mission member.

^b a = project analyst, c = counsel, d = Director, e = economist, p = project officer, t = assistant, PPTA = project preparatory technical assistance.

I. PROGRAM DESCRIPTION

1. The Asian Development Bank (ADB) approved a \$65 million assistance program in December 2004 to develop Sri Lanka's private sector by strengthening the country's financial markets. The program was the second of two subprograms (subprogram I and II) under the Private Sector Development Program (PSDP) cluster for Sri Lanka, which was approved in December 2000. The program (PSDP subprogram II), titled "Financial Markets Program for Private Sector Development," is designed to augment the achievements of the PSDP subprogram I.

2. The program consists of two loans: (i) a policy loan of \$60 million from ADB's ordinary capital resources, and (ii) a technical assistance (TA) loan of \$5 million equivalent from ADB's Special Funds resources. The impact of the program was private sector development through strengthened financial markets. The outcome was developed financial markets in Sri Lanka and reduced fiscal burden on account of the state-owned People's Bank. The outputs were twofold. The first set of outputs comprised (i) increased financial products and services available to the capital markets, (ii) enhanced corporate governance in the financial markets, resulting in fostered competition and promoted transparency in the financial markets, and (iii) improved regulations of the insurance industry. The second set of outputs consisted of (i) improved corporate governance of state-owned commercial banks (SOCBs), and (ii) operational improvement of People's Bank.¹

3. Through the program, the Government of Sri Lanka (government) intended to continue on the earlier financial sector reform efforts that began in the 1990s to reform the banking system, reinforce banking regulations, improve supervision and corporate governance, and develop the debt and equity markets.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

4. The proposed financial sector development agenda was relevant to Sri Lanka's broader political and economic context in the early 2000s. Two decades of civil conflict affected the country's economic growth potential, reducing the gross domestic product (GDP) by an estimated 2 percentage points per year.² The private sector was constrained by the political uncertainty that depressed the confidence in long-term capital investment and business expansion. Poverty remained. The 2002 peace talks inspired some political optimism and the government decided to implement the overdue economic reforms. A thorough overhaul of the financial sector was proposed.³ The sector development program was designed in this context to address the systemic and structural deficiencies in the financial sector for private sector development.

¹ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Republic of Sri Lanka for the Financial Markets Program for Private Sector Development*. Manila.

² ADB. 2003. *Country Strategy and Program: Sri Lanka, 2004–2008*. Manila.

³ While the government intended to privatize state-owned commercial banks in the early stage of the financial sector reform in the 1990s, this strategy was subsequently modified to focus only on the improvement of SOCBs' operations while maintaining government ownership. This reflected a policy change from the earlier government that was more supportive of the private and financial sector development agenda. The most recent government vision of Mahinda Chintana is not explicit about the development priority in private and financial sector development.

5. The program design was consistent with ADB's Sri Lanka country strategy and program (CSP) 2004-2008 (footnote 2), which focused on (i) promoting private sector development, and (ii) supporting poverty reduction through sector intervention and broad-based growth. The program design was also consistent with Sri Lanka New National Strategy (2005–2008),⁴ which outlined the regulatory deficiencies in banking, insurance, and other financial services, and affirmed the need to strengthen the operations of the SOCBs so they could better compete in the financial services industry.

6. The quality of the project preparatory technical assistance (PPTA) was satisfactory. The PPTA assessed a wide array of financial sector issues and identified financial sector constraints that affected private sector development. Despite a few obstacles in subsequent program implementation, such as the resistance from People's Bank's labor union to the recapitalization plan and the government's change of mindset regarding utilization of the TA loan (para. 32), PPTA's proposed program design was sound.

B. Program Outputs

1. Increased Financial Products and Services Available to the Capital Markets.

7. **Mortgage finance.** The housing sector in Sri Lanka was constrained by the underdevelopment of the mortgage market. The creation of asset-backed securities (ABSs) could help mortgage lenders sell off otherwise illiquid receivables and make more funds available for additional lending. ABSs could also help better match mortgage lenders' longer-term assets (mortgages) with their short-term liabilities (deposits), reducing financial uncertainty and narrowing the interest margin for borrowers. The Securities and Exchange Commission (SEC) spearheaded the introduction of the Securitization Act. The act was approved by the Parliament on 3 June 2009, but is yet to be gazetted for adoption by the Ministry of Finance and Planning (MOFP) because of concerns over ABS' excessive risk as manifested in the subprime mortgage market crisis in the United States in 2008.⁵ This output target is partly achieved.

8. **Financing movable property.** Secured transactions in movable properties increased dramatically from 2002 to 2010 (Table 1).⁶ However, the lack of a centralized national registry affected the continued expansion of the secured transactions. Existing registration system was scattered, and each district has its own registry. The scattered information makes it difficult for financial institutions to keep track of the pledged assets. Therefore, the establishment of a centralized registry is critical to improve the credit review process of movable assets across the country. In 2007, the government designated Sri Lanka's Credit Information Bureau (CRIB) to establish an online registry for movable assets to consolidate relevant credit information. Because of the change in CRIB management in July 2008, CRIB only submitted its business plan for the establishment of an online registry to MOFP on 16 July 2009, after the cancellation of the TA loan in February 2008 (para. 32). Thereafter, CRIB received no financial support from the government for the establishment of the online registry. CRIB however conducted an initial study tour and developed a software system for the registry with the assistance from

⁴ Government of Sri Lanka. 2005. *Sri Lanka New Development Strategy*. Colombo.

⁵ Although Securitization Act has not been adopted, there are quasi-securitization transactions in Sri Lanka, such as those originated by leasing companies, which pledge their assets (often accounts receivables) to a trustee (often a reputable international bank) in order to secure borrowings from investors. This type of transaction is not considered "true sell securitizations" because the underlying assets are not transferred to the trustee but remain on the leasing companies' balance sheets. These transactions are essentially collateralized lending.

⁶ The transaction volumes of hire purchase and other similar products offered by leasing companies and other nonbank financial institutions are used as a proxy for evaluating the volume of secured transactions.

International Finance Corporation. As of October 2011, the central registry has not been established. In terms of the regulatory framework, the Cabinet approved the secured transaction bill on 13 March 2009, and the bill was subsequently approved by the Parliament on 20 August 2009 as the Secured Transaction Act No. 49 of 2009. This output target is partly achieved.

Table 1: Secured Transactions of Registered Finance Companies, Sri Lanka, 2002–2010
(number of transactions)

Type of Transaction	2002	2003	2004	2005	2006	2007	2008	2009	2010
Hire purchase	2,129	3,321	8,307	15,678	24,821	34,780	42,773	42,911	55,542
Others	6,657	8,260	9,126	12,726	15,827	26,545	39,396	27,272	46,216

Source: Central Bank of Sri Lanka. 2010. *Economic and Social Statistics 2010*. Colombo.

9. **Equity market and trading settlement cycle.** The equity market in Sri Lanka has been underdeveloped. In 2003, the market capitalization of the Colombo Stock Exchange (CSE) was SLRs262.8 billion (Table 2) or 14.4% of GDP. Since 2009, the equity market has expanded rapidly following the end of civil conflict and the global economic recovery. In May 2011, CSE's market capitalization increased to SLRs2,342 billion. From 2009 to 2010, the All Share Price Index (ASPI) rose by 96%, and the Milanka Price Index (MPI) rose by 83%.⁷ For the same period, the number of shares traded increased four times and average daily turnover was more than three times as large; but turnover to market capitalization ratio (Table 2) fluctuated as a result of increase in market capitalization. The new listing rules improved financial disclosure requirement and compliance on corporate governance provisions. The CSE improved its settlement system (for equity transactions) from T+6 to T+3⁸ on 10 December 2007, reducing the transaction risk exposures for the market participants. This output target is achieved.

Table 2: Capital Market Data, Sri Lanka, 2002–2011

Item	2003	2004	2005	2006	2007	2008	2009	2010	2011 ^a
IPOs (no.)	8	5	6	3	0	3	4	8	5
IPO value (SLRs million)	4,420	3,878	9,698	500	0	1,519	1,489	4,056	16,651
Listed companies (no.)	244	242	239	237	235	235	231	241	252
Turnover/Market cap. (%)	28.1	15.4	19.6	12.6	12.8	22.6	13.0	25.8	11.8
Market cap. (SLRs billion)	262.8	382.1	584.0	834.8	820.7	488.8	1,092	2,211	2,342
Market cap./GDP (%)	14.4	18.3	23.8	28.4	22.9	11.1	22.6	39.5	...

cap. = capitalization, GDP = gross domestic product, IPO = initial public offering.

^a data for 2011 are up May/June period.

Source: Colombo Stock Exchange. Central Bank of Sri Lanka. 2011. *Economic and Social Statistics 2011*. Colombo.

10. **Mutual funds.** The program featured a sound design to develop a functioning mutual fund (unit trust) industry in Sri Lanka that would distribute the gains from the financial market to a wider population. In 2003, the mutual fund industry was disproportionately small: total assets under the 12 mutual funds amounted to only SLRs3.9 billion (1.5% of market capitalization in 2003), with a limited range of investment options.⁹ Today, there are 21 funds managed by six SEC-licensed asset management companies with a total net asset value of SLRs18.0 billion (0.8% of market capitalization in May 2011) (Table 3.). The declining market share of the mutual fund net asset value is attributed to the rapid expansion of the total market capitalization in recent years. The range of available investment options is still narrow. Public's lack of understanding of mutual funds continues to be the main obstacle to the sector's development. This output target is partly achieved.

⁷ All Share Price Index (ASPI) and Milanka Price Index (MPI) are principal stock indices of the CSE.

⁸ It means that securities (mostly stocks) transactions are settled 3 days after the transaction date instead of 6 days.

⁹ The investment options were mostly conservative money market funds, equity funds, and gilt funds.

Table 3: Unit Trust Industry Data, Sri Lanka, 2007–2010

Item	2007	2008	2009	2010
Net asset value (SLRs million)	6,295	6,781	9,952	18,005
Equities (SLRs million)	3,649	2,589	6,036	12,797
Equities as percentage of net asset value	58%	38%	61%	71%
Total units	23,191	22,699	23,116	24,025

Source: Central Bank of Sri Lanka. 2011. *Financial System Stability Review 2010*. Colombo.

Note: The data for 2010 are as of September.

11. **Other output targets.** Two additional output targets were mentioned in the program matrix as performance indicators. However, they were not included in the program output section of the report and recommendation of the President (RRP, footnote 1).

(i) **Bond market development.** Progress in developing the bond market in Sri Lanka has been gradual. The bond market has been dominated by government securities, which were mainly held by the country's largest institutional investors—provident funds, commercial banks, insurance companies, and unit trusts. In addition, the government relies on private placement for selling a large share of its debt. In 2010, SLRs346 billion of the SLRs1,000 billion Treasury bills and SLRs462 billion of the SLRs509 billion Treasury bonds were privately placed.¹⁰ Since corporations still rely mainly on commercial banks for credit, as of May 2011, only 59 corporate bonds were listed on the CSE, with a total market capitalization of SLRs30 billion (1.3% of total market capitalization). The amount of private placement of corporate bonds is unavailable. Pricing in the government securities market in the past reflected distortions attributed in part to fiscal policy requirements – or fiscal policy subordination - given strong public sector borrowing requirements. However, more recently, pricing has gradually moved toward market-based pricing. This has paved the way for more efficient resource allocation and more profitable financial intermediation as fiscal pressures eased and there has been an increasing recognition of the importance of commercial orientation of state banks such as People's Bank, including maintaining strong balance sheets and improving profitability and return on equity. Commercial paper has a market capitalization of SLRs12 billion as of 2010, with maturities mostly below 3 months. Short- to medium-term government bonds are traded in sufficient volume on the secondary market to produce useful benchmark yield curves of up to 3 years. The four sovereign (dollar) bond issuances in 2007 (8.25%, 5 years, \$500 million), 2009 (7.40%, 5 years, \$500 million), 2010 (6.25%, 10 years, \$1 billion), and 2011 (6.25%, 10 years, \$1 billion) effectively set the benchmark yield curve for sovereign (dollar) debt for Sri Lanka. Publicly traded securitized bonds have not been developed, although quasi-securitization is available (footnote 5). With respect to debt market trading infrastructure, a delivery-versus-payment system has been installed in the debt securities trading system (DEX).¹¹ This target is achieved.

(ii) **Reduction in the lending spread.** The lending spread in Sri Lanka was historically high. Despite the continuous reduction in the policy rates of the Central Bank of Sri Lanka (CBSL) in the 2000s, the SOCBs took advantage of the reduced rates to cover their accumulated loan losses and high operating

¹⁰ CBSL. 2010. *Public Debt Management in Sri Lanka*. Colombo.

¹¹ Designed to facilitate the trading of corporate and government debt securities, the system has been instrumental in the secondary trading of government treasury bills and bonds. All corporate debentures listed on the CSE are also traded through the DEX. The system is flexible and supports multiple settlement cycles, depending on the settlement date agreed on by the parties at the time of the transaction.

costs, and did not pass on the full benefits (of the reduced rates) to the end borrowers.¹² The lack of competition in Sri Lanka's banking system and weakened credit portfolio from the large share of directed lending mandated on these banks may partly explain this phenomenon. Over the past few years and with the lessening of the fiscal burden, the government has increasingly promoted greater competition in the banking system by removing traces of barriers to entry and segmented markets. In addition, market distortions have been reduced reflecting (i) improved fiscal and overall macroeconomic performance, and (ii) the pursuit of increasing commercial orientation by SOCBs. As a result, the lending spread began to improve from 2009 to meet the performance target of below 4% (Table 4). This target is achieved.

Table 4: Interest Rate Environment, Sri Lanka, 2004–2011
(% at end of period)

Interest Rate	2004	2005	2006	2007	2008	2009	2010	2011 ^a
AWPLR (6-month)	9.84	11.97	14.64	17.36	19.36	12.96	9.96	9.19
AWDR (6-month)	5.40	6.43	7.60	9.85	11.20	9.74	6.67	6.23
Interest rate spread	4.44	5.54	7.04	7.51	8.16	3.22	3.29	2.96

AWDR = average weighted deposit rate, AWPLR = average weighted prime lending rate.

