Leasing and Finance Companies (LFCs)

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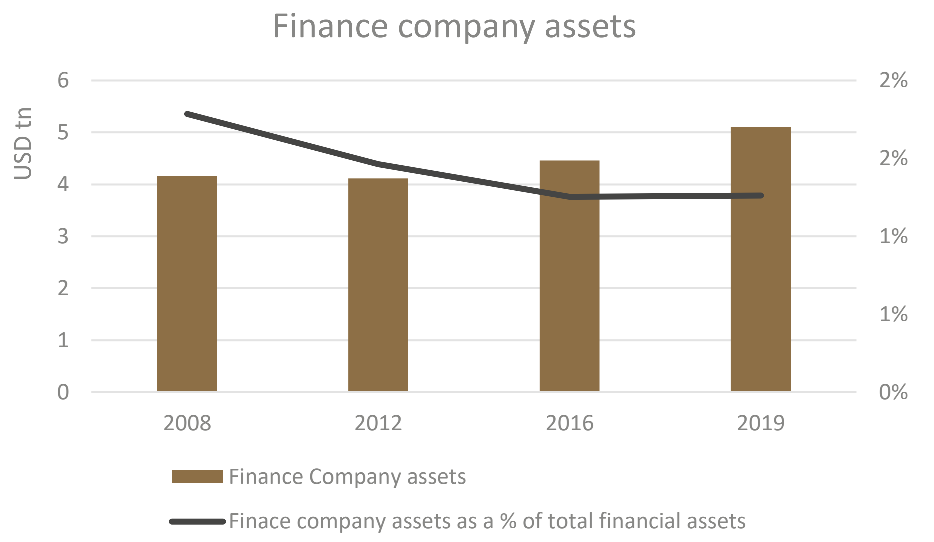
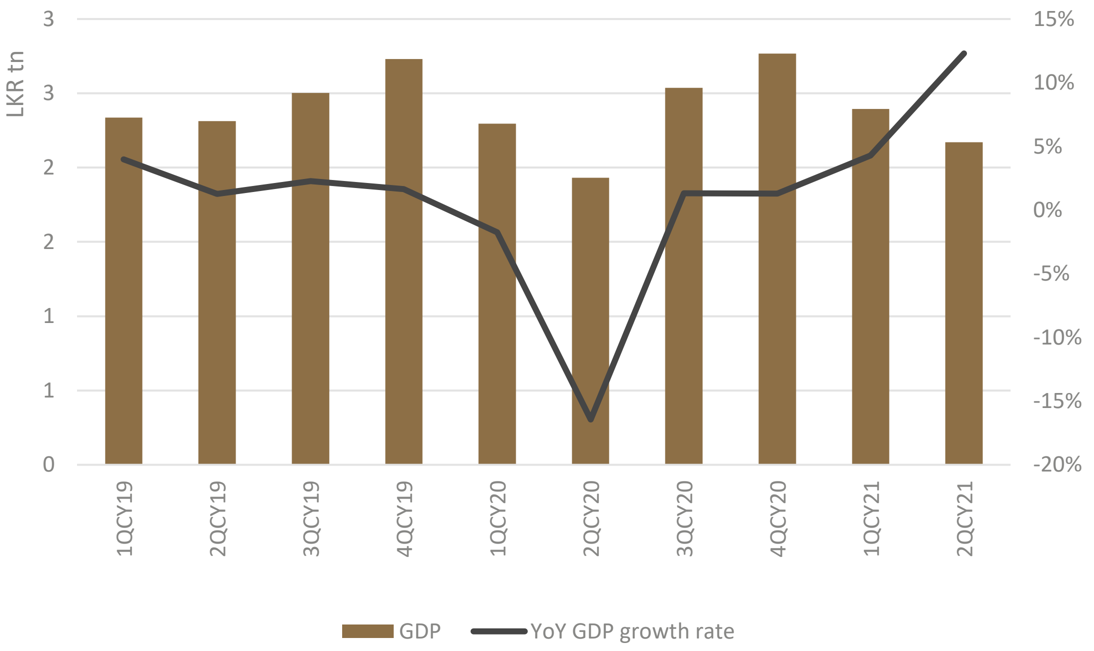
Global Industry

- The financial assets of the LFC sector amounted to $5.1 trillion in 2019 (a growth of 4.1% from 2018), accounting for only 1.3% of the global financial system in 2019.
- In 2019, the growth in finance companies' assets accelerated in most advanced economies. For Emerging economies, the majority of jurisdictions presented slower growth rates in 2019 than in 2018 (and the average annual rate during 2013-18), with large declines in Brazil (-66%) and Turkey (-14%). Finance companies' assets also decreased in Hong Kong (-25%). The US, Japan, and India account for the largest shares of global finance company assets (at 34%, 16% and 13%, respectively).



Economic Outlook of Sri Lanka

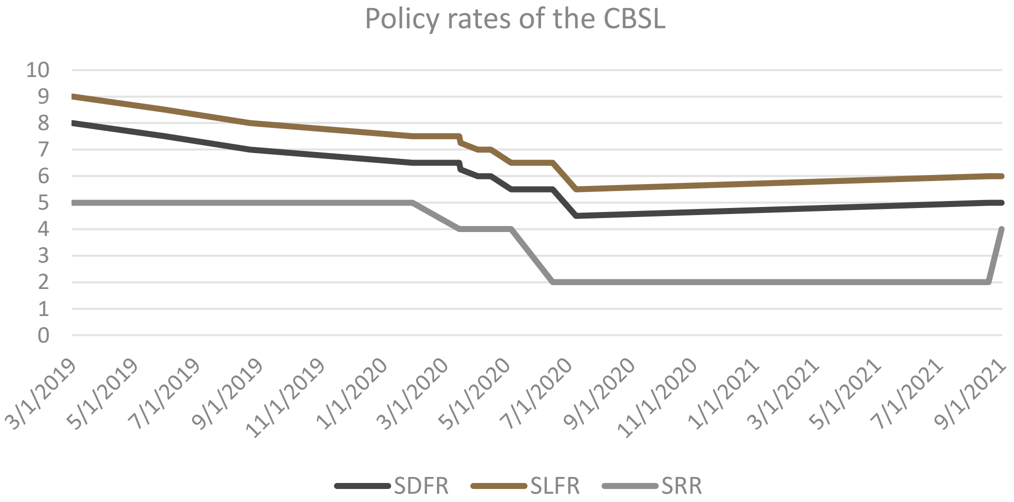
- Sri Lanka is facing mixed economic conditions in CY21 with the domestic sector recovering after the Covid-19 induced slum last year. A strong vaccination drive has enabled the country to re-open in 4QCY21 after a series of lockdowns and travel restrictions. A trickle of tourists too have started visiting the country.
- However, the country is facing a severe foreign currency crisis with forex reserves levels being very low in the face of looming debt service payments.
- Imports have been increasing over the past few months despite there being import restrictions in place for certain luxury items. This is primarily due to an increasing in the commodity prices specially the fuel price which increased by 57% during the past year.

