



Impact of Covid-19 on SL Banking & Financial sector

*A primer on banking and finance
industry*

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Role of the Financial System

1. Provision of payment services – retail and wholesale
2. Provision of pure insurance service, life and general, wholesale and retail which allows the transfer of risk by pooling with others
3. The creation of markets in spot and short-term futures in instruments – examples are foreign exchange, commodities, etc.
4. Financial intermediation between providers of funds (surplus units) typically savers and investors and users of funds (deficit units) typically borrowers and businesses. This typically involves maturity transformation between borrowers who are more longer term and depositors who are shorter term. This function plays a crucial role in capital allocation in the economy.

What drives the economic engine?

Spending = Money + Credit

Credit expansion boosts economic growth



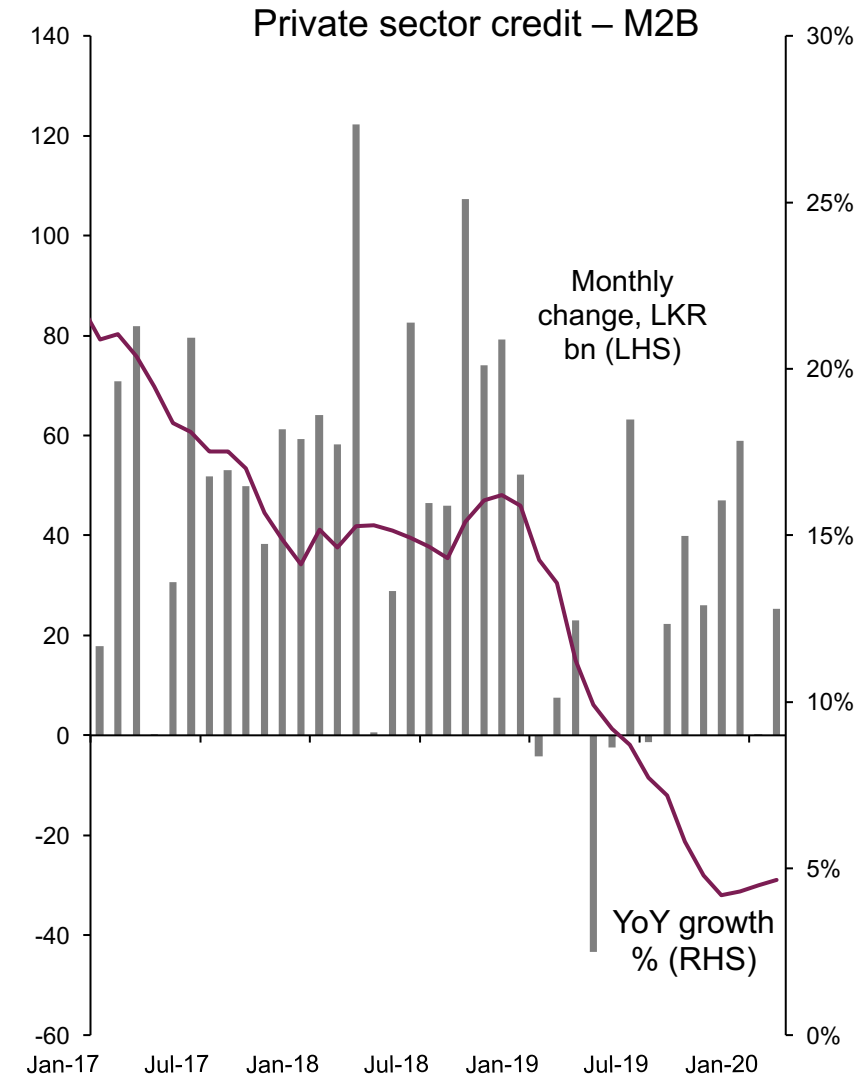
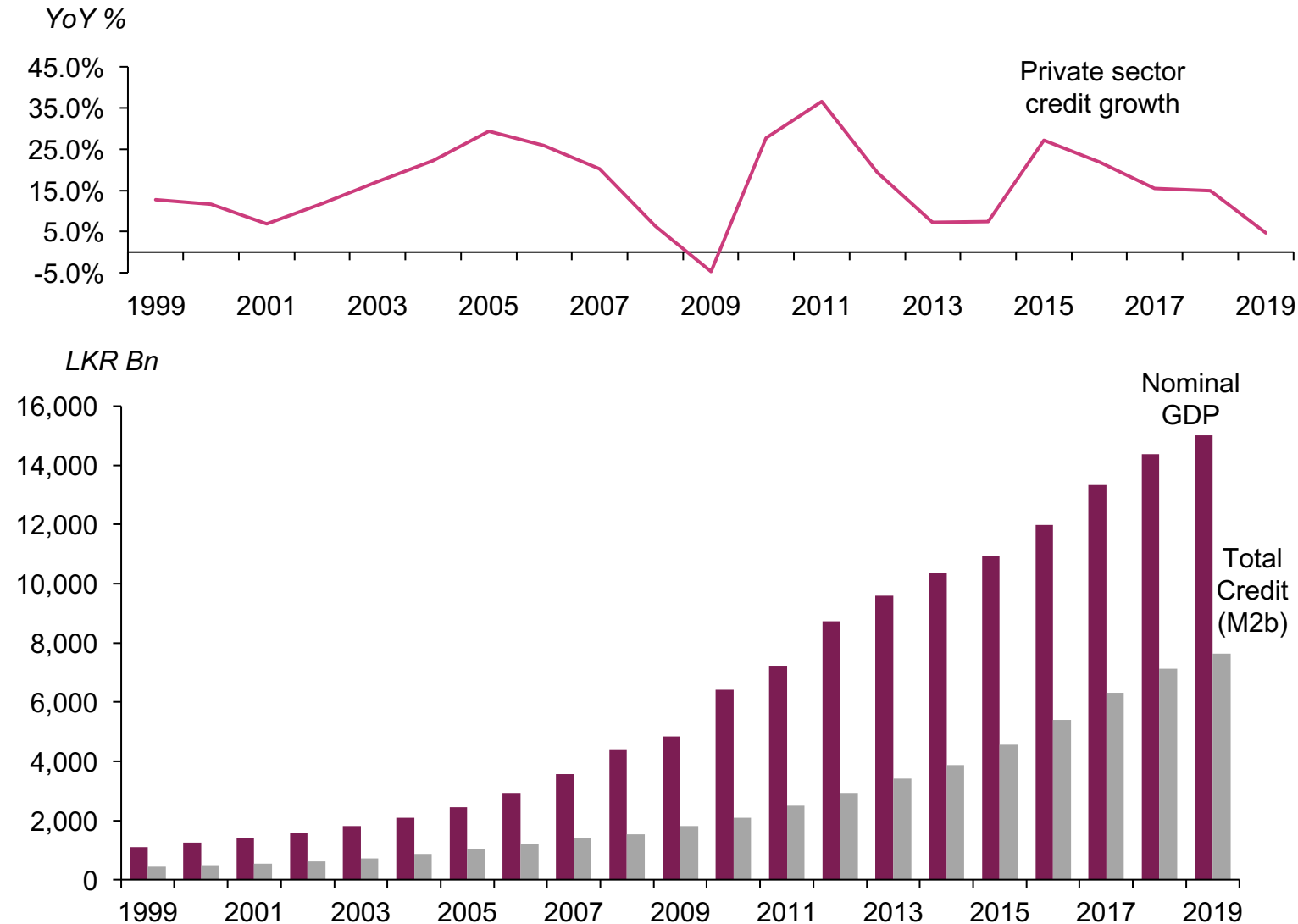
Borrowing increases growth as it allows you to spend more than you earn

Credit contraction reduces economic growth

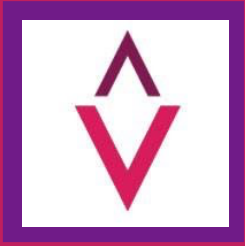


Paying back borrowings reduces growth as you must spend less than you earn

A contraction in credit creates a reduction in GDP growth



Source: Central Bank of Sri Lanka

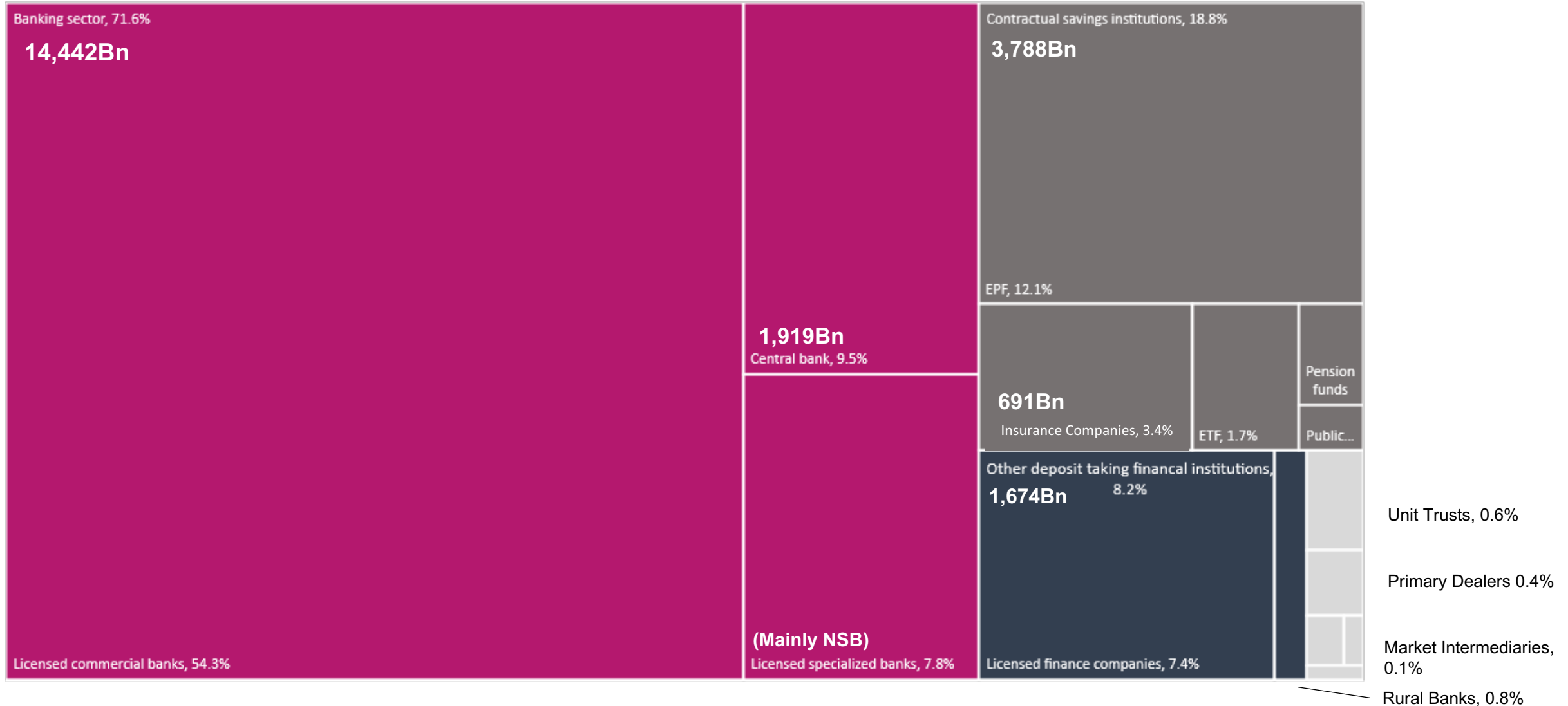


Who are the players?

Total size of the financial sector

Size: LKR 20,159Bn

As at Dec 2019



Source: Central Bank of Sri Lanka

Licensed Commercial Banks (LCB)



— State Banks (2) — Private Banks (11) — Foreign Banks (12)

Specialized Commercial Banks (SCB) & Licensed Finance Companies (LFC)



- 07 – Specialized Commercial Banks
- 43 – Licensed Finance Companies
- 04 – Specialized Leasing Companies

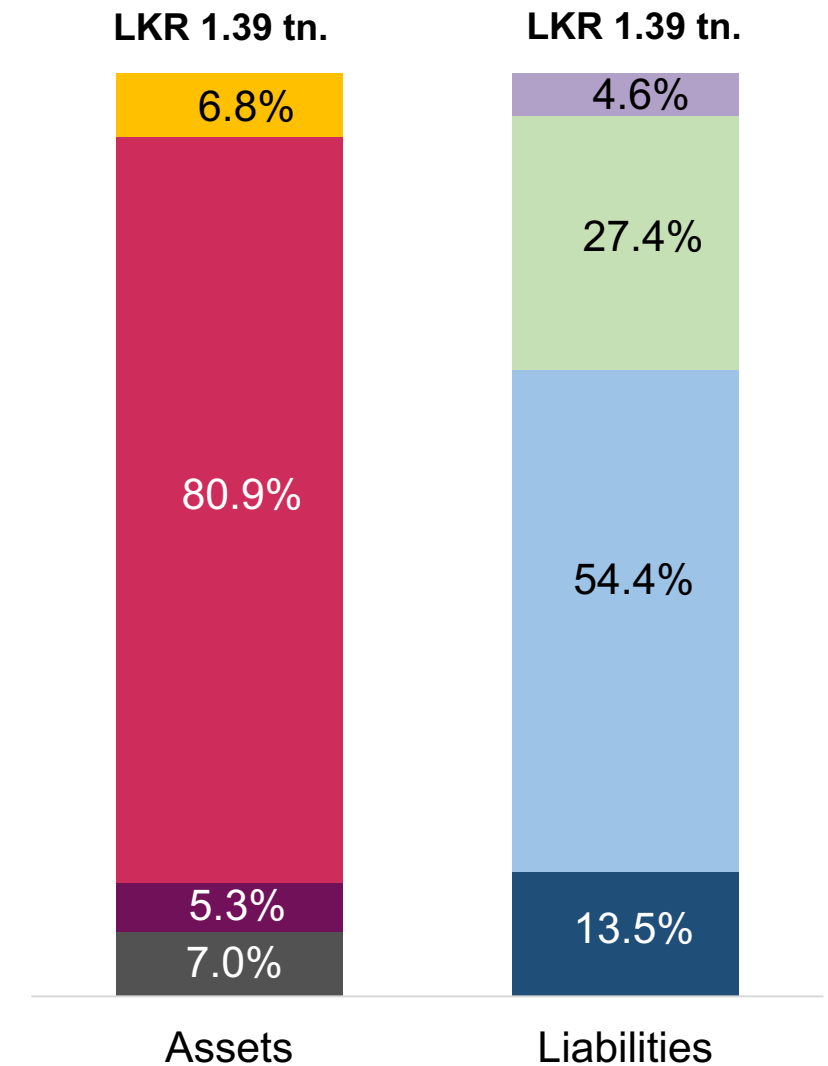
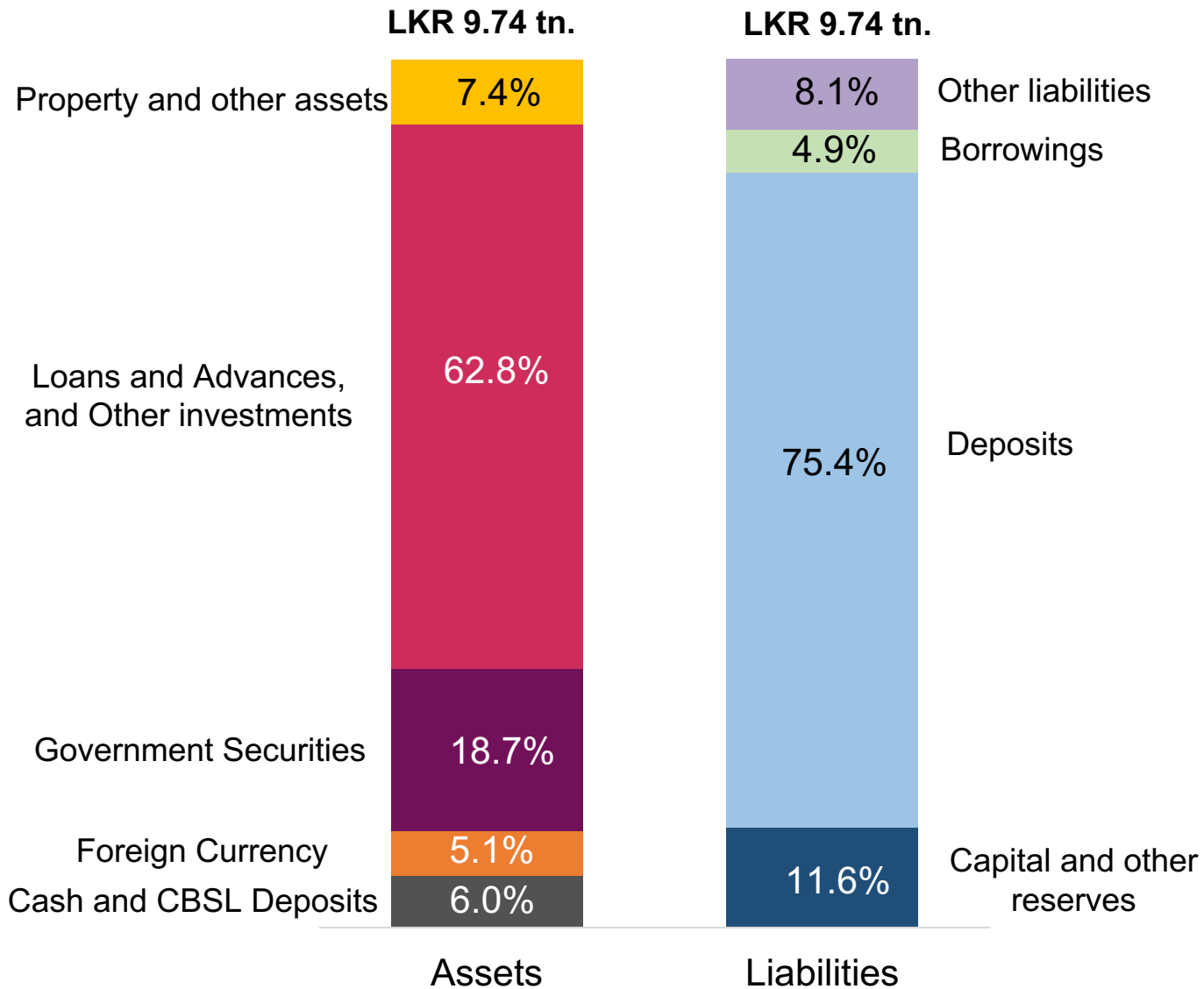


37 Others

Breakdown of assets and liabilities

Commercial Banks

Finance Companies



Source: Central Bank of Sri Lanka

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Asset Side

Drivers of credit

Drivers of credit extension

Affordability

Disposable income

Nominal interest cost

Duration

Debt service to disposable income ratio

Credit worthiness

Collateral

Liquidity

Price discovery

Asset mobility

Transaction cost

Income assessment

History

Verifiability

Variability

Stability

Credit enhancement

Enforceability

Standing of the guarantor

Regulation

Capital Adequacy

Leverage

Reserve Ratio

Liquid Assets Ratio

LTV Ratio

Government policy

Funding

Credit Underwriting

Priority sector lending

Development of internal systems

Product/Service innovation

Customization

Outreach marketing

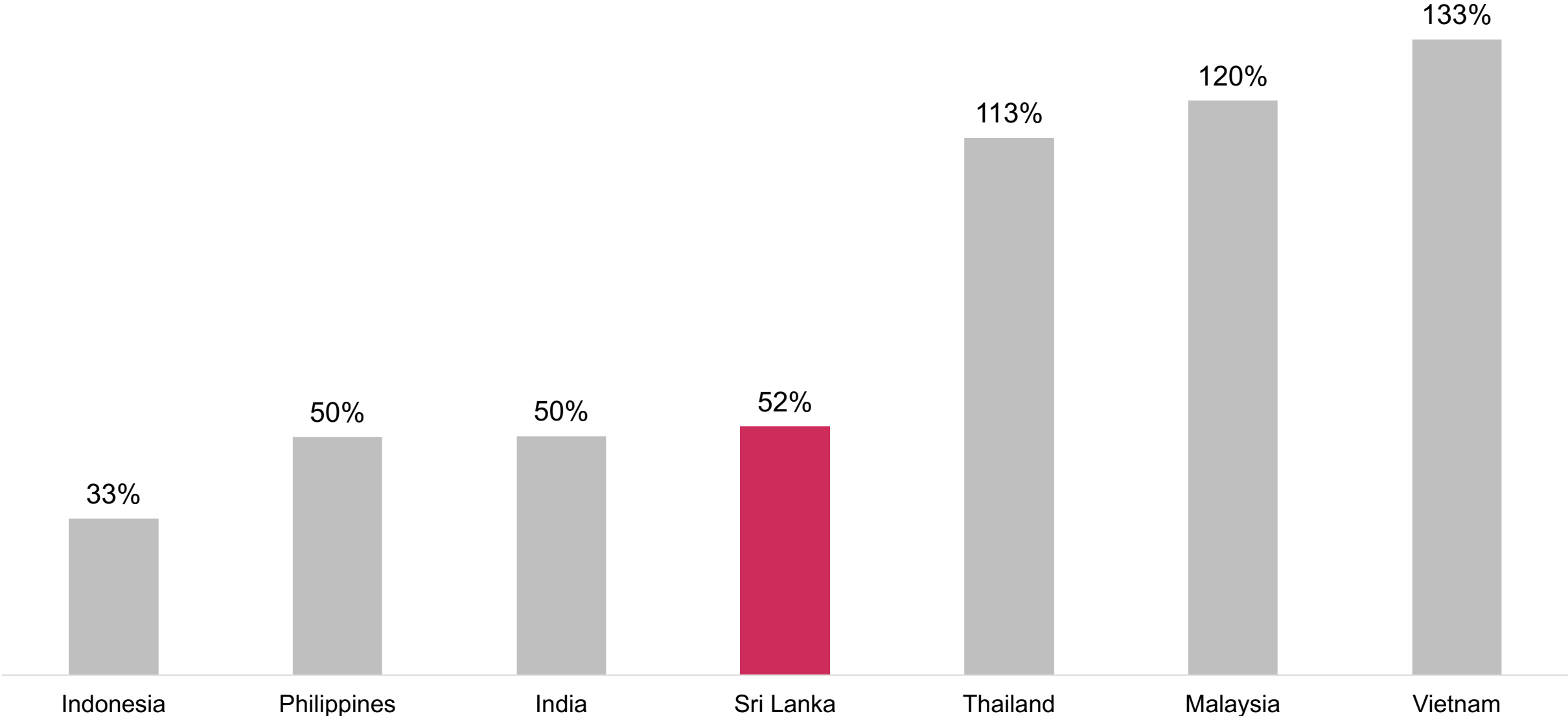
Efficiency

Speed of service

Efficient Recoveries

Centralized credit information

Sri Lanka's private sector credit to GDP is relatively low, 2018



Source: World Bank
www.advocata.org

Banking sector loans and advances

	Market Share
State Banks	41.8%
Others	58.2%

CAGR 2014-19

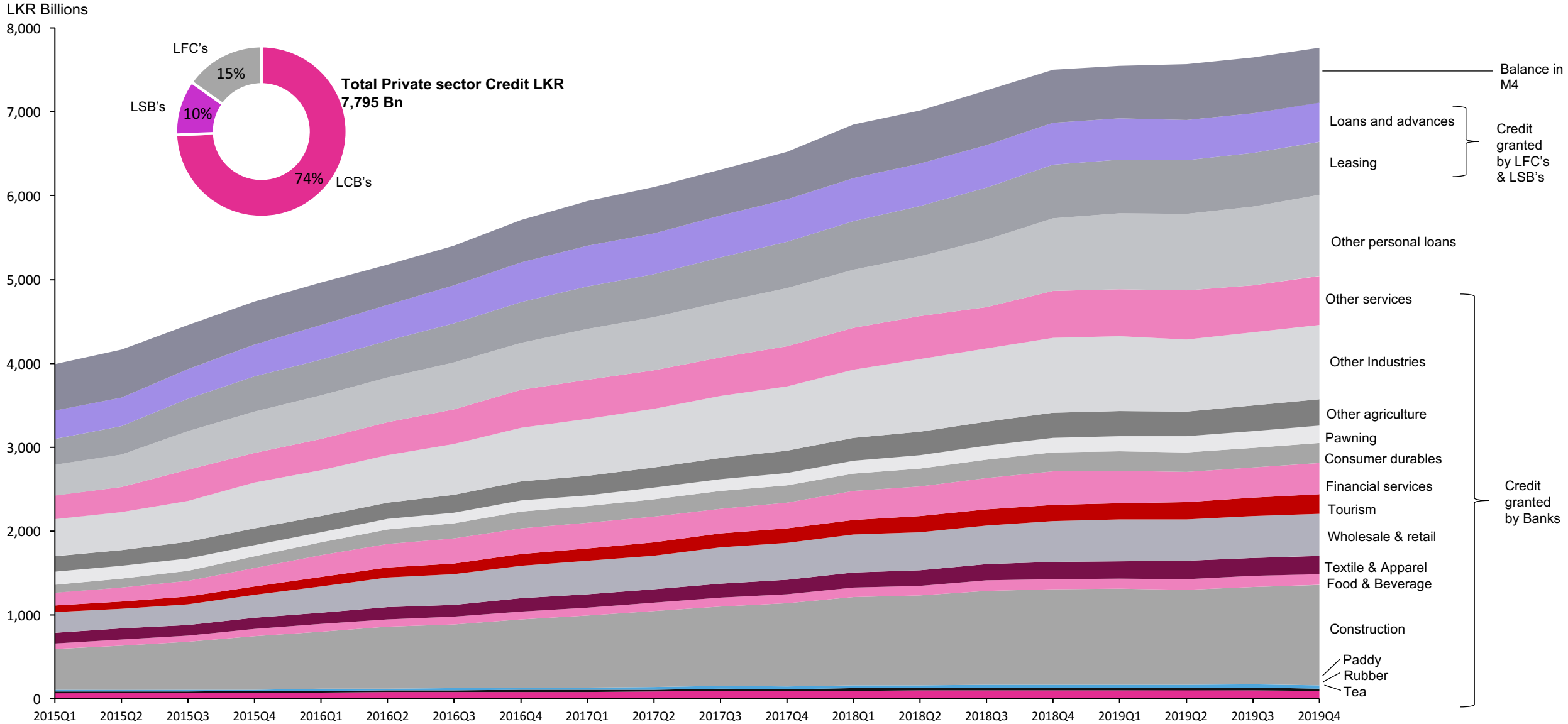


Sources- Bank Annual/Quarterly Reports

Private sector credit

Private sector credit as a percentage of GDP stood at 51.7% as at 31st December 2019