^a May/June 2011.

Source: Central Bank of Sri Lanka. 2011. Available : http://www.cbsl.gov.lk/htm/english/_cei/ir/i_4.asp?date=&Keyword=&Mode=2&Page=7.

2. Enhanced Corporate Governance in Financial Markets, Resulting in Fostered Competition and Promoted Transparency in Financial Markets

12. Issuance and sale of public debt. CBSL's management of public debt was a potential source of conflict-of-interest: according to the International Monetary Fund (IMF)'s guideline for public debt management,¹³ public borrowing should be based on government budget projection, and (a central bank's function in managing) monetary policy should be carried out independently from debt management decisions and not be influenced by interest rate consideration. The program proposed a separation of CBSL's debt management function, but the government decided that the proposal was not viable. The government based its decision on (i) a 2005 CBSL assessment of the viability of a separate independent public debt management office, and (ii) a 2005 review of the feasibility of a separate independent public debt management office. The government has nonetheless addressed the conflict-of-interest issue by ensuring transparency in the pricing of government debt, segregating the front- and back-office functions of CBSL's public debt department (PDD), and strengthening the capacity of the PDD for debt management and reporting. These steps effectively separated CBSL's management of interest rates from its function in issuing the public debt. This output target is achieved.

13. Increased supervision of financial regulators. In early 2000s, a number of unregulated financial entities in Sri Lanka were selling securities and other financial instruments to the general public. The program intended to strengthen the financial regulation and supervision to prevent such unregulated and unsupervised raising of public capital. A proposed finance business bill was passed by the Parliament on 21 September 2011.¹⁴ Among others, the

¹² ADB. 2005. *Sri Lanka: Financial Sector Assessment*. Manila.

¹³ IMF. 2001. *Guidelines on Public Debt Management*. Washington DC. Available: <http://www.imf.org/external/np/mae/pdebt/2000/eng/index.htm>.

¹⁴ Government of Sri Lanka. 2011. *Official Website*. Colombo. Available: http://www.priu.gov.lk/news_update/Current_Affairs/ca201109/20110926new_act_for_effective_regulation_&_supervision.htm

approved Bill (i) stops unauthorized deposit taking and make the acceptance of deposits without authorization an offense, (ii) strengthens CBSL's powers to investigate and punish unauthorized deposit-taking entities, and (iii) prohibits the establishment of companies with the same names or acronyms as those of registered finance companies. This output target is achieved.

14. **Independence of SEC.** Under the Securities and Exchange Commission Act No. 36 of 1987 (2003 amendment), six of the ten SEC members were to be appointed by the finance minister. This provision was contrary to international best practice, which calls for regulators to be operationally free from political influence. The amended Securities and Exchange Commission of Sri Lanka Act No. 47 of 2009 stipulates that six commission members "be drawn from the private sector." This change ensured the independence of the SEC and balanced representation of public and private interests. This output target is achieved.

15. **Corporate governance code.** In the early 2000s, there was a lack of strict requirement for CSE listed companies to comply with the corporate governance codes. On 19 February 2007, the SEC issued a directive to registered and listed banks on the compliance of the disclosure requirements under the Banking Act Direction No. 11 of 2007 (Amendments to Disclosures in terms of Banking Act Direction on Corporate Governance). From 1 April 2008,¹⁵ all listed companies must comply with the CSE listing rules on corporate governance, and include the relevant affirmative statements in their annual reports. Corporate governance standards in the newly published CSE listing rules, issued on 1 April 2011, covered appointment of independent directors, board remuneration, and the audit committee. According to the SEC and the CSE, compliance with the listing rule has been satisfactory, particularly among larger businesses. This is supported by the SEC's improved surveillance capacity: a total of 20 investigations were conducted in the year 2010, including one case of non-compliance of the listing rules.¹⁶ This output target is achieved.

16. **Prevention of money laundering.** Sri Lanka has been relatively late in implementing anti-money laundering (AML) and combating the financing of terrorism (CFT) legislations. Currently, the country has successfully passed three AML and CFT legislations: (i) the Convention on the Suppression of Terrorist Financing Act (2005), (ii) the Prevention of Money Laundering Act (2006), and (iii) the Financial Transactions Reporting Act (2006). In terms of their effectiveness in compliance with the 40 "recommendations" and 9 "special recommendations" of the Financial Action Task Force (FATF), Sri Lanka is (i) compliant with 2 recommendations, (ii) largely compliant with 4 recommendations, (iii) partially compliant with 19 recommendations and 5 special recommendations, and (iv) noncompliant with 15 recommendations and 4 special recommendations.¹⁷ Despite Sri Lanka's political commitment to work with the FATF and the Asia/Pacific Group on Money Laundering to address its strategic AML and CFT deficiencies, the FATF stated in 2011 that it was not yet satisfied with Sri Lanka's progress in implementing its action plan, and that certain strategic AML and CFT deficiencies remain.¹⁸ This output target is partly achieved.

17. **Other output targets.** Four other output targets were listed in the program matrix as output performance indicators, but they were not included in the RRP's program output section.

¹⁵ Before that, listed companies only had to publish a table in their annual reports confirming their compliance.

¹⁶ Securities and Exchange Commission. 2010. *Annual Report 2010 – The Right Moves*. Colombo.

¹⁷ International Monetary Fund. 2008. *Sri Lanka: Report on Observance of Standards and Codes for Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) and Mutual Evaluation Report on AML and CFT*. Washington, DC.

¹⁸ Financial Action Task Force. 2011. Available: http://www.fatf-gafi.org/document/49/0,3746,en_32250379_3223699_2_472218_09_1_1_1_1,00.html.

- (i) **Greater private sector share in capital markets.** Vast majority of the equity shares listed on the CSE are from private businesses and total CSE market capitalization has increased substantially (Table 2). In this connection, it can be reasonably assumed that the private sector share in the capital market has improved. This target is achieved.
- (ii) **More new initial public offerings (IPOs).** The number of new IPOs changed very little from 8 in 2003 to 5 in May 2011 (Table 2). The five IPOs in the first 5 months of 2011 alone raised SLRs 16.7 billion, far exceeding the SLRs 4.1 billion raised in entire 2010. As of May 2011, CSE had a pipeline of a total of 16 new IPO issues to be listed within 2011. This target is achieved.
- (iii) **More listed companies and higher volume of trading on the Colombo Stock Exchange.** The number of companies listed on the CSE changed very little from 244 in 2003 to 252 in May 2011 (Table 2). In terms of trading volume, the annual CSE market turnover to total market capitalization reached 25.8% in 2010, surpassing an annual average of 17.7% in the previous 7 years (Table 2). This target is partly achieved.
- (iv) **Higher market capitalization.** CSE market capitalization increased from 14.4% of GDP in 2003 to 39.5% in 2010 (Table 2), with an annual average of 22.6% of GDP, exceeding the performance target of 15.7%. This target is achieved.

3. Regulations of the Insurance Industry

18. Insurance Board of Sri Lanka (IBSL) was established in 2001 under the Regulation of Insurance Industry Act (2000) to develop, supervise, and regulate the insurance industry in Sri Lanka. In 2003, IBSL was understaffed and without a board, and could not function properly as a regulator. Its operation has since been strengthened. IBSL now has a board of directors, made up of a deputy secretary of the Treasury, a deputy governor of CBSL, a director general of SEC, and four other members appointed by the minister of MOFP. IBSL's ability to manage the insurance industry has also been strengthened through the passages of a series of industry legislations since 2003,¹⁹ and their compliances have been satisfactory.²⁰

Table 5: Performance of the Insurance Sector, Sri Lanka, 2003–2009
(SLRs million)

Item	2003	2004	2005	2006	2007	2008	2009	2010
L-T premium income	10,613	12,518	14,814	17,104	20,729	23,613	23,767	31,151
General premium income	13,534	17,037	22,410	25,931	31,156	34,553	33,485	37,342
Total premium income	24,147	29,555	37,224	43,035	51,885	58,166	57,252	68,493
Total premiums/GDP (%)	1.33	1.41	4.52	1.46	1.45	1.32	1.19	1.22
Total premium growth (%)	19.06	22.39	25.94	15.61	20.56	12.11	(1.57)	19.63

GDP = gross domestic product, L-T: long-term.

Source: Insurance Board of Sri Lanka, 2011.

19. In 2010, 19 long-term and general insurance companies were registered with the IBSL. Industry concentration was high: five largest (long term) insurance companies accounted for 89% of total premiums as of December 2010. In terms of improving insurance companies' ability to invest in a wider range of long-term assets, other than government securities, the industry's investments in government securities was reduced from 65% of the total assets in 2001 to 50%

¹⁹ Insurance Board of Sri Lanka. 2011. *Insurance Legislations*. http://www.ibsl.gov.lk/insurance_legislations/insurance_legislations.htm.

²⁰ Insurance Board of Sri Lanka. 2011. *Compliance Regulatory Reporting*. http://www.ibsl.gov.lk/compliance_regulatory_reporting.htm.

in 2010. The Regulation of Insurance (amendment) Industries Act (2011) strengthened prudential regulation to protect policyholders' interests. From 2003 to 2010, there was substantial improvement in premium income (Table 5). All insurance companies will be required to list on the stock exchange by the end of 2014. This output target is achieved.

4. Improved Corporate Governance of State-Owned Commercial Banks

20. In the early 2000s, a significant number of SOCBs and state-owned enterprises (SOEs) were performing poorly. Because of the high operating costs and politically influenced lending practices, People's Bank was on the verge of bankruptcy. The government understood the need to reduce its day-to-day management of Bank of Ceylon (BOC) and People's Bank in order to improve their corporate governance and eventually financial performances. In 2004, some large SOCBs and SOEs were placed under the oversight of Strategic Enterprise Management Agency (SEMA), which was mandated to turn these poorly performing state-owned entities into commercially viable businesses. Under such a conducive political environment, the government reduced its level of interference in BOC and People's Bank, except for strategic and policy decisions. On 23 April 2008, the boards of BOC and People's Bank adopted respective corporate charters that created independent boards and corporate management teams. According to their 2010 annual reports, BOC and People's Bank now draw their board members and management teams largely from the private sector, significantly improving their corporate governance positions and financial performances in recent years. This output target is achieved.

5. Improved Operations of People's Bank

21. People's Bank, established under the People's Bank Act No. 29 of 1961, is the second-largest commercial bank in terms of total assets, next to BOC. From 1990s to early 2000s, People's Bank was poorly capitalized, requiring repeated government subsidies to meet its regulatory capital adequacy requirement. From 2004, while under SEMA, People's Bank's financial performance began to improve: key financial ratios recovered dramatically (Appendix 8). From 2008, the bank's capital adequacy ratio has surpassed the regulatory minimum threshold of 10% (10.5% in 2008, 13.4% in 2009, and 12.8% in 2010). As a result, the government's comfort letter to People's Bank was withdrawn in 2009.²¹ Fitch Ratings upgraded People's Bank's long-term credit rating from "A-" in 2008 to "A" in 2009 and again to "AA-" in 2010 (Appendix 8).

Table 6: People's Bank Operating Performance Targets, 2004–2010
(SLRs million)

Item	2004 Actual	2005 Actual	2006 Actual	2007		2008 Actual	2009 Actual	2010 Actual
				Target	Actual			
After-tax profit	2,086	2,772	3,157	>2,920	2,373	2,705	3,320	5,206
Retained earnings	1,414	2,050	2,059	>2,041	1,454	1,485	1,901	3,038
Cost/Income ratio (%)	73.1	72.7	73.8	<69.0	68.7	65.4	60.4	60.2
Return on assets (%)	1.2	1.6	1.3	>1.06	1.4	1.5	1.4	1.7
Number of employees	9,592	9,531	9,645	<9,100	8,416	8,587	8,863	8,400

Source: People's Bank annual reports, 2005–2010.

²¹ From 1999, the People's Bank was operating under a comfort letter from the government to provide it with the equity investment when needed, as a result of not being able to meet the minimum capital adequacy requirement.

22. The program specifically evaluated People's Bank's financial performance against five operating benchmarks set for 2007: (i) net profit after tax, (ii) retained earnings, (iii) cost/income ratio, (iv) return on assets (ROA), and (v) number of employees (see shaded columns in Table 6). People's Bank in 2007 did not meet the performance targets for after-tax profit and retained earnings, but met the three others in cost to income ratio, ROA, and number of employees. In light of the dramatic improvement of People's Bank's financial performance from 2010 onward, the 2010 after-tax profit and retained earnings surpassed the benchmarks set in 2007, and therefore these output targets were eventually achieved.

23. Another output target is People's Bank's payback of the government's phased-in recapitalization cost by 2014. People's Bank received a series of government financial support to help it meet the CBSL's 10% capital adequacy requirement, including the phased-in recapitalization under the program in the amount of SLRs6.0 billion (SLRs2.0 billion in December 2005, SLRs1.0 billion in December 2006, SLRs1.5 billion in December 2007, and SLRs1.5 billion in December 2008). People's Bank has contributed SLRs5.9 billion to the Treasury in the form of a special levy from 2004 to 2010 (Table 7). It is therefore highly likely that People's Bank can pay back the SLRs6.0 billion by 2014. This target is achieved.

Table 7: People's Bank's Financial Contribution to the Government, 2002–2010
(SLRs million)

Item	2002	2003	2004	2005	2006	2007	2008	2009	2010
Dividend on restructuring bonds ^a	571.7	571.7	571.7	571.7	498.3	219.7	219.7	219.7	18.3
Special levy to the Treasury			100	150	600	700	1,000	1,200	2,150

^a In April 1993, People's Bank received a restructuring bond from the government in the amount of SLRs 10,541 million. According to the Agreement with the government, People's Bank is required to pay back 25% of the bond interest as dividend. People's Bank has contributed SLRs3.5 billion to the government as dividend on the restructuring bond.

Source: People's Bank annual reports, 2003–2010.