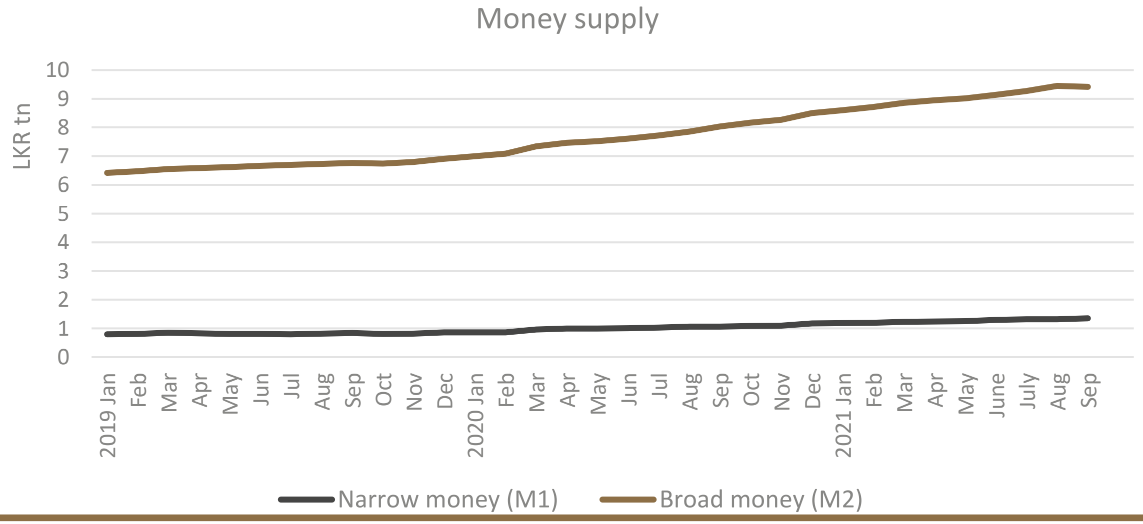


- 2QCY21 recorded a YoY growth of 12%, however a decline from 1QCY21 which was mainly due to the spike in Covid-19 cases after the festive and holiday season in April, which caused the country to go into lockdowns for over 3 months.
- LRA expects the economy of Sri Lanka to grow by 3.6% in the year CY21. The vaccination drive has been successful, and the country had mostly adopted the new normal. Tourism too has resumed and is expected to perform well in the upcoming holiday season.

Economic Outlook of Sri Lanka

- The Government together with the Central Bank of Sri Lanka (CBSL) took various measures to reduce the impact of the pandemic and support the nation.
- Policy interest rates together with the Statutory Reserve Ratio (SRR) were reduced and special lending schemes were introduced at concessionary rates.
- Policy rates were increased to 5% (SDFR) and 6% (SLFR) in August, and SRR was doubled to 4% in September 2021 with a view of addressing the imbalances on the external sector of the economy and to preempt the buildup of any excessive inflationary pressures over the medium term, amidst improved growth prospects.
- Debt moratoriums and concessions were offered to support individuals and businesses affected by the pandemic along with various other additional measures to increase market liquidity.





Central bank of Sri Lanka

Economic Outlook of Sri Lanka

	CY15	CY16	CY17	CY18	CY19	CY20	1HCY21
GDP growth rate (YoY)	5.0%	4.5%	3.6%	3.3%	2.3%	-3.6%	12.30%
Exchange rate (USD/LKR)	144.06	149.80	152.85	182.75	181.63	186.41	201.14
Inflation	2.2%	4.0%	6.6%	4.3%	4.3%	4.6%	5.2%
SDFR	6.00%	7.00%	7.25%	8.00%	7.00%	4.50%	5.50%
SLFR	7.50%	8.50%	8.75%	9.00%	8.00%	5.50%	6.50%
USD bn	CY15	CY16	CY17	CY18	CY19	CY20	1HCY21
Current Account balance	(1.90)	(1.70)	(2.30)	(2.80)	(1.80)	(1.10)	(1.50)
Exports	10.55	10.31	11.36	11.89	11.94	10.05	5.70
Imports	18.94	19.18	20.98	22.23	19.94	16.06	10.01
Trade balance	(8.39)	(8.87)	(9.62)	(10.34)	(8.00)	(6.01)	(4.31)
Workers' remittances	6.98	7.24	7.16	7.02	6.72	7.10	3.32
Foreign exchange reserve	7.30	6.02	7.96	6.92	7.64	5.66	4.06

Central bank of Sri Lanka

LFCs

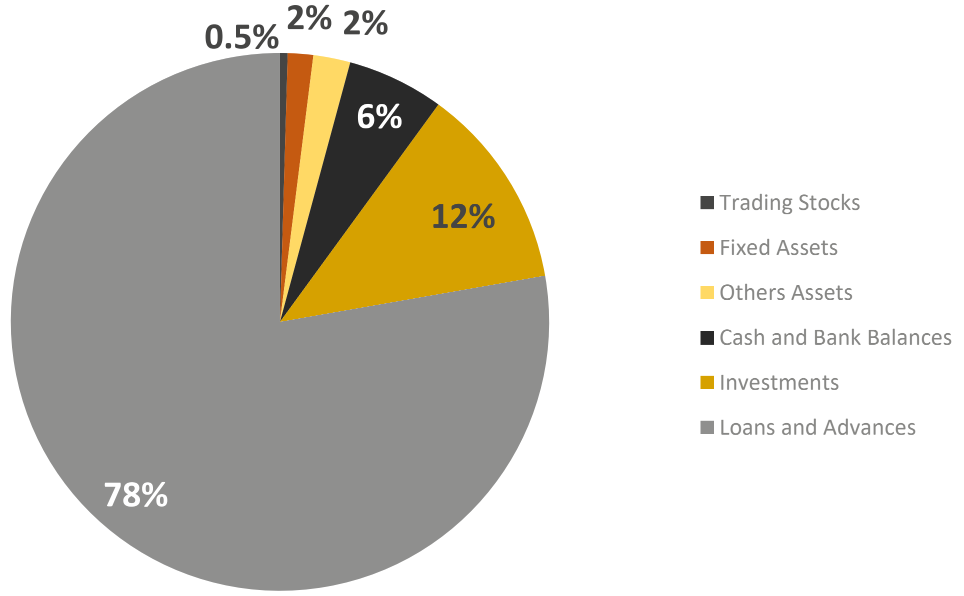
products and services offered by LFCs

- Leasing and Hire purchase (Vehicles, equipment and machinery)
- Fixed deposits and savings
- Housing, personal and educational loans
- Gold loans
- Development finance and SME finance
- Islamic finance (Wakalah, Ijarah, Murabaha and Mudharabah
- Real estate
- Factoring

Local Industry – Leasing and Finance Companies

- Leasing and Finance sector comprises of
  - 39 Licensed Finance companies (of which 29 are listed on the CSE) which provide the products and services listed in slide 7 and
  - 3 Specialized leasing companies
- Total capital base of the industry as at 4QFY21 is LKR 219bn of which LKR 201bn (92%) is Tier I (core) capital.
- Total assets of the LFC sector is LKR 1.4tn (4QFY21) of which LKR 1.1tn (76%) is loans and advances.
- Total assets have been growing at a CAGR of 9.9% from 4QFY14 to 4QFY21.
- Loans and advances have been growing at a CAGR of 10.4% during the same period