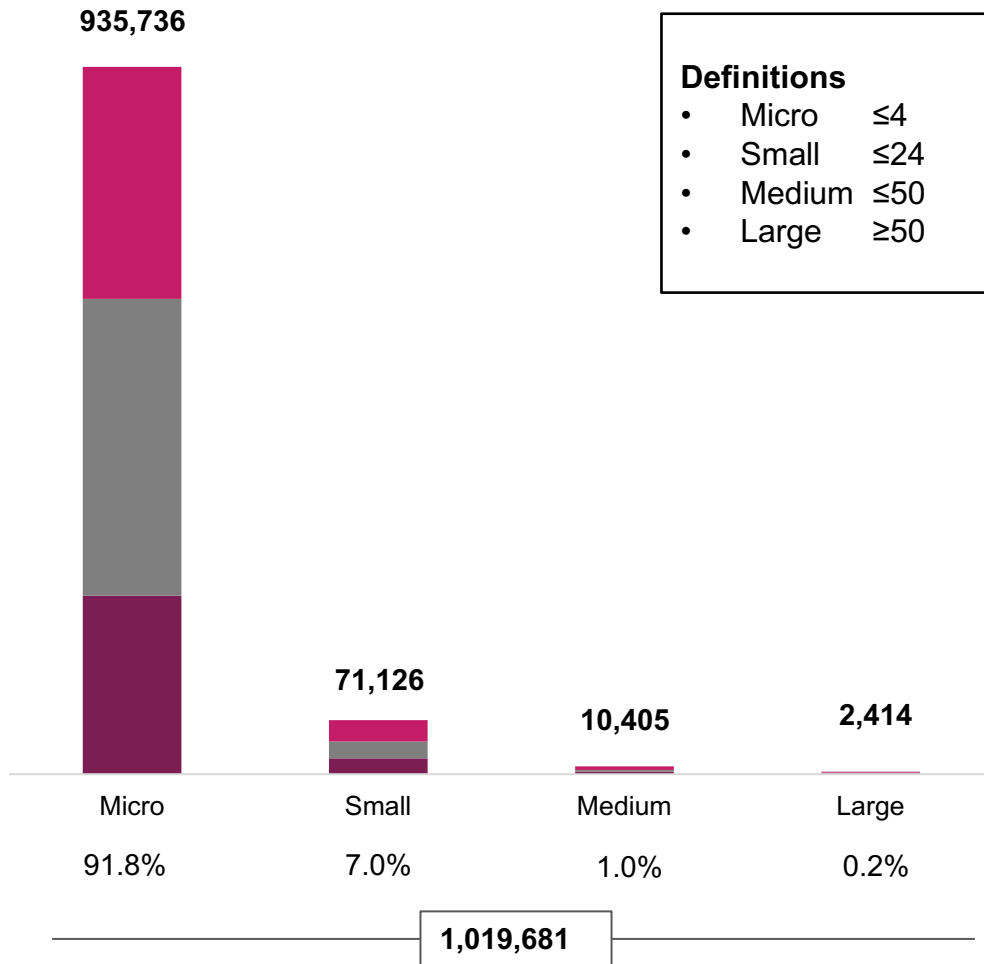
31 December 2019



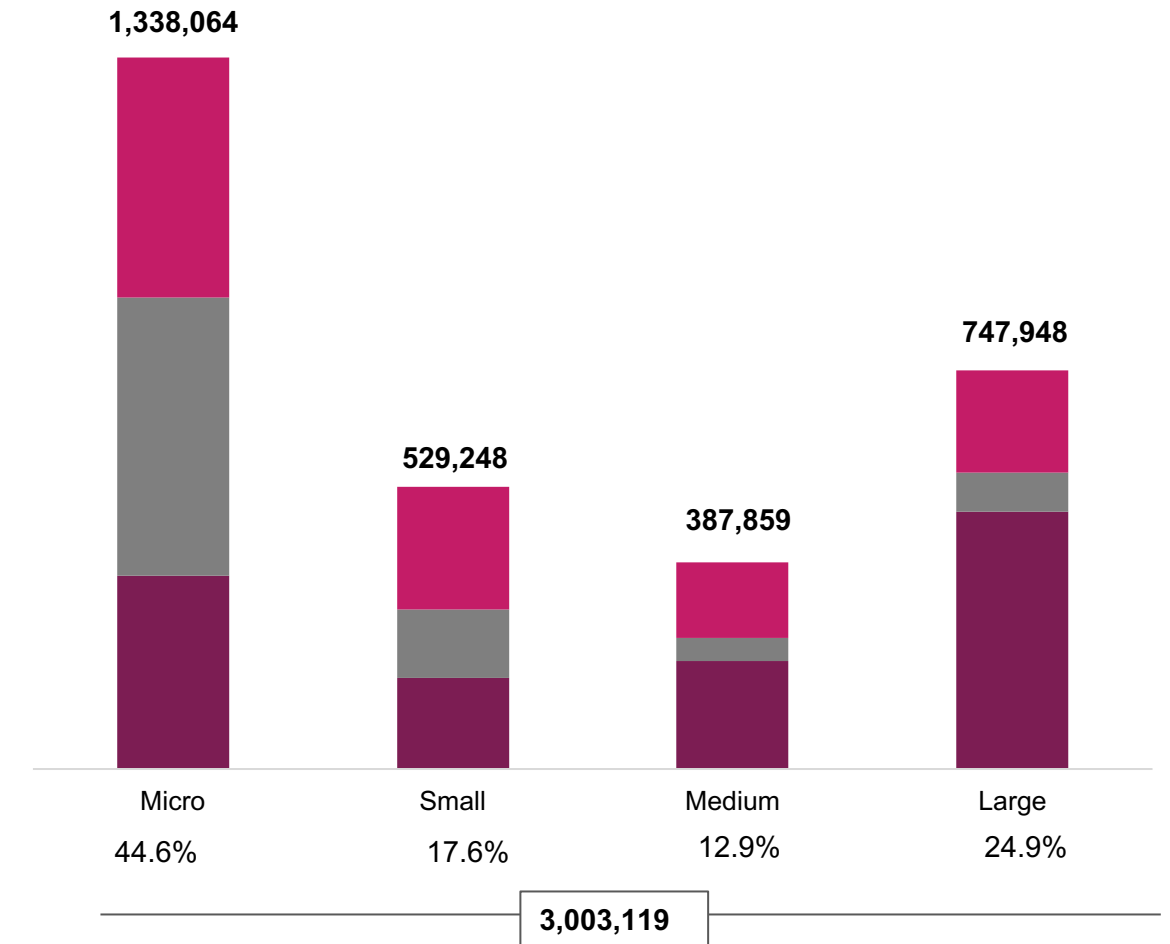
Source: Central Bank of Sri Lanka

Distribution of establishments in the country

Establishments

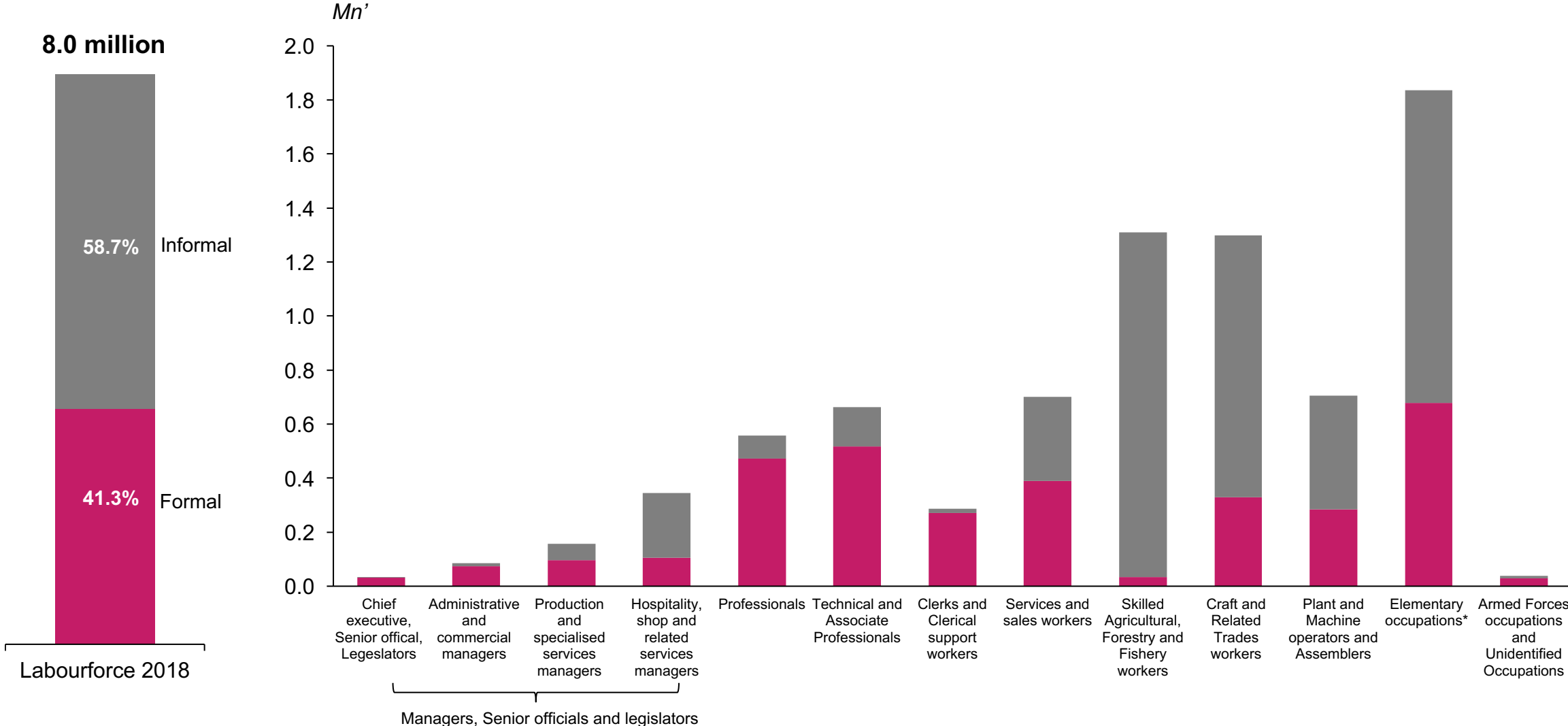


Employment



Source: Department of Census and Statistics, Economic Census

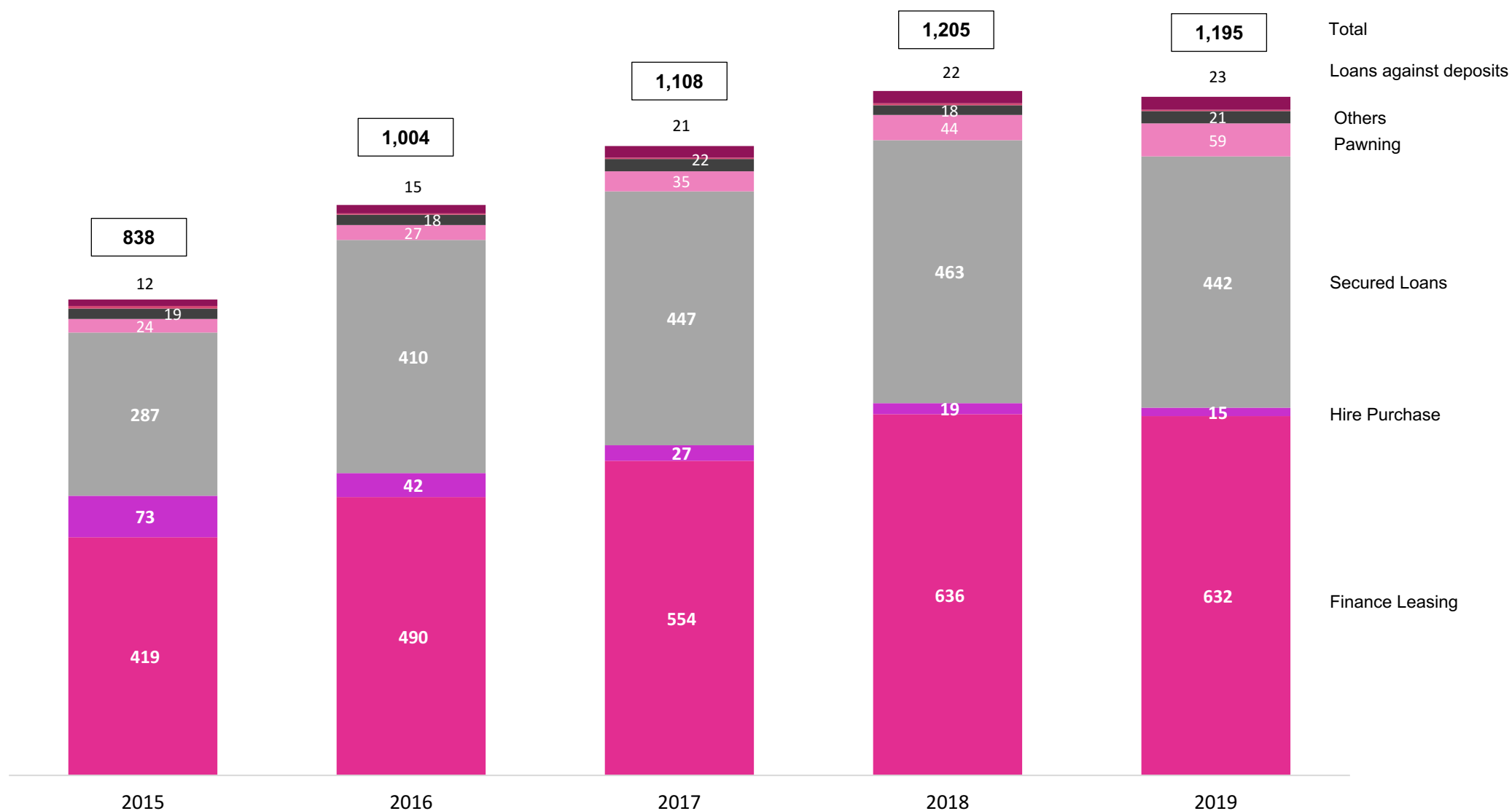
Sri Lanka's labor force is skewed to the informal sector



*Elementary occupations include Sales and services elementary occupations, Agricultural, fishery and related laborers, Laborers in mining, construction, manufacturing and transport
 Source: Department of Census and Statistics

Product wise distribution of LFC's / SLC's advances

LKR Billions

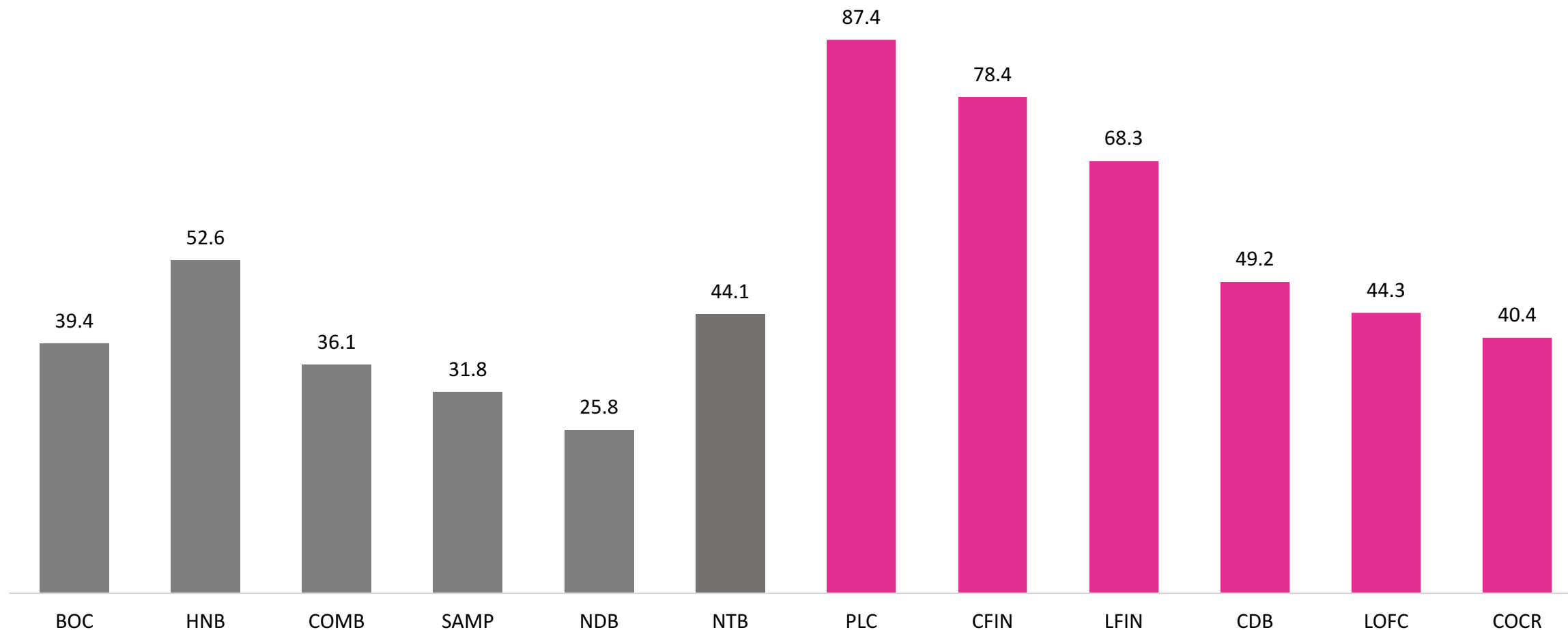


Source: CBSL

Leasing & Hire Purchase advances across the industry

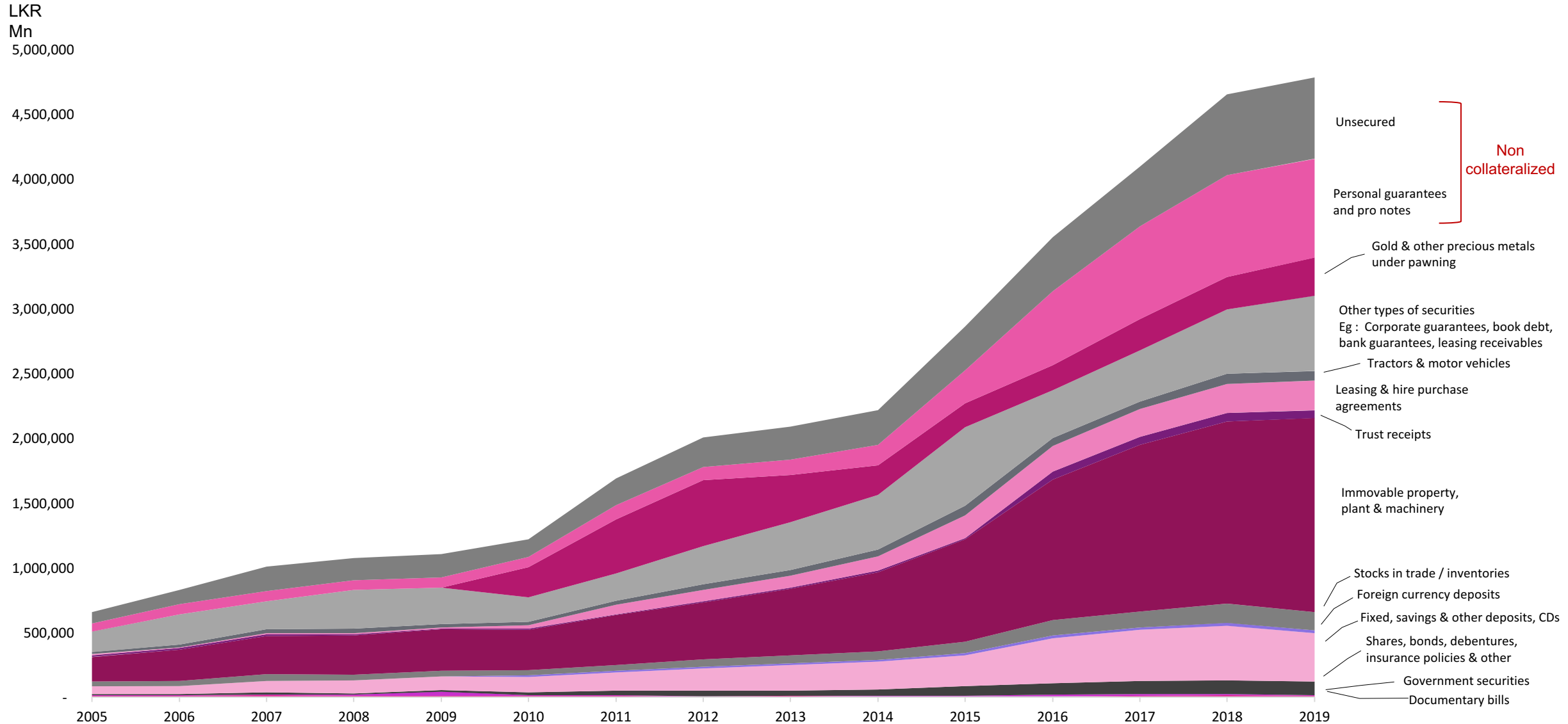
Banks- as at 31 Dec 2019
LFC's – as at 31 Mar 2019

LKR Billions



Source: Company Annual reports/ quarterly reports

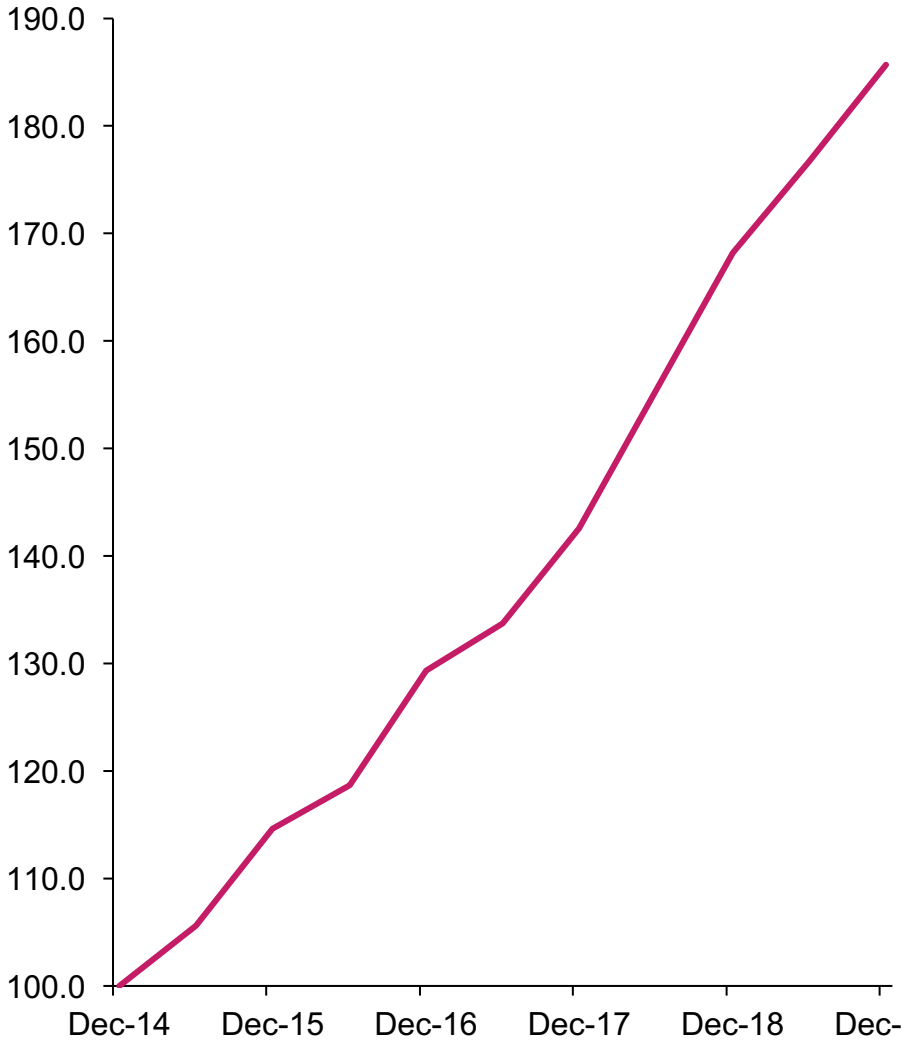
Commercial banks' loans & advances by type of security



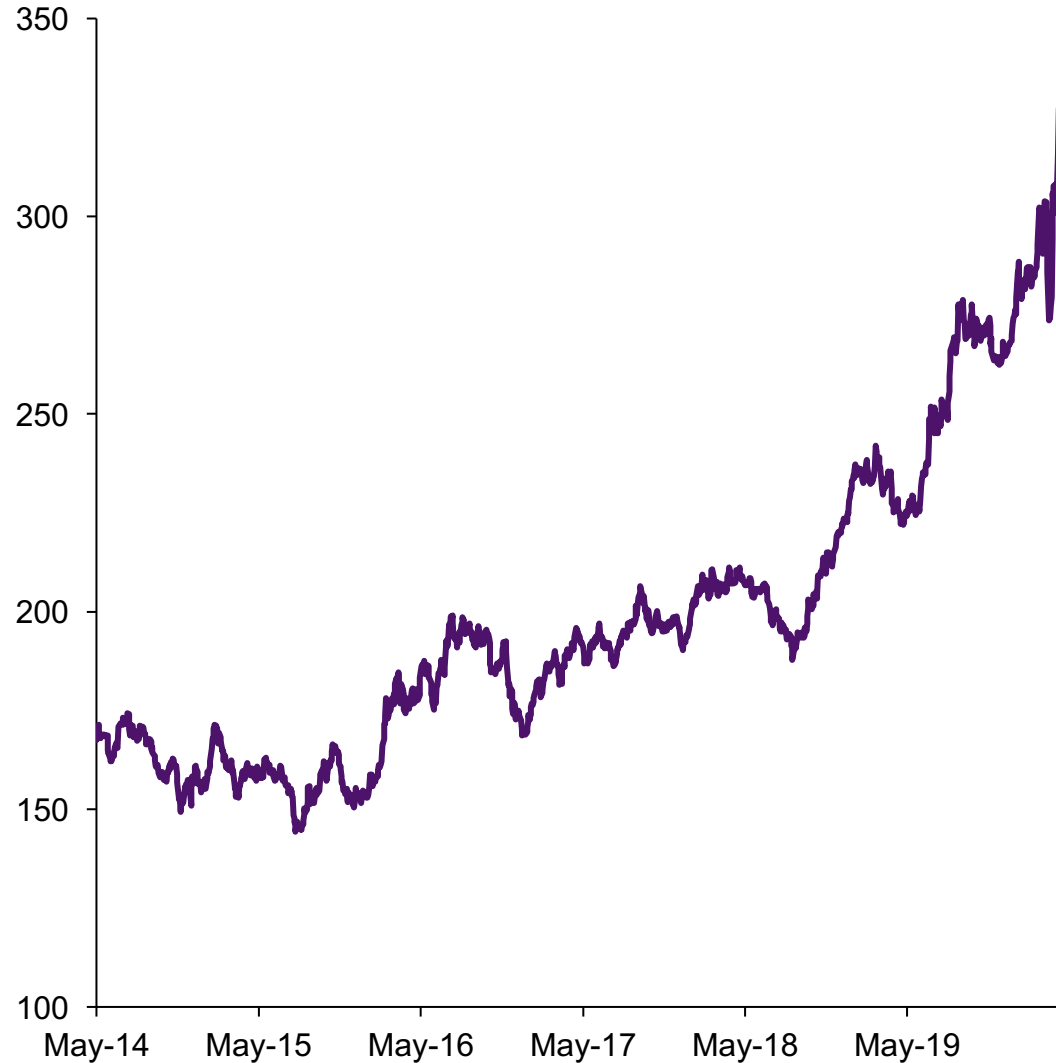
Source: Central Bank of Sri Lanka

Performance of collateral

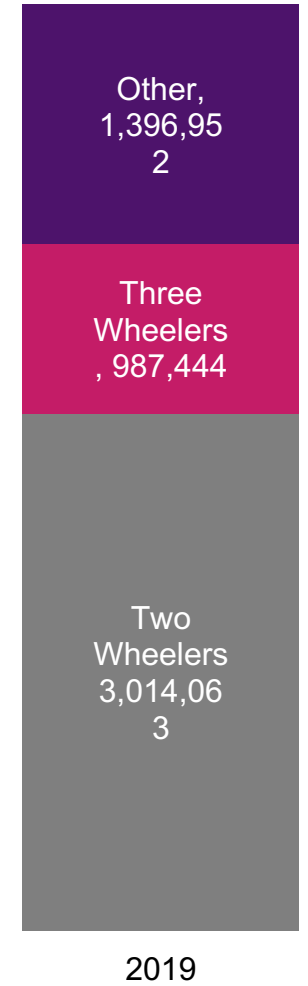
Land Price Index (Dec 2014 = 100)



Gold Price (LKR 000`)