C. Program Costs

24. ADB provided the government with a program loan of \$60.0 million (SLRs6.2 billion in 2004) to support the financial market development. The fund was specifically used to support People's Bank's phased-in recapitalization cost to meet CBSL's 10% capital adequacy requirement. Following ADB's first tranche release of \$20.0 million, the government released SLRs2.0 billion to People's Bank as the first installment of the phased-in capitalization contribution. Afterwards, because the government could not comply with ADB's policy actions for the release of subsequent two tranches, MOFP made three capital injections into People's Bank from its own account (SLRs1.0 billion in December 2006, SLRs1.5 billion in December 2007, and SLRs1.5 billion in December 2008). Although the releases of ADB's second and third tranches were delayed until October 2010, the program eventually met key output and outcome targets with respect to the performance of People's Bank and the development of the financial markets. The economic and financial returns of the program cost are therefore considered adequate.

D. Disbursements

25. The program loan was designed for a 3-year period, from December 2004 to December 2007. The funds were to be released in three equal tranches of \$20 million. The first tranche was to be released upon loan effectiveness in December 2004, but was delayed until 22 March 2005. The second and third tranches were to be released in June 2006 and December

2007, 18 and 36 months after the loan effectiveness, but they were delayed to October 2010 (para. 26). Despite unpredictable factors such as the breakdown of the peace talks, the 2008 global financial crisis, and the escalation of military activities, the government showed a high degree of commitment to the proposed reform agenda. The disbursement schedule at appraisal was realistic. In terms of the TA loan, the disbursement was affected by the government's cancellation of \$4.5 million of the \$5.0 million (para. 32) loan proceeds because the government subsequently decided that it could undertake most of the TA loan activities from its own resources. The imprest account at CBSL was utilized to help disburse the program proceeds to the implementing agencies. The use of the imprest account eased implementing agencies' institutional burden to establish their respective separate accounts to manage the ADB funds.

E. Program Schedule

26. The original program schedule was for 3 years: from December 2004 to December 2007. However, this schedule was extended for additional three years as a result of the government's inability to meet ADB's second and third tranche release policy actions. The internal factors that caused the delay were (i) the change in government after the presidential elections in November 2005 that resulted in the need to rebuild program ownership and find an appropriate way forward;²² (ii) the initial resistance from People's Bank's labor union to the recapitalization and restructuring plan; and (iii) the escalation of military activities in 2008 and 2009. The external factors were (i) the impact of the December 2004 tsunami and (ii) the 2008 global financial crisis. Slippage in meeting the output targets occurred in the passage of the secured transactions bill, the securitization bill, and the amendment to the SEC act.²³ Because these intensive loan actions require legislative approvals, and given the extended program implementation under an administration that did not hold a majority of seats in the Parliament, these legislative approval processes were significantly delayed. Similarly, the preparation and passage of the People's Bank act, the Bank of Ceylon act, and the SEMA act were delayed.²⁴ As a result, the second and third tranches were released only in October 2010. The program closing date was extended three times, from December 2007 to December 2008, December 2009, and December 2010.

F. Implementation Arrangements

27. MOFP was the executing agency for both the loan and the TA loan; CBSL, CRIB, CSE, IBSL, People's Bank, SEC, and SEMA were the implementing agencies for the TA loan. MOFP showed overall commitment to manage the program. However, implementation issues existed. A steering committee, chaired by the MOFP secretary and made up of key officials from the ministries and agencies concerned, was to be established upon loan effectiveness in December 2004. However, because of the pending November 2005 presidential election and the subsequent lack of a political party majority in the Parliament, significant time was spent on

²² Mahinda Rajapaksa of the People's Alliance Party came to power after the 17 November 2005 presidential election, but no single party held a parliamentary majority. Significant consensus needed to be built on a common political platform on the economic strategies to move the country forward. As a result, some time passed before the program could resume.

²³ See paras. 7 and 8 above for the status of the secured transaction bill and the securitization bill. The bill to amend the SEC act was approved by the Parliament only in July 2009, after the initial loan closing date of December 2008.

²⁴ Alternative approaches to meeting the tranche release conditions have been proposed. They include the issuance of corporate charters by People's Bank and Bank of Ceylon to comply with (i) the Code of Best Practice in Corporate Governance for Public Enterprises (2009), (ii) Banking Act Direction No. 11 of 2007 (Amendments to Disclosures in terms of Banking Act Direction on Corporate Governance), and (iii) the Companies Act (regarding the roles of the board directors).

building a common political platform before any legislative agenda could move forward. With a delayed consensus to guide the program implementation, MOFP only established the steering committee on 20 July 2007. In addition, MOFP did not effectively facilitate People's Bank's compliance with the loan covenants in terms of the submission of required monitoring reports. The government cancelled the TA loan in 2008 (para. 32). As a result, few actions were undertaken by the implementing agencies to fulfill the designed TA loan objectives. Despite these drawbacks, key program output and outcome targets were achieved. In this connection, the implementation arrangement is partly satisfactory.

G. Conditions and Covenants

28. The loan effectiveness and subsequently the release of the first tranche were delayed as a result of the omission of a key clause from the document that ADB used as a legal reference to determine loan effectiveness.²⁵ The covenants in the loan agreements between ADB and the Government of Sri Lanka, People's Bank, and IBSL were relevant to the monitoring and review of program implementation and the eventual assessment of the achievement of the output targets. There were two different sets of covenants, one for Loan 2138 (program loan) and the other for Loan 2139 (TA loan).

29. **Loan 2138.** The government (through People's Bank) did not submit all the audited project accounts (APAs), agency financial statements (AFSs), and audit reports for 2005–2010. Submitted audited financial statements in the form of People's Bank's annual reports only covered ADB's (covenant) requirements for AFSs. MOFP submitted four APAs for 2005–2009 only on 18 October 2010, and these APAs did not fully comply with the ADB requirements, particularly in stating the funds used exclusively for the program. The partial compliance of People's Bank, due to its lack of experience in managing donor-funded programs, affected ADB's ability to review program implementation and assess program effectiveness. Such a partial compliance to the program loan covenants could have been avoided if the institutional capacity of the implementing agency had been assessed more carefully during program fact finding.

30. **Loan 2139.** The covenants for Loan 2139 were largely complied with. MOFP submitted its APAs, AFSs, and audit reports for 2005–2009 generally on time. However, the 2010 APA was not submitted. People's Bank submitted its AFSs in the form of annual reports. Because of the relatively small amount of TA loan proceeds to the seven implementing agencies, the implementing agencies did not establish separate accounts under the ADB TA loan, and could not provide separate financial statements and audit reports. The program management unit disbursed the funds through the imprest account at CBSL.

31. Compliance with the covenants for the release of the second and third tranches was partially waived after the government promised to furnish all the required APAs, AFAs, and audit reports to ADB in full compliance of the covenant requirements. But by October 2011, ADB has not received the required reports. The overall compliance to the loan and TA covenants was weak.

H. Related Technical Assistance

32. The TA loan of \$5.0 million equivalent from ADB's Special Funds resources supports

²⁵ The government refused to include the sentence "drafting and preparing appropriate legislation, regulations, and/or directives to ensure the independence and autonomy of People's Bank" because of its political sensitivity.

(i) capacity building and skills development of People's Bank; (ii) capacity building to IBSL; (iii) the creation of a national computerized movable property registry including the provision of computer equipment; (iv) improvement of SEMA's management of its SOCB portfolio; and (v) legal and governance advisory for corporate securities, financial markets, commercial and banking law, and policy reforms. Between 2005 and 2007, only components (i) and (iv) were partially carried out. The executing agency preferred domestic consultants instead of international consultants. The consultant work on People's Bank was delayed by the ongoing redesign of the bank's corporate strategy.²⁶ Other implementing agencies preferred to use their own resources instead of the TA loan to achieve their respective institutional objectives. Of the \$5.0 million total, only \$453,120 was disbursed. The implementing agencies' preferences to undertake the TA loan objectives from their own resources instead of utilizing the TA loan facility led to the government's cancellation of \$4.5 million of the TA loan proceeds on 8 February 2008. The TA loan usage was therefore very limited, and the TA loan is rated unsuccessful.

I. Recruitment and Performance of Consultants

33. Under the TA loan, two consultants were recruited on three different contracts—two contracts for PriceWaterhouseCoopers Sri Lanka and one contract for an international banking expert. There are no ADB performance ratings for these consultants, but the last project officer stated that all three consultants' performances are generally satisfactory.

J. Performance of the Borrower and the Executing Agency

34. The assessment of the capabilities of the government and the executing agency (MOFP) at appraisal was accurate. Despite the program's implementation delays, the government showed genuine interest in reforming the financial sector and key SOCBs. The implementation delays were largely due to a series of internal and external events that could not be prevented (para. 26). Despite resistance from the People's Bank labor union, MOFP demonstrated significant ingenuity and dedication in carrying out the proposed recapitalization and restructuring plan by continuously working with People's Bank management and staff. In terms of the TA loan, the implementing agencies preferred to undertake the proposed activities from their own resources, and MOFP cancelled the TA loan (para. 32). Compliances to the program loan and TA loan covenants were poor (see section G above). Nevertheless, key program outputs were delivered. The outcome of the program was largely satisfactory. Thus, the performance of the government and MOFP was satisfactory.

K. Performance of the Asian Development Bank

35. ADB managed the program implementation through 14 review missions from 2005 to 2010. A total of 6 years of program implementation led to a normal staff turnover of 3 project officers. Notwithstanding program implementation by ADB on a best efforts basis, releases of the second and third tranches were delayed due to a combination of internal and external factors (para. 26). Diligent follow-ups by ADB eventually led to the meeting of all three tranche release milestones by the end of 2010. Despite ADB's efforts to promote TA utilization, the cancellation of the TA loan probably affected progress in implementation. More attention could be given to ensuring the compliance of the program covenants, particularly in People's Bank's submission of APAs, AFAs, and audit reports. ADB's performance was satisfactory.

²⁶ PriceWaterhouseCoopers Sri Lanka was hired to review People's Bank's operations, but the delay from the finalization of the corporate strategy eventually led to the cancellation of the consultant contract.

III. EVALUATION OF PERFORMANCE

A. Relevance

36. The program was relevant. The program design addressed some of Sri Lanka's financial market deficiencies in promoting private sector development. The program aligned well with the government's development strategy and ADB's CSP. From 2010, Sri Lanka's financial sector performance improved significantly, as reflected in program performance indicators (para. 37) and those of the People's Bank (para. 21-22). The financial market is currently operating with high liquidity, declining interest rates/yield rates, lower cost of financial intermediation, and rising stock prices. The prudential regulations have also been improving, including the establishment of new CSE listing rules. This progress in financial market development corresponds to the rapid improvement in the macroeconomic climate and expanded private sector development.

B. Effectiveness in Achieving Outcomes

37. The program was effective in achieving the two outcomes: (i) the development of the financial markets and (ii) the reduction of public spending on People's Bank. With respect to the development of the financial markets, the regulatory framework was strengthened through the passage of the proposed legislations (Section B: Program Outputs). The CSE market capitalization was SLRs2,342 billion as of May 2011, far exceeding the performance target of SLRs263 billion. There were 252 listed companies in June 2011, versus the performance target of 244; CSE had a daily average turnover of SLRs2,940 million, against a performance target of SLRs308 million; and the corporate debt market capitalization of SLRs30.6 billion was well over the performance target of SLRs9.7 billion. However, the total market turnover in 2010 was 26% of market capitalization (Table 2), lower than the performance target of 28%. The program did not lead to the establishment of a securitized bonds market (para. 11). In terms of reducing public spending on People's Bank, because People's Bank has achieved 10% capital adequacy ratio since 2008 and performed well in recent years, it no longer requires additional government funds for recapitalization. The outcome performance targets were achieved.

C. Efficiency in Achieving Outcomes and Outputs

38. The program was less efficient in achieving the outcomes and outputs. Although the outcome and output targets were largely met at the end, additional 3 years' implementation delays affected the efficiency with which the project had been managed and the efficiency of ADB's support, supervision, and administration. There is no cost overrun to achieve the targets, although there may have been opportunity costs from time overrun.

D. Preliminary Assessment of Sustainability

39. The program is likely to be sustainable. The political stability following the end of a decade-long civil conflict led to a more conducive political environment and allowed the government to capitalize on the peace dividend to carry the achieved program results forward. Building on a consolidated political platform, the government is more likely to continue on the current economic reform process, and thereby sustain (and reinforce) the program outputs and outcomes for financial and private sector development.

E. Impact

40. The intended program impact to “facilitate private sector development by strengthening the financial markets, including the restructuring and recapitalization of People’s Bank” is likely to be achieved and be sustainable. With improved investor confidence and financial market liquidity, lending to the private sector has increased. The trend line of gross credit to the private sector to M2 gradually moved upwards from an annual average of 75.7% from 2001 to 2005 to 80.6% from 2006 to 2010.²⁷ Private sector’s industrial production to GDP (both calculated at 2001 constant price level) also moved higher from an annual average of 1.12% to 1.21% for the same time period. People’s Bank was restructured and recapitalized.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

41. Despite the cancellation of the TA loan, the intended program outcomes have been achieved. The intended program outputs of (i) increased financial products and services available to the capital market, (ii) enhanced corporate governance in the financial market, (iii) improved regulations of the insurance industry, (iv) improved corporate governance of SOCBs, and (v) operational improvement of People’s Bank have also been generally achieved. In this connection, the program was implemented as conceived. The program is rated successful.

B. Lessons

42. The timing of a program is crucial to the effectiveness of its outputs and outcomes. Difficulties to obtain approvals of the numerous legislative actions in this program could be traced to the change of government (and the fact that the government did not hold a majority of seats in the Parliament). The program’s achievements of performance targets benefited from the eventual improvement of the political and economic landscape from 2009 onwards. Therefore, to ensure the effective and pragmatic design of similar programs in the future, it is imperative that ADB be cognizant of potential changes in the country’s political environment as well as factor in important variables (such as the internal conflict in this case) that could impact program implementation.

43. Furthermore, it is prudent to minimize the number of legislative actions to ensure effective program implementation. The program had an excessive number of legislative actions that contributed to program implementation delays. In addition, a salient feature of this program is the transparent and effective approach to monitoring the restructuring of a bank. This feature can be applied to other similar entities. The key performance indicators that were embedded in People’s Bank Strategic Plan 2009-2014 were rigorously reviewed on a biannual basis to ensure that the bank restructuring was on track. These key performance indicators were comprehensive and broad-based and encompassed major aspects of operational activities such as capacity adequacy, asset quality, management, earning, and liquidity.