Distribution of total assets in the LFC sector – 4Q FY21

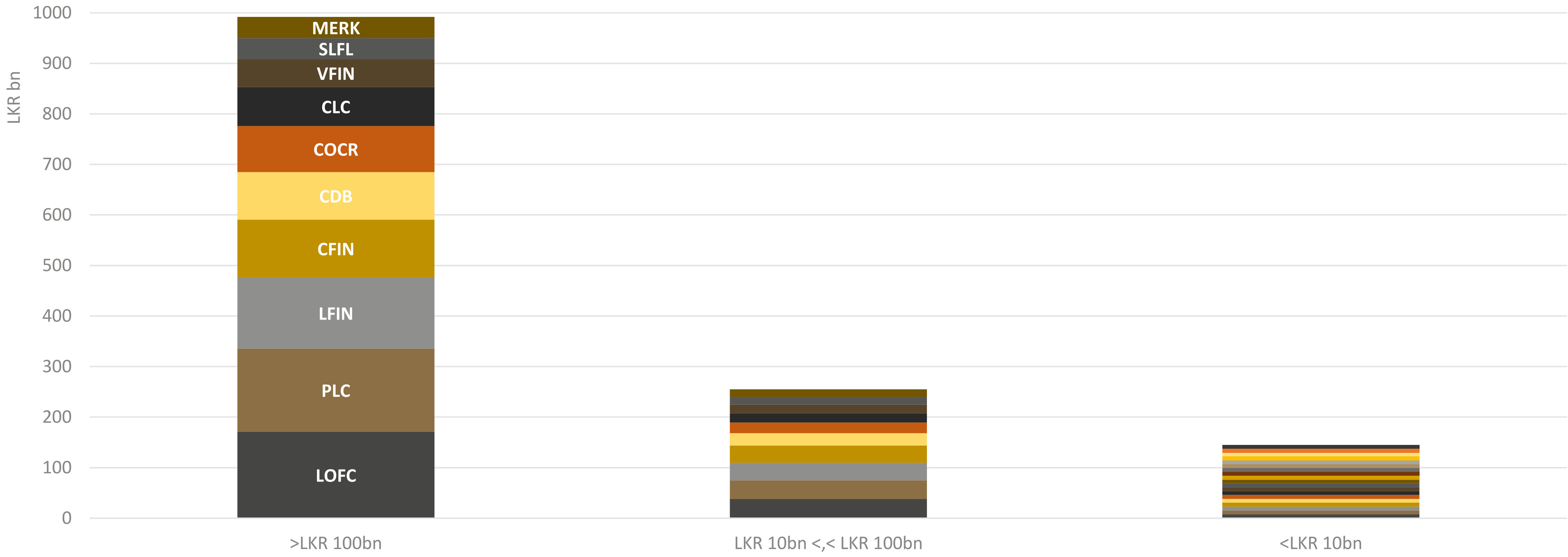


Total Capital	CAGR (FY14-21)
LKR 219bn	**15%**

Total assets	CAGR (FY14-21)
LKR 1.4tn	**10%**

Local Industry - assets

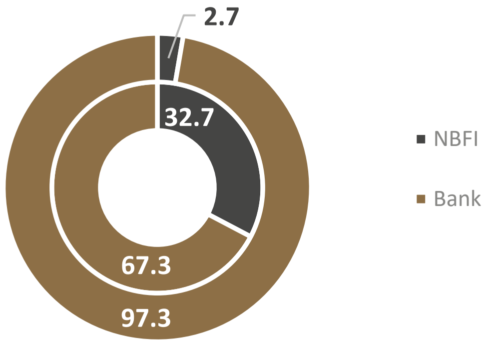
- The industry is skewed towards the large companies with the 10 largest entities accounting for over 71% (almost LKR 1tn) of the total assets.

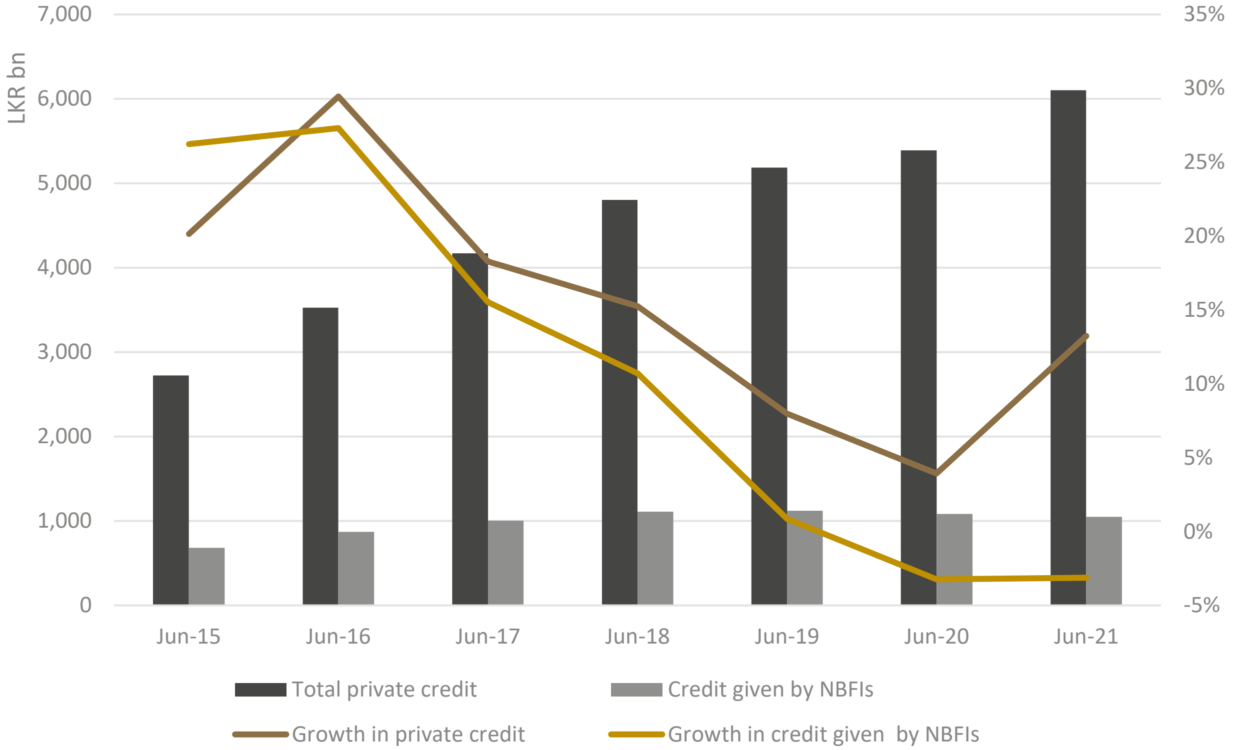


Local Industry - assets

- Total private sector credit in June 2021 was LKR 6,100 bn of which only LKR 1,049bn (17%) was held by LFCs.
- Growth in LFC credit has been negative for two years consecutively.
- The growth in LFC credit over the years has not matched the growth in private sector credit and the share of private sector credit held by the LFC sector has been decreasing gradually, with larger portions leaking out to the banking sector.
- LFC share of private credit has reduced to 17% in Jun-2021 from 25% in June-2015.
- Of credit given to households, 33% is held by LFCs while LFCs hold only 3% of credit given to institutions (which includes the corporate sector, government and public corporations).