No of registered vehicles



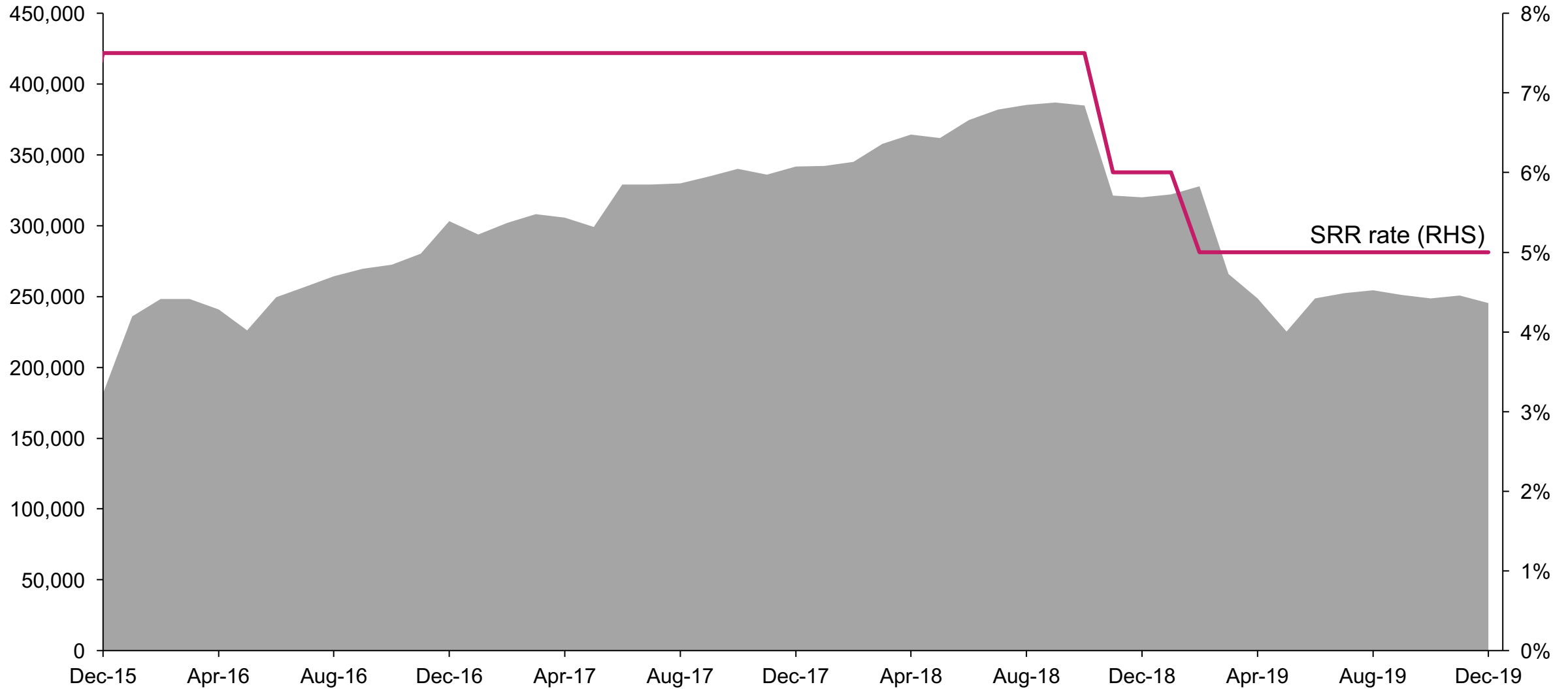
2019

Source: CBSL

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Bank Reserves held with the Central Bank – non interest bearing

LKR Mn (LHS); % (RHS)



Note: Bank reserves do not include till cash which could be up to 2% of deposits

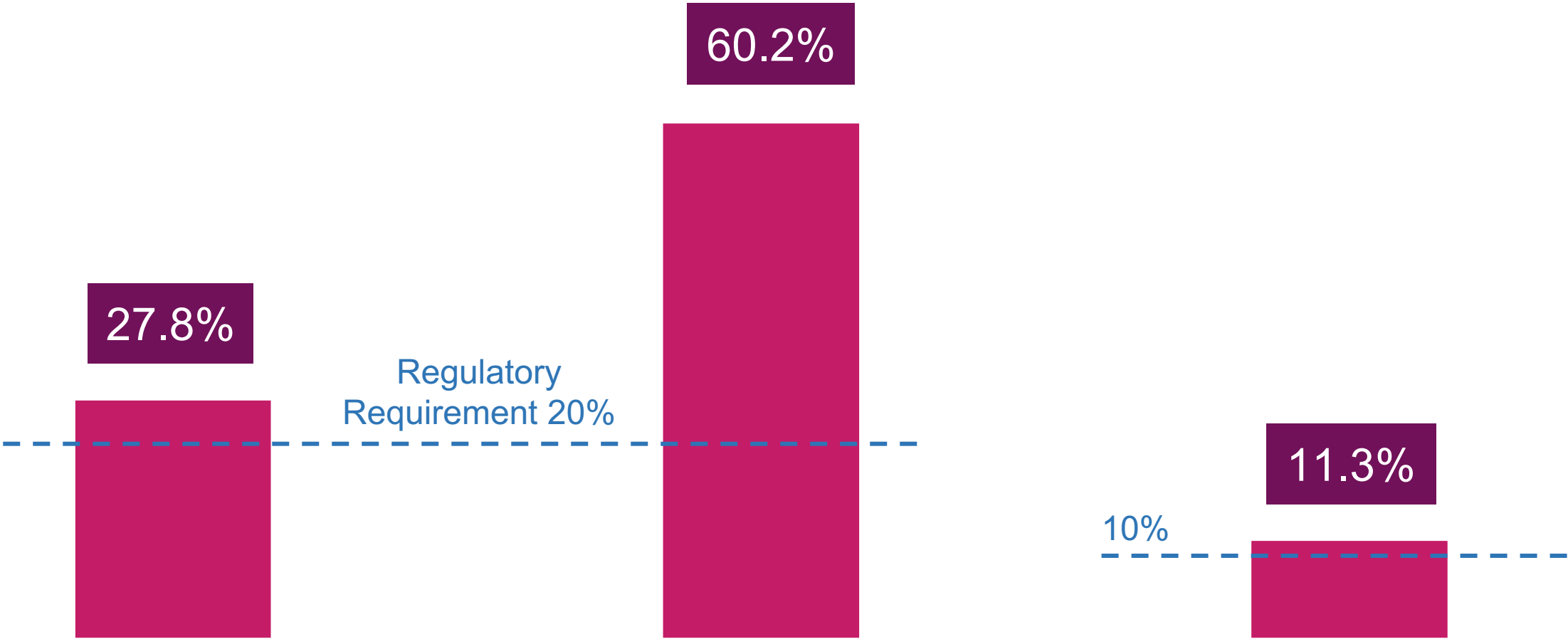
Source: CBSL

Statutory Liquid Asset Ratio

Licensed Commercial Banks

National Savings Bank (NSB)

Licensed Finance Companies

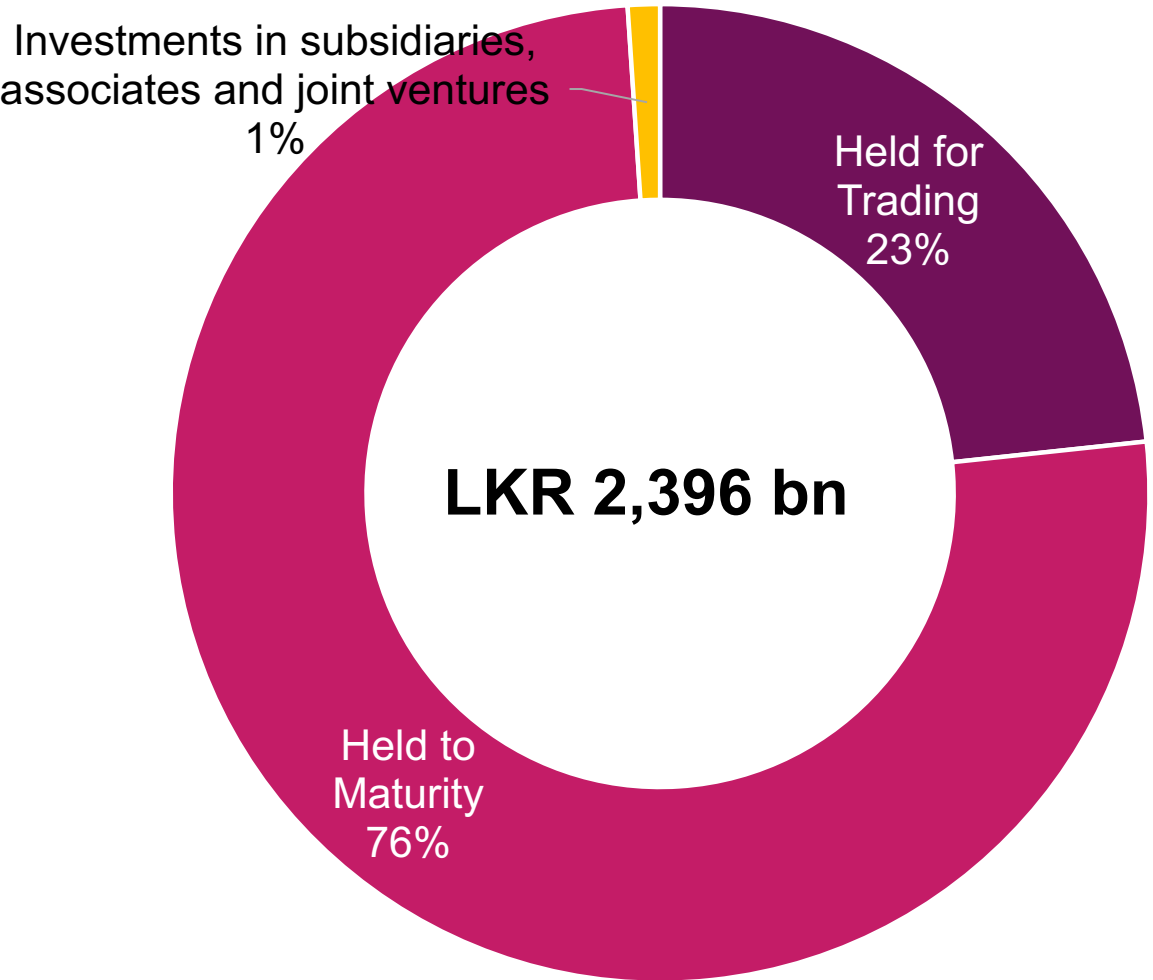


NSB's regulatory requirement to maintain 60% of its deposits in government securities forces up its SLAR

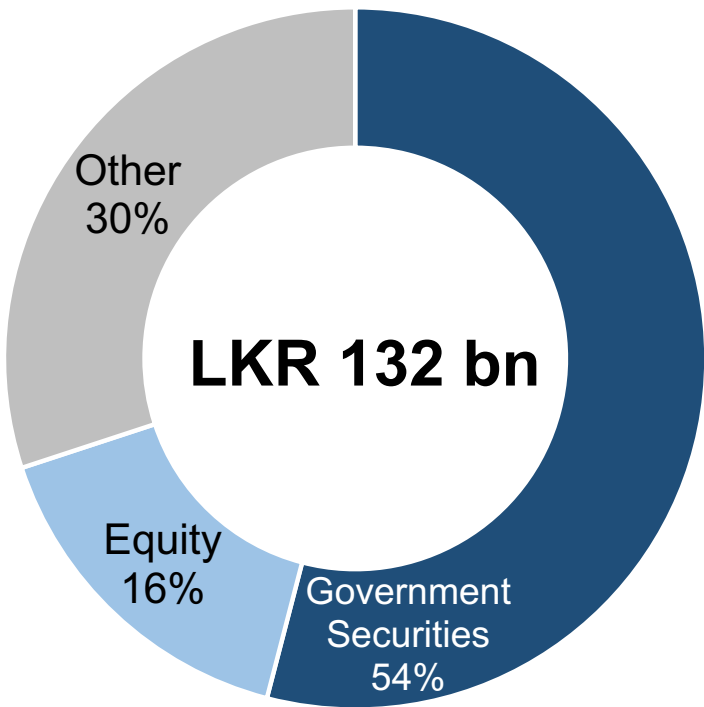
Source: Central Bank of Sri Lanka, NSB Interim Reports

Breakdown of Investment Portfolios

Licensed Commercial Banks



Licensed Finance Companies

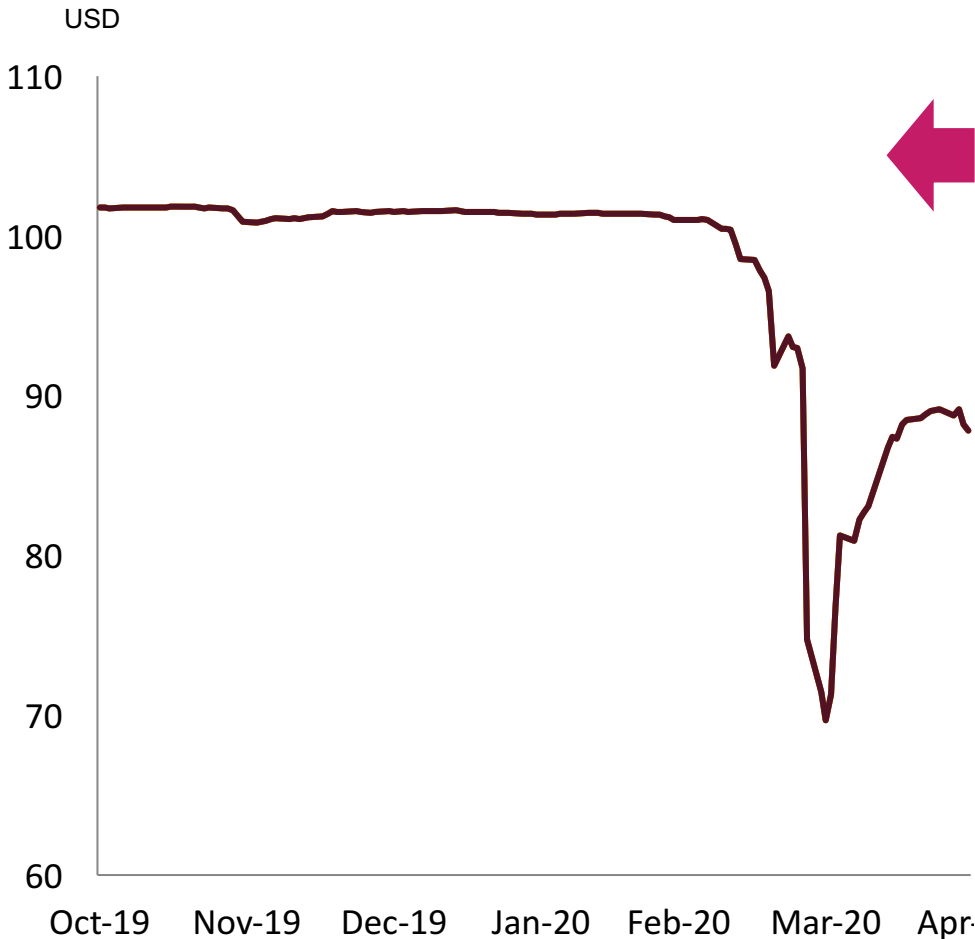


Finance companies must hold 20% of interest-bearing liabilities

As at 31 December 2019
Source: Central Bank of Sri Lanka
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International Sovereign Bonds

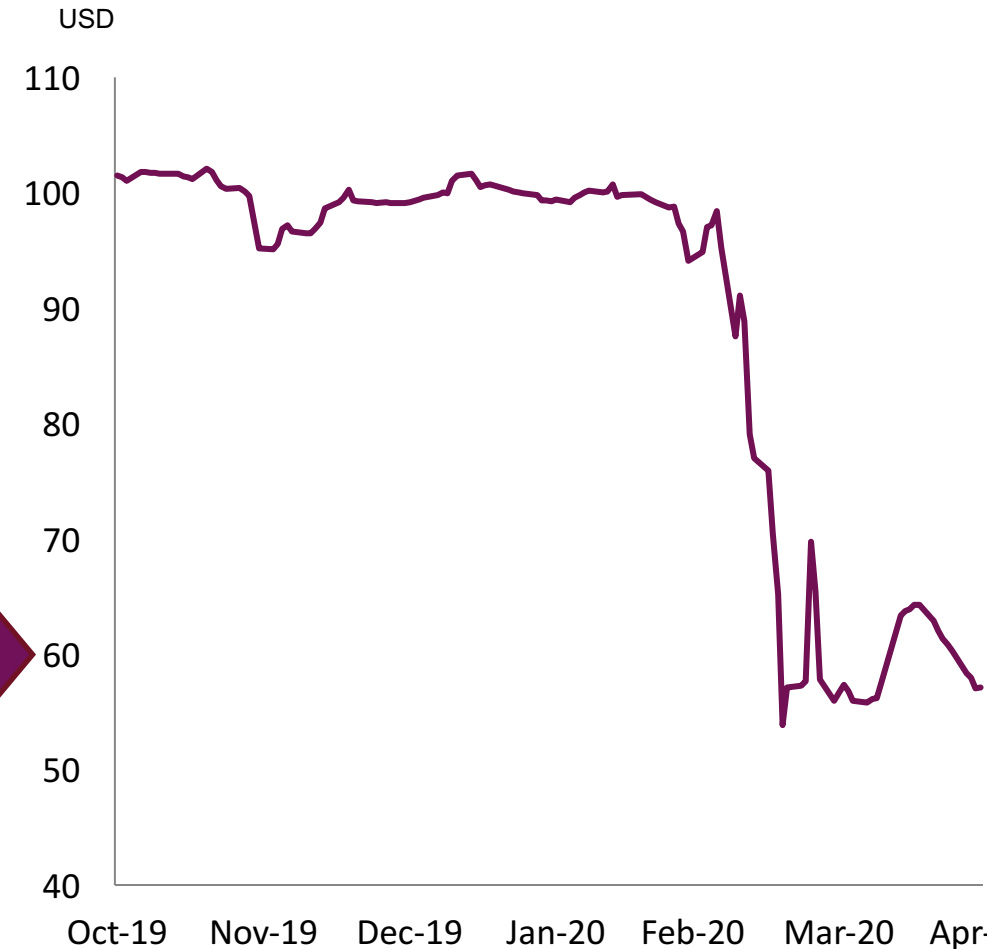
ISB 2020



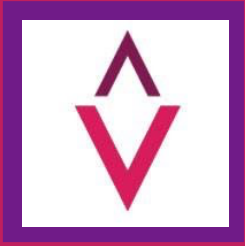
Actual traded ISB 2020		
Date	Price	Volume
04/28/2020	90.5022	7,507,000
04/21/2020	90.0289	1,300,000
04/14/2020	86.0256	1,465,000
04/07/2020	68.3333	6,000,000
03/31/2020	83.9251	2,950,000
03/17/2020	100.285	200,000
03/03/2020	101.0542	4,850,000
02/25/2020	101.4538	1,150,000
02/04/2020	101.3125	200,000
01/21/2020	101.476	500,000

Actual traded ISB 2030		
Date	Price	Volume
04/28/2020	63.2397	3,295,000
04/14/2020	58.2923	2,430,000
04/07/2020	56.8438	800,000
03/31/2020	62.1589	3,000,000
03/24/2020	60.2133	1,500,000
03/17/2020	82.8884	5,000,000
03/10/2020	97.6028	1,415,000
03/03/2020	97.4845	3,576,000
02/25/2020	99.5845	3,735,000
02/18/2020	100.8414	7,800,000

ISB 2030

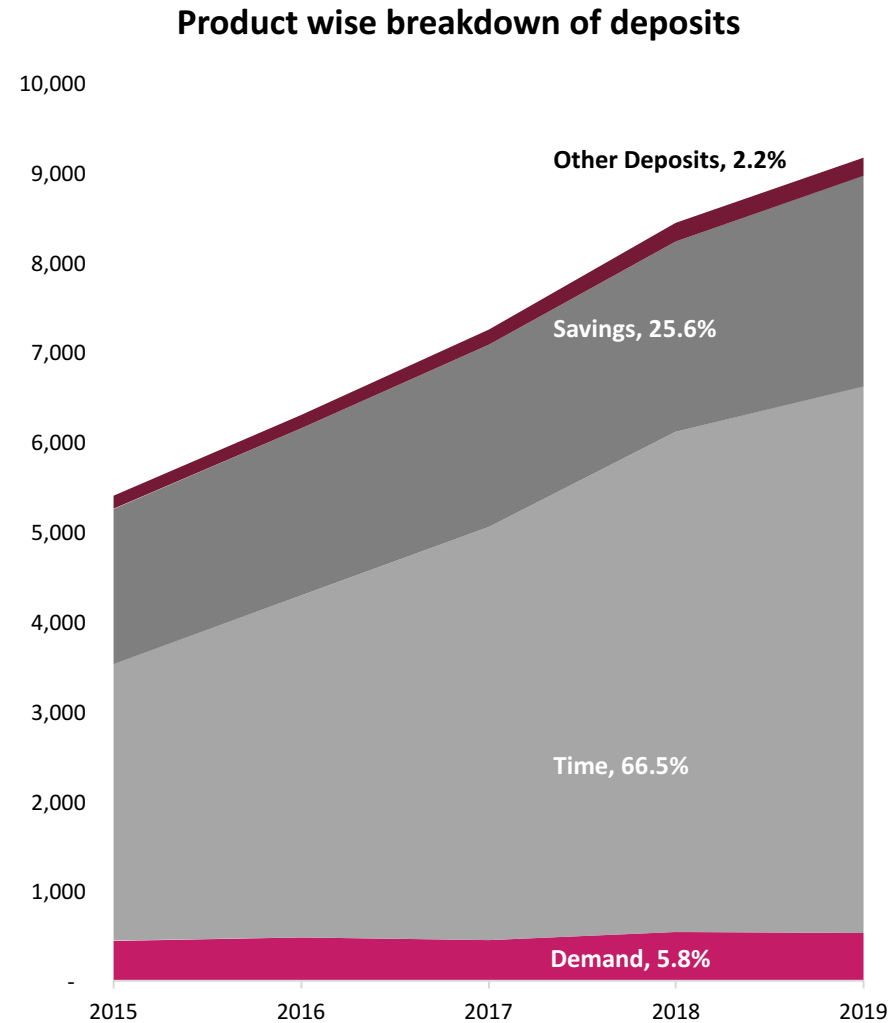
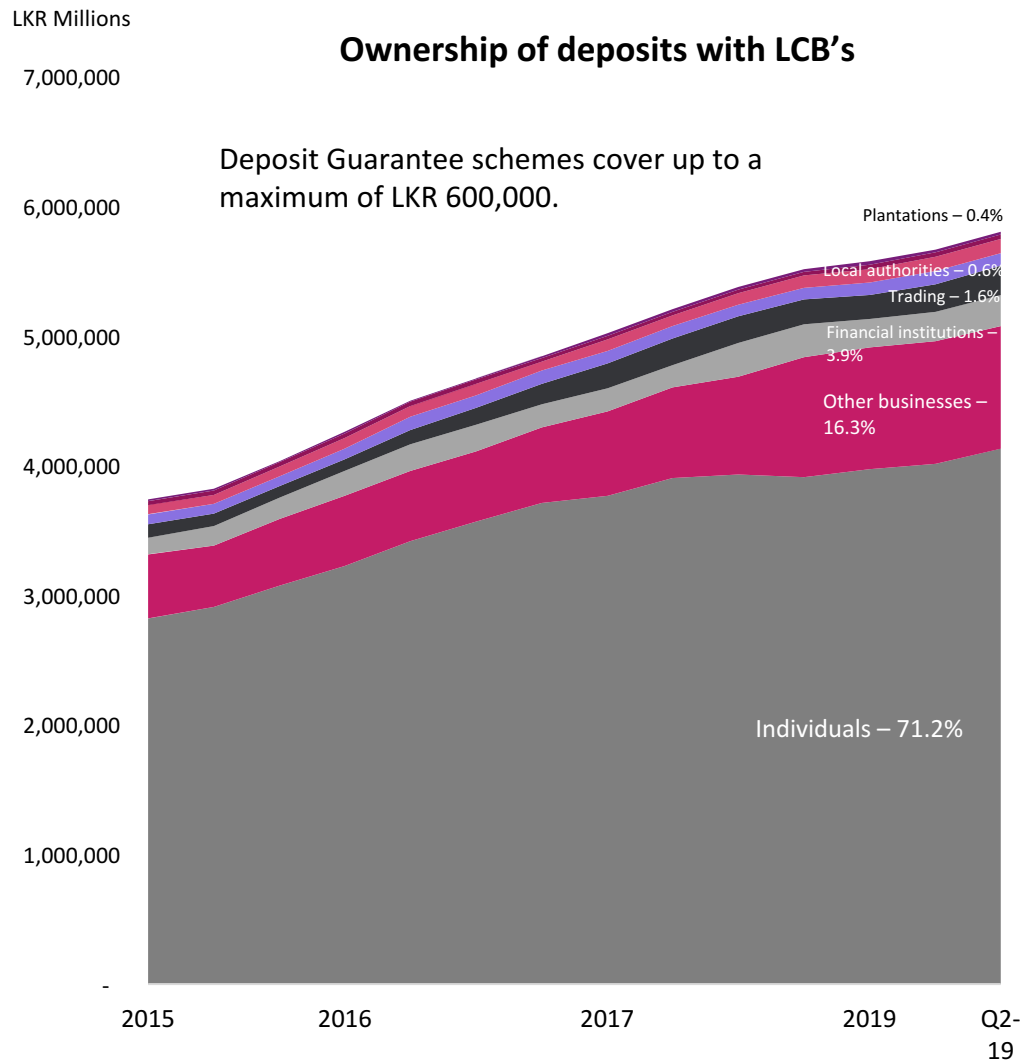


Source: Bloomberg

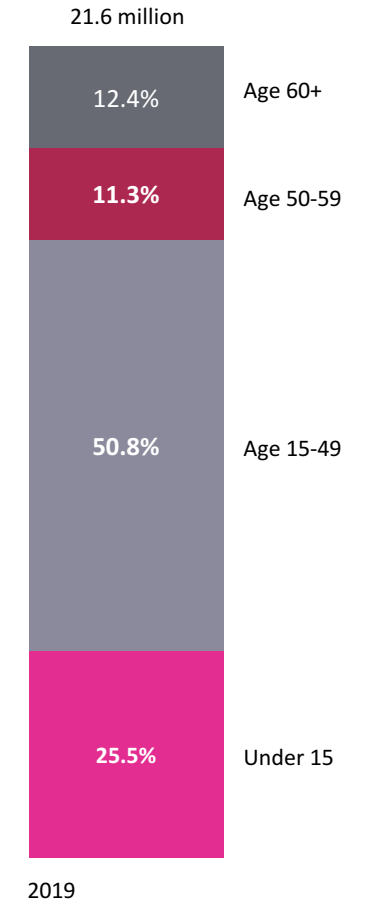


Liability Side

Ownership of deposits with commercial banks



Age wise breakdown of population



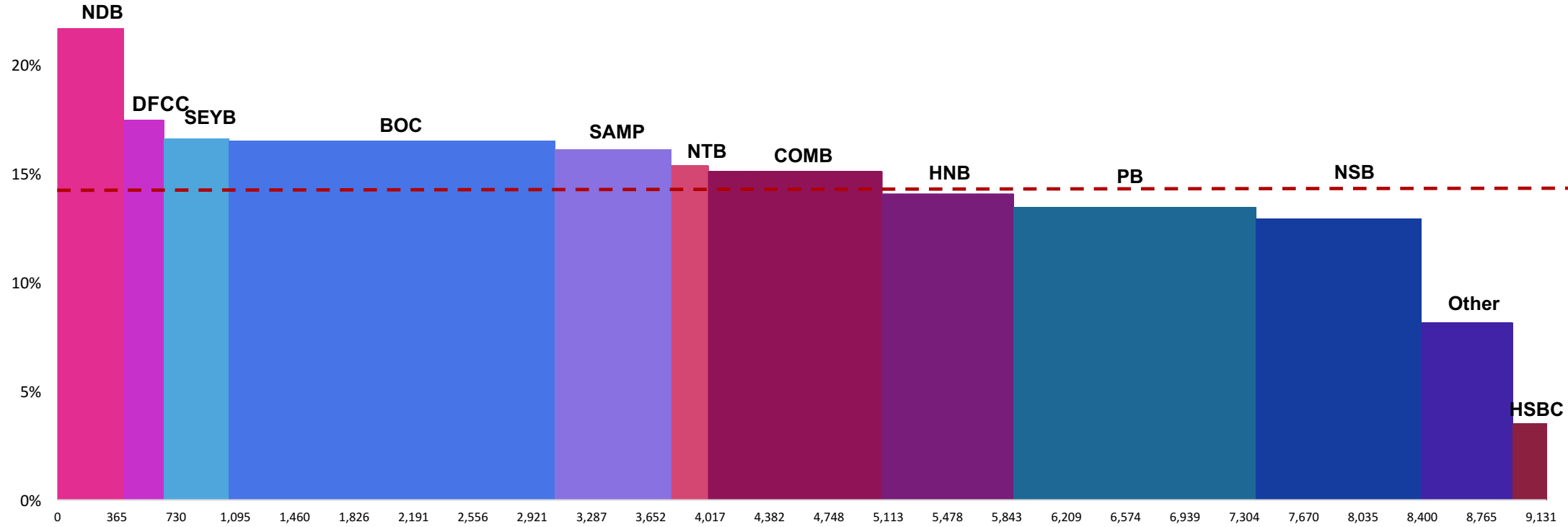
*Excludes Government & Public Corporations deposits