44. Finally, a key success of a reform program is the relevant design that incentivizes strong government ownership on institutional strengthening, in this case, by improving bank’s operational management: supporting profitable business lines such as pawning, tightening credit reviews and recoveries to reduce NPL, and controlling overhead costs such as reducing headcounts to improve performance on a per employee basis (appendix 8). The fact that

²⁷ Central Bank of Sri Lanka. 2011. *Economic and Social Statistics 2011*. Colombo.

People's Bank continued restructuring and committed itself to performance indicators to improve bank operations over and beyond what was agreed to under the program underscored the success and sustainability of the ADB support.

C. Recommendations

1. Program-Related

45. **Future monitoring.** In the short- to medium-term, ADB should monitor (i) the performance of the SOCBs; (ii) the expansion of the capital markets, particularly the development of the bond market;²⁸ and (iii) the overall growth of the private sector. The political stability following the end of the civil conflict and the country's rebound from the global economic crisis, supported by the \$2.5 billion IMF standby facility,²⁹ have facilitated the achievement of ADB's program targets. The proposed follow-up actions could verify the linkage between the ADB program inputs and observed achievements of the program targets to help design any follow-on assistance.

46. **Covenants.** The covenants in the program and TA loan agreements safeguard ADB's interests and implementation success. Partly owing to their lack of institutional capacities, the implementing agencies had some difficulty complying with stated covenants, especially in keeping separate program accounts and submitting timely financial and audit reports. Because of the relative small amount of the TA loan being distributed to seven implementing agencies, the ADB program-specific accounts were best managed by a centralized unit, such as the CBSL.

47. **Additional assistance.** ADB remains in dialogue with MOFP to provide the government with a support for capital market development program to promote (i) further development of a bond market, (ii) demutualization of CSE, (iii) establishment of a commodities exchange, (iv) development of the regulatory framework for domestic credit rating agencies, and (v) development of qualification framework for financial industry professionals. As a follow-up and natural progression to this program, the capital market development program was proposed in the 2011 ADB country programming mission. Government concurrence is still awaited.

48. **Timing of the project (program) performance evaluation report.** Program milestones were largely accomplished by October 2010. Continued assessment of economic growth and financial sector development is necessary to ascertain the effectiveness of the program inputs. The project performance evaluation report could be prepared in 2012.

2. General

49. The program's design and monitoring framework could have been simplified with a reduced number of legislative actions that may have led to a more timely implementation of the program. ADB could have better assessed the implementing agencies' experiences and capacities to manage donor-funded programs, although the government's decision to cancel the TA appears to have adversely affected timely implementation of the program. Finally, a better attempt at factoring in the perceived political outlook could have ensured more effective and efficient implementation.

²⁸ ADB has offered the government a capital market reform program as a follow-on assistance package to the (Financial Markets) Program for Private Sector Development, but the government has so far declined to include it in its ADB country program.

²⁹ In April 2011, IMF conducted its sixth review of Sri Lanka's economic performance and found it satisfactory for the immediate disbursement of \$218.3 million, bringing the total disbursement to about \$1.75 billion.

PROGRAM FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Facilitate private sector development by strengthening the financial markets, including the restructuring and recapitalization of People's Bank</p>	<p>Increased economic growth rate (increased from present growth rate of 5% per year)</p> <p>Increased private sector investment as a percentage of gross domestic product from the present level of 16.7%</p> <p>Eliminated Government budgetary support to People's Bank; dividend payments and/or other proceeds paid by People's Bank to Government by 2014 at least equal to phased-in recapitalization amount by 2014</p> <p>Increased establishment of financially viable SMEs throughout the country</p>	<p>Economic reports, official statistics</p> <p>Government budget</p> <p>ADB review missions</p> <p>People's Bank quarterly and annual financial reports</p>	
<p>Purpose (1) Develop financial markets</p>	<p>Strengthened competition, enforcement, and regulatory framework in the capital market</p> <p>Increased turnover of the capital market (e.g. increased turnover to market capitalization ratio from present 28%)</p> <p>Increased amount of available risk capital in the capital market (increase stock market capitalization from SLRs263 billion)</p> <p>Increased number of listed companies on CSE from present 244 companies</p> <p>Increased products and services available in the financial markets (e.g. usage of publicly traded securitized bonds increase from 0)</p> <p>Improved liquidity in the stock market (increase daily average turnover from SLRs308 million) and debt</p>	<p>Quarterly and audited annual reports of banks, insurance companies, asset managers, brokerage firms, and primary dealers</p> <p>Economic reports and official statistics from CBSL, SEC, and CSE</p> <p>ADB review missions</p>	<p>Delays may occur in the implementation of reforms</p> <p>Lack of capacity or necessary monitoring and supervisory skills of regulations</p>

Continued on next page

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
	<p>markets (e.g. increase number of trades per year from 1,685)</p> <p>Reduced interest rate spreads (presently averaging 4% for all licensed commercial banks)</p> <p>Increased debt capital formation; increase corporate debt market capitalization from SLRs9.7 billion</p>	CBSL annual report	
(2) Reduce public sector spending in People's Bank	<p>Reduced Government budget deficit resulting from a positive net contribution from People's Bank</p> <p>Implemented restructuring plan of People's Bank</p> <p>Improved profitability of People's Bank; improved financial and operational performance indicators, (e.g. reduced cost/income ratio from 73.5% as of December 2004)</p>	<p>National budget prepared by the Government; Quarterly and yearly annual reports of People's Bank</p> <p>Economic reports and official statistics</p> <p>Quarterly and audited reports of SEMA</p> <p>Quarterly and audited annual reports of People's Bank</p> <p>ADB review missions</p>	<p>Labor union unrest</p> <p>Lack of political will to carry out the reforms</p> <p>Political opposition may delay public sector disengagement from commercial activities</p>
Outputs (1.a) Increased financial products and services available to the capital market	<p>Increased number of secured transactions, especially for movable property</p> <p>Improved yield curve on publicly listed bonds; increased maturity of Government bonds from 5–7 years</p> <p>Improved liquidity of shares traded on CSE; increased turnover to market capitalization ratio from present 28%</p> <p>Reduced interest rates spreads from average of 4% for licensed commercial banks</p> <p>Increased volume of assets managed through mutual funds; increased volume of assets from \$36 million</p>	Periodic reports of CBSL, CSE, and Sri Lanka Leasing Association, and SEC	Lack of capacity to implement regulations

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
(1.b) Enhanced corporate governance in the financial market; resulting in fostered competition and promoted transparency in the financial market	<p>All public listed companies followed corporate governance code</p> <p>Reduced money laundering activities</p> <p>Increased private sector share of financing from capital markets; increased amount of capital raised through initial public offerings through the CSE presently equal to 3.2% of total yearly private sector investments</p> <p>Increased number of companies listed and daily volume of shares traded on CSE; increased number of companies listed from 244 and increased daily value of volume of shares traded on CSE from \$2.3 billion as of year-end 2003</p> <p>Increased market capitalization of companies traded on the CSE from \$2.6 billion as of year-end 2003</p> <p>Increased market capitalization of stock exchange as a % of GDP from 15.7% as of year-end 2003</p>	<p>Annual reports of banks, brokerage firms, CBSL, and CSE</p>	<p>Political will to implement the necessary change</p> <p>Negative economic environment created by low growth, high interest rates, and/or no progress in peace process</p>
(1.c) Improved Regulations of the Insurance Industry	A fully functional Board of Directors of the IBSL, with a majority of the directors representing the private-sector	<p>Periodic reports of IBSL</p> <p>ADB review missions</p>	Lack of political will to implement the reforms
(2.a) Improved Corporate Governance of State-owned Banks	Reduced Government intervention in the day-to-day management of People's Bank and Bank of Ceylon	<p>Quarterly and audited annual reports of People's Bank and Bank of Ceylon</p> <p>Quarterly reports of SEMA</p> <p>ADB review missions</p>	<p>Labor unrest</p> <p>Lack of skills to implement the restructuring plan</p> <p>Lack of political will to implement the plan</p>
(2.b) Operational Improvement of People's Bank	Increased periodic financial profitability and improved key financial ratio performance of People's Bank (e.g. net profit, return on assets, reduced cost/income ratio, etc. see:	<p>Quarterly and audited annual reports of People's Bank</p> <p>Quarterly reports of SEMA</p> <p>ADB review missions</p>	<p>Labor unrest</p> <p>Lack of skills to implement the restructuring plan</p> <p>Lack of political will to</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
	<p>Activities (2.b) (i) Performance indicators/targets)</p> <p>Dividend and/or other proceeds paid by People's Bank to Government by year 2014 at least equal to the phased-in recapitalization</p>		implement the plan
<p>Activities (1.a) Improve the availability of financial products and services of the capital market</p> <p>(i) Facilitate secured transactions financing</p> <p>(ii) Introduce publicly traded securitized bonds</p>	<p>Computerized registry for codifying and operating and maintaining movable property</p> <p>Increased issuance in number and volume of publicly traded securitized bonds present amount of 0</p> <p>Lowered interest rates spreads from the present average of 4% of licensed commercial banks</p> <p>Alternative financing mechanisms available for (i) mortgage companies to finance home mortgages, and (ii) companies to finance receivables; increased number of publicly traded securitized bonds and amount of funds raised through publicly traded securitized bonds from present amount of 0.</p>	<p>Introduction of Secured Transaction Bill to Parliament</p> <p>Introduction of Amendments of Finance Companies Act to Parliament</p> <p>Quarterly and audited annual reports from CBSL and reports from Land Commissioner's Department</p> <p>Reports from banks, leasing companies, and leasing associations</p> <p>ADB review missions</p> <p>Introduction of Securitization Bill to Parliament</p> <p>Quarterly and audited financial reports of SEC, CBSL, CSE, home mortgage companies and other companies</p> <p>ADB review missions</p>	<p>Lack of capacity to draft on effective the Secured Transaction Bill</p> <p>Delays may occur in the implementation of reforms</p> <p>Delay might occur due to lack of capacity to draft the Securitization Bill</p> <p>Lack of political will to implement reforms</p> <p>Insufficient capacity building to implement product in the financial markets</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
(iii) Strengthen CBSL regulations to include financial products for forward risk management	Introduction of interest rate swaps and derivatives Increased use of interest rate swaps and derivatives Decreased interest rate Points	Introduction of Amendments to Securities Act to Parliament Quarterly and audited annual reports of CBSL, CSE, and brokerage firms	Lack of political will to implement reforms Capital market not mature enough to trade in derivatives
(iv) Harmonize tax rules across financial instruments	Elimination of double taxation on fixed income mutual funds Increased volume of corporate bonds and commercial paper issued; increased issuance of commercial papers from \$111 million and corporate bonds from \$96.7 million as of year-end 2003 Increased volume of assets under management in money market mutual fund, from present value of \$36 million	Amendments to Internal Revenue Act ADB review missions	Lack of political will to introduce and complement the necessary policy reforms Capital market not mature enough to issue and trade new financial instruments
(v) Improve bond market performance	Establishment of Public Debt Office	ADB review missions Report from CBSL	Lack of political will to introduce the necessary policy reforms Insufficient capacity building to implement the reforms
(1.b) Enhance corporate governance in the financial market			
(i) SEC becomes a more effective regulator	Improved investor confidence and increased capital (from domestic and international investors) invested in the equity and bond markets SEC commissioners are appointed and SEC becomes fully operational SEC extended the license of CSE for 5 years	Quarterly and audited annual financial reports of SEC, CBSL, and CSE Annual report of SEC	Regulators do not have the skills to supervise acts appropriately Lack of political will to introduce reforms Lack of capacity to design and finalize the regulation and enforcement plan
(ii) Improve the reporting, regulation, and functioning of the capital market	Mandatory use by publicly listed companies of the Sri Lanka Corporate Governance Code for reporting purpose	Issuance of a directive from SEC to make the compliance of the Sri Lanka Corporate Governance Code mandatory	Lack of capacity to finalize the regulation and enforcement plans

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
(iii) Increase Investor disclosure and protection safeguards for investors	CSE implemented systems to reduce equity settlement cycle from trade date plus 6 days (T+6) to trade date plus 3 days (T+3)	Issuance of a directive to CSE to submit a plan to reduce equity settlement cycle to T+3 Quarterly and audited financial reports from SEC and CSE ADB review missions	Technical difficulty and/or limited capital resources to change equity clearing system to T+3
	Increased number of investors in stock listed companies	Introduction of Amendments of the SEC Act to Parliament	Lack of political will to introduce and implement the policy reforms
	Increased market capitalization of CSE from present \$2.6 billion	ADB review missions	
	Increased liquidity of trade shares in CSE; increased turnover to market capitalization ratio from present 28%		
(iv) Prevent money laundering	Reduction in money laundering activities	Submission of Anti-Money Laundering (AML) Bill to Cabinet ADB review missions	Lack of political will to introduce and implement reforms
(1.c) Improve regulations of the insurance industry			
(i) Strengthen insurance supervision and regulation	Appointment of IBSL board of directors with at least 50% representing the private sector IBSL monitored and supervised all of the insurance companies in Sri Lanka on a timely basis Insurance companies meet international financial ratio standard	Periodic reports of IBSL Quarterly and audited annual reports of insurance companies ADB review missions	Lack of capacity within IBSL
(2.a) Improve Corporate Governance of State-owned banks	Reduction of Government intervention in the day-to-day management of People's Bank and Bank of Ceylon	Introduce to Parliament new (i) People's Bank Act, and (ii) Bank of Ceylon Ordinance Act Quarterly and annual audited reports of People's Bank and Bank of Ceylon ADB review missions	Labor unrest Lack of political will to implement changes