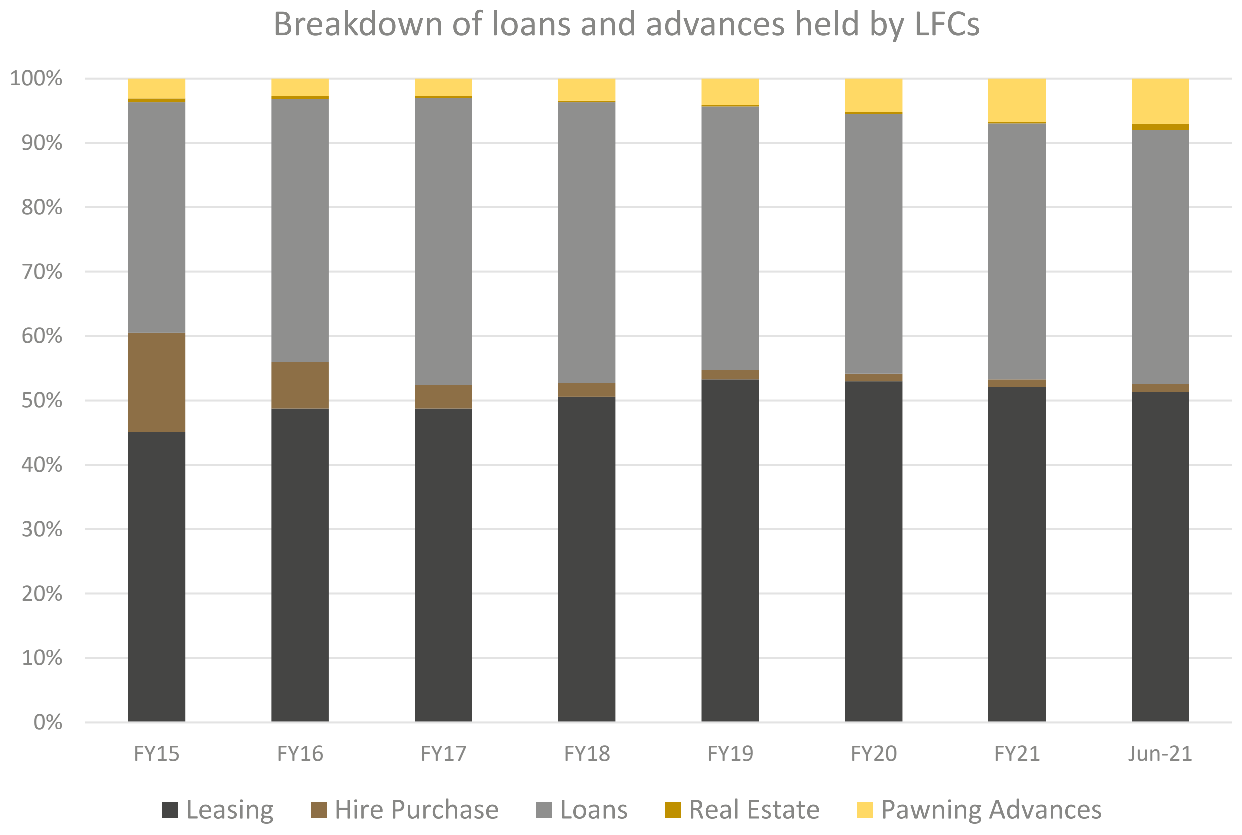
Distribution of credit from bank and non-bank sectors to households (inner doughnut) and institutions (outer doughnut)





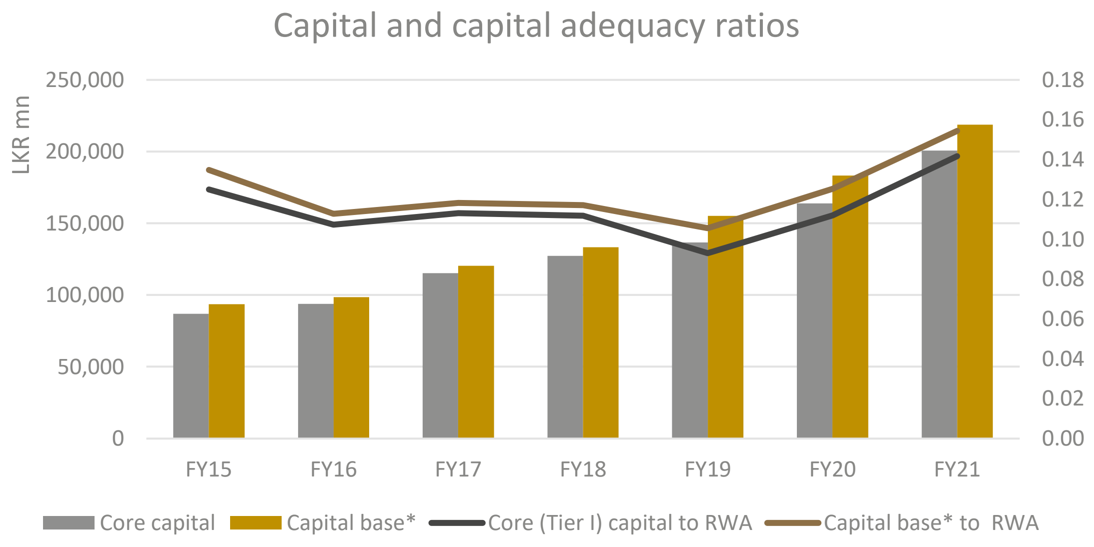
Local Industry - assets

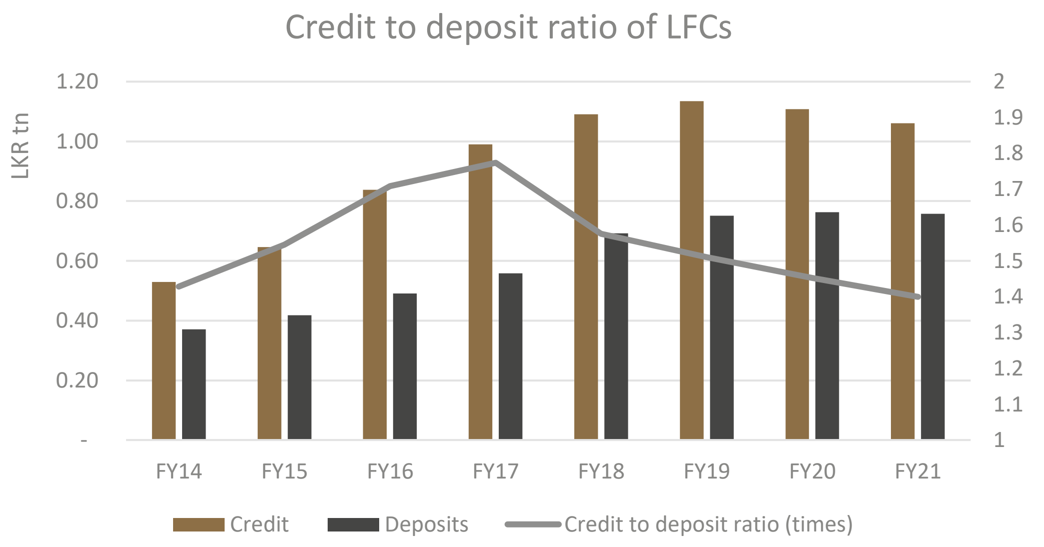
- Leasing dominates the loans and advances held by LFCs amounting to 51%, and has grown at a CAGR of 13% from Jun-14 to Jun-21.
- The loans segment too has grown considerably at a CAGR of 15% amounting to 39% in Jun-21.
- Hire purchases used to be quite popular (almost 21% of the total assets in Jun-14), but has reduced to just 1% after removal of the tax advantage it had over leasing.
- Pawning too has increased, specially in the last three years, with the percentage of credit given for pawning doubling from 4% in June 2018 to 8% in June-2021
- Loans against real estate are a very small percentage (1% in June 2021) in the LFC sector of loans and advances, and are primarily taken from banks.