Banking industry deposits

	Market Share
State Banks	49.3%
Others	50.7%

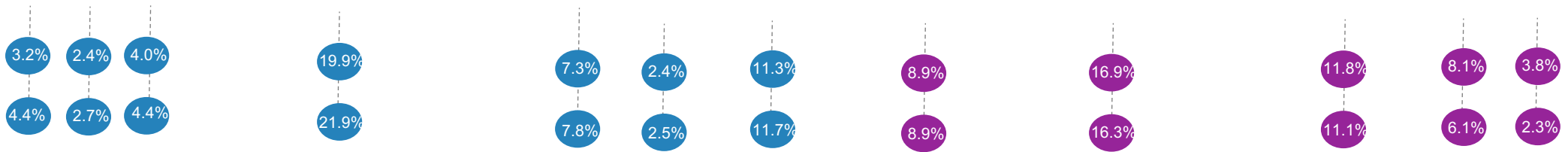
CAGR 2014-19

25%



Growth in deposits (2014-19)
LKR 4,476bn

Industry CAGR 2014-19= 14.3%



Total Deposits 2019 (LKR Bn)

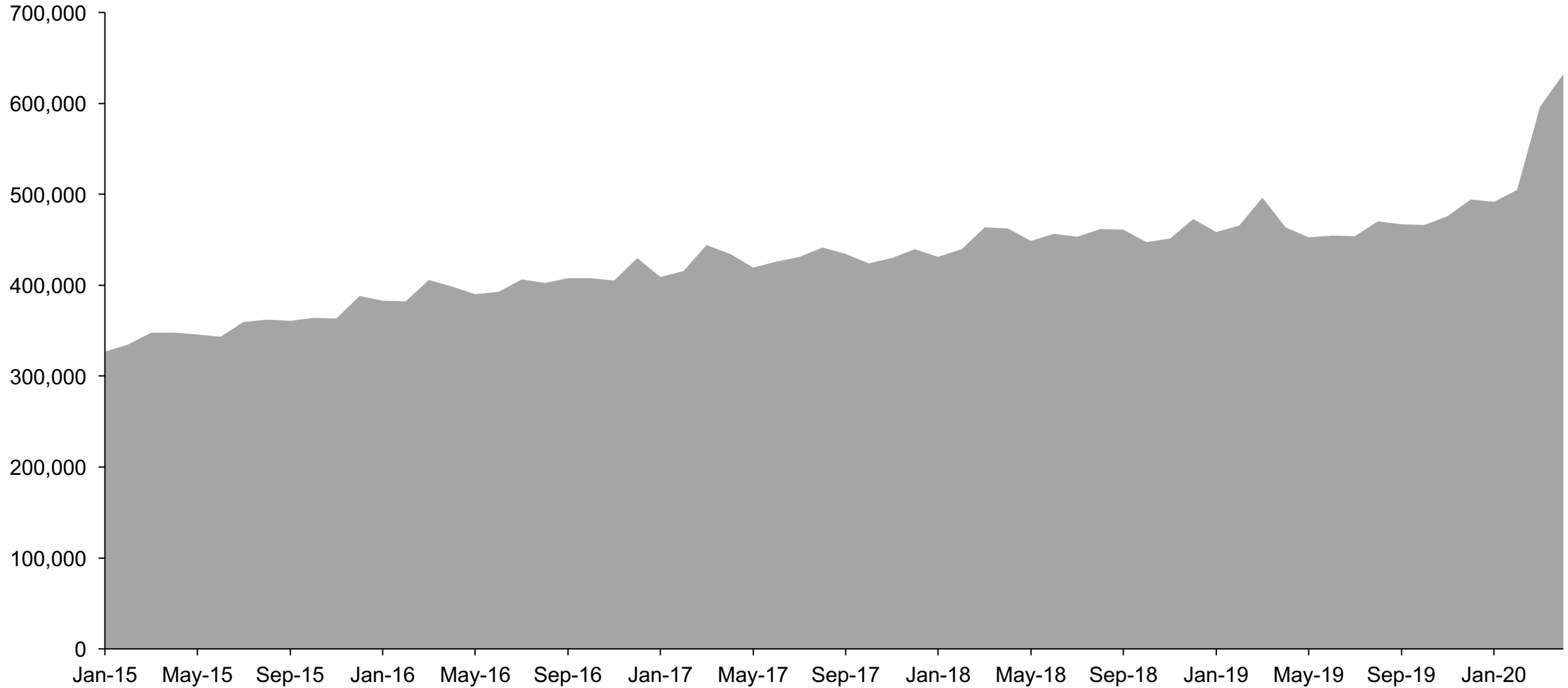
Market Share (Dec 2014)

Market Share (2019)

Sources- Bank Annual/Quarterly Reports

Public hold more cash amid COVID-19 Lockdown

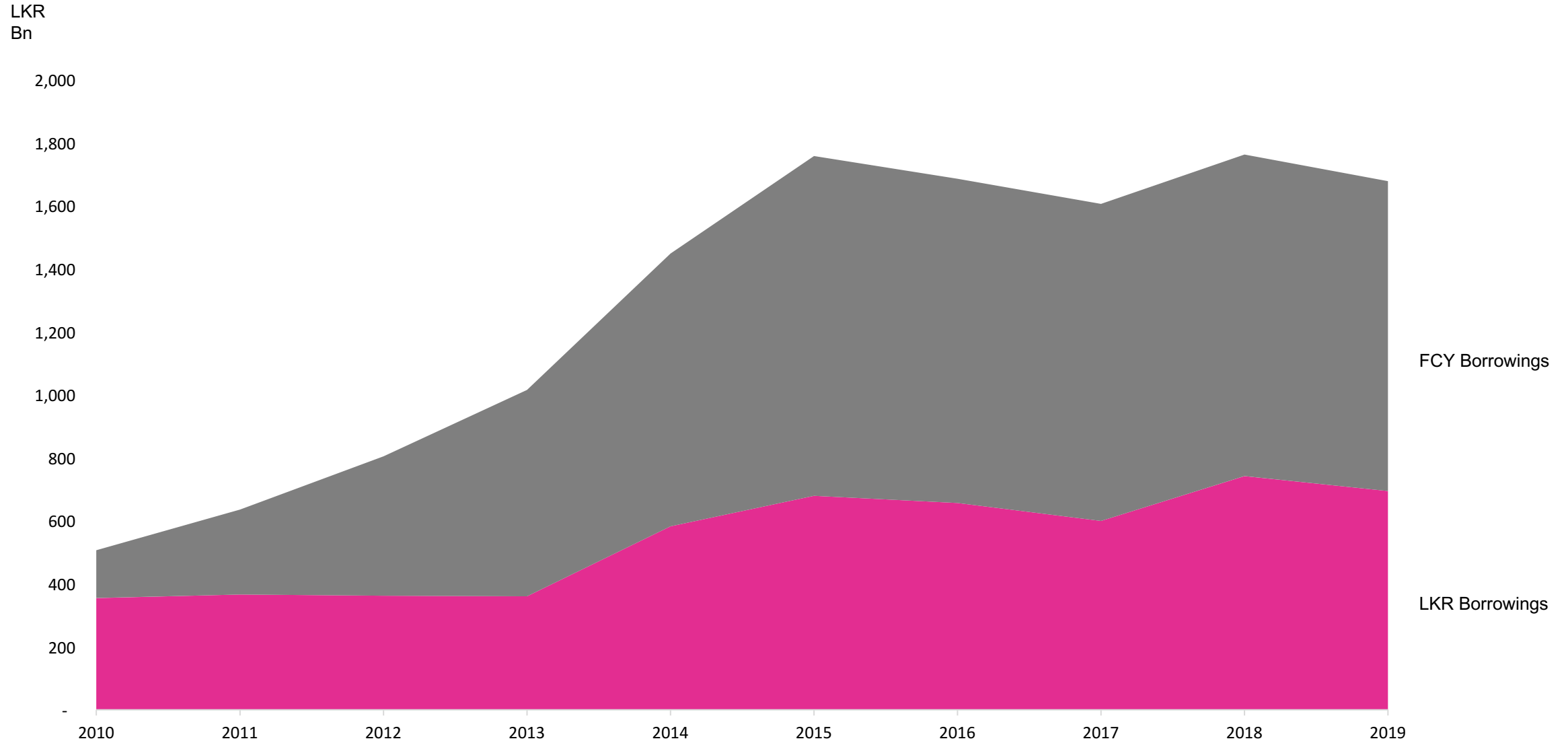
Currency held by the public, LKR Mn



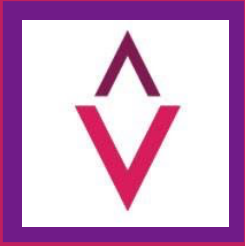
Note: Data as of 28th April 2020, Figures for February 2020 onwards are estimates.

Source: CBSL

Borrowings by Banks



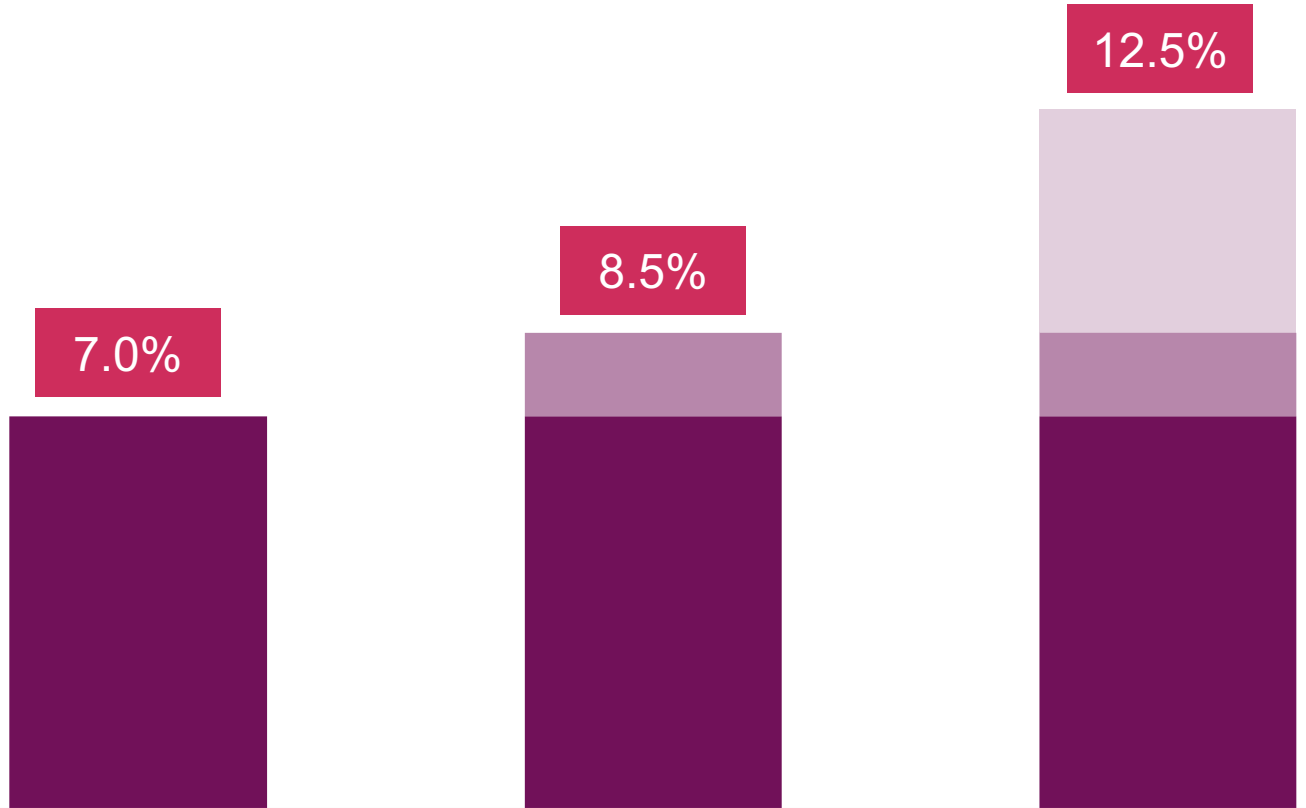
Source: Central Bank of Sri Lanka



Capital

Capital Adequacy – Licensed Commercial Banks

Capital adequacy ratios measures a bank's **capital** in relation to its **risk-weighted assets** (RWA).



Common Equity Tier 1

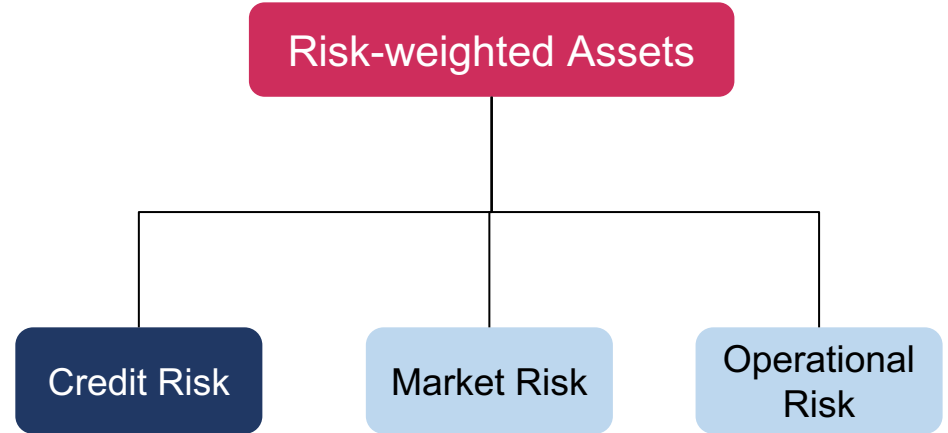
Tier 1

Tier 1 + Tier 2

CET1 includes just common share capital. It excludes preferred shares and non-controlling interest

Tier 1 capital forms the core capital of the bank and includes equity capital and disclosed reserves.

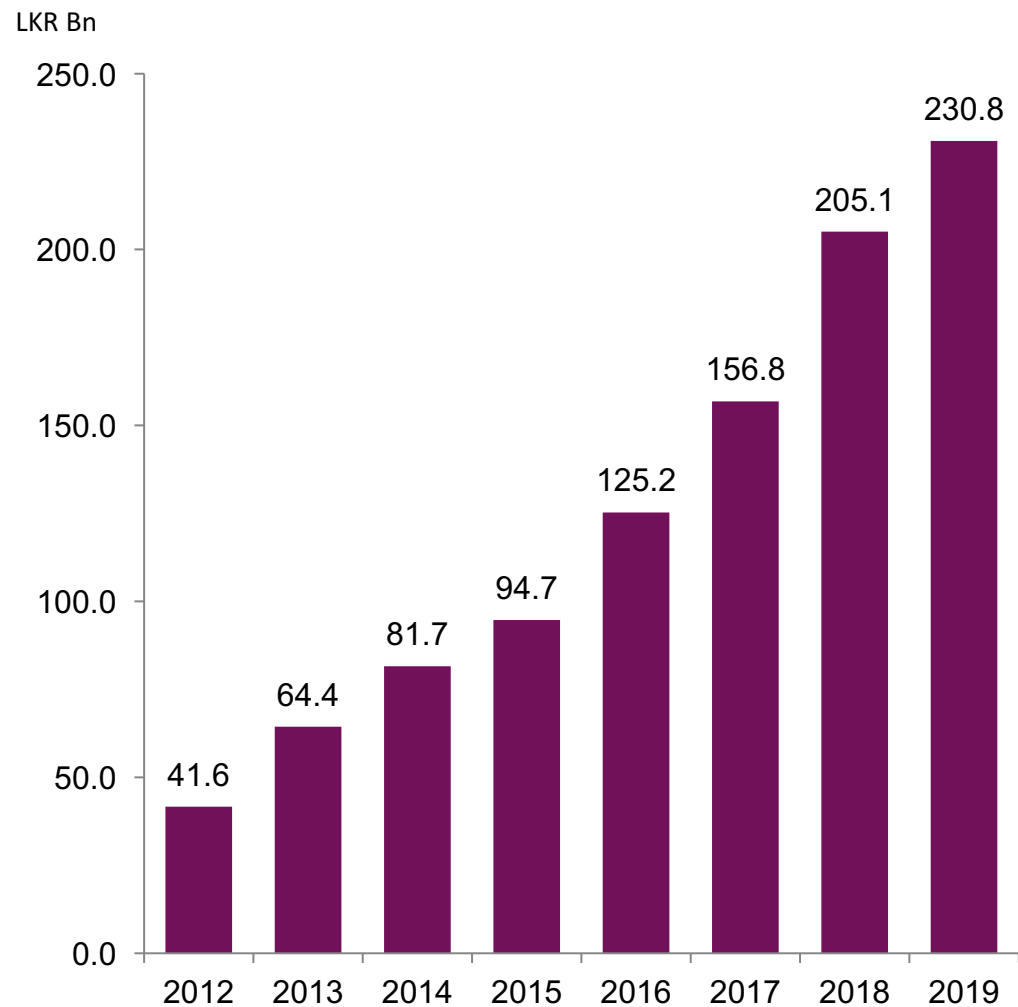
Tier 2 capital includes hybrid capital instruments, loan-loss and revaluation reserves and undisclosed reserves



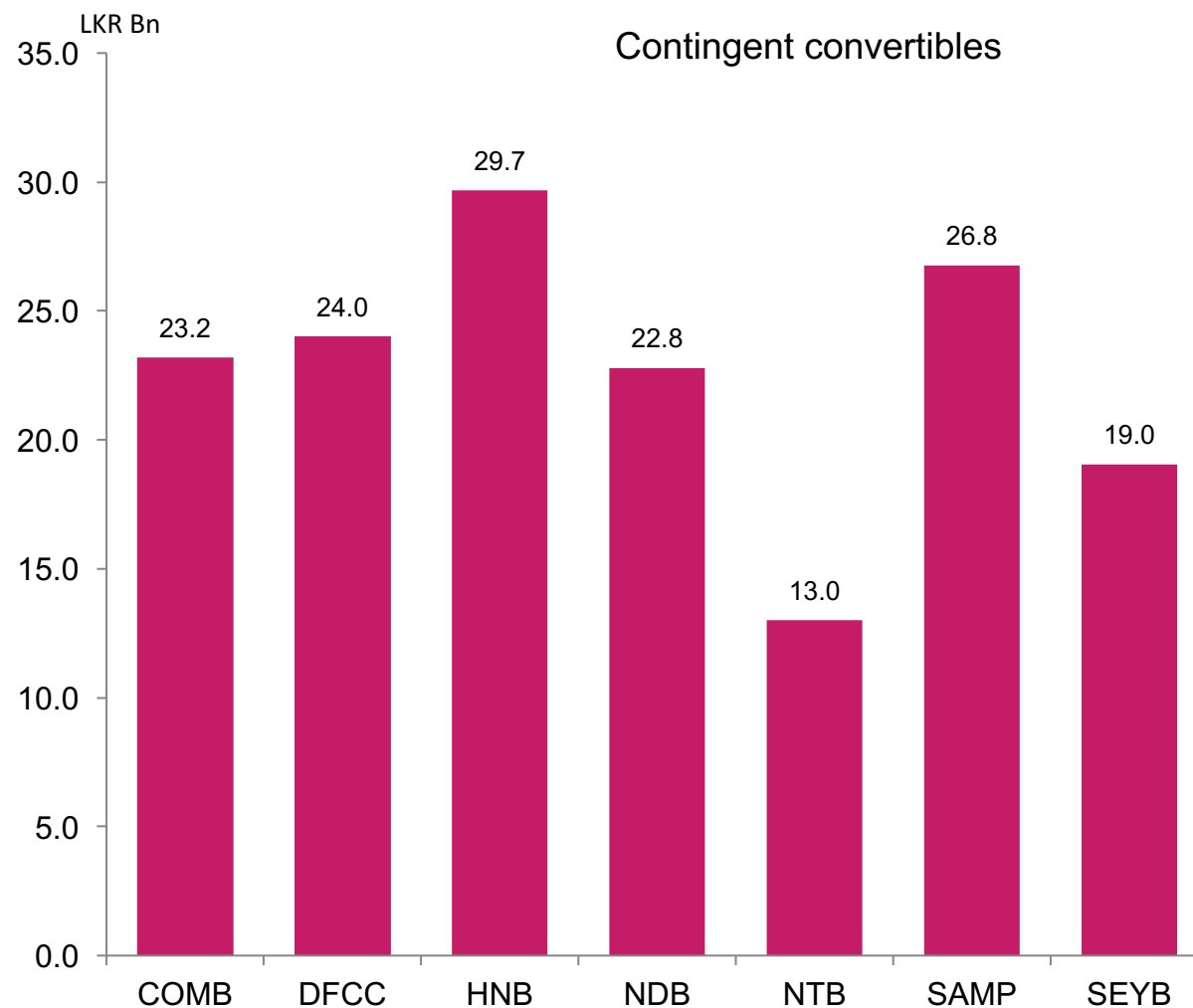
Asset	Weighting
Cash & Government Securities	0%
Balance with Banks	20%
Corporate Loans	50%
Other loans	100%
Equity	125%

Tier 2 Capital - mainly COCOs on a trigger event can covert to equity

Tier 2 capital

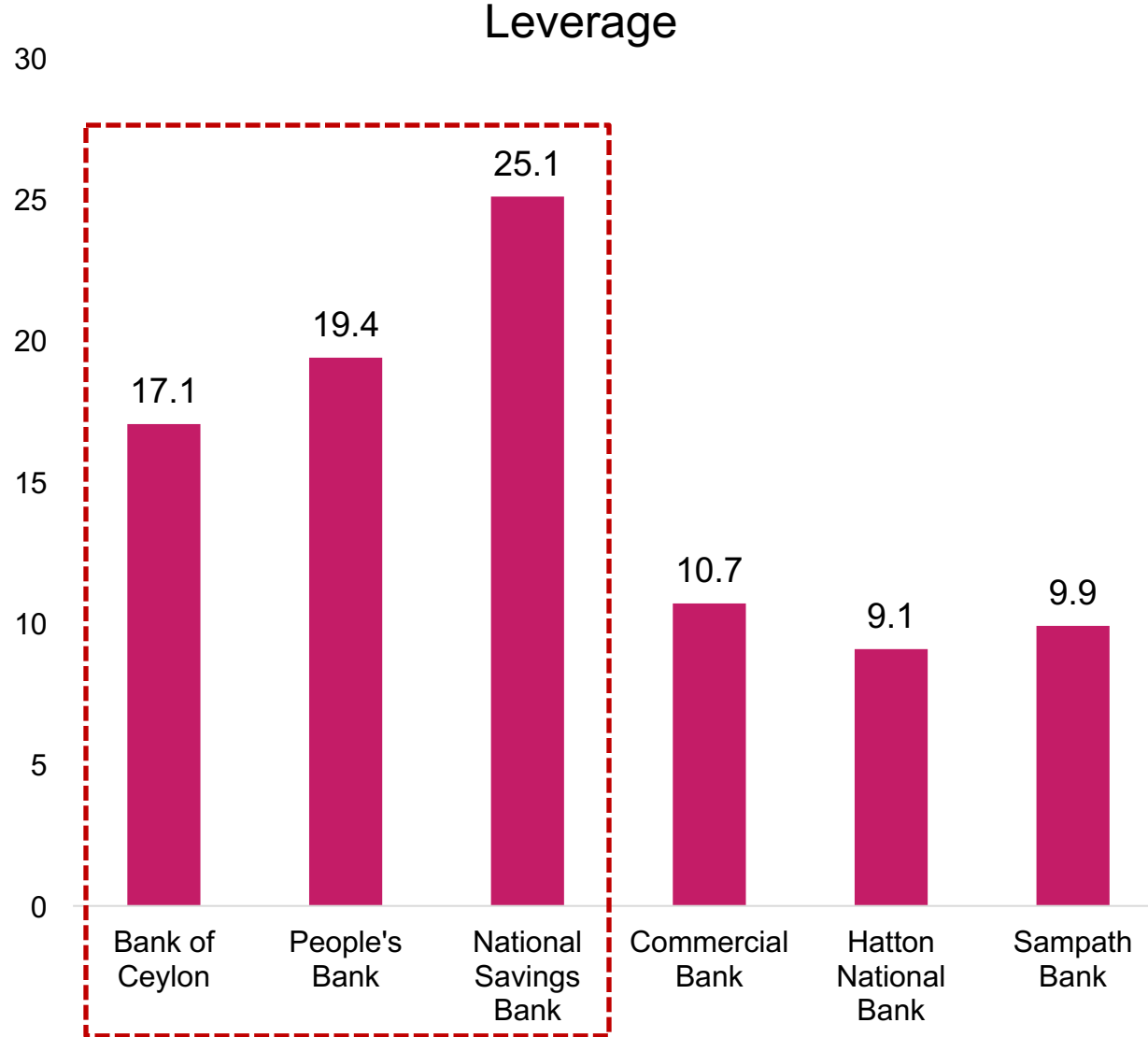
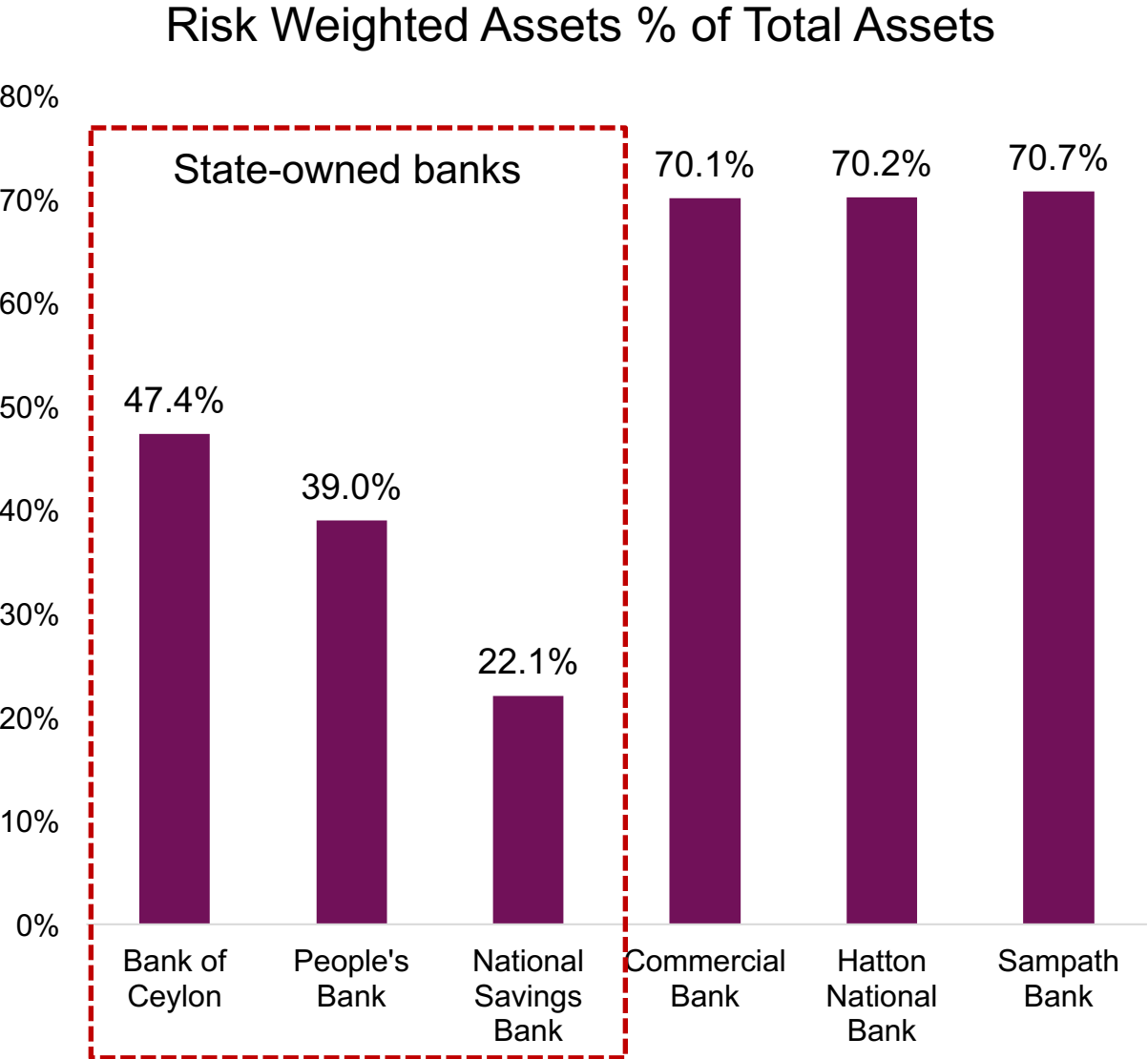