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>(2.b) Improve operations of state-owned commercial banks</p> <p>(i) Restructure People's Bank</p> <p>(ii) Recapitalize People's Bank</p>	<p>Approved and implemented People's Bank's restructuring plan including performance targets to be met</p> <p>Improved financial performance and key financial ratios by year-end 2007:</p> <ul style="list-style-type: none"> (i) Net profit after tax improved to at least SLRs2,920 million (ii) Retained profit improved to at least SLRs2,041 million (iii) Cost/income ratio improved to at least 69.0% (iv) Return on assets improved to at least 1.06% (v) Number of employees reduced to 9,100 <p>The Government committed a maximum of SLRs8.5 billion for a phased recapitalization for People's Bank based on the agreed recapitalization schedule and restructuring plan, including the performance targets to be met</p>	<p>SEMA approved restructuring plan for People's Bank</p> <p>An MOU entered into between (i) SEMA and Government; and (ii) the board of directors and management relating to the restructuring and recapitalization plan</p> <p>A Collective Agreement entered into between (i) management of People's Bank; and (ii) appropriate trade union(s) relating to the restructuring and recapitalization plan.</p> <p>Independent review of operations on the sustainability of People's Bank</p> <p>Quarterly and audited annual reports of People's Bank</p> <p>Independent review reports of People's Bank every 6 months provided by SEMA</p> <p>ADB review missions</p> <p>Quarterly and annual audited reports of People's Bank</p> <p>ADB review missions</p>	<p>Political will to implement changes</p> <p>Opposition or resistance from labor unions could delay or stop the process</p> <p>Management can not fully implement restructuring plans</p> <p>Labor unrest</p> <p>Labor unrest</p> <p>Lack of political will to recapitalize People's Bank</p>
<p>Inputs</p> <p>Program loan (\$60 million ordinary capital resources) made effective</p>		<p>Program documents and agreements</p> <p>Periodic reports from steering committee and MOFP</p>	

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Technical assistance loan (\$5 million equivalent Asian Development Fund) made effective</p> <p>(i) Capacity building and skills development for People's Bank, in the following areas:</p> <ol style="list-style-type: none"> Human relations management Management training Consumer service and supervision SME business strategy Credit and financial risk management <p>(ii) International actuarial specialist employed at Insurance Board of Sri Lanka</p> <p>(iii) Expertise to develop movable property registry</p> <p>(iv) Banking expert to better manage SEMA's four state-owned banks</p> <p>(v) Legal and governance experts</p>		<p>Quarterly and annual audited reports of People's Bank</p> <p>Quarterly and audited annual financial reports of People's Bank</p> <p>Insurance Board of Sri Lanka quarterly and audited annual reports</p> <p>Quarterly and audited financial reports of SEMA</p> <p>Quarterly and audited financial reports of SEMA</p> <p>Periodic reports of steering committee and MOFP</p>	

ADB = Asian Development Bank, CBSL = Central Bank of Sri Lanka, CSE = Colombo Stock Exchange, GDP = gross domestic product, IBSL = Insurance Board of Sri Lanka, MOFP = Ministry of Finance and Planning, MOU = memorandum of understanding, SEC = Securities and Exchange Commission, SEMA = Strategic Enterprise Management Agency.

Source: ADB. 2004. Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Republic of Sri Lanka for the Financial Markets Program for Private Sector Development. Manila.

LEVEL 2: CORE OUTPUTS AND OUTCOMES

Results Framework Indicators (Level 2)	Targets	Results	Methods / Comments
Finance			
Microfinance accounts opened or end borrowers reached (number)	No such target was provided in the loan document.	3,556,571	In 2004, 9,343,429 deposit accounts were opened at People's Bank. In 2010, the number increased to 12,900,000 (estimated). ^a This total includes all business and individual accounts, inclusive of microfinance and SME loans. People's Bank customers are largely micro businesses and SMEs in the rural areas. However, ADB is unable to isolate the number of accounts created as a direct result of the ADB assistance.
Small and medium-sized enterprise loan accounts opened or end borrowers reached (number)	No such target was provided in the loan document.	Inclusive of above	See above.
Microfinance loans provided (amount in millions of dollars)	No such target was provided in the loan document.	\$2,113 million (SLRs231,595 million)	Loans and advances from People's Bank totaled SRLs140,209 million in 2004. In 2010, the amount increased to SRLs371,804 million. This total includes all business and individual loans, inclusive of microfinance and SME loans. People's Bank customers are largely micro businesses and SMEs in the rural areas. However, ADB is unable to isolate the amount of increase in loans and advances resulting directly from the ADB assistance.
SME loans provided (amount in millions of dollars)	No such target was provided in the loan document.	Inclusive of above	See above.

SME = small and medium-sized enterprises.

^a People's Bank Annual Report 2006 (<http://www.peoplesbank.lk/downloads/financial/2006/Financial%20Achievements.pdf>) and 2010 (<http://www.peoplesbank.lk/downloads/financial/2010/PeoplesBank2010.pdf>).

Source: ADB staff review.

STATUS OF COMPLIANCE WITH LOAN COVENANTS

Covenant	Reference in Loan Agreement	Status of Compliance
<p>Loan Agreement between Democratic Socialist Republic of Sri Lanka and Asian Development Bank (Program)</p> <p>The Borrower shall cause the Program to be carried out with due diligence and efficiency and in conformity with sound administrative, financial, environmental, banking, capital market, corporate governance, insurance, and labor practice.</p> <p>In the carrying out of the Program, the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 5 to this Loan Agreement.</p> <p>The Borrower shall make available, promptly as needed, the funds, facilities, services, and other resources that are required, in addition to the proceeds of the Loan, for the carrying out of the Program.</p> <p>The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Program are conducted and coordinated in accordance with sound administrative policies and procedures.</p> <p>The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and to indicate the progress of the Program.</p> <p>The Borrower shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section 4.04.</p> <p>As part of the reports and information referred to in Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the Loan, and the expenditure of the proceeds and maintenance of the service thereof, (ii) the goods financed out of the proceeds of the Loan; (iii) the implementation of the</p>	<p>Section 4.01 (a)</p> <p>Section 4.01 (a)</p> <p>Section 4.02</p> <p>Section 4.03</p> <p>Section 4.04 (a)</p> <p>Section 4.04 (b)</p> <p>Section 4.05</p>	<p>Partly complied with. The government has submitted audited project accounts (APAs), audited financial accounts (AFA), and audit report, but the submitted reports were not fully compliant to ADB's requirements.</p> <p>Partly complied with. The stated political and external factors delayed program implementation by 3 years. The separation of the debt management unit from the Central Bank of Sri Lanka was not carried out.</p> <p>Complied with.</p> <p>Partly complied with. The government largely complied with its reporting requirement</p> <p>Complied with.</p> <p>Complied with.</p> <p>Partly complied with. MOFP has largely complied with ADB's reporting requirement, albeit some delays and noncompliant on certain covenant requirements.</p>

Covenant	Reference in Loan Agreement	Status of Compliance
<p>Program, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter; (iv) financial and economic conditions in the territory of the Borrower and the international balance-of-payments position of the Borrower; and (v) any other matters relating to the purposes of the Loan.</p> <p>Program Agreement between Asian Development Bank and People's Bank</p> <p>People's Bank shall carry out the Program with due diligence and efficiency, and in conformity with sound administrative, financial, environmental, banking, capital market, corporate governance and labor practices.</p> <p>In the carrying out of the Program, People's Bank shall perform all obligations set forth in the Program Loan Agreement to the extent that they are applicable to People's Bank.</p> <p>People's Bank shall make available, promptly as needed, the facilities, services, equipment, and other resources that are required, in addition to the proceeds of the Loan, for the carrying out of the Program.</p> <p>Except as ADB may otherwise agree, all goods and services to be financed out of the proceeds of the Loans shall be procured in accordance with the provisions of Schedule 4 to the Program Loan Agreement.</p> <p>People's Bank shall carry out the Program in accordance with plans, specifications, work schedules and financial methods acceptable to ADB, including the Restructuring Plan. People's Bank shall furnish, or cause to be furnished, to ADB, promptly after their preparation, such plans, specifications and work schedules, and any material modifications subsequently made therein, in such detail as ADB shall reasonably request.</p> <p>People's Bank shall maintain, or cause to be maintained, records and accounts adequate to identify the goods and services and any other items of expenditure financed out of the proceeds of the Loan, to disclose the use thereof in the Program, to</p>	<p>Section 2.01. (a)</p> <p>Section 2.01. (b)</p> <p>Section 2.02. (a)</p> <p>Section 2.02. (b)</p> <p>Section 2.03.</p> <p>Section 2.04.</p>	<p>Partly complied with. The implementation process has shown significant delays and a lack of compliance on the submissions of APAs, AFA, and audit reports.</p> <p>Not complied with. People's Bank was unable to meet ADB's second tranche release conditions and had to take government funds to help it achieve required capital adequacy.</p> <p>Complied with. People's Bank was cooperating with ADB on most aspects of the program implementation.</p> <p>Complied with.</p> <p>Partly complied with. People's Bank was unable to meet ADB's second tranche release conditions and had to take government funds to help it achieve required capital adequacy.</p> <p>Not complied with. People's Bank eventually submitted all AFAs (2005-2010) in 2010 through its annual reports. There was a 2008 Board paper and</p>

Covenant	Reference in Loan Agreement	Status of Compliance
record the progress of the Program (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, its operations and financial condition.		separate auditor's opinion on the ADB program. Nevertheless, People's Bank's compliance on ADB's loan covenants was inadequate.
ADB and People's Bank shall cooperate fully to ensure that the purposes of the Loan will be accomplished.	Section 2.05. (a)	Complied with.
People's Bank shall promptly inform ADB of any condition that interferes with, or threatens to interfere with, the progress of the Program, the performance of its obligations under this Program Agreement, or the accomplishment of the purposes of the Loan.	Section 2.05. (b)	Complied with.
ADB and People's Bank shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters relating to the Program, People's Bank and the Loan.	Section 2.05. (c)	Complied with. This was reflected in the successful ADB review missions.
People's Bank shall furnish to ADB all such reports and information as ADB shall reasonably request concerning (i) the Loan and the expenditure of the proceeds thereof; (ii) the goods and services and other items, of expenditure financed out of such proceeds; (iii) the Program; (iv) the administration, operations and financial condition of People's Bank; and (v) any other matters relating to the purposes of the Loan.	Section 2.06. (a)	Not complied with. People's Bank did not prepare appropriate program reports. It only submitted AFAs in 2010 through its annual reports, a 2008 Board paper, and separate auditor's opinion on the ADB program.
Without limiting the generality of the foregoing, People's Bank shall furnish to ADB quarterly reports on the execution of the Program and on the operation and management of the Program facilities. Such reports shall be submitted within 30 days of the end of each quarter, in such form and in such detail as ADB shall reasonably request, and shall indicate, among other things, progress made and problems encountered during the quarter under review, steps taken or proposed to be taken to remedy these problems, and the proposed program of activities and expected progress during the following quarter.	Section 2.06. (b)	Not complied with. No quarterly reports have been received by ADB.
Promptly after completion of the Program, but in any event not later than three (3) months thereafter or such later date as ADB may agree for this purpose, People's Bank shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the execution and initial operation of the Program, including its cost, the performance by People's Bank of its obligations under this Program Agreement and the	Section 2.06. (c)	Not complied with. No such reports have been received by ADB.

Covenant	Reference in Loan Agreement	Status of Compliance
<p>People's Bank shall enable ADB's representatives to inspect the Program, the goods financed out of the proceeds of the Loans, all other branches, sites, properties and equipment of People's Bank, and any relevant records and documents.</p>	Section 2.08.	Not requested.
<p>People's Bank shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations, and to acquire, maintain and renew all rights, properties, powers, privileges and franchises which are necessary in the carrying out of the Program or in the conduct of its business.</p>	Section 2.09. (a)	Complied with.
<p>People's Bank shall at all times conduct its business in accordance with (a) sound administrative, financial, environmental, banking, capital market, corporate governance, and labor practices, and under the supervision of competent and experienced management and personnel; (b) all applicable laws, including in the case of People's Bank all applicable labor and workers laws; and (c) in the case of People's Bank internal procedures that shall be established to ensure compliance with such laws.</p>	Section 2.09. (b)	Complied with.
<p>People's Bank shall at all times operate and maintain its branches, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound administrative, financial, environmental, banking, capital market, corporate governance, labor, and sound maintenance and operational practices.</p>	Section 2.09. (c)	Complied with.
<p>Except as ADB may otherwise agree, People's Bank shall not sell, lease or otherwise dispose of any of its assets that shall be required for the efficient carrying on of its operations or the disposal of which may prejudice its ability to perform satisfactorily any of its obligations under this Program Agreement.</p>	Section 2.10.	Complied with.
<p>People's Bank shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of the People's Bank Act, the Restructuring Plan, the SEMA MOU, or the Collective Agreement, and shall not take any action to conclude such proposal without ADB's approval thereon.</p>	Section 2.11.	Complied with.
<p>Loan Agreement between Democratic Socialist Republic of Sri Lanka and Asian Development Bank (TA Loan)</p> <p>In the carrying out of the TA Project and operation of the TA Project facilities, the Borrower shall perform,</p>	Section 4.01.	Partly complied with. A steering committee, chaired by the MOFP

Covenant	Reference in Loan Agreement	Status of Compliance
or cause to be performed, all obligations set forth in Schedule 6 to this TA Loan Agreement.		Secretary and consisting of key officials from all implementing agencies was established on 20 July 2007, more than 2 years after loan effectiveness. The government also cancelled \$4.5 of the \$5.0 million TA loan. The required separate accounts for the TA loan and proper monitoring of the expenditure and program progress were not carried out.
The Borrower shall (i) maintain, or cause to be maintained, separate accounts for the TA Project; (ii) have such accounts and related financial statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; (iii) furnish to ADB, as soon as available but in any event not later than 6 months after the end of each related fiscal year, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the Loan proceeds and compliance with the financial covenants of this TA Loan Agreement as well as on the use of the procedures for imprest account, all in the English language; and (iv) furnish to ADB such other information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.	Section 4.02. (a)	Partly complied with. None of the implementing agencies (IAs) established separate accounts, and none has submitted required APAs, AFAs, and audit reports before the government's cancellation of \$4.5 million of the \$5.0 million TA loan.
The Borrower shall enable ADB, upon ADB's request, to discuss the Borrower's financial statements for the TA Project and its financial affairs related, to the TA Project from time to time with the Borrower's auditors, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower shall otherwise agree.	Section 4.02. (b)	Complied with, prior to the cancellation of \$4.5 million of the TA loan.
The quarterly reports to be furnished pursuant to Section 6.05(a) and (b) of the Loan Regulations shall be furnished within 30 days of the end of each quarter.	Section 4.03. (a)	Not complied with. No such reports have been received by ADB.
Without limiting the generality of Section 6.05(a) of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on	Section 4.03. (b)	Not complied with. No such reports have been received by ADB.