Local Industry – capital

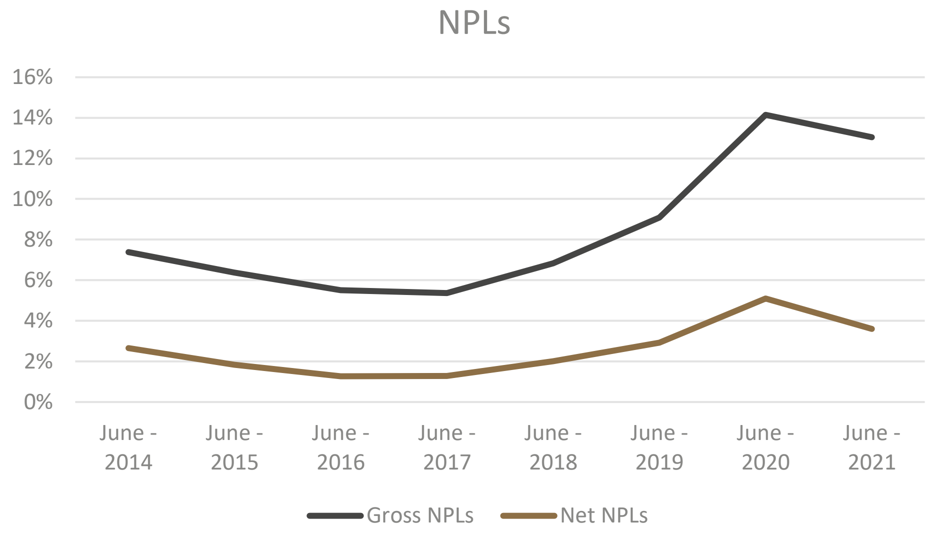
- Capital adequacy ratios are monitored and regulated by the CBSL. Depending on the size of the financial institution, it should have between 7% and 8% of Core capital to risk weighed assets (RWA) and between 11% and 12% of the total capital base to RWA. (These percentages are set to increase in July 2022)
- The core and total regulated capital has been increasing during the period studied (from FY15 to FY21). During the period FY15 to FY18 total capital grew by a CAGR of 12% while total credit given grew by 18%. This mismatch resulted in the capital adequacy ratios declining, which prompted the CBSL to increase the minimum capital adequacy ratios in 2020.



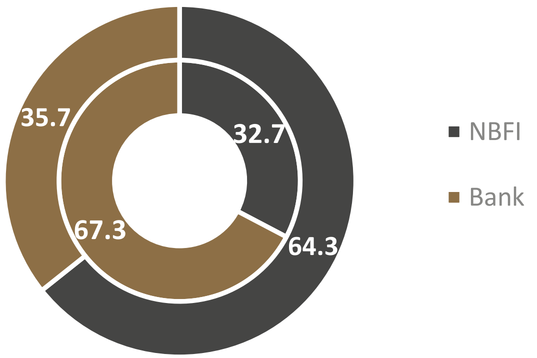


Local Industry – asset quality

- Asset quality has been depleting over time with NPLs growing steadily since FY18. Gross NPL increased to a staggering 13% in FY20.
- However a reduction was observed in the NPL ratio this year with the gross NPL reducing from 14% in June 2020 to 13% in June 2021 and the net NPL reducing from 5% to 4%.
- NPLs are higher in the LFC sector compared to the banking sector. As an example, the total credit given to the household sector by LFCs is 32.7%, however the percentage of household sector NPLs in the LFC sector is almost at 64.3%.
- Since April 2020, under instruction from CBSL, bank and non-bank financial institutions have been providing concessions and moratoria to credit holders due to the financial distress caused by the Covid-19 pandemic.
- Therefore the NPLs could increase further once the CBSL issues notice to discontinue these moratoria.



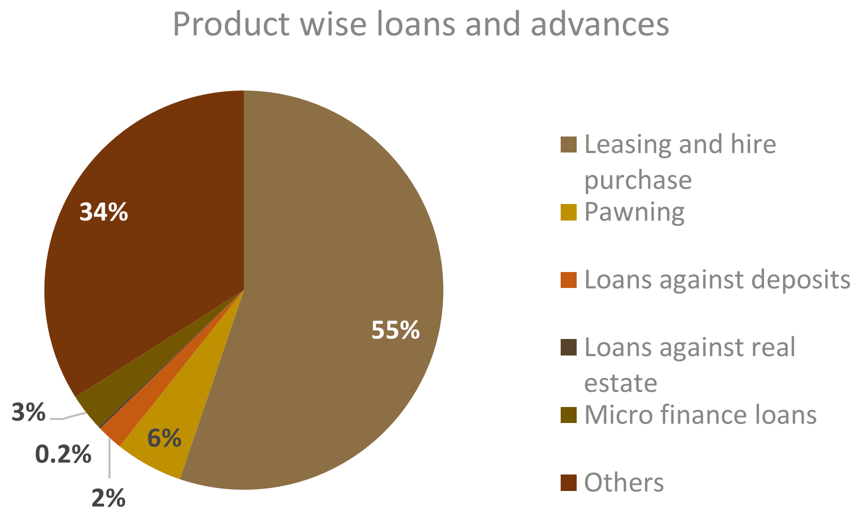
Total credit to the household sector (inner doughnut) and NPLs of the household sector (outer doughnut)