Debenture outstanding March 2020



Source: Central Bank, CSE daily report

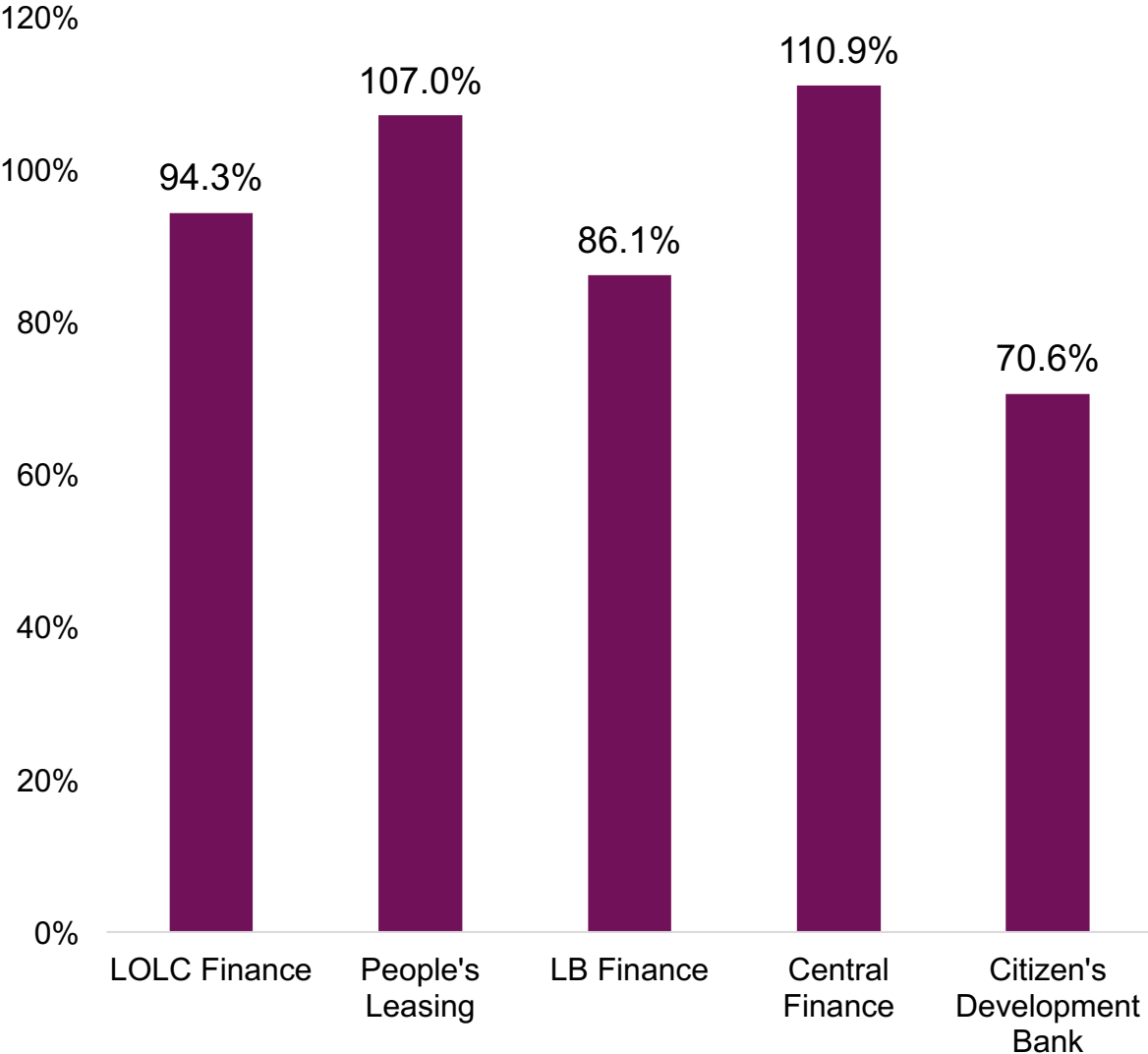
Leverage – Licensed Commercial Banks



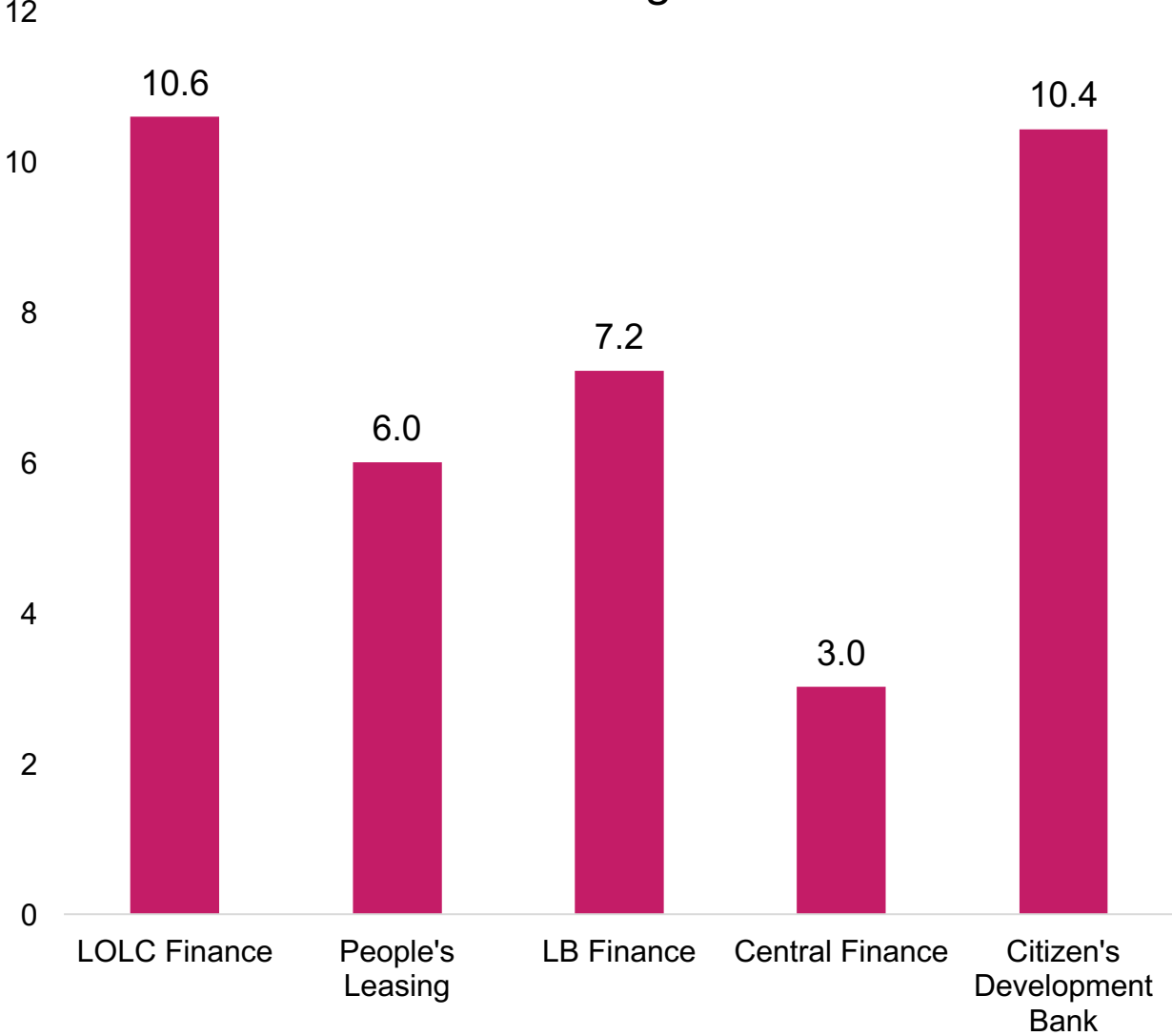
Source: Various Annual Reports
www.advocata.org

Leverage – Licensed Finance Companies

Risk Weighted Assets % of Total Assets

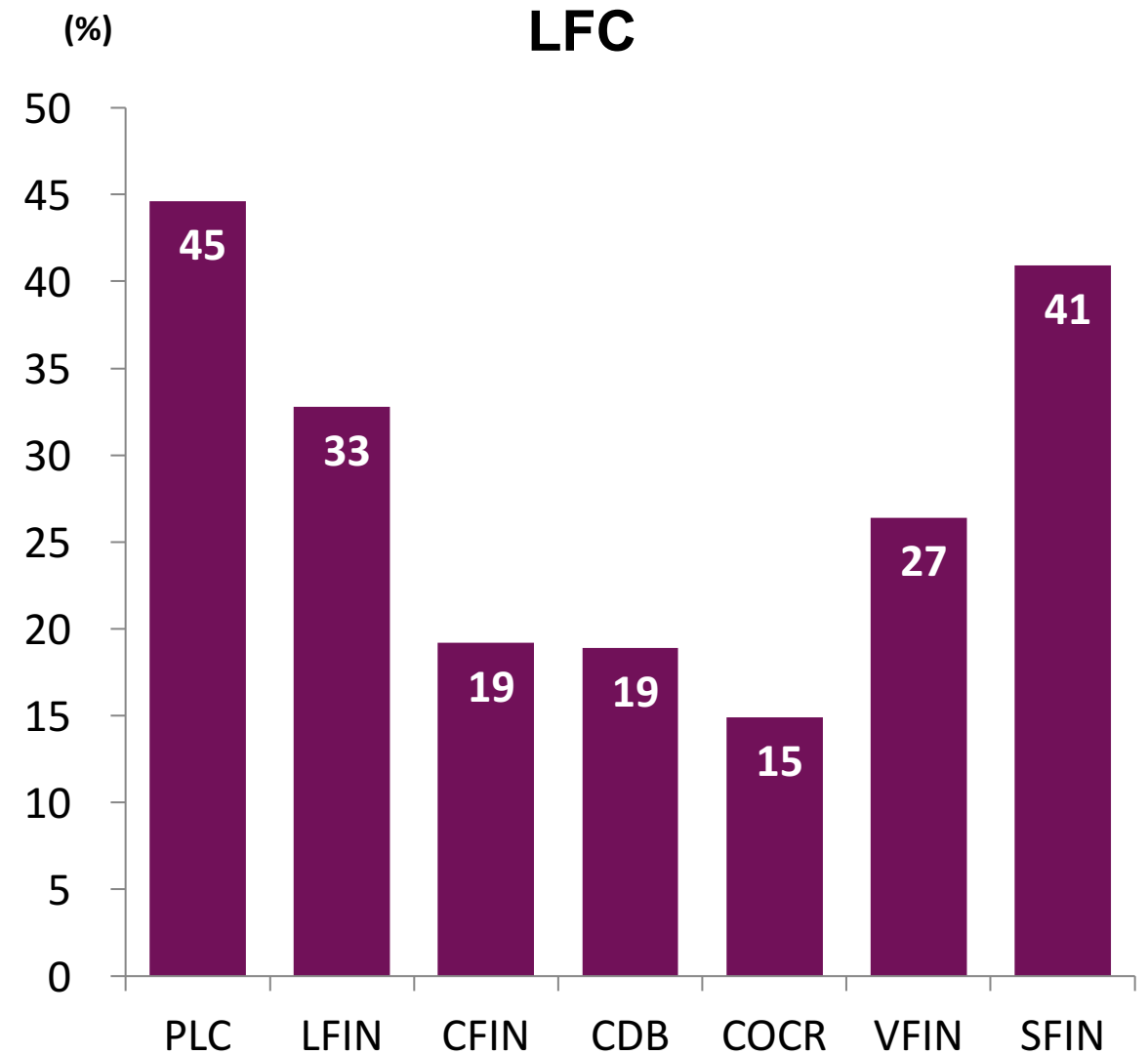
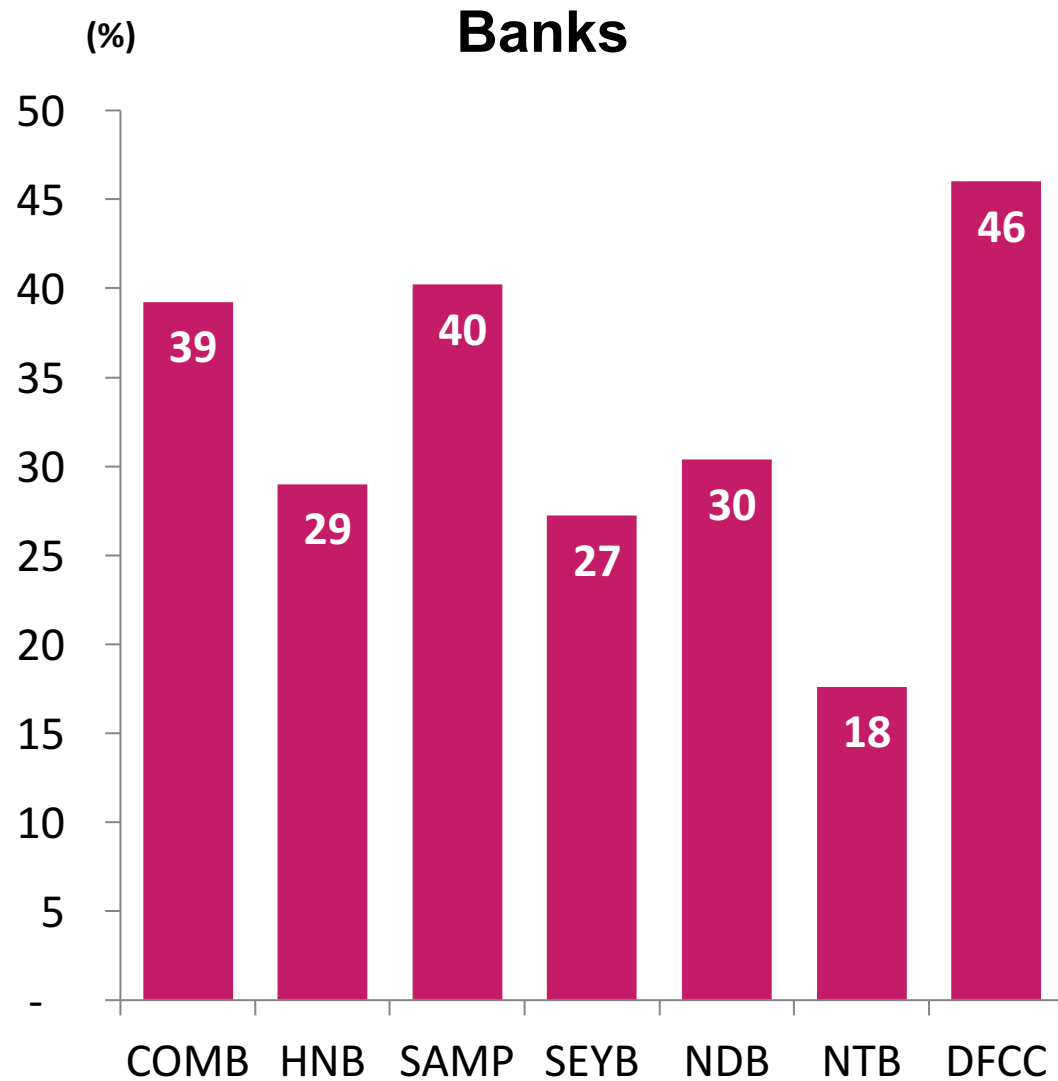


Leverage



Source: Various Annual Reports

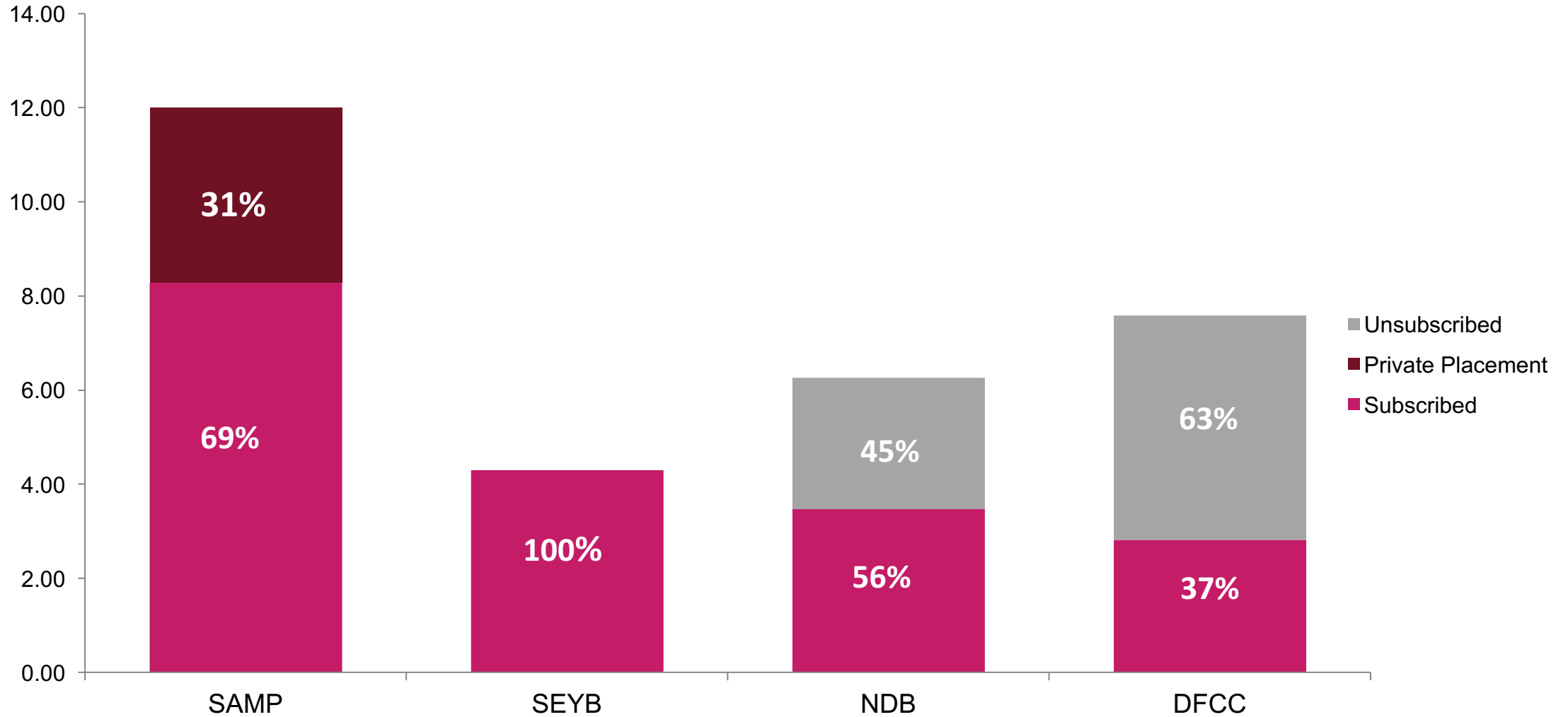
Dividend Payout Ratio - 2019



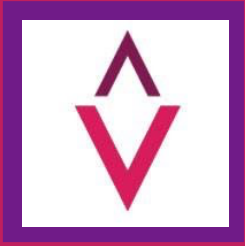
Source: Company Annual Report

www.advocata.org

Capital raised – Rights Issue

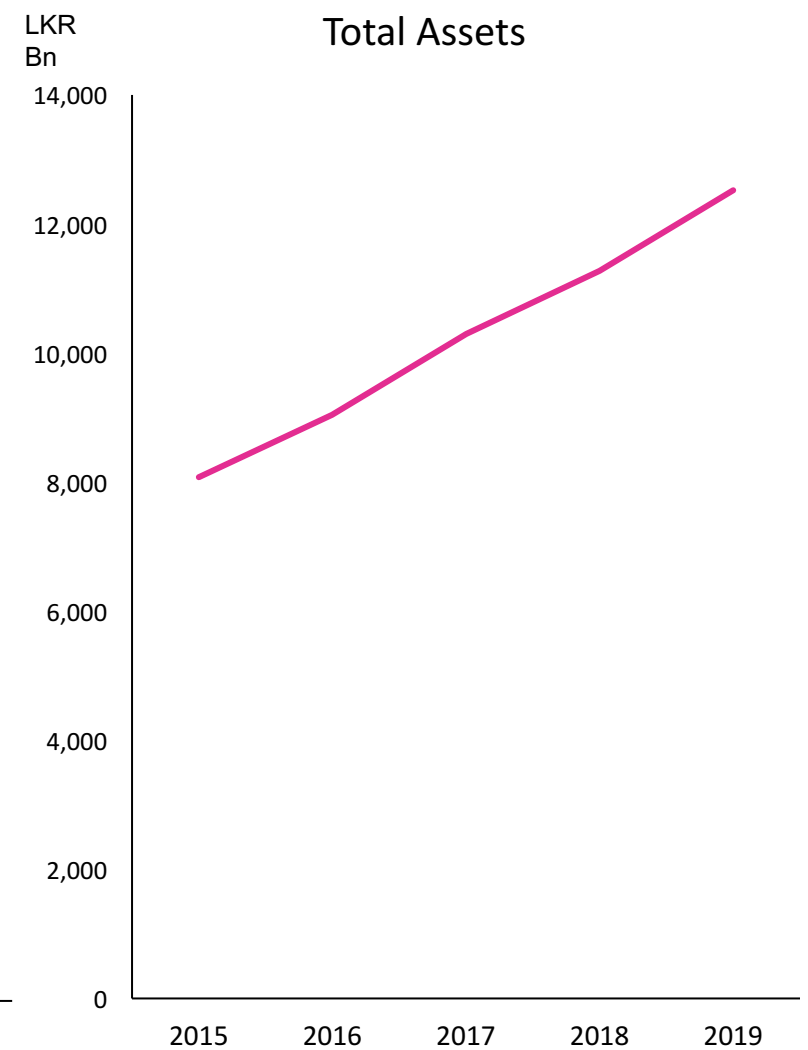
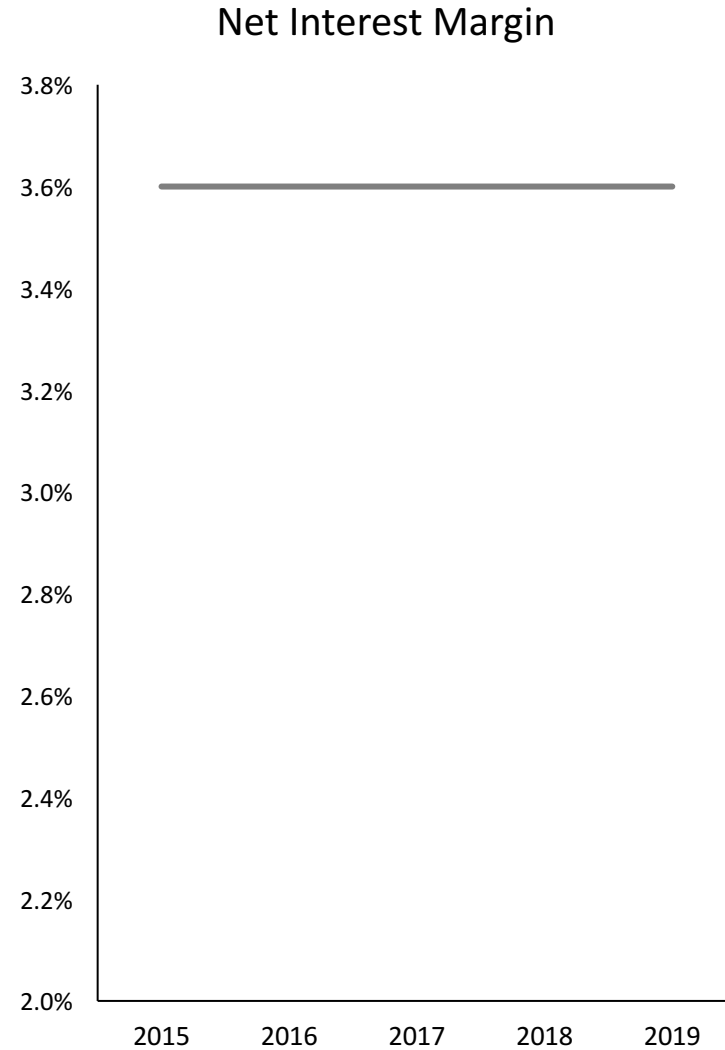
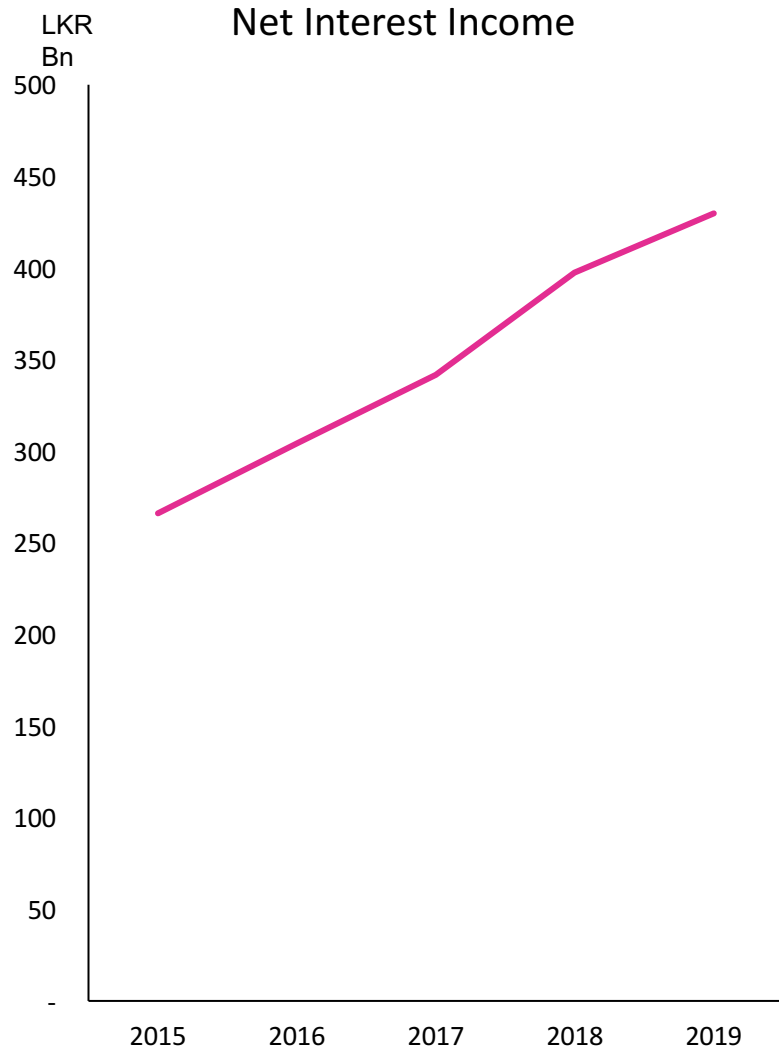