Covenant	Reference in Loan Agreement	Status of Compliance
<p>the carrying out of the TA Project and on the operation and management of the TA Project facilities.</p> <p>The Borrower shall enable ADB's representatives to inspect the premises where the TA Project is conducted, the goods financed out of the proceeds of the Loan, and any relevant records and documents.</p> <p>Project Agreement between Asian Development Bank and People's Bank and Insurance Board of Sri Lanka</p> <p>Each Implementing Agency shall carry out the Project with due diligence and efficiency, and in conformity with sound administrative, financial, environmental, banking, commercial, corporate governance, human resources, management, and insurance practices as appropriate.</p> <p>In the carrying out of the Project and operation of the Project facilities, each Implementing Agency shall perform all obligations set forth in the TA Loan Agreement to the extent that they are applicable to such Implementing Agency.</p> <p>Each Implementing Agency shall make available, promptly as needed, facilities, services, equipment, and other resources that are required, in addition to the proceeds of the TA Loan, for the carrying out of their respective part of the TA Project.</p> <p>In the carrying out of the Project, each Implementing Agency shall employ competent and qualified consultants and contractors, acceptable to ADB, to an extent and upon terms and conditions satisfactory to ADB.</p> <p>Except as ADB may otherwise agree, all goods and services to be financed out of the proceeds of the TA Loan shall be procured in accordance with the provisions of Schedule 4 and Schedule 5 to the TA Loan Agreement. ADB may refuse to finance a contract where goods or services have not been procured under procedures substantially in accordance with those agreed between the Borrower and ADB or where the terms and conditions of the contract are not satisfactory to ADB.</p> <p>Each Implementing Agency shall carry out the Project in accordance with plans, specifications, and work schedules acceptable to ADB. Each Implementing Agency shall furnish, or cause to be furnished, to</p>	<p>Section 4.04.</p> <p>Section 2.01. (a)</p> <p>Section 2.01. (b)</p> <p>Section 2.02.</p> <p>Section 2.03. (a)</p> <p>Section 2.03. (b)</p> <p>Section 2.04.</p>	<p>Not requested.</p> <p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p> <p>Partly complied with. APAs, AFAs, and audit reports were not submitted on time. No separate accounts were established for each IA.</p> <p>Complied with. No adverse information has been received by ADB.</p> <p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p> <p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p> <p>Partially complied with. IAs were unable to furnish ADB information on the implementation work.</p>

Covenant	Reference in Loan Agreement	Status of Compliance
ADB, promptly after their preparation, such plans, specifications and work schedules, and any material modifications subsequently made therein, in such detail as ADB shall reasonably request.		
Each Implementing Agency shall maintain, or cause to be maintained, records and accounts adequate to identify the goods and services and other items of expenditure financed out of the proceeds of the TA Loan, to disclose the use thereof in the Project, to record the progress of the Project (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, its operations and financial condition.	Section 2.05.	Not complied with. Separate accounts for each implementing agency were not established and no monitoring and review reports from each implementing agency were submitted.
Each Implementing Agency shall cooperate fully with ADB, and as necessary with the Borrower, its agencies and authorities, and each other Implementing Agency to ensure that the purposes of the TA Loan will be accomplished.	Section 2.06. (a)	Complied with, prior to the cancellation of \$4.5 million of the TA loan.
Each Implementing Agency shall promptly inform ADB of any condition that interferes with, or threatens to interfere with, the progress of the Project, the performance of its obligations under this Project Agreement, or the accomplishment of the purposes of the TA Loan.	Section 2.06. (b)	Complied with, prior to the cancellation of \$4.5 million of the TA loan.
ADB and each Implementing Agency shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters relating to the Project, each Implementing Agency and the TA Loan.	Section 2.06. (c)	Complied with, as reflected in the successful program review missions, prior to the cancellation of the TA loan.
Each Implementing Agency shall furnish to ADB all such reports and information as ADB shall reasonably request concerning (i) the TA Loan and the expenditure of the proceeds thereof; (ii) the goods and services and other items of expenditure financed out of such proceeds; (iii) the TA Project; (iv) the administration, operations and financial condition of such Implementing Agency; and (v) any other matters relating to the purposes of the TA Loan.	Section 2.07. (a)	Not complied with. No separate accounts, APAs, AFA, or progress reports were submitted to ADB.
Without limiting the generality of the foregoing, each Implementing Agency shall furnish to ADB quarterly reports on the execution of the TA Project and on the operation and management of the TA Project facilities. Such reports shall be submitted in such form and in such detail and within such a period as ADB shall reasonably request, and shall indicate, among other things, progress made and problems encountered during the quarter under review, steps	Section 2.07. (b)	Not complied with. The IAs were unable to furnish ADB the information on the implementation work.

Covenant	Reference in Loan Agreement	Status of Compliance
<p>taken or proposed to be taken to remedy these problems, and proposed program of activities and expected progress during the following quarter.</p> <p>Promptly after physical completion of the Project, but in any event not later than three (3) months thereafter or such later date as ADB may agree for this purpose, each Implementing Agency shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the execution and initial operation of the Project, including its cost, the performance by each Implementing Agency of its obligations under this Project Agreement and the accomplishment of the purposes of the TA Loan.</p> <p>Each Implementing Agency shall (i) maintain separate accounts for the TA Project and for its overall operations; (ii) have such accounts and related financial statements (balance sheet, statement of income and expenses, and related statements) audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; and (iii) furnish to ADB, promptly after their preparation but in any event not later than 6 months after the close of the fiscal year to which they relate, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the TA Loan proceeds and compliance with the financial covenants of the TA Loan Agreement as well as on the use of the procedures for the imprest account all in the English language. Each Implementing Agency shall furnish to ADB such further information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.</p> <p>Each Implementing Agency shall enable ADB, upon ADB's request, to discuss such Implementing Agency's financial statements and its financial affairs from time to time with such Implementing Agency's auditors, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of such Implementing Agency unless such Implementing Agency shall otherwise agree.</p> <p>Each Implementing Agency shall enable ADB's</p>	<p>Section 2.07. (c)</p> <p>Section 2.08. (a)</p> <p>Section 2.08. (b)</p> <p>Section 2.09.</p>	<p>N/A. The government cancelled the TA loan in 2008.</p> <p>Partly complied with. Separate accounts were not maintained by the IAs. IAs did not provide APAs, AFA, or audit reports other than People's Bank's annual reports, prior to the cancellation of the TA loan.</p> <p>N/A. The government cancelled the TA loan in 2008. No such discussion took place prior to 2008.</p> <p>Complied with, prior to the</p>

Covenant	Reference in Loan Agreement	Status of Compliance
<p>representatives to inspect the premises whereby the TA Project is conducted, the goods financed out of the proceeds of the TA Loan, all other branches, sites, works, properties and equipment of each Implementing Agency, and any relevant records and documents.</p>		<p>cancellation of \$4.5 million of the TA loan.</p>
<p>Each Implementing Agency shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations, and to acquire, maintain and renew all rights, properties, powers, privileges and franchises which are necessary in the carrying out of the TA Project or in the conduct of its business.</p>	<p>Section 2.10. (a)</p>	<p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p>
<p>Each Implementing Agency shall at all times conduct its business in accordance with (a) sound administrative, financial, environmental, banking, financial, human resources, management, commercial, labor and insurance practices, and under the supervision of competent and experienced management and personnel; (b) all applicable laws, including in the case of People's Bank all applicable labor and worker laws; and (c) in the case of People's Bank internal procedures that shall be established to ensure compliance with such laws.</p>	<p>Section 2.10. (b)</p>	<p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p>
<p>Each Implementing Agency shall at all times operate and maintain its plants, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound administrative, financial engineering, environmental, banking, financial, human resources, management, commercial and insurance practices, and sound maintenance and operational practices.</p>	<p>Section 2.10. (c)</p>	<p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p>
<p>Except as ADB may otherwise agree, each Implementing Agency shall not sell, lease or otherwise dispose of any of its assets which shall be required for the efficient carrying on of its operations or the disposal of which may prejudice its ability to perform satisfactorily any of its obligations under this Project Agreement.</p>	<p>Section 2.11.</p>	<p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p>
<p>Except as ADB may otherwise agree, each Implementing Agency shall apply its proceeds of the TA Loan to the financing of expenditures on the TA Project in accordance with the provisions of the TA Loan Agreement and this Project Agreement, and shall ensure that all goods and services financed out of such proceeds are used exclusively in the carrying out of the TA Project.</p>	<p>Section 2.12.</p>	<p>Complied with, prior to the cancellation of \$4.5 million of the TA loan.</p>

Covenant	Reference in Loan Agreement	Status of Compliance
People's Bank and IBSL, respectively, shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of People's Bank Act, or the Insurance Act, as relevant and shall afford ADB an adequate opportunity to comment on such proposal prior to taking any action thereon.	Section 2.14.	Complied with, prior to the cancellation of \$4.5 million of the TA loan.

ADB = Asian Development Bank, APA = audited project accounts, AFA = audited financial accounts, SEMA = Strategic Enterprise Management Agency, IA = implementing agency, IBSL = Insurance Board of Sri Lanka, MOFP = Ministry of Finance and Planning, MOU = memorandum of understanding, N/A = not applicable, TA = technical assistance.

TECHNICAL ASSISTANCE LOAN COST ESTIMATES
(\$'000)

Item	Foreign Exchange	Local Currency	Total
A. Asian Development Bank Financing			
1. Consultants			
a. Remuneration			
i. International	2,800,000	0	2,800,000
ii. Domestic	0	128,000	128,000
b. Per diem	0	0	0
i. International	490,500	0	490,500
ii. Domestic	0	0	0
c. Travel	0	0	0
i. International	115,000	0	115,000
ii. Domestic	0	73,000	73,000
2. Hardware and software for movable property registry	100,000	30,000	130,000
3. Documentation and communication	42,700	28,500	71,200
4. Workshops, training, and seminars	224,500	140,500	365,000
5. Interest and commitment charge	258,159	51,024	309,183
6. Contingencies	496,380	21,737	518,117
Subtotal (A)	4,527,240	472,760	5,000,000
B. Government Financing			
1. Counterpart facilities: office space, equipment, furniture, and fixtures	0	310,000	310,000
2. Counterpart Operational Support: communications, secretarial and related services	0	690,000	690,000
Subtotal (B)	0	1,000,000	1,000,000
Total (A+B)	4,527,240	1,472,760	6,000,000

Note: Figures may not add up to totals given because of rounding.

Source: ADB. 2004. Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Democratic Republic of Sri Lanka for the Financial Markets Program for Private Sector Development. Manila.

STATUS OF POLICY ACTIONS FOR THE RELEASE OF THE SECOND AND THIRD TRANCHES

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
1. Secured Transaction Financing		
(1) Cabinet approval of Secured Transactions Bill (T2)	(a) Establishment of a national system of registration for securing moveable property, including machinery and equipment (the "Moveable Property Registry"); (b) Establishment or appointment of an agency responsible for the Moveable Property Registry; and (c) Any necessary consequential amendments to the Registration of Documents Ordinance No. 23 of 1927, and the Companies Act (a bill reflecting the measures in paragraphs 2(a) – (c), the "Secured Transactions Bill.	Carried out. The Cabinet approved the Secured Transactions Bill. The gazetted notification is dated 13 March 2009. The policy paper to establish a registry was submitted to the MOFP on 16 July 2009.
(2) Introduce Secured Transactions Bill in Parliament (T3)		Carried out. The Secured Transactions Bill was submitted to Parliament on 3 June 2009.
(3) Cabinet approval and publication of an amendment to Finance Companies Act (T2)	Permitting leasing company to transfer assets to SPV.	Carried out. On 8 August 2005, the Finance Leasing Amendment Act No. 24 (2005) amended para. 24 of the Finance Leasing Act No. 56 (2000) to permit leasing companies to transfer assets to an SPV for securitization of assets.
(4) Introduce amendment to the Finance Companies Act in Parliament (T3)		Carried out. The amendment to the Finance Companies Act was submitted to Parliament in October 2005.
2. Public Trading of Securitized Bonds / Public Debt Office		
(1) Cabinet approval of Securitization Bill (T2)	(a) SPVs may be established as separate legal entities to own and pool assets ("Securitized Assets") against which securities may be	Carried out. The Cabinet approved the Securitization Bill. The gazetted notification is dated 13 March 2009.

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
	<p>issued;</p> <p>(b) The Securities Exchange Commission will (i) regulate and supervise SPVs, and (ii) be afforded the authority to issue regulations relating to SPVs including (a) procedures and requirements for establishment and registration of SPVs, and (b) reporting, disclosure and any other requirements to facilitate the ability of SPVs to own and transfer related securities;</p> <p>(c) SPVs must be registered with the Securities and Exchange Commission; and</p> <p>(d) Parate Rights will be revised or amended to permit the transfer of ownership rights to assets held by SPVs.</p>	
(2) Introduce Securitization Bill in Parliament (T3)		Carried out. The Securitization Bill was submitted to Parliament on 3 June 2009.
(3) Cabinet approval of a bill to establish public debt office (T3)	Establish public debt office as an agency independent from the CBSL and the MOFP and responsible for management, administration, and issuance of all of the Borrower's sovereign debt.	Waiver requested. Approval of a bill establishing the debt office is unlikely since the government has decided to focus on CBSL's Department of Public Debt instead of establishing a separate public debt office. The government is committed to addressing conflict-of-interest between monetary policy and debt management functions as well as strengthening debt management within CBSL. The primary market auction and cutoff rates are now determined entirely by CBSL's Department of Public Debt. The front and back office functions of the department are now segregated.