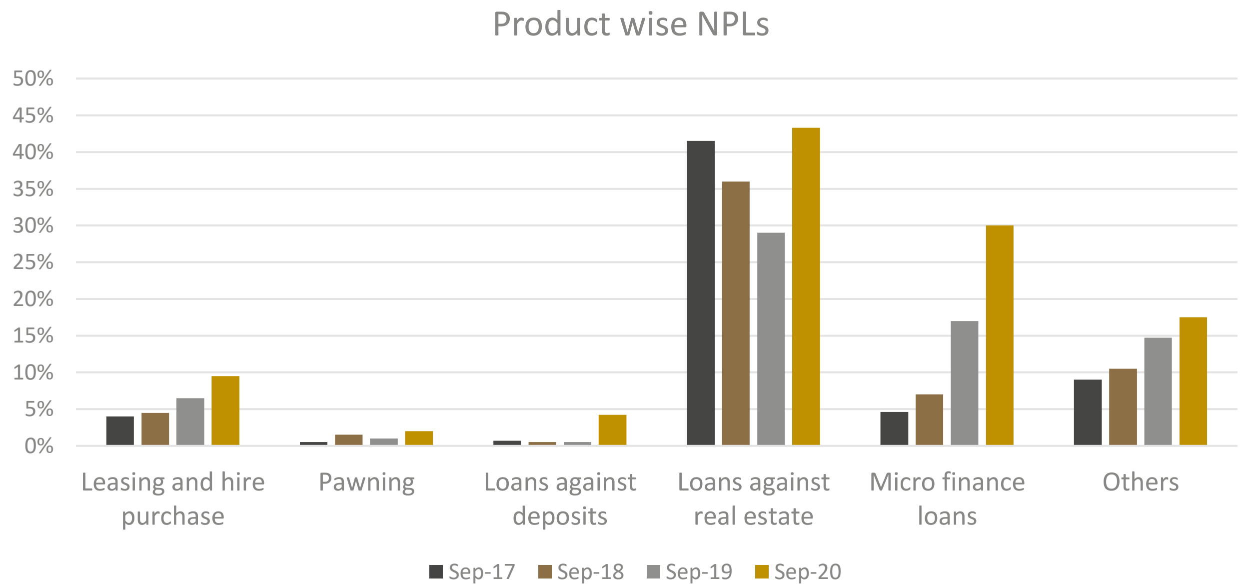


Source – Central Bank of Sri Lanka

Local Industry – asset quality

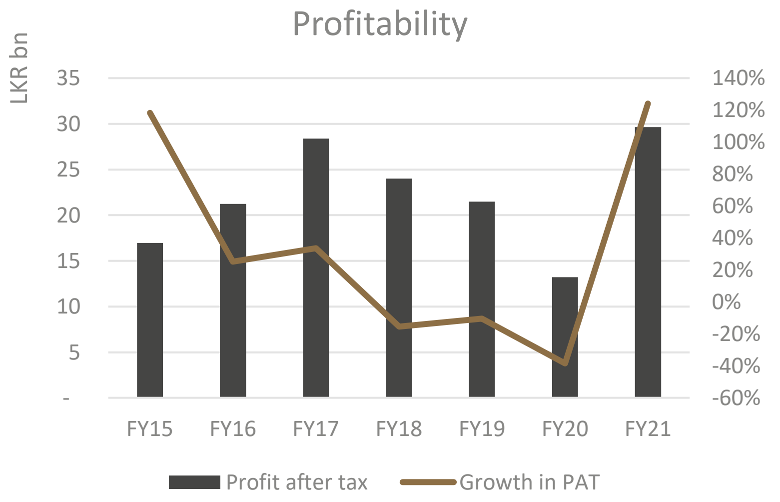
- The largest sector (product) to which the LFC sector has lent is for leasing and hire purchase. However the largest sectors that have defaulted are loans against real estate and micro finance loans.
- The year to Sep-2020 saw a rise in NPLs of all products. The rise in micro-finance loan defaults was the highest, which increased by 76% from 17% to 30%. This was because low income people and their small businesses were the most affected by the Covid-19 pandemic and related lockdowns and travel restrictions and the reduction in tourist arrivals.

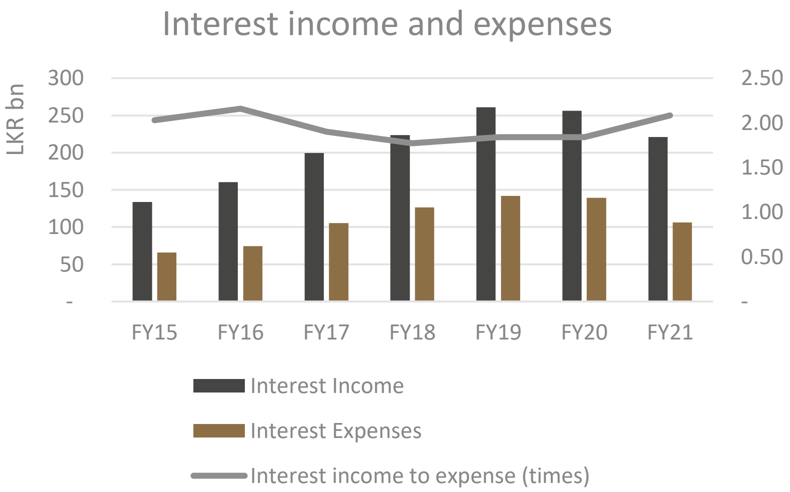


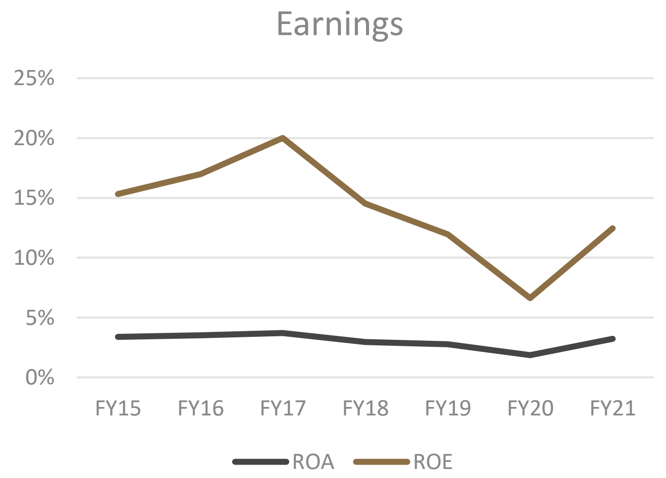


Local Industry – profitability

- Profitability of the LFC sector had be declining over the 4 years to FY20, but it grew by a staggering 124% in FY21. ROA and ROE too increased in FY21. However, it should be note that the net interest income declined by ~2% (LKR 2bn).
- Interest income dropped for the second consecutive year at a GAGR of -8%.
- Therefore the increase in profit was due to the reduction in operating costs and loan loss provisions compared to FY20. Operating costs reduced by LKR 11bn (13%), which was bought about by changes in working structure due to the Covid-19 pandemic. Provisions for loan loss too reduced by LKR 8bn (24%) since a high provision of LKR 35bn (39% higher than the previous year) was already made in CY20.
- While total deposits increased in FY21 (slide 11), the total interest expense reduced, this was because LFCs were able to reduce borrowings (borrowings reduced by 25%) due to the reduction in credit given out and the increase in liquidity in the system.







Covid-19 relief measures

Initial (24th March 2020)	• Six month debt moratorium (on capital and interest) on lease rentals of three-wheelers, school vans, lorries, small goods transport vehicles and busses operated by the self-employed. • Six month debt moratorium on capital and interest, provision of working capital at an interest rate of 4% per annum for affected industries in SMEs, tourism, apparel, plantations, IT and related logistics service providers. • A moratorium until 30/05/2020 on all personal loans granted to all private sector non-executive employees. • A 3 month moratorium for all personal loans and leasing rentals of values less than LKR 1 mn. • Penal interest of NPLs will be waived off and NPLs would be re-scheduled. • Suspension of recovery actions against eligible borrowers
Current (06th October 2021)	• Option 1 – NBFIs shall restructure existing credit facilities (both performing and non-performing) over a longer period considering the repayment capacity of the borrower. (Interest rate applicable shall be the original contractual rate minus 3% per annum – floored at 11.5% and capped at 15%) • Option 2 – facilitating early settlement without any additional charges. • Option 3 – Extending the moratorium of performing credit facilities up to 31st March 2022. • All types of recovery actions would be suspended till 31st March 2022. • Borrowers of NBFIs who are facing financial difficulties such as loss/reduction in income/salaries due to Covid-19 would be eligible to receive these concessions which would be reviewed on a case-by-case basis.