Source: Company Announcements



Revenue

Banking sector revenues

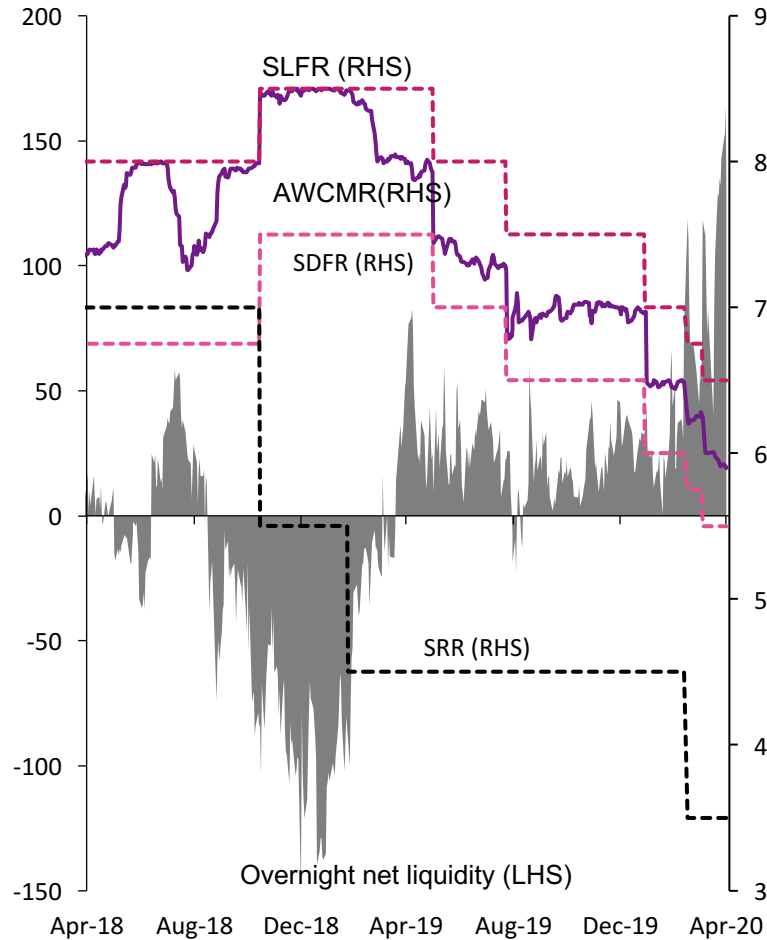


Source: Central Bank of Sri Lanka

CBSL policy actions

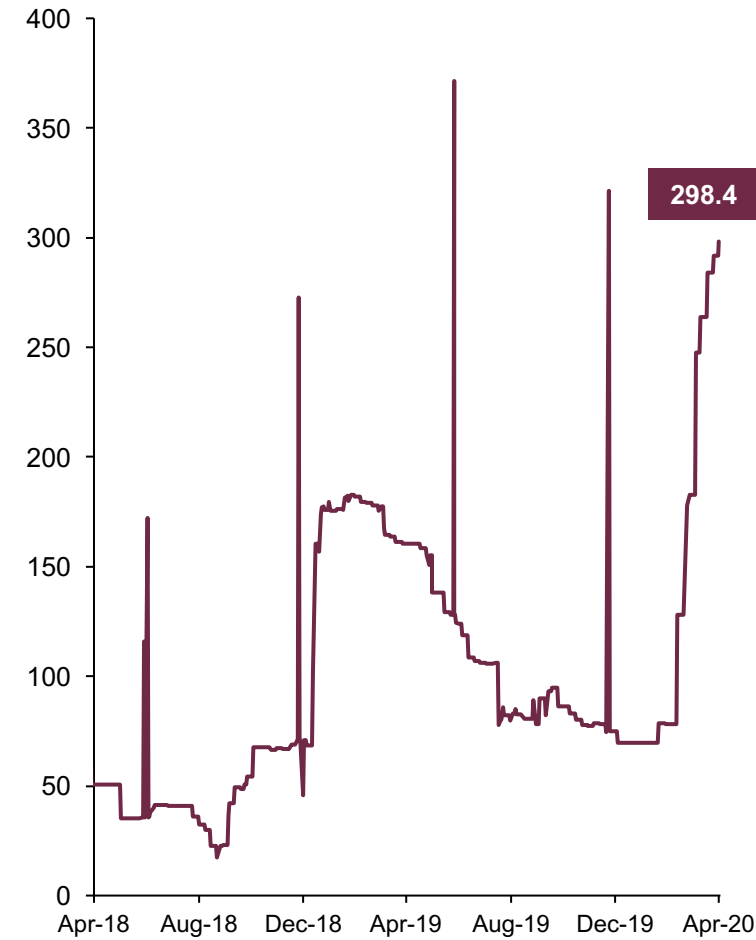
Policy rates and overnight liquidity

LKR bn (LHS); % (RHS)



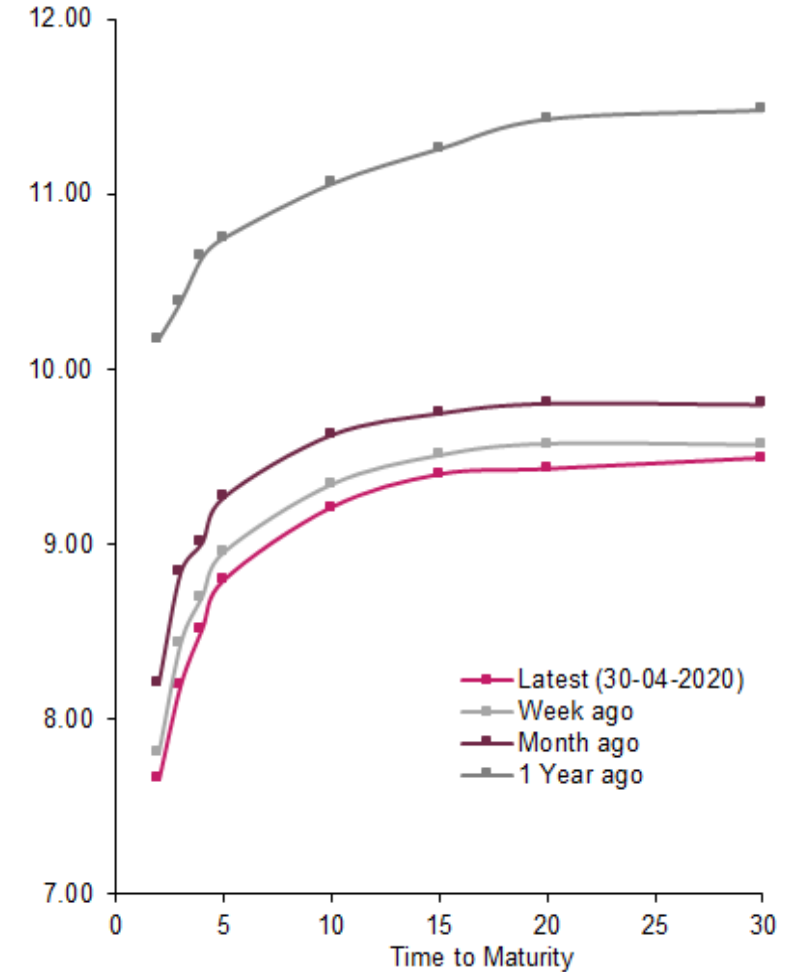
CBSL net holdings of G-Secs (face value),

LKR bn



G-Secs Yields (face value),

%

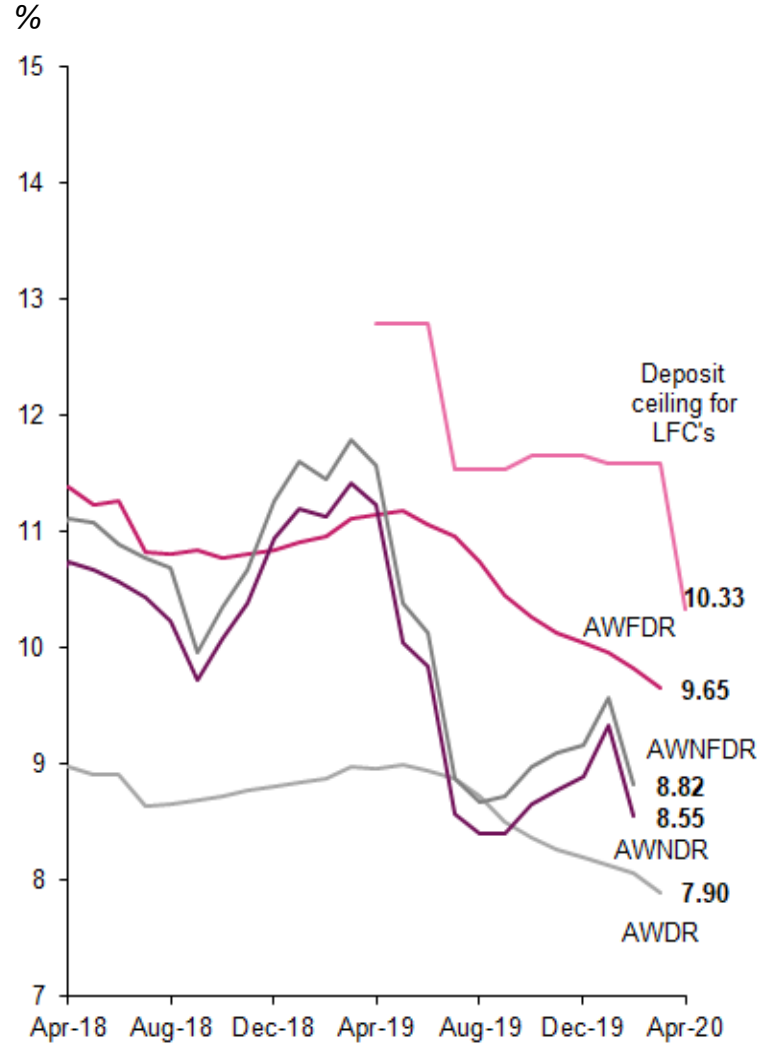


Note: Latest figures as at 28th April 2020

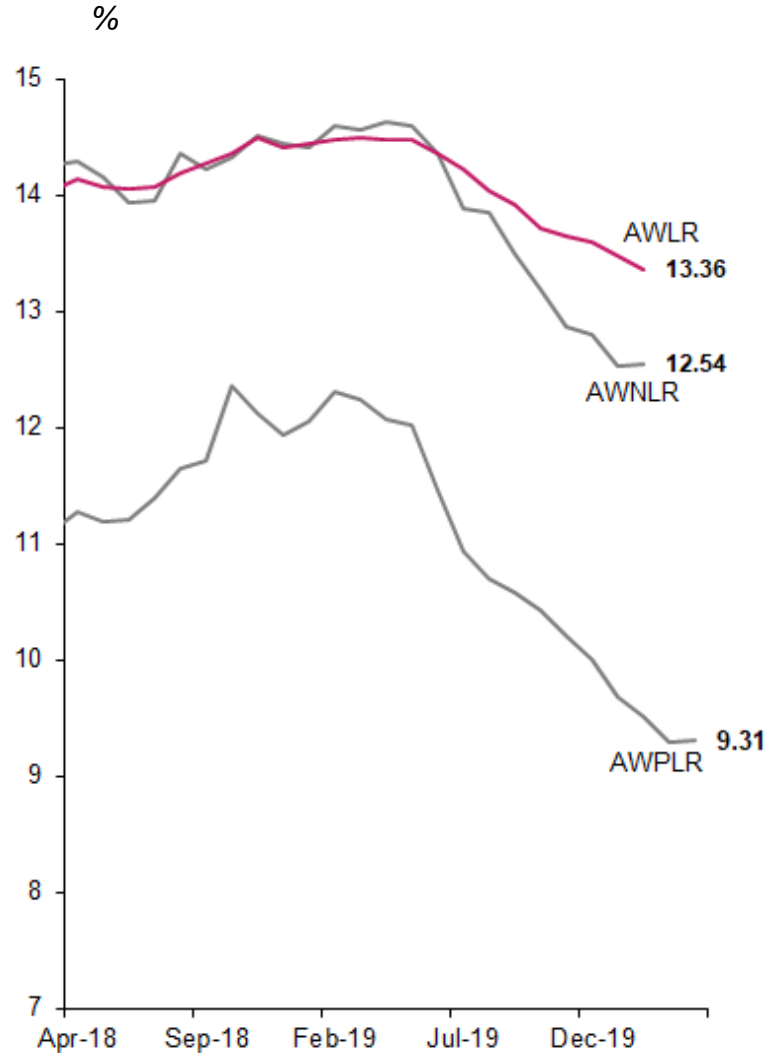
Source: Central Bank of Sri Lanka

Industry interest rates

Deposit rates



Lending rates



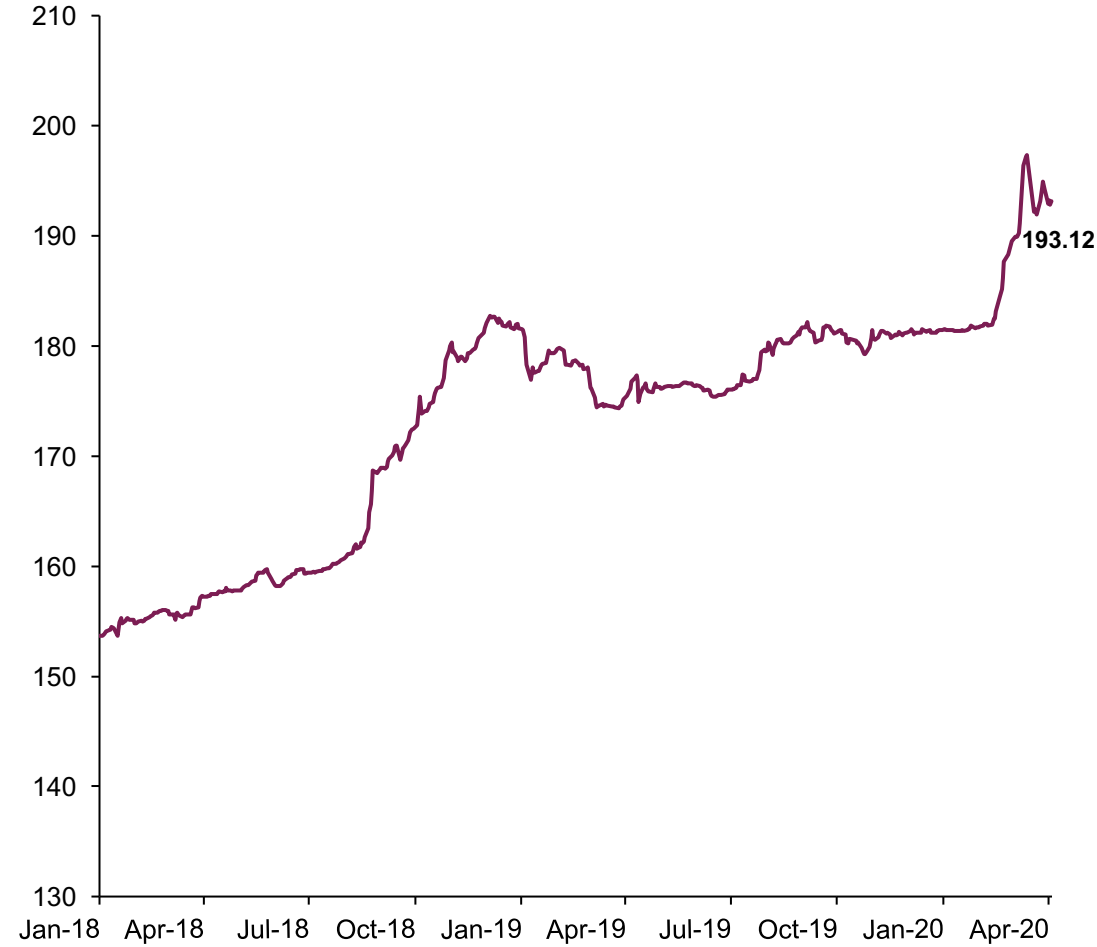
Spread



Source: Central Bank of Sri Lanka

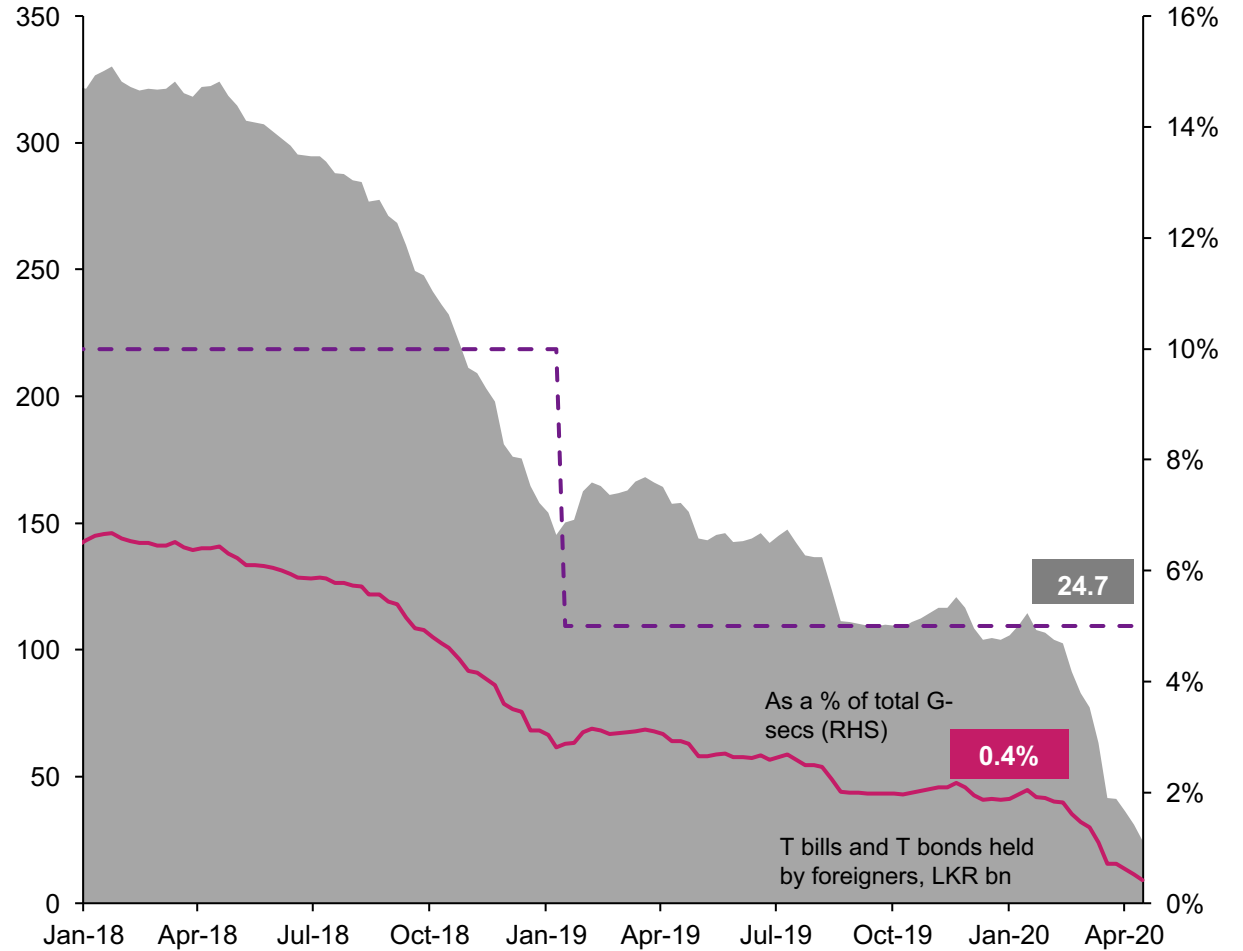
USD/LKR depreciated 6.4% YTD largely due to an outflow of LKR 89.7bn since end-Jan from government securities

USD/LKR average buying and selling rate



Note: Latest figures as at 30th April 2020
 Source: Central Bank of Sri Lanka

LKR bn (LHS); % of total (RHS)



Note: Latest figures as at 22nd April 2020

Non-interest Income

Facilitating
Payments

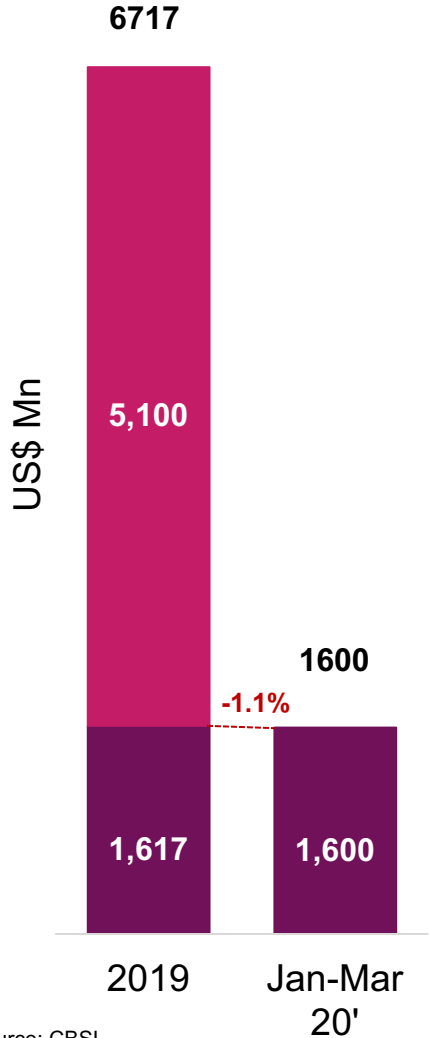
FOREX

Guarantees

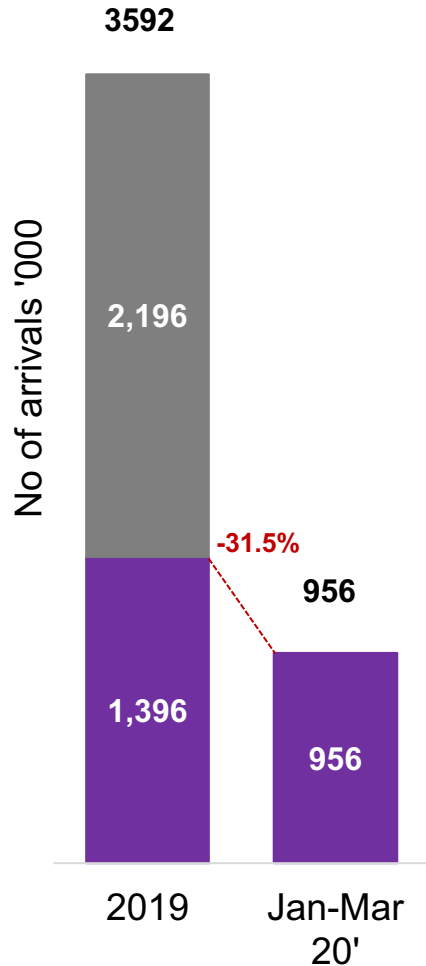
Distribution

Payment and FOREX Opportunities

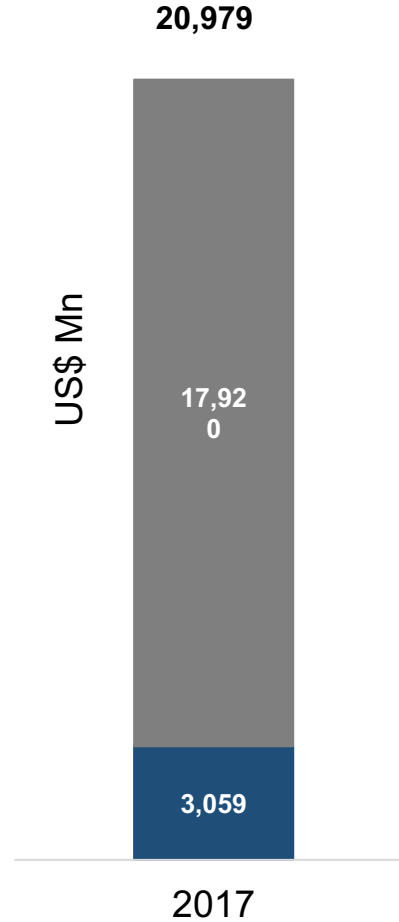
Marginal declines in remittances



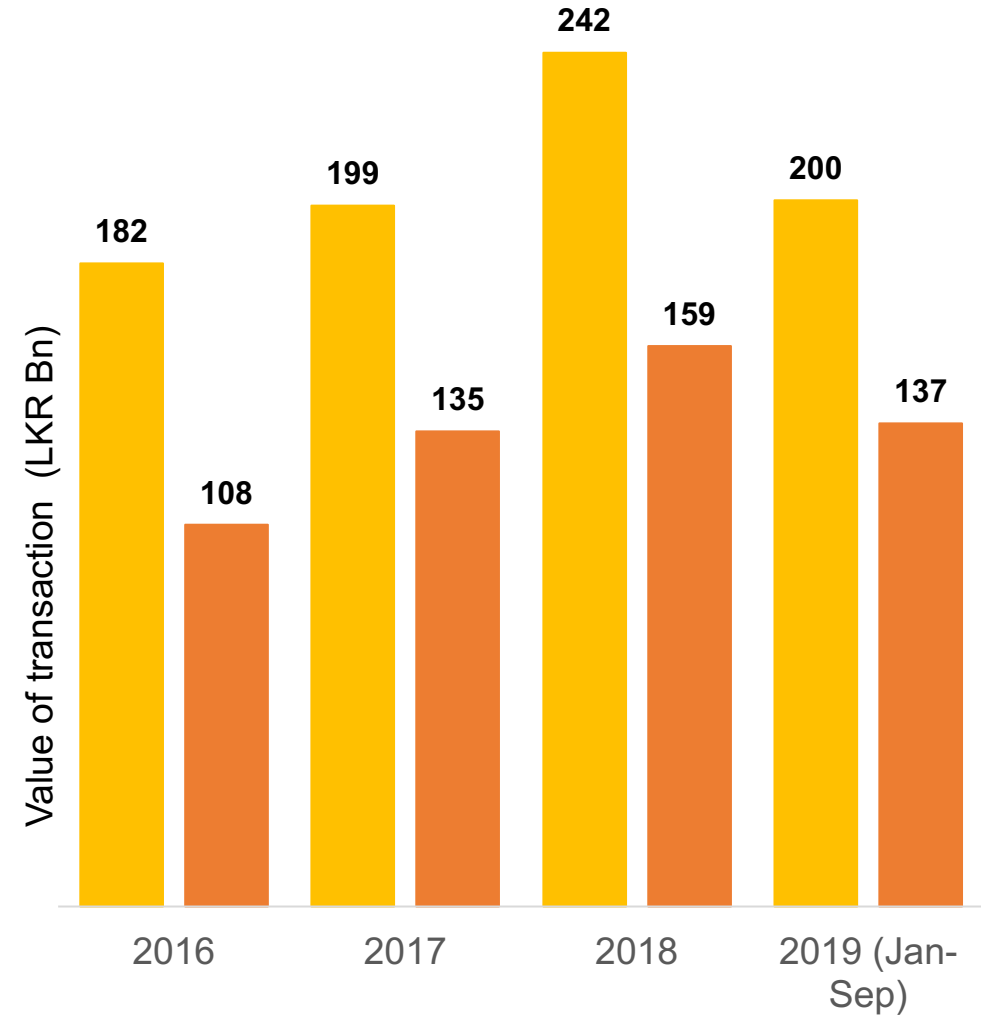
Earnings from tourism has been decreasing