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
(4) System to reduce time of equity settlement cycle to T+3 is fully operational at the CSE (T3)	Introduce system at CSE for reducing the period between the time a buyer of shares listed on the CSE places an order with a registered dealer to buy shares ("Trade") and the transfer of payment for and delivery of such shares to the seller; from the date of Trade plus 6 days (T+6) to the date of Trade plus 3 days (T+3)	Carried out. On 10 December 2007, CSE effectively moved to a T+3 settlement cycle for buying and selling in the equities market.
3. Corporate Governance in the Financial Market		
(1) Directive regulation issued by the Securities and Exchange Commission requiring companies registered under the Companies Act, and publicly listed on the Colombo Stock Exchange to comply with the Sri Lankan Corporate Governance Code. (T2)		Carried out. On 19 February 2007, the Securities and Exchange Commission issued a directive for registered and listed companies to comply with the Corporate Governance Code effective 1 April 2007. Within 1 year, companies are allowed to explain noncompliance with the directive. The directive has been strictly enforced since 1 April 2008.
(2) Introduction to Parliament of a bill to amend the Securities and Exchange Commission Act (T2)	Incorporating an obligation of the MOFP to appoint Securities and Exchange Commission commissioners that collectively facilitate a Securities and Exchange Commission that is independent from the Borrower by virtue of reflecting a balanced and diverse representation of public and private interests.	Carried out. The Cabinet approved the Securities and Exchange Commission Act amendment; the gazetted notification is dated 13 March 2009. The Securities and Exchange Commission Act amendment was submitted to Parliament on 3 June 2009.
(3) Introduction to Parliament of a bill to amend the Banking Act (T2)	To provide the Central Bank the power and authority to take action against Fraudulent Financial Schemes.	Carried out. On 10 February 2005, the Banking Amendment Act No. 2 inserted Article 83C in the Banking Act, stipulating the powers of CBSL to take action against fraudulent financial schemes.

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
4. Money Laundering		
(1) Cabinet approval of Anti-Money Laundering Bill (T2)		Carried out. The anti-money laundering framework includes three laws. On 8 August 2005, the Convention on the Suppression of Terrorist Financing Act was enacted. This is consistent with the United Nations convention of 10 January 2000. It provides for a FIU under CBSL with the responsibility to make investigations. The Prevention of Money Laundering Act and the Financial Transactions Reporting Act, both enacted on 6 March 2006, set out measures to combat money laundering and provide the FIU with the appropriate legal powers, and provide for the establishment of the FIU. The FIU receives reports of all cash and electronic transactions exceeding SLRs0.5 million and requires financial institutions and fund managers to appoint compliance officers and undertake customer due diligence. The FIU was established on 23 March 2006 and submitted its first progress report in November 2006.
(2) Introduce Anti-Money Laundering Bill in Parliament (T3)		Carried out. The Anti-Money Laundering Bill was submitted to Parliament in October 2005.
5. Insurance Industry Regulation		
(1) Cabinet approval of amendment to the Insurance Industry Act. (T2)	Permitting insurance companies registered under the Insurance Act to invest in securities including unit trusts, commercial paper, debt securities, and bonds issued against Securitized Assets (the "Amendments to the Insurance Act")	Carried out. The Insurance Board of Sri Lanka prepared a draft amendment to the Regulation of Insurance Industry Act. The Cabinet approved the amendment on 10 December 2007.
(2) Introduce amendment to the Insurance Industry Act in Parliament (T3)		Carried out. The amendment to the Insurance Industry Act was submitted to Parliament on 3 June 2009.
6. Corporate Governance of State-Owned Commercial Banks		
(1) Introduction to Parliament of a bill to amend the People's		Partially carried out. An amendment to the People's Bank Act is not feasible due to lack of support from People's Bank Employees

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
Bank Act incorporating measures to ensure the commercial and political independence of the People's Bank board of directors and management. (T2)		<p>Union. The government and People's Bank have committed to undertake an alternative action to meet the policy objectives by issuing a People's Bank corporate charter consistent with (i) the code of best practice in corporate governance in public enterprises issued by MOFP in January 2003, (ii) the CBSL guidelines for corporate governance of banks effective January 2008, and (iii) responsibilities and duties of directors and officers under the Companies Act. The People's Bank board adopted the corporate charter on 25 January 2008 after stakeholder consultation with the government, CBSL, and ADB.</p> <p>The corporate charters of People's Bank and Bank of Ceylon will catalyze improved operating efficiency of both banks by enhancing responsible, accountable, and value-based performance management, as well as furthering effective oversight through stringent accountability procedures (such as an effective internal audit system and the appointment of specialized board subcommittees for compliance, audit, governance, and risk management). In line with international best practices, detailed guidelines are given under the charters to ensure that competent boards and corporate management teams are appointed that will function effectively by promoting value added and independent decision making processes in the best interest of the two banks. The corporate charters emphasize that the state's role in the two banks will be limited to strategic issues and policies. The state will not intervene in day-to-day management of the banks.</p>
(2) Introduction to Parliament of a bill to amend the Bank of Ceylon Act incorporating measures to ensure the commercial and political independence of the Bank of Ceylon board of directors and management. (T2)		Partially carried out. The amendment to the Bank of Ceylon Act is unlikely due to lack of support from Ceylon Bank Employees Union. The government and Bank of Ceylon have committed to undertake an alternative action to meet the policy objectives by issuing a Bank of Ceylon corporate charter consistent with (i) the Code of Best Practice in Corporate Governance in Public Enterprises issued by MOFP in January 2003, (ii) the CBSL guidelines for corporate governance of banks effective January 2008, and (iii) responsibilities and duties of directors and officers under the Companies Act. On 14 November 2007, the Bank of

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
		<p>Ceylon board approved the Bank of Ceylon Code of Best Practice on Corporate Governance after stakeholder consultation with the government, CBSL, and ADB.</p> <p>The corporate charters of People's Bank and Bank of Ceylon will catalyze improved operating efficiency of both banks by enhancing responsible, accountable, and value-based performance management as well as furthering effective oversight through stringent accountability procedures (such as an effective internal audit system and the appointment of specialized board subcommittees for compliance, audit, governance, and risk management). In line with international best practice, detailed guidelines are given under the charters to ensure that competent boards and corporate management teams are appointed that will function effectively by promoting value-added and independent decision-making processes in the best interest of the two banks. The corporate charters emphasize that the state's role in the two banks will be limited to strategic issues and policies. The state will not intervene in their day-to-day management.</p>
7. Strategic Enterprise Management Agency		
Introduction of Strategic Enterprise Management Agency (SEMA) Act to Parliament (T2)	<p>Incorporating at least:</p> <ul style="list-style-type: none"> (a) the essential principles contained in the Presidential Decree, dated 4 June 2004, establishing SEMA; (b) measures to ensure the commercial and political independence of the People's Bank (i) board of directors; and (ii) management; (c) measures to ensure the commercial and political independence of the Bank of Ceylon's (i) board of directors; and (ii) management; and (d) any necessary consequential amendments to the People's Bank Act, and the Bank of Ceylon Act. 	<p>Partially carried out. MOFP advised that the passage of the Strategic Enterprise Management Agency Act is not feasible due to lack of support from People's Bank Employees Union and Ceylon Bank Employees Union. The following alternative actions were agreed to meet the policy objective of commercial and political independence of People's Bank and Bank of Ceylon. MOFP has established a steering committee for the banking system, chaired by the governor of CBSL and cochaired by the treasury secretary. SEMA is a member of the committee. The committee oversees the consistent application of governance reforms for banking in line with the corporate governance codes issued by CBSL for all banks. In the case of state-owned banks, it also oversees compliance with MOFP guidelines on corporate governance for public enterprises issued in 2003.</p> <p>CBSL issued a new code of corporate governance for banks in</p>

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
		<p>December 2007 consistent with pillar 2 of the Basel II framework. The code is designed to strengthen board and management oversight and competence for risk management. Considering the fiduciary responsibility of boards to their stakeholders, and in the interest of wider financial system stability, CBSL issued a directive on corporate governance in December 2007 requiring the banks to streamline their governance practices from 2008. Furthermore, on 23 April 2008, the boards of People's Bank and Bank of Ceylon adopted a corporate charter under which detailed guidelines are given to ensure that competent boards and corporate management teams are appointed that will function effectively by promoting value-added and independent decision-making processes in the best commercial interest of the two banks. The corporate charter emphasizes that the state's role in the two banks will be limited to strategic issues and policies. The state will not intervene in their day-to-day management.</p>
8. People's Bank Unions		
Establishment of a collective agreement by the People's Bank (T2)		<p>Waiver requested. People's Bank signed collective agreements with the Ceylon Bank Employees Union and People's Bank Officers Association on 29 June 2006. The collective agreements do not explicitly support the restructuring plan. During the midterm review, the government asked that this policy action be waived. The People's Bank board and management have demonstrated their resolve and ability to carry out restructuring of People's Bank without formal union support.</p>
9. Restructuring and Recapitalization of People's Bank		
(1) The People's Bank shall have continued to implement (a) the Restructuring Plan; and (b) the Performance Indicators, (i) in accordance with the agreed time-schedule stated in the Restructuring Plan, or such other time-schedule as shall have been agreed by the		<p>Carried out. The People's Bank development plan 2004–2008 forms the basis for benchmarking the bank's reforms under the program. People's Bank submitted its final strategic plan for 2009–2014 in March 2009, and is now implementing it.</p>

Focus of Reform	Policy Actions to be Taken before Second Tranche (T2) and Third Tranche (T3) Release	Comments
People's Bank, SEMA, and ADB in a separate writing, and (ii) to the satisfaction of each of SEMA and ADB. (T2+T3)		
(2) The Borrower shall have provided the People's Bank with funds in the amounts and at the times required in accordance with the Phased Recapitalization Plan. (T2+T3)		Carried out. To date, the government has provided People's Bank with recapitalization funds on four occasions: SLRs2.0 billion in December 2005, SLRs1.0 billion in December 2006, SLRs1.5 billion in December 2007, and SLRs1.5 billion in December 2008.

ADB = Asian Development Bank, CBSL = Central Bank of Sri Lanka, CSE = Colombo Stock Exchange, FIU = financial intelligence unit, MOFP = Ministry of Finance and Planning, SEMA = Strategic Enterprise Management Authority, SPV = special-purpose vehicle.

Source: ADB. 2010. Progress Report on Tranche Release Sri Lanka: Financial Markets Program for Private Sector Development. Manila.

STATUS OF NON-TRANCHE RELEASE POLICY ACTIONS

Focus of Reform	Status and Comments
Other Covenants	
Schedule 5 para. 7 Within one month of the Effective Date, a Steering Committee shall be formed chaired by the Secretary, MOFP and comprised of key officials from concerned ministries and agencies, including the CBSL, Insurance Board of Sri Lanka, SEMA, the Securities and Exchange Commission, the Land Commissioner's Department, and the People's Bank.	A steering committee was formed in July 2007, more than 2 years after the effective date. This was due to significant time spent by the new government (which came into power at the end of 2005) to rebuild ownership and find an appropriate way forward.
Schedule 5 para. 10 The Borrower shall ensure that the Borrower's phased recapitalization of the People's Bank shall be suspended if the People's Bank does not achieve the Performance Indicators in accordance with the agreed time-schedule contained in the Recapitalization Plan.	ADB agreed to the borrower's phased recapitalization of People's Bank even though People's Bank did not achieve its performance indicators in accordance with the agreed time schedule in the recapitalization plan.
Schedule 5 para. 11 The Borrower shall ensure that (a) SEMA and the People's Bank inform ADB of any change to the People's Bank Board of Directors, or the People's Bank senior management team as soon as reasonably practicable, following such change, and (b) any such change is made in consultation with SEMA.	Carried out.
Schedule 5 para. 12 The Borrower shall cause SEMA to, and SEMA shall, coordinate the conduct of an independent third-party review of the implementation of the Restructuring Plan of People's Bank at least every six months basis, and shall provide ADB with a report of each such review within 45 days of the end of every six months.	Carried out.
Schedule 5 para. 13 No later than 30 January 2005, the People's Bank shall commence a formal process of consultation and dialogue with the Joint Council on the Restructuring Plan, to consult and discuss the implementation of the Restructuring Plan and to obtain their input and consider their views in the context of the Restructuring Plan; and shall inform employees and obtain feedback through the Team Briefing Process on the Restructuring Plan.	The consultation process was conducted but proved to be unsuccessful.
Schedule 5 para. 14 No later than 30 September 2005, the Borrower and SEMA will ensure that the	Compliance was not possible since the unions refused to support the restructuring plan in writing. This was an unrealistic objective the

Focus of Reform	Status and Comments
<p>People's Bank enters into an agreement with the Ceylon Bank Employees Union and any trade union of the Joint Council the People's Bank deems relevant following the consultation process on the Restructuring Plan, that requires the parties to implement the Restructuring Plan (the "Collective Agreement").</p>	<p>change of government was undertaken at the end of 2005.</p>
<p>Schedule 5 para. 15</p> <p>Within 6 months of the Effective Date, the Borrower shall cause the Securities and Exchange Commission to commence preparation of a Sri Lankan Corporate Governance Code for companies registered under the Companies Act and publicly listed on the CSE taking into account the <i>Code of Corporate Governance for Banks and other Financial Institutions (2002)</i> issued by the Central Bank of Sri Lanka in 2002 and international best practice.</p>	<p>Carried out. On 19 February 2007, the Securities and Exchange Commission issued a directive for registered and listed companies to comply with the Corporate Governance Code effective 1 April 2007. During the first year, companies were allowed to explain noncompliance with the directive; however, since 1 April 2008, the directive has been strictly enforced.</p>
<p>Schedule 5 para. 16</p> <p>The Borrower shall ensure that public and private sector entities covered under the Program comply with all applicable environmental regulations, and in particular with provisions of the National Environment Act of 1980, as amended, and ADB's Environment Policy.</p>	<p>Carried out. No applicable environmental regulations relate to policy actions to be carried out by private and public sector entities under the program.</p>
<p>Schedule 5 para. 17</p> <p>The Borrower shall ensure that that Counterpart Funds are used to finance the local currency costs relating to the implementation of the programs and other activities consistent with the objectives of the Program and the Policy Letter.</p>	<p>Carried out. A significant portion of the counterpart funds was used to finance the recapitalization of People's Bank, consistent with the objectives of the program and the policy letter.</p>
<p>Schedule 5 para. 18</p> <p>Within three months of the Effective Date, the MOFP shall establish and maintain a Program Performance Management System for the monitoring and evaluation of the Program during and after implementation, acceptable to ADB (the "PPMS"). The PPMS shall include a database on the status of policy measures. Quarterly reports of the PPMS shall be submitted to the Steering Committee and ADB within 30 days of the end of each quarter.</p>	<p>Carried out.</p>
<p>Schedule 5 para. 19</p> <p>The MOFP shall provide ADB with quarterly progress reports on policy and institutional reforms. ADB shall monitor implementation of the Program through</p>	<p>Carried out.</p>

Focus of Reform	Status and Comments
periodic reviews and progress reports.	
Schedule 5 para. 22 The Borrower shall have used its best efforts to introduce into Cabinet a bill to amend the Securities and Exchange Commission Act to permit trading of derivative and futures instruments no later than the release of the Second Tranche.	Carried out.
Schedule 5 para. 23 The Borrower shall encourage the Central Bank to issue a directive requiring interest rate swap transactions to comply with the Protocols of the International Swaps and Derivatives Association, Inc. no later than the release of the Second Tranche.	Carried out. On 31 December 2005, CBSL issued a directive on derivatives trading permitting interest rate swaps, interest rate options, forward rate agreements, cross-currency swaps, and currency commodity options for up to 10 years based on the underlying asset.