CBSL requirements for LFCs

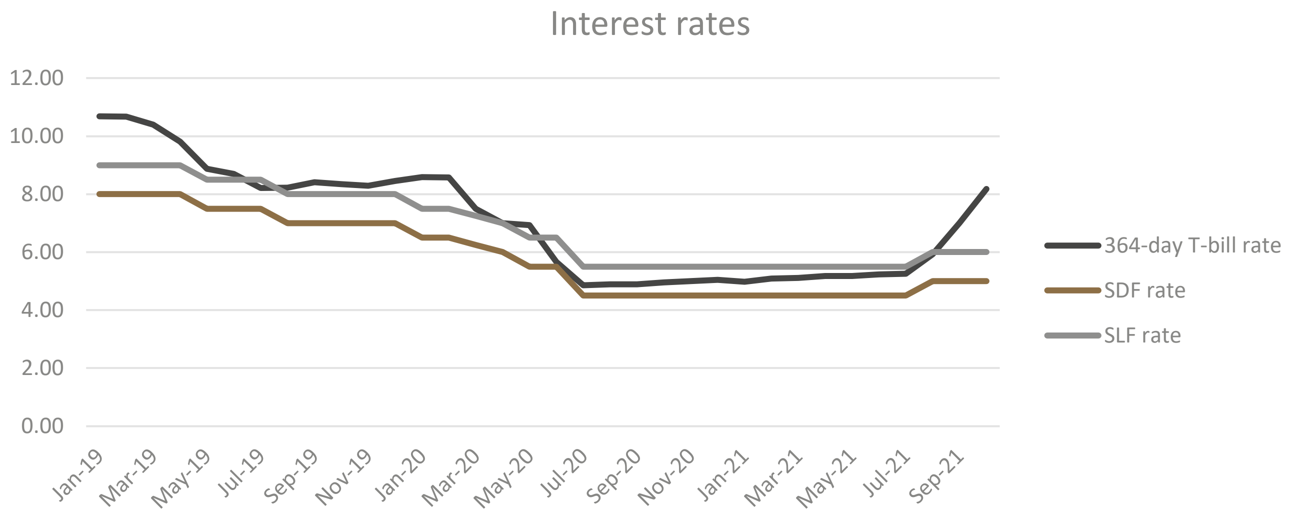
	Requirement	
Core capital	LKR 2.0bn by 31/12/2020	LKR 2.5bn by 31/12/2021
Capital adequacy for LFCs with total assets more than 100bn		
Tier 1 to RWA	8.00 by 01/07/2021	10.00 by 01/07/2022
Total capital to RWA	12.00 by 01/07/2021	14.00 by 01/07/2022
Capital adequacy for LFCs with total assets less than 100bn		
Tier 1 to RWA	7.00 by 01/07/2021	8.50 by 01/07/2022
Total capital to RWA	11.00 by 01/07/2021	12.50 by 01/07/2022
Total asset base	LKR 20bn by mid 2023	
Liquid assets	10% of time deposits + 15% of savings deposits + 5% of unsecured borrowings The above should include government treasury bills, government securities and CBSL securities equivalent to 7.5% of the average of its month end total deposit liabilities and borrowings of the 12 months of the proceeding financial year.	
Single borrower limit	Individual – LKR 412mn	Group – LKR 549mn

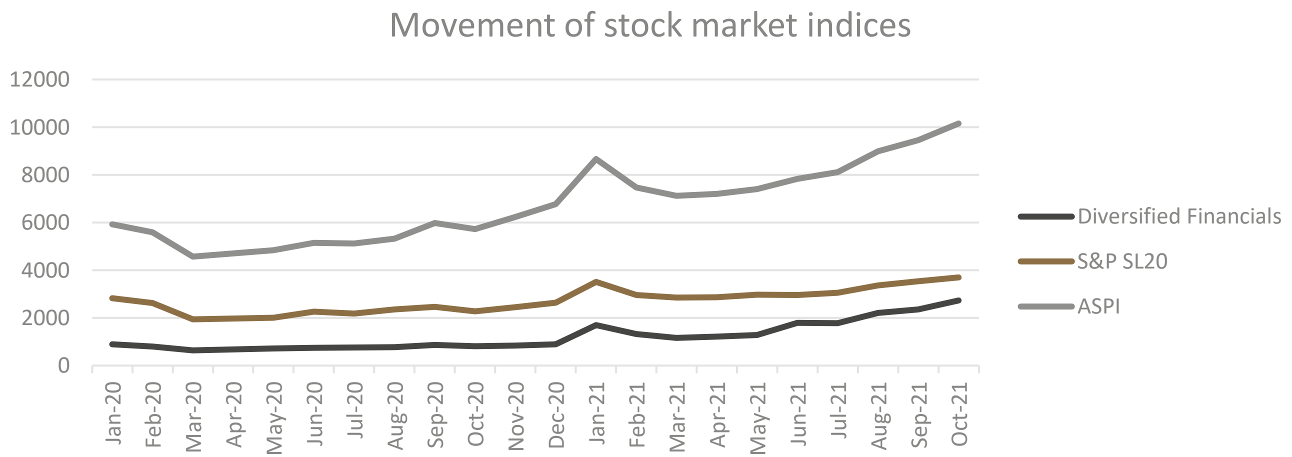
The Financial Sector Consolidation Master Plan (FSCMP)

- The Central Bank of Sri Lanka (CBSL) introduced a master plan to revive and re-consolidate weak and stressed financial institutions. This entailed reaching specific capital and asset targets set by the CBSL.
- The CBSL hopes to reduce the total number of LFCs to 25, with all of them listed on the CSE by mid 2026.
- Bimputh Finance PLC, Kanrich Finance Ltd. and Nation Lanka Finance PLC have not complied with the minimum capital adequacy ratios (as at 01/07/2021) and are required to rectify this non-compliance.
- Arpico Finance PLC has been amalgamated with Associated Motor Finance PLC w.e.f. 01/04/2021 and Trade Finance and Investments PLC has been amalgamated with Commercial Credit and Finance PLC w.e.f. 31/12/2020.
- On October 29, 2021 the CBSL appointed an advisory committee to examine possible revival options for the following failed finance companies, of which the licenses have been either suspended or cancelled as at date.
    - Central Investment & Finance Ltd.
    - ETI Finance Ltd.
    - TKS Finance Ltd.
    - The Finance Company PLC
    - The Standard Credit Finance Ltd.
- If, however reviving a particular entity does not seem feasible, the Committee may recommend liquidation of the said entity as well.