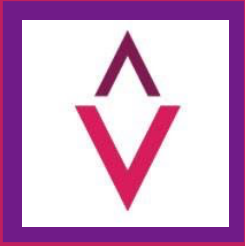
14.6% of total imports prohibited by the import ban



Card Payments

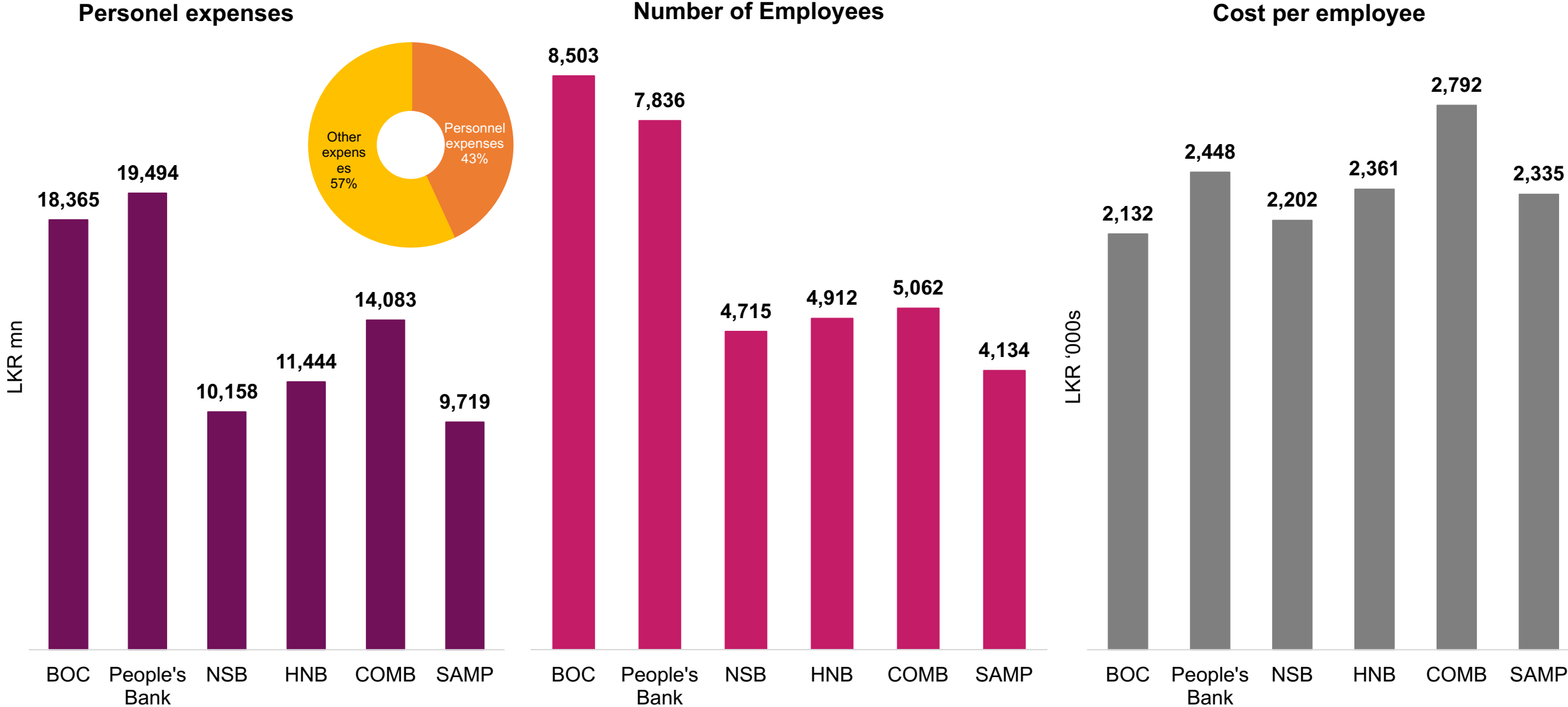


Source: CBSL



Expenses

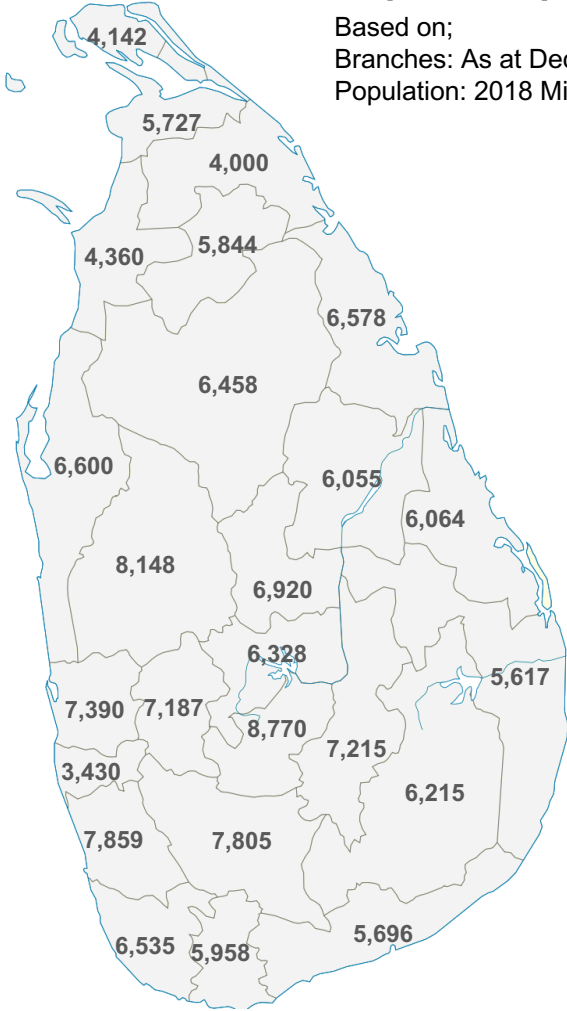
43% of bank expenses are accounted for by personnel costs...



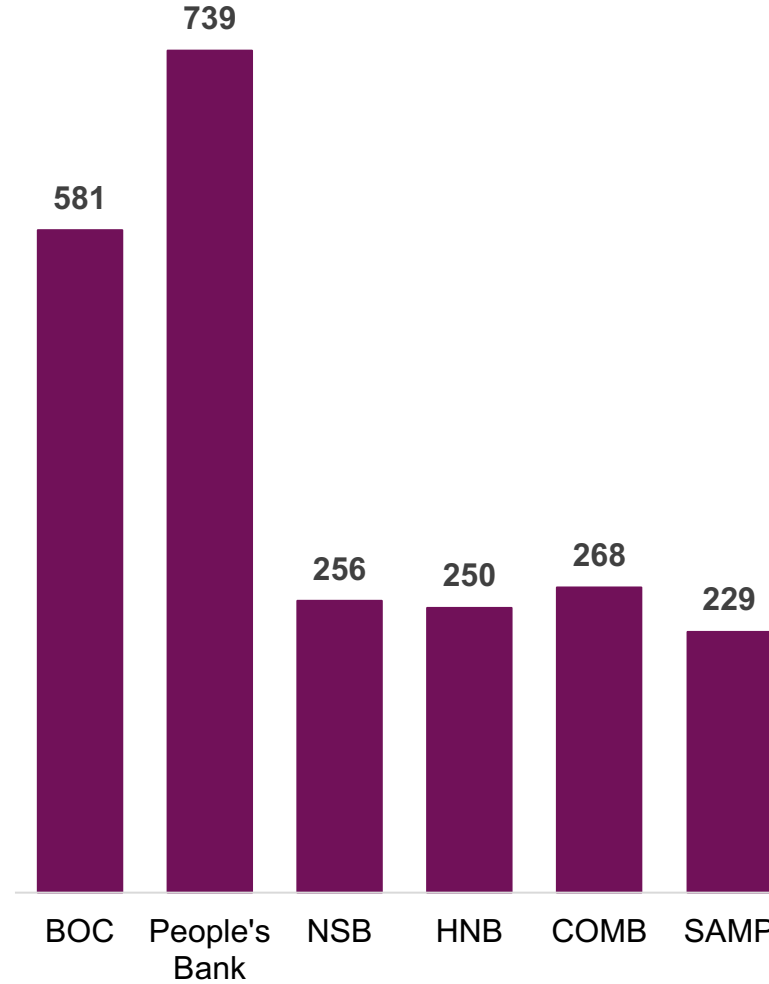
Banking industry channel penetration and facility costs

Population per Branch

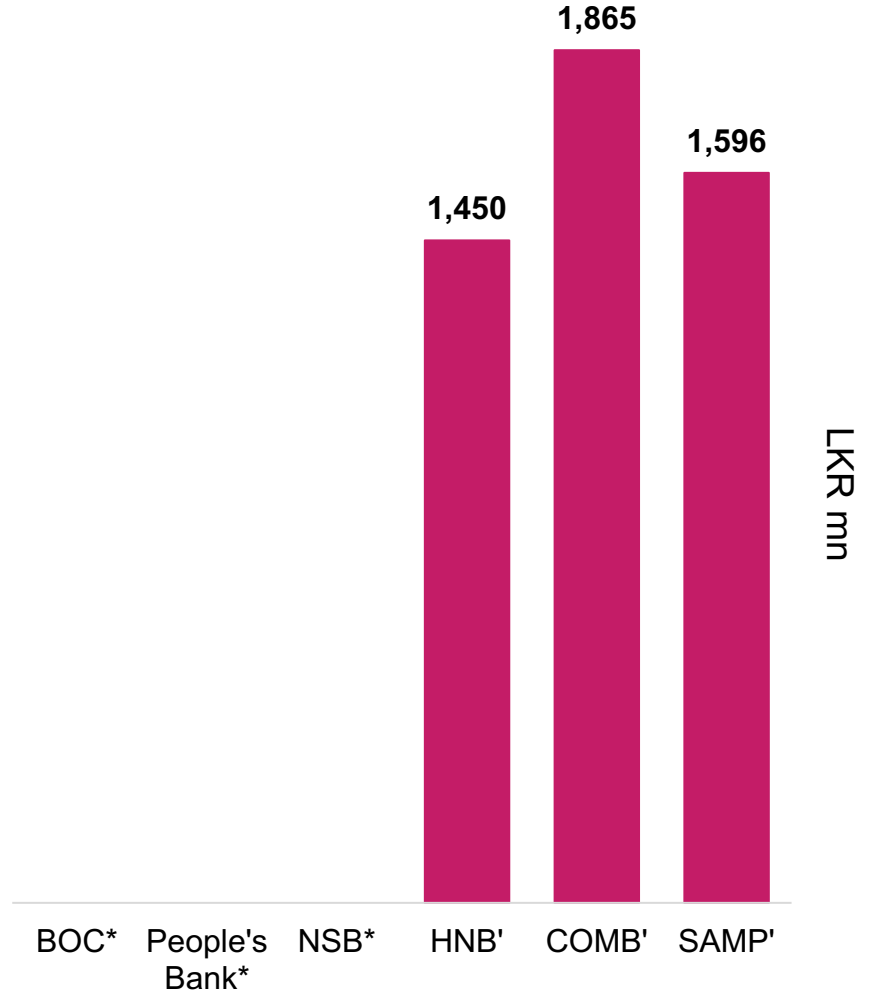
Based on;
Branches: As at December 2019
Population: 2018 Mid Year



Number of branches



Facility Costs

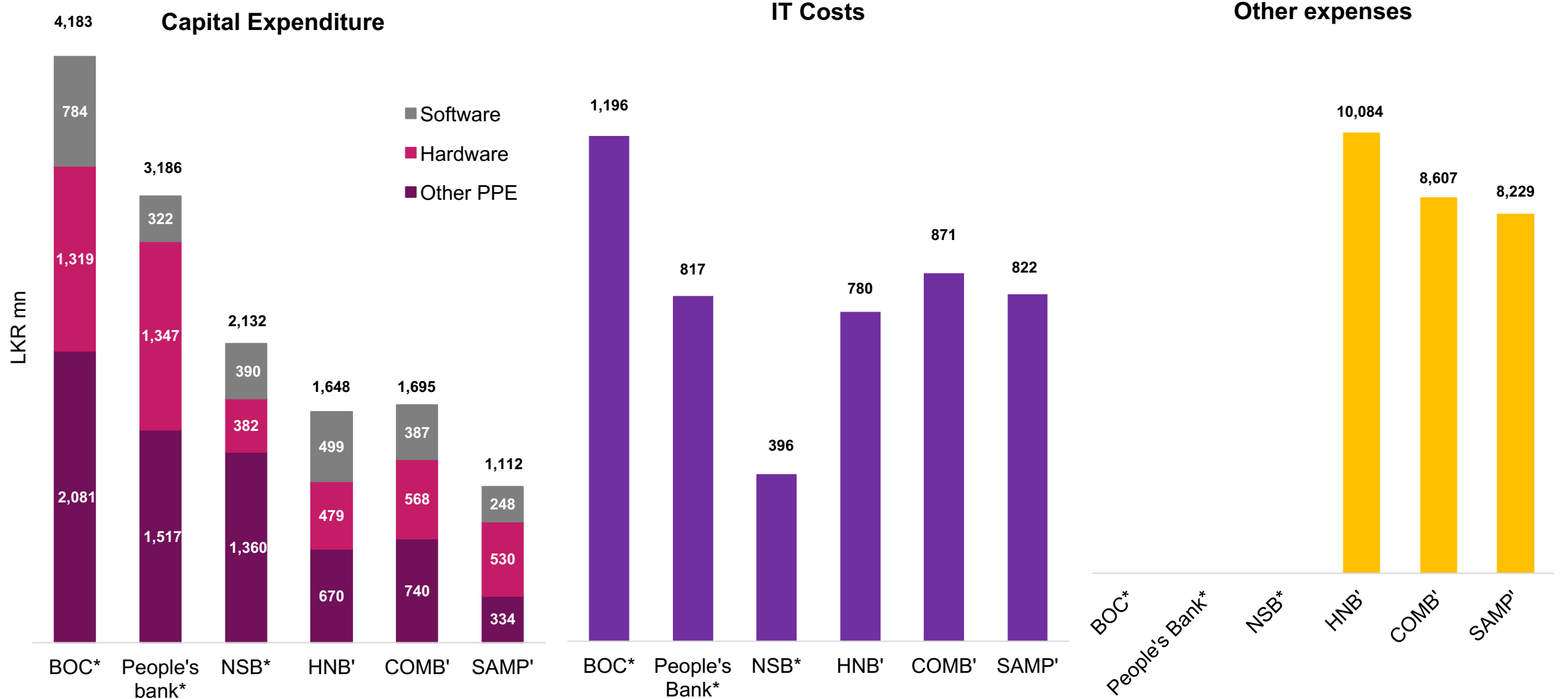


LKR mn

2019 data not available

'2019 data

Capital Expenditure, IT Costs and Other Expenses

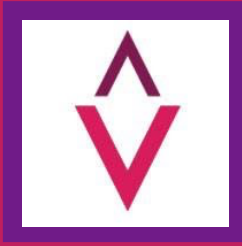


Source: Bank Annual Reports

www.advocata.org

*2019 data not available

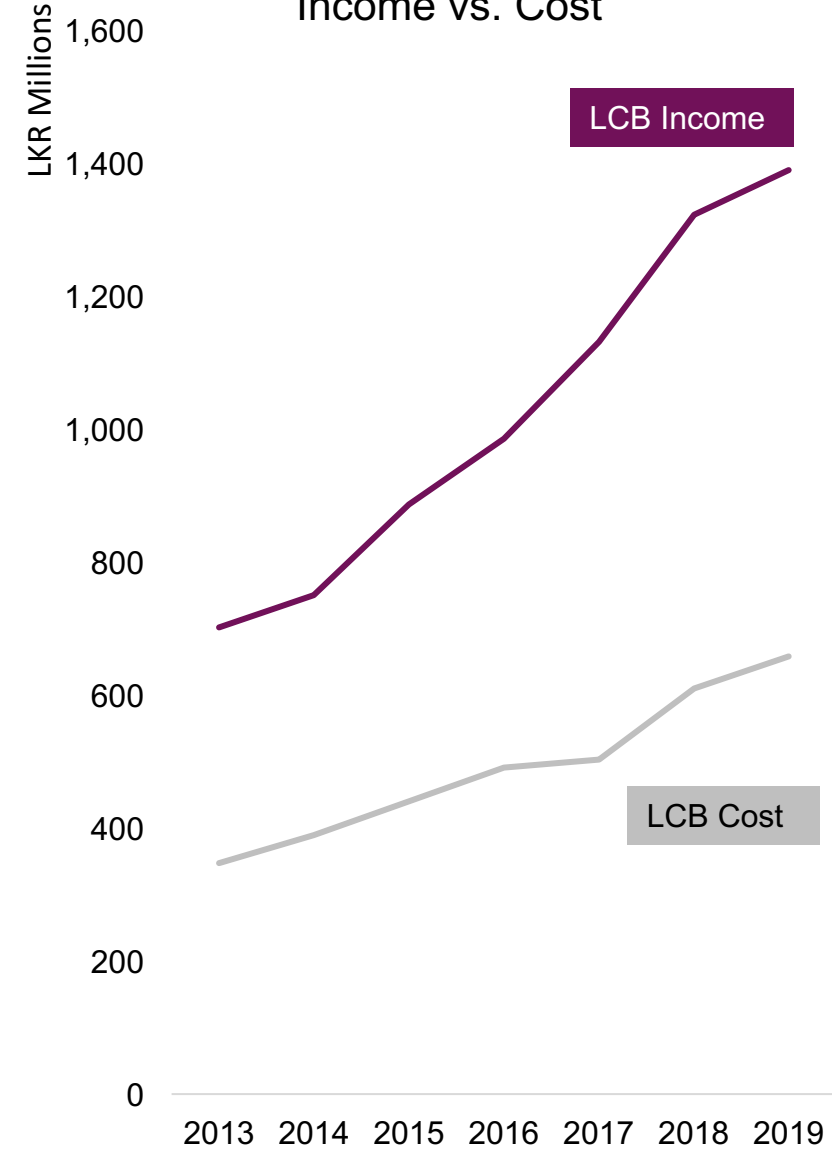
'2019 data



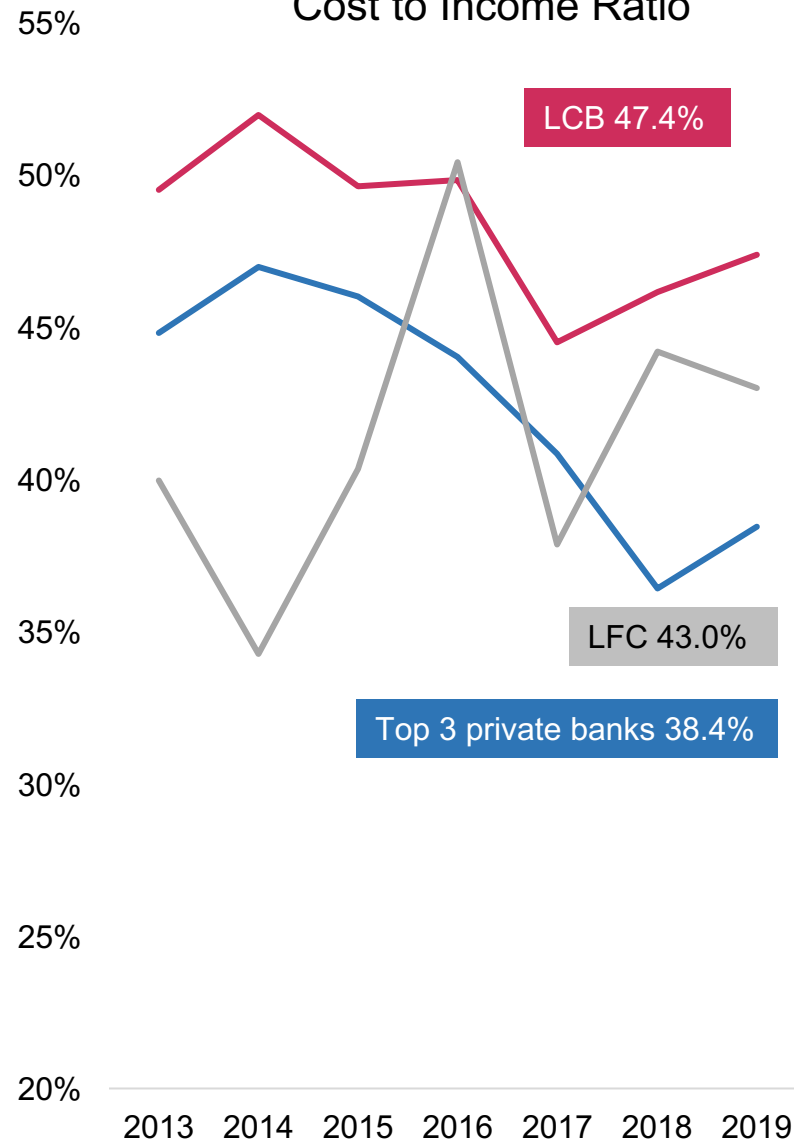
Operating Profit

Cost-to-income ratio

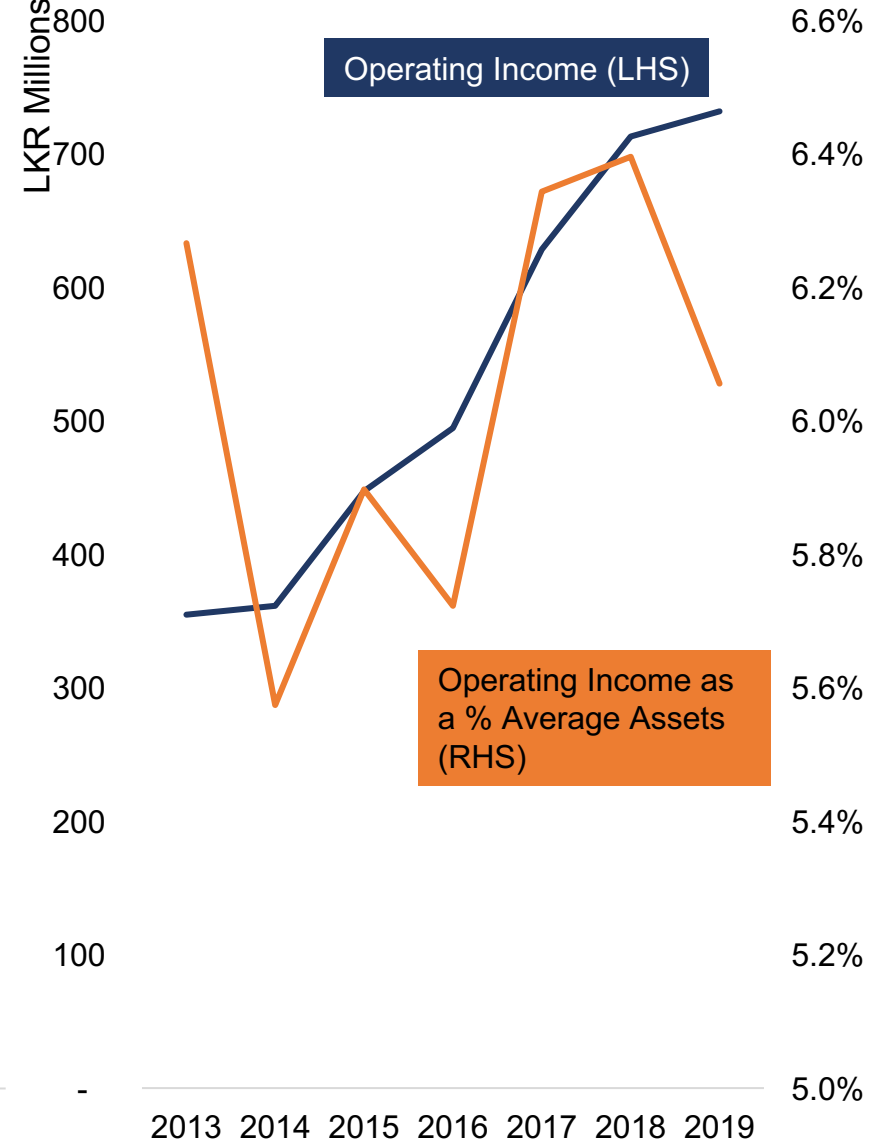
Income vs. Cost



Cost to Income Ratio

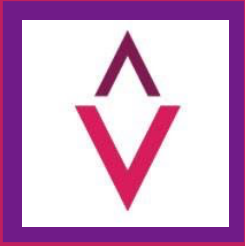


LKR Millions



Source: Central Bank of Sri Lanka

www.advocata.org



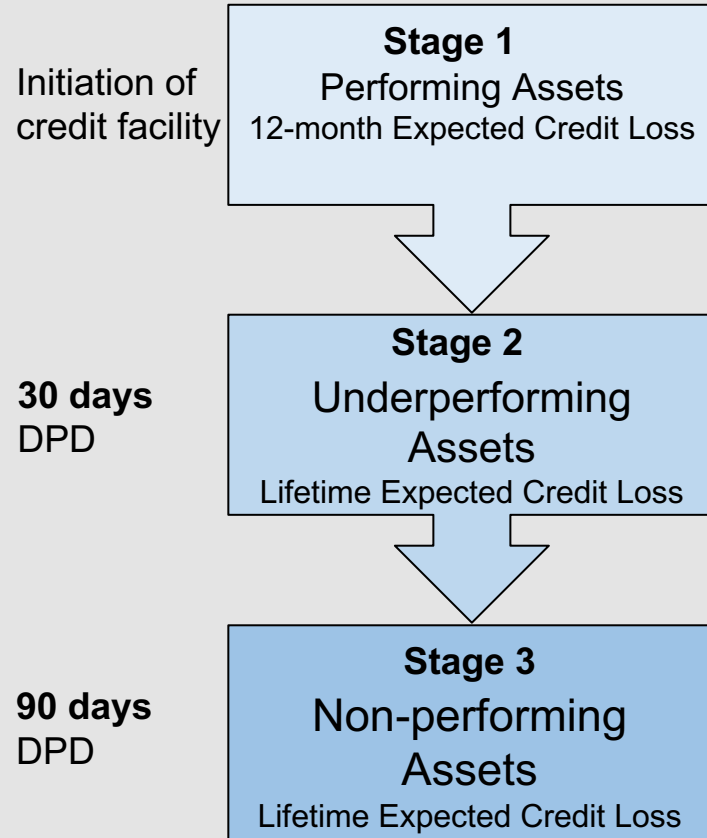
Provisioning

Types of provisioning

Incurring Loss Model (pre-2018)