ADB = Asian Development Bank, CBSL = Central Bank of Sri Lanka, CSE = Colombo Stock Exchange, MOFP = Ministry of Finance and Planning, PPMS = project performance management system, SEMA = Strategic Enterprise Management Agency.

Source: ADB. 2010. Progress Report on Tranche Release Sri Lanka: Financial Markets Program for Private Sector Development. Manila.

OVERVIEW OF SRI LANKA'S FINANCIAL SECTOR

1. Sri Lanka's financial system comprises various financial institutions, namely, the Central Bank of Sri Lanka (CBSL), licensed commercial banks, licensed specialized banks, registered finance companies, specialized leasing companies, primary dealers, pension and provident funds, insurance companies, rural banks, merchant banks, unit trusts and thrift, and credit cooperative societies. Major financial markets are the foreign exchange market, the money market, the capital market, and the informal financial market (Table A7).

Table A7: Sri Lanka's Financial Sector, 2010

Financial Institutions	Total Assets	
	SLRs Billion	% of Total
Banking sector		
Central bank	975.4	15.2
Licensed commercial banks	2,808.5	43.8
Licensed specialized banks	553.2	8.6
Other financial institutions regulated by CBSL		
Registered finance companies	216.0	3.4
Primary dealers	146.6	2.3
Specialized leasing companies	135.3	2.1
Institutions not regulated by CBSL		
Rural banks and cooperatives	164.8	2.6
Employee provident fund	864.0	13.5
Insurance companies	209.8	3.3
Other contractual saving institutions	271.8	4.3
Stock brokerage companies	17.3	0.3
Unit trust	18.8	0.3
Venture capital companies	1.4	0
Other financial institutions	31.1	0.5
Total	6,413.9	100.0

CBSL = Central Bank of Sri Lanka.

Source: Central Bank of Sri Lanka. 2010. *Economic and Social Statistics 2010*. Colombo.

2. In 2008 and 2009, Sri Lanka's financial sector also suffered from the spillover effects of the global financial crisis. Combined with the outflow of foreign investments from the government securities market, the economic contraction constrained the supply of credit and restricted bank lending. From 2010, rapid economic growth was supported by (i) improved investor confidence following the end of the civil conflict, (ii) the recovery of the global and Sri Lankan economies, and (iii) the approval in July 2009 of the \$2.6 billion IMF standby facility for an economic reform program. As a result, the financial sector also fared better in 2010. The improved performance was reflected in all leading indicators of financial institutions, markets, payments systems, and safety nets. Annual gross domestic product (GDP) growth is expected to reach 7.0% in 2011,¹ leading to further demand for financial services.

3. The banking sector experienced significant recovery in credit growth and profitability. Capital adequacy improved, nonperforming loans were reduced, and loan loss provision increased. The financial safety net was further strengthened with the introduction of a mandatory deposit insurance scheme for licensed banks and finance companies to protect small depositors, and the implementation of a number of regulations to encourage prudence in the operations of financial institutions. There was concern over

¹ GDP grew by 8.5% in the second quarter of 2010 (ADB. 2011. *Asian Development Outlook 2010*. Manila).

"high intermediation cost (as reflected in high interest margins of banks), excess liquidity in relation to certain commercial banking institutions, recovery of bad assets and the effective implementation of deposit repayment plans in respect of distressed-finance companies to boost confidence, combating fraudulent investment proposals and prohibited schemes operated under the mask of multi-level marketing, the sustainability of the current stock price boom, marginal level of activity and primitive status of the corporate debt securities market, lack of initiatives taken by derivatives market participants for their further development, monitoring international capital flows to promote economically healthy flows of foreign capital and the conduct of suitable programs to enhance financial literacy of the general public." ²

4. The Colombo Stock Exchange (CSE) achieved record gains in 2010. The All Share Price Index (ASPI) rose by 96% in 2010 and the Milanka Price Index (MPI) increased by 83%. The number of shares traded in 2010 was four times as large as the number traded a year earlier, and average daily turnover was more than three times as large. The market price earnings ratio increased further in 2010 and reached 25.2, compared with 16.6 in 2009. Market capitalization more than doubled in 2009, and doubled again in 2010, reaching SLRs2.2 trillion by the end of that year. New share issues also rose in 2010, with eight new initial public offerings (IPOs) being announced and significantly oversubscribed, reflecting positive investor confidence. More than SLRs4.3 billion was raised through IPOs during the year. Further, 28 companies made rights issues and raised a total of SLRs24.3 billion.

5. The domestic debt market comprises the corporate and government bond markets. Issues of government securities in the primary market through primary dealers stayed almost unchanged in 2010, at SLRs1.5 trillion. Secondary market transactions almost doubled to SLRs41.2 trillion. With the easing of the monetary policy stance and improved market liquidity, yield declined in 2010. Activities in the corporate bond market were also relatively limited by the narrow issuer and investor base. There were only two issues of debentures in 2010. The total value of commercial paper declined from SLRs22 billion in 2009 to SLRs12 billion in 2010. Interest rates also declined significantly, from 9%–36% in 2009 to 7%–16% in 2010. Nearly 97% of the commercial paper had a maturity of up to 3 months. The trading turnover of debentures listed on the debt securities trading system (DEX) of the CSE declined from SLRs137 million in 2009 to SLRs72 million in 2010. To broaden the investor base and improve liquidity in the secondary market, exchange control regulations were relaxed to permit foreigners to invest in rupee-denominated debentures issued by local companies, up to 50% of the issue.

6. The foreign debt market was highlighted by the government's issuance of \$1 billion in September 2010 through its third international bond issue, which was listed on the Singapore Exchange at a comparatively attractive rate of 6.25%. This followed the government's first sovereign bond issuance in 2007 (priced at 8.25% for \$500 million and 5 years' tenor) and 2009 (priced at 7.40% for \$500 million and 5 years' tenor). Foreign investment in treasury bills and treasury bonds reached the ceiling of 10% of the total treasury issuance outstanding. Foreign investments in treasury bills amounted to SLRs57 billion in 2010, while foreign investments in treasury bonds amounted to SLRs184 billion.

7. The asset securitization market is small but showed signs of growth in 2010. Trust certificates are a popular instrument for the securitization of finance leasing and hire purchase

² Central Bank of Sri Lanka. 2010. *Annual Report 2010*. Colombo.

receivables. There were 31 issues of trust certificates amounting to SLRs13 billion for the year up to October 2010, compared with 26 issues and SLRs6 billion mobilized in 2009. Asset securitization is often used by finance companies to obtain relatively longer-term tenor debt.

8. The insurance sector, which consists of 19 insurance companies, 48 insurance broking companies and about 37,000 insurance agents, showed improved performance in 2010. Total assets increased by 22%, income by 40%, and pretax profit by 262%, showing the expansion of insurance business. The asset composition tended to increase toward equities and cash/deposits, while government securities remained the dominant asset. While both premium and investment income continued to register considerably high increases, the share of investment income tended to increase considerably, from 19% in 2008 to 35% in 2010, with a corresponding decline in the share of premium income. Reflecting the high growth of profit, return on equity for general insurance increased by 37% and return on assets by 18%, while return on assets for life insurance rose to 2.6%. The solvency margin, which measures the adequacy of capital to meet obligations, improved for life insurance, and both insurance business lines complied with the minimum solvency margin requirements.

9. The unit trust sector expanded with a substantial growth in net asset value (NAV), investors, and number of units in issue in 2010. At the end of 2010, there were 21 unit trusts under six management companies. In 2010, the total number of unit holders increased by 6.6%, to 24,640 and NAV grew by 122%, to SLRs22 billion. The share of equities in the investment portfolio is 53%, while the share of government securities is 34%. The improved profitability was reflected in the increase in dividends (estimated weighted average) paid to unit holders, from SLRs0.96 to SLRs1.21. However, net asset value per unit improved only marginally, from SLRs18 to SLRs19. One of the budget proposals for 2011 was to exempt foreigners and foreign funds from exchange control restrictions on investments in unit trusts. The unit trust sector therefore promises to be another attractive investment avenue in the future.

FINANCIAL PERFORMANCE OF PEOPLE'S BANK

Table A8.1: Financial Performance of People's Bank, 2000–2010

Item (SLRs unless stated)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Loans and advances (bn)	87.1	106.1	101.1	101.1	122.5	142.5	207.1	238.3	248.6	283.8	357.3
Gross earning (bn)	18.5	25.2	24.0	23.1	22.6	27.2	35.1	48.0	59.0	49.1	62.5
Net income (bn)	8.5	10.5	11.0	13.6	13.7	14.8	19.5	21.4	24.5	30.6	31.9
Profit after tax (bn)	(1.3)	0.9	1.6	2.1	2.1	2.8	3.2	2.4	2.7	3.3	5.2
CAR (tier 1) %	(9.6)	(4.8)	(2.9)	1.5	3.7	4.3	6.5	7.7	7.9
CAR (total) %	(11.3)	(10.5)	(9.2)	(4.5)	(2.3)	1.9	5.6	6.1	10.5	13.4	12.8
Gross NPA/Gross loans	18.9	20.9	19.6	18.2	14.1	11.0	7.1	5.9	6.8	6.7	5.0
NPA/Net loans	4.4	8.2	6.7	4.0	2.4	1.8	0.9	0.7	1.6	2.0	1.3
NPL coverage ratio	76.9	61.0	65.8	78.1	83.0	83.9	87.1	88.0	75.7	70.6	73.6
Cost/Income Ratio	102.8	89.2	79.7	70.2	73.1	72.7	73.8	68.7	65.4	60.6	60.2
ROA	(0.9)	0.5	0.8	1.1	1.2	1.6	1.3	1.4	1.5	1.4	1.7
ROE	22.8	(13.9)	(33.3)	(90.3)	(289.0)	139.2	44.2	20.5	18.8	19.7	26.9
Fitch local long-term rating					BBB+	BBB+	A–	A–	A–	A	AA–
Fitch outlook						P	P	P	S	P	P

bn = billion, CAR = capital adequacy ratio, NPA = nonperforming assets, P = positive, ROA = return on assets, ROE = return on equity, S = stable.

Note: The shaded cells parallel those in Table A8.2, for comparison of performance with commercial bank industry averages in Sri Lanka.

Sources: Central Bank of Sri Lanka 2011; People's Bank annual reports, various editions; and Fitch Ratings Sri Lanka, various versions, 2004–2010.

**Table A8.2: Financial Performance of Commercial Banks in Sri Lanka
(Industry Averages), 2005–2010**

Item	2005	2006	2007	2008	2009	2010
CAR, tier 1 (%)	12.3	11.3	11.9	11.1	12.9	12.3
CAR, total (%)	13.2	12.7	13.6	13.8	15.4	14.8
Gross NPA/Total loan	6.9	5.5	5.0	6.0	8.2	6.0
ROA	1.7	1.9	1.9	2.0	1.7	2.7
ROE	17.7	16.2	15.0	14.8	11.0	21.3

CAR = capital adequacy ratio, NPA = nonperforming assets, ROA = return on assets, ROE = return on equity.

Source: Central Bank of Sri Lanka, 2011; People's Bank annual reports, various editions.

STRATEGIC PLAN OF PEOPLE'S BANK, 2009–2014

Item	2009 Actual	2009 Strategic Plan Targets	2010 Strategic Plan Targets	2011 Strategic Plan Targets	2012 Strategic Plan Targets	2013 Strategic Plan Targets	2014 Strategic Plan Targets
Cost/income ratio	60.6	71.0	57.6	54.9	56.4	52.7	50.0
Nonfunded income to net income	21.9	22.6	17.4	16.9	17.0	16.8	16.1
Number of employees	8,863	8,600	8,750	8,790	8,780	8,710	8,650
Profit per employee (SLRs,000)	375	302	497	601	644	808	885
Return on assets (pre-tax)	1.4	1.3	1.4	1.7	1.6	1.8	1.9
Return on equity	19.7	14.6	23.0	24.0	23.0	25.0	24.0
Capital adequacy	12.6	12.0	12.1	12.2	12.1	12.4	12.3
Advances to deposit ratio	75.0	82.0	79.0	80.0	80.0	81.0	81.0
Net interest margin	5.2	4.6	5.2	5.0	4.9	4.8	4.8
Nonperforming advances/total advances	6.7	6.3	6.7	6.3	5.8	5.3	4.8
Total loans and advances	299,077	293,545	253,631	398,669	508,373	508,373	574,363
Total nonperforming loans	20,040	18,600	23,800	24,990	27,027	27,027	27,837

Source: ADB. 2010. Progress Report on Tranche Release Sri Lanka: Financial Markets Program for Private Sector Development. Manila.