- Delays recognition until a loss has been incurred
- Expected future losses are not recorded
- The incurred loss model estimates losses for loans likely to default in the next 12 months

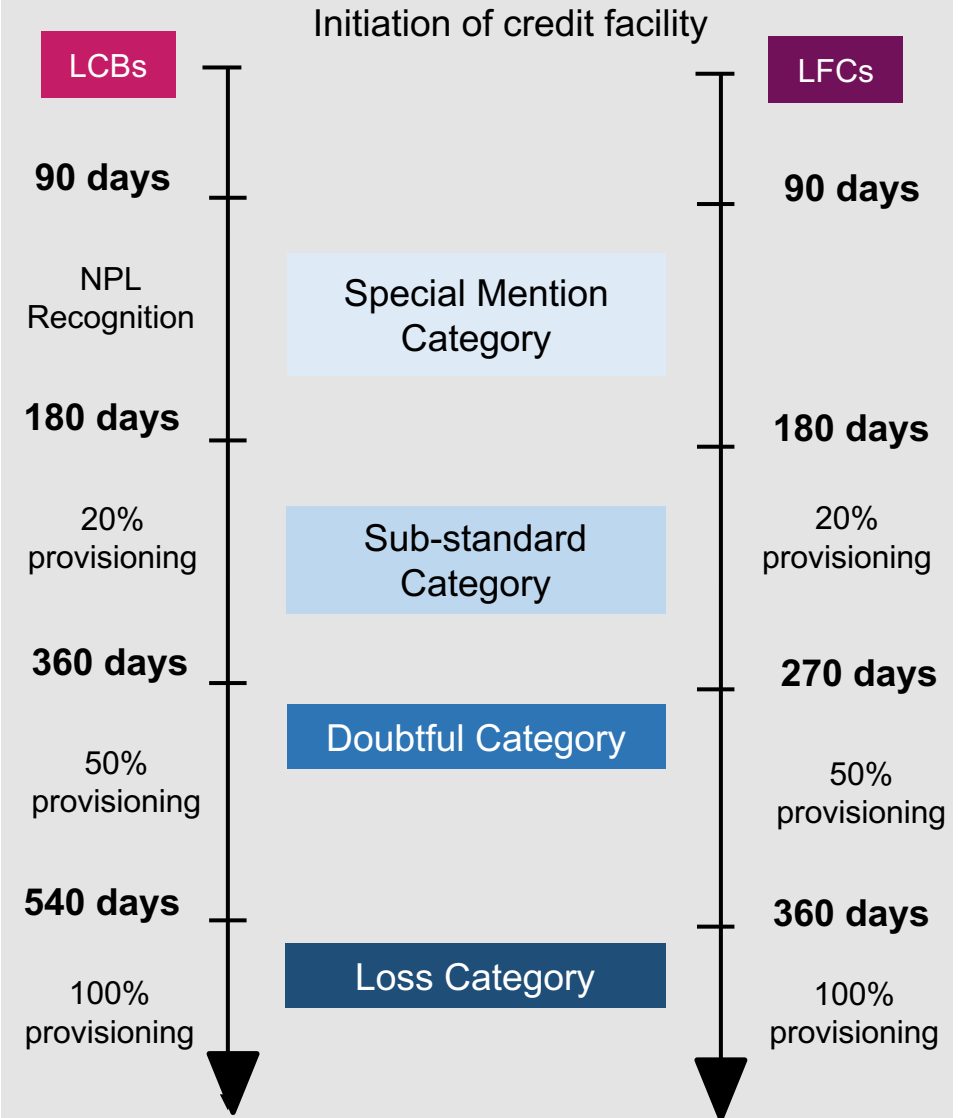
Expected Loss Model (2018 -)



$$ECL_{12m} = PD_{12m} \times LGD_{12m} \times EAD_{12m} \times DF_{12m}$$

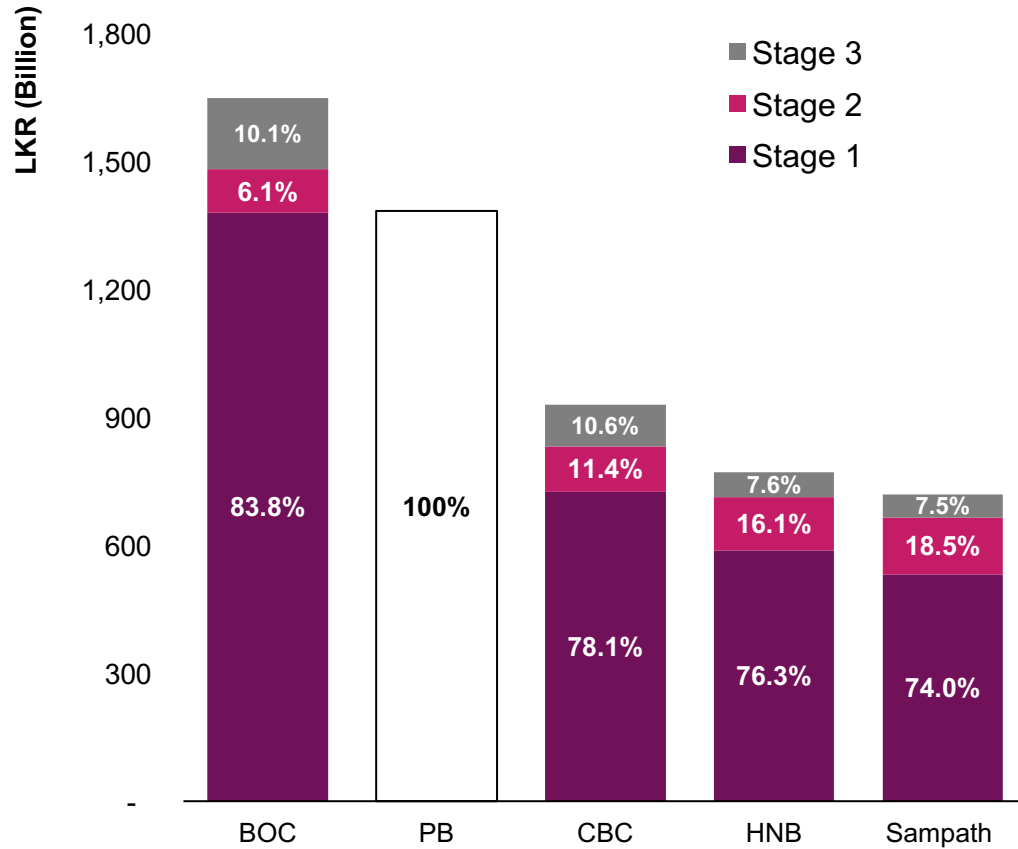
$$ECL_{Lifetime} = \sum_{t=1}^{Lifetime} ECL_{12m,t}$$

CBSL Provisioning (Net exposure)

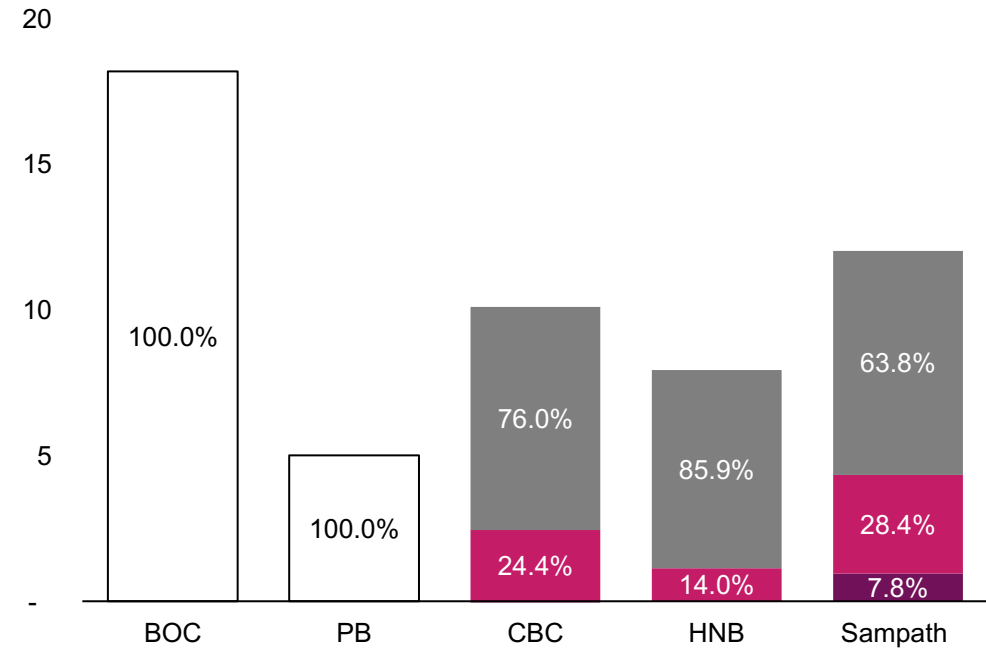


Industry impairment trend 2019

Gross loans and advances

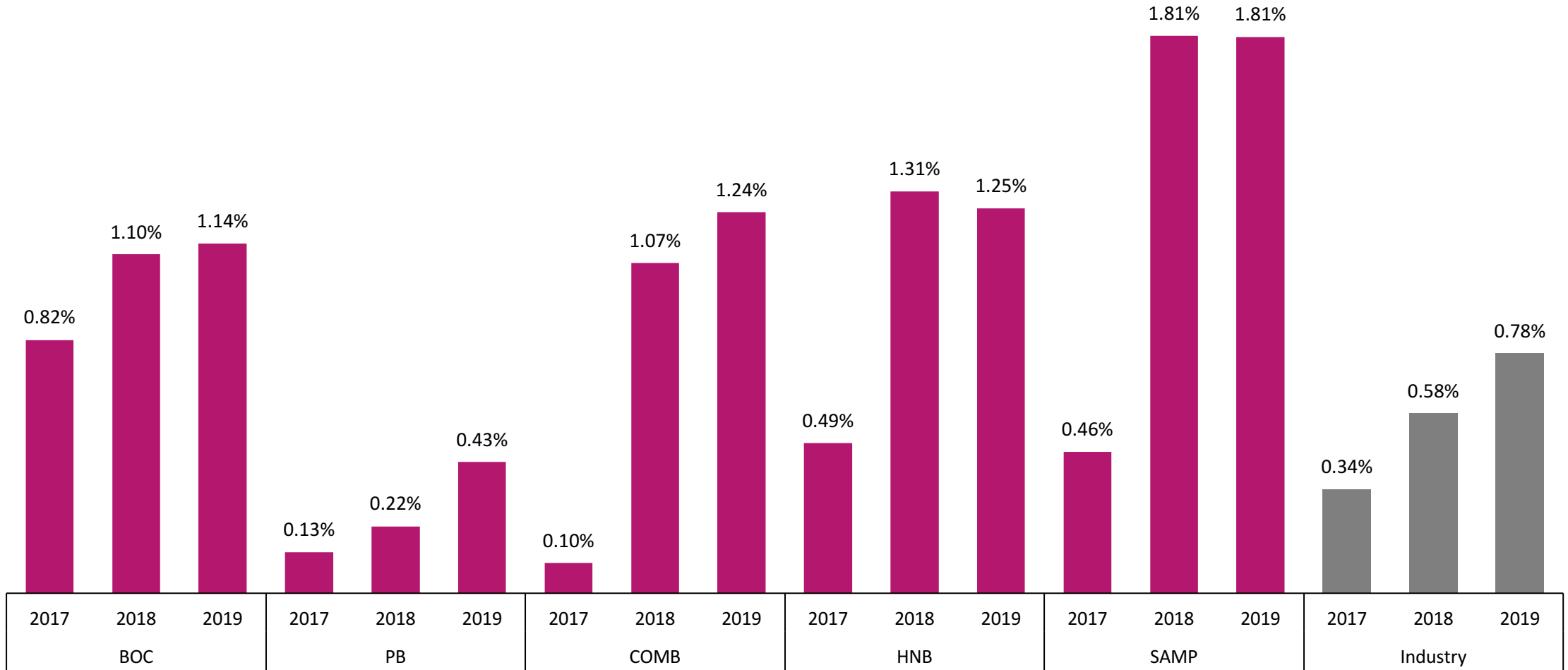


Impairment charge



Credit cost of major players

X.XX% Impairment Charge/Avg. Gross Loans



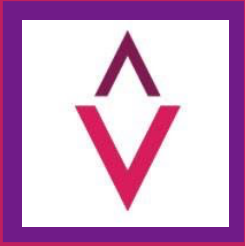
Source: CBSL / Company annual reports

NPL ratios of major players

2.9% Gross NPL %
 Net NPL %



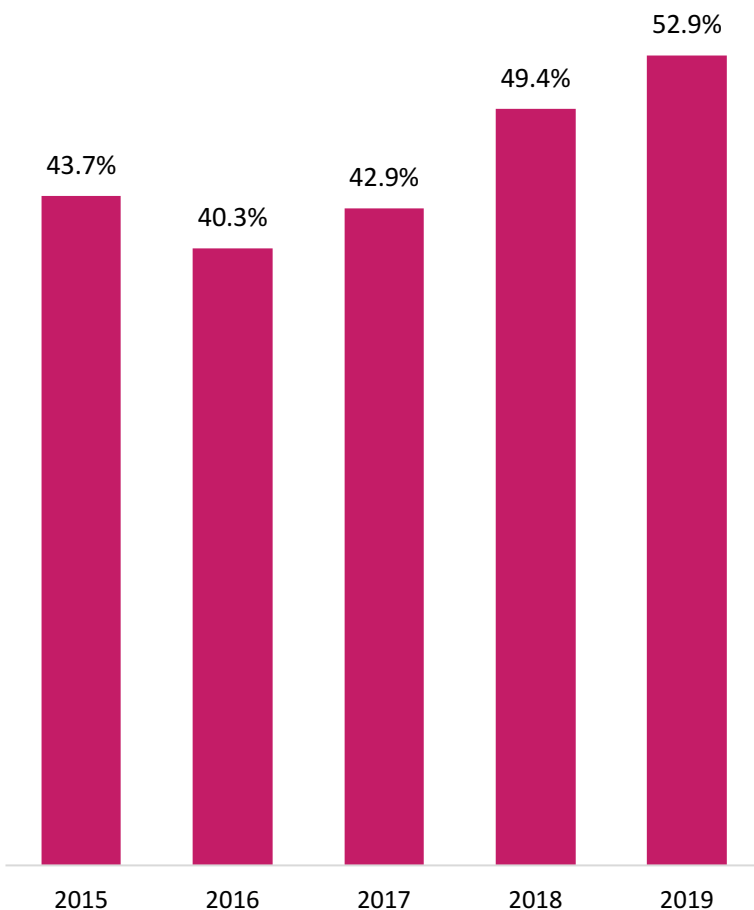
Source: Annual Report/ Interim Reports



Taxes

Taxation- Banking Industry

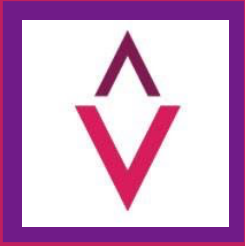
Effective tax rate



- Net interest income on SLDB's and ISB's are tax exempted
- Impairment provision is considered a disallowable expense, whereas CBSL time based provisioning is allowed

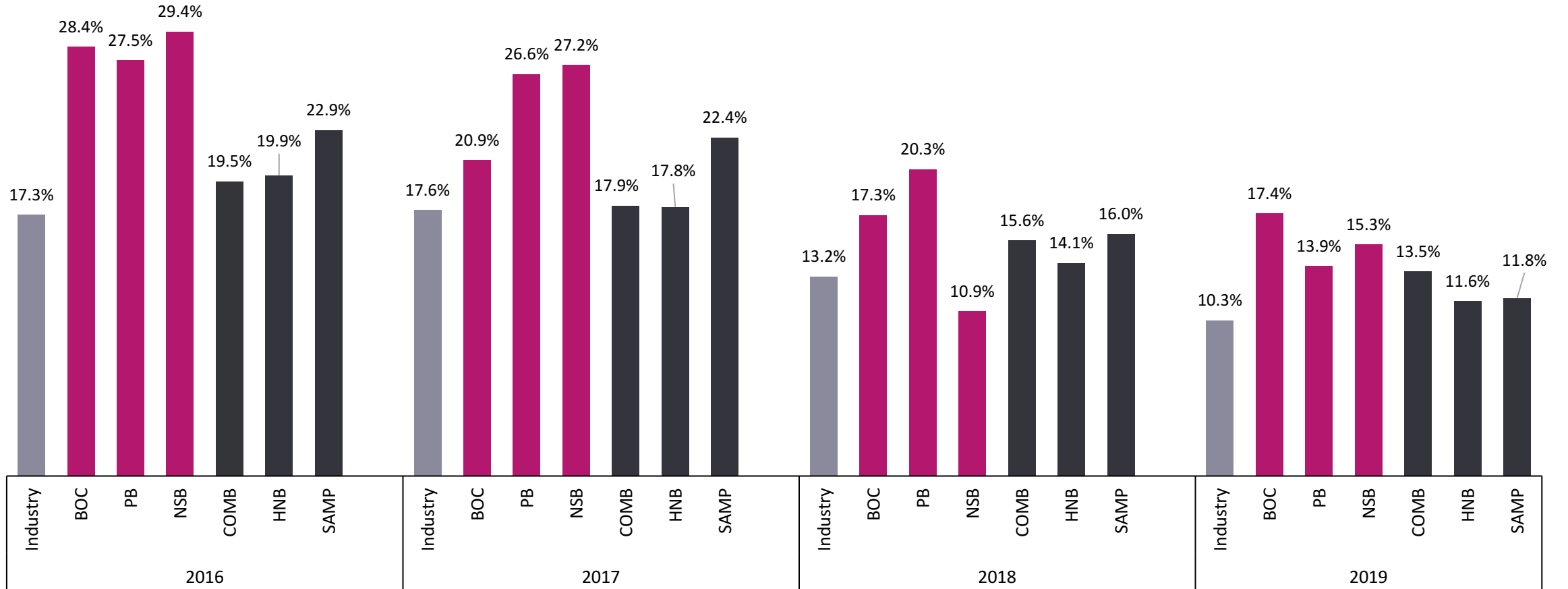
	Pre-revision Tax structure	Post-revision Tax structure
Income tax	28%	24%
Financial VAT	15%	15%
NBT	02%	N/A
Debt Repayment Levy	07%	N/A

Source: Central Bank of Sri Lanka/ Inland Revenue Dept

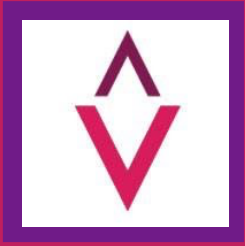


Profitability

Return on Equity

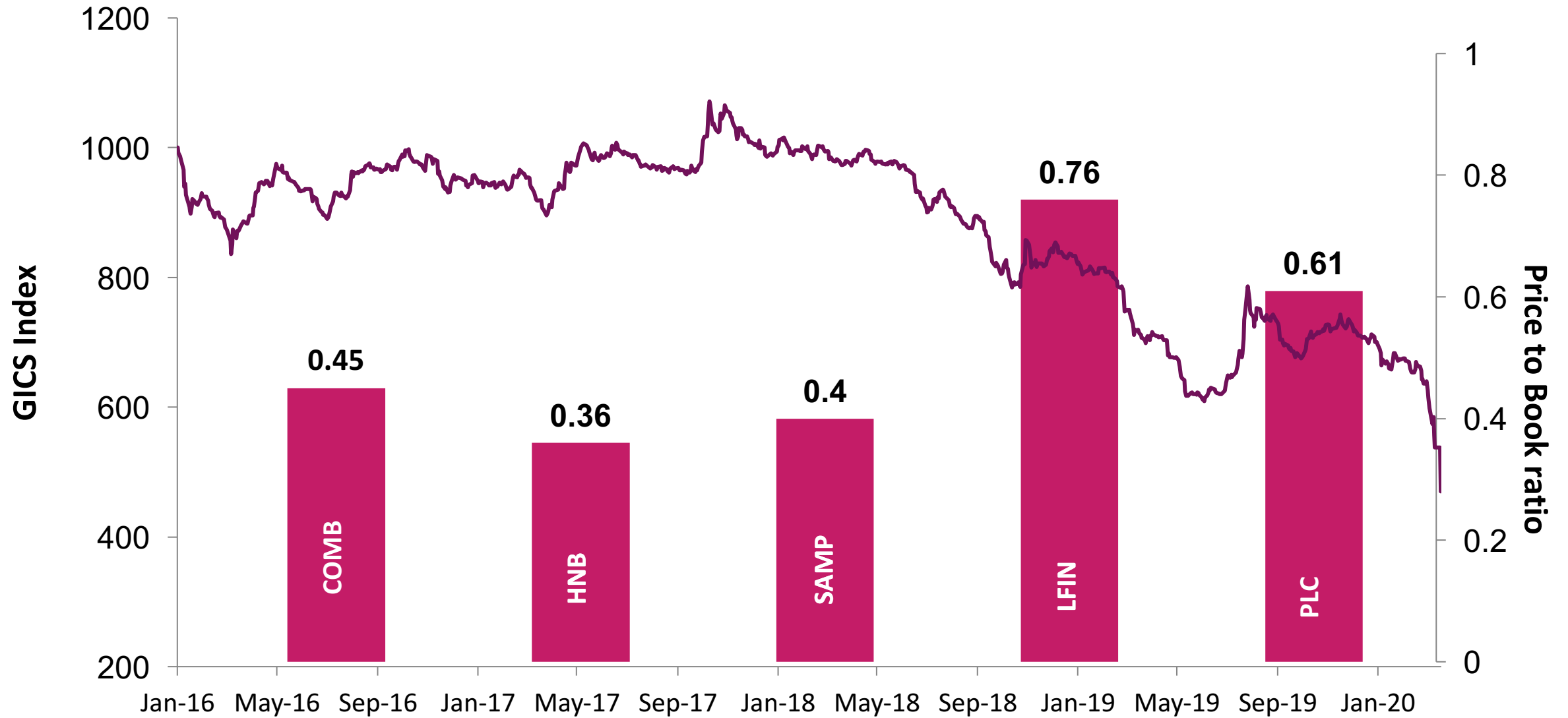


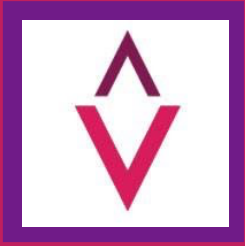
Source: Annual Report/ Interim Reports



Investors

GICS Index vs Price to Book Ratio





Moratoriums and regulatory relaxations

Summary of COVID-19 relief measures

Loan Moratoriums	
Period	Eligible Loans
6 months	<ul style="list-style-type: none"> - Three-wheelers, school vans, lorries, small goods transport vehicles & Busses and taxis - Affected industries in SME, Tourism, Apparel, Plantation, IT etc., and all other eligible sectors/ businesses - Eligible trade finance facilities maturing during period ending 25.03.2020
3 months	<ul style="list-style-type: none"> - Personal loans and leasing rentals less than LKR 1 Mn
2 months	<ul style="list-style-type: none"> - Temporary OD's
Up to 30.09.2020	<ul style="list-style-type: none"> - Permanent OD's - Eligible trade finance facilities maturing during period ending 25.03.2020 - Pawning facilities maturing during period ending 25.03.2020
Up to 31.05.2020	<ul style="list-style-type: none"> - Personal loans to all private sector non-executives given a moratorium

Financial Reporting

- Accounting for modifications- Recognizing loss upfront or accruing a lower interest rate?
- Mark to market accounting- At which price?

Regulatory relaxations

- D-SIB's and non- D-SIB's are permitted to **drawdown** their Capital Conservation Buffers **by 100 bps and 50 bps** respectively
- Defer enhancement of Capital by LSB's until end 2022
- Liquid Assets Requirements maintained by LFC's has been reduced to 6% of savings deposits and 10% of time deposits

Working capital

- Working capital facility **not exceeding LKR 25 Mn** per bank or **LKR 10 Mn** per LFC to be **repaid over 2 years** at a **rate of 4%**, provided a credible **business plan** is presented
- Investment purpose loan to be granted by **Banks only**, to **performing borrowers**, not exceeding **LKR 300 Mn**, to be repaid over **5 years** at a maximum rate of **AWPLR + 1.5% p.a.**

Source: Central Bank of Sri Lanka

Moratorium accounting - LHS is not substantial, RHS substantial

Illustration 2: Loan Amorisation Schedule where the modification is considered as substantial, then the loan is treated as a new loan derecognising the original loan

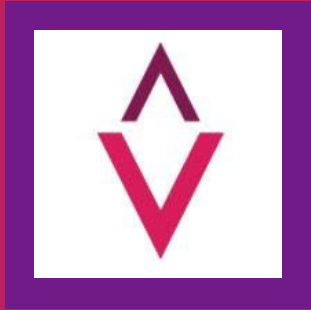
Capital Outstanding as at 01st April 2020 1,079,304
New IRR of the loan 8.22%

Month	Principal o/s at the beginning	Interest for the month	Payment of Installment	Principal o/s at the end
			1,079,304	
Apr-20	1,079,304	7,393	-	1,086,697
May-20	1,086,697	7,443	-	1,094,140
Jun-20	1,094,140	7,494	-	1,101,635
Jul-20	1,101,635	7,546	-	1,109,180
Aug-20	1,109,180	7,597	-	1,116,778
Sep-20	1,116,778	7,649	-	1,124,427
Oct-20	1,124,427	7,702	(97,926)	1,034,202
Nov-20	1,034,202	7,084	(97,926)	943,360
Dec-20	943,360	6,462	(97,926)	851,895
Jan-21	851,895	5,835	(97,926)	759,804
Feb-21	759,804	5,204	(97,926)	667,082
Mar-21	667,082	4,569	(97,926)	573,725
Apr-21	573,725	3,930	(97,926)	479,729
May-21	479,729	3,286	(97,926)	385,088
Jun-21	385,088	2,638	(97,926)	289,800
Jul-21	289,800	1,985	(97,926)	193,858
Aug-21	193,858	1,328	(97,926)	97,260
Sep-21	97,260	666	(97,926)	0
Total Interest Income and Impact to P&L (Cr)		95,810		

Illustration 3: Loan Amorisation Schedule where the modification is considered as not substantial and accounted as a modification in the original loan

Original Loan Outstanding as at 1 April 2020 1,079,304
At the original rate the PV of the loan as at 1st April 2020 is 996,850
 $1,079,304 / (1 + 0.16/12)^6$
Accordingly the day 1 loss of (1,07,304 - 996,850) has to be charged in the month of March 2020 82,454

Month	Principal o/s at the beginning	Interest for the month	Payment of Installment	Principal o/s at the end
			996,850	
Apr-20	996,850	13,291	-	1,010,142
May-20	1,010,142	13,469	-	1,023,610
Jun-20	1,023,610	13,648	-	1,037,258
Jul-20	1,037,258	13,830	-	1,051,089
Aug-20	1,051,089	14,015	-	1,065,103
Sep-20	1,065,103	14,201	-	1,079,304
Oct-20	1,079,304	14,391	(97,926)	995,769
Nov-20	995,769	13,277	(97,926)	911,120
Dec-20	911,120	12,148	(97,926)	825,342
Jan-21	825,342	11,005	(97,926)	738,420
Feb-21	738,420	9,846	(97,926)	650,339
Mar-21	650,339	8,671	(97,926)	561,084
Apr-21	561,084	7,481	(97,926)	470,639
May-21	470,639	6,275	(97,926)	378,988
Jun-21	378,988	5,053	(97,926)	286,115
Jul-21	286,115	3,815	(97,926)	192,004
Aug-21	192,004	2,560	(97,926)	96,638
Sep-21	96,638	1,289	(97,926)	(0)
Total Interest Income		178,264		
Day 1 Loss (Charged to P&L)		(82,454)		
Net Impact to P&L (Cr)		95,810		



Thank you