LFC interest rates and movement in stock market indices

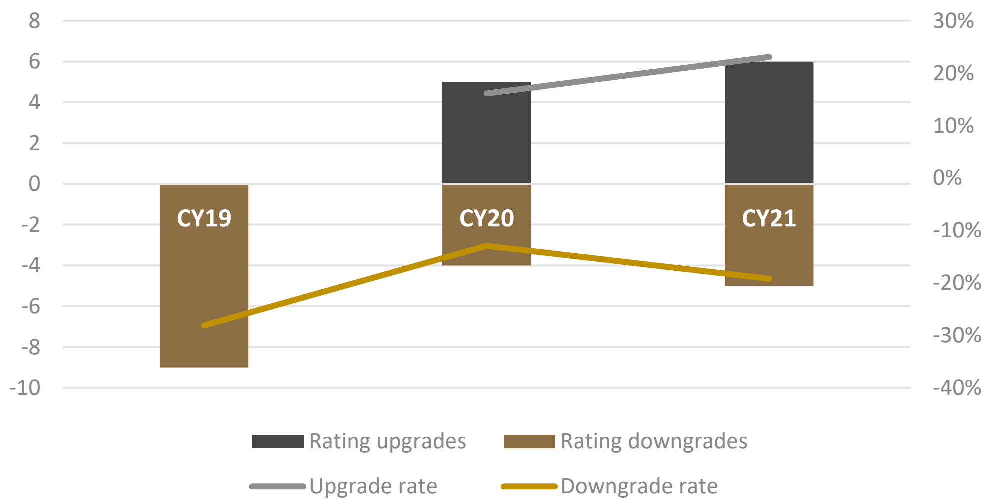
Maximum interest rates – 01st November 2021	
Savings and deposits of tenure less than 1 month	SDFR
Less than 3 months	364- day T-bill rate (WAYR)
Less than 6 months	WAYR +0.25%
Less than 1 year	WAYR +0.5%
Less than 2 years	WAYR +2%
less than 3 years	WAYR +2.25%
Less than 5 years	WAYR +2.75%
More than 5 years	WAYR +3.25%

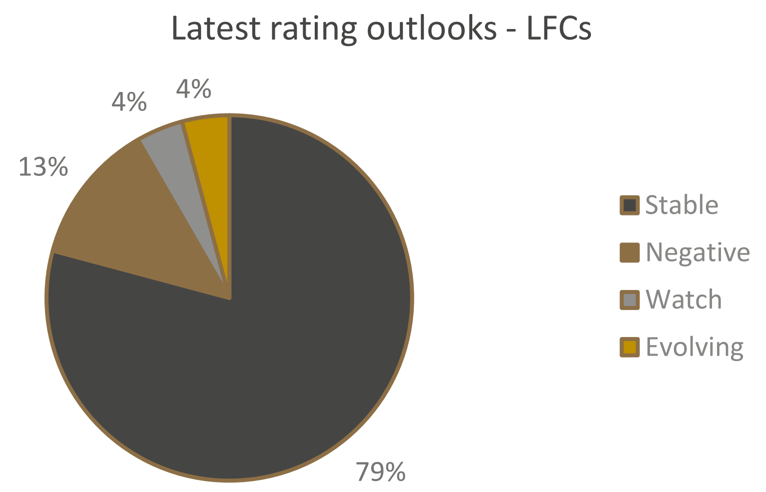




Rating curve

	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC/C+	CC/C	C/C-	D
Fitch			1	2		5		1	1							1				
ICRA						4	3	5	3	4		2	2	3	2		2			1





Peer comparison

Client	Commercial Leasing and Finance PLC				LOLC Finance PLC				People's Leasing and Finance PLC			
Year	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19
Rating		A	A	A	N/A	A	A	A		A+	A+	AA-
Outlook		Stable	Under Rating Watch	Stable		Stable	Under Rating Watch	Stable		Stable		
Net Interest Income	2,231	7,868	6,632	7,429	5,154	21,315	18,910	21,772	2,706	11,919	15,672	15,190
Profit After Tax	549	2,216	1,547	1,198	515	4,366	3,780	5,963	200	4,033	2,942	4,416
Net Worth	21,971	21,422	18,925	17,459	36,400	35,889	31,048	22,525	34,530	34,341	30,247	28,603
Loans and Advances	48,617	60,739	54,139	53,493	110,415	104,565	133,956	136,191	137,521	141,388	147,757	151,708
Total Assets	78,217	76,841	69,631	70,856	177,341	170,224	191,888	211,035	160,809	164,546	171,660	172,541
Return on Equity	2.50%	10.99%	8.50%	7.05%	1.41%	13.00%	13.98%	29.91%	0.58%	12.49%	10.00%	15.88%
Return on Assets	0.70%	3.64%	2.84%	2.83%	0.29%	2.41%	1.88%	2.83%	0.12%	3.49%	2.64%	3.95%
Gross NPA		6.49%	7.05%	4.90%		15.20%	11.06%	6.75%		9.21%	7.62%	3.91%
Capital Adequacy Ratio (Tier 1)		22.25%	21.79%	20.51%		13.50%	13.25%	10.22%		17.72%	15.12%	14.36%
Gearing	2.56	2.49	2.61	2.99	3.87	3.74	4.9	7.3	3.66	0.91	1.05	1.97

Company financial statements

Peer comparison

Client	Valibel Finance PLC				Commercial Credit and Finance				Prime Finance			
Year	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19
Rating		BBB+	BBB	BBB		BBB	BBB	BBB		BBB-	BBB-	BBB-
Outlook		Stable	Stable	Stable		Stable	Negative	Negative		Stable	Stable	Stable
	Company financial statements											
Net Interest Income	1,282	4,264	4,058	3,363	2,355	9,035	9,373	10,856	145	426	584	539
Profit After Tax	569	1,728	1,253	1,129	517	2,335	1,664	2,079	25	46	71	179
Net Worth	8,404	8,188	6,478	5,471	15,913	15,396	13,317	11,987	2,289	2,264	1,692	1,621
Loans and Advances	49,741	47,761	41,136	38,973	18,292	68,567	61,615	60,855	3,327	4,249	4,594	4,305
Total Assets	57,392	55,241	51,424	47,660	88,838	91,130	80,360	80,111	6,951	7,160	6,242	5,706
Return on Equity	27.41%	23.57%	20.98%	25.73%	13.00%	15.60%	13.20%	17.10%	4.37%	2.32%	4.31%	15.99%
Return on Assets	4.04%	3.24%	2.53%	2.62%	2.33%	2.60%	2.10%	2.50%	1.44%	0.69%	1.21%	3.81%
Gross NPA	5.47%	4.48%	5.01%	3.02%		5.40%	9.90%	6.50%	6.73%	20.21%	21.17%	5.52%
Capital Adequacy Ratio (Tier 1)	11.77%	12.98%	11.93%	11.13%		13.45%	14.14%	11.38%		33.72%	23.76%	27.28%
Gearing	5.52	5.5	6.58	7.41	4.58	4.92	4.9	5.5	2.04	1.98	2.46	2.37

Peer comparison

Client	Orient Finance PLC				UB Finance				Softlogic Finance				Associated Motor Finance Company			
Year	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19	Q1FY22	FY21	FY20	FY19
Rating	BB	BB	BB+	BB+		BB	BB	BB		BB-	BB-	BB-	B+	B+	B+	B+
Outlook	Stable	Negative	Negative	Negative		Negative	Negative	Negative		Stable	Under Rating Watch	Negativ e	Stable	Negative	Negative	Negative
Net Interest Income	330	1,107	1,253	1,289		592	593	721		549	1,081	1,184	133	1,050	1,471	2,255
Profit After Tax	60	194	(437)	29		(41)	5	20		(903)	(334)	204	(170)	6	(111)	252
Net Worth	2,951	2,887	2,711	2,166		738	768	770		3,028	2,041	1,757		1,504	1,492	1,356
Loans and Advances	4,530	3,524	4,257	4,359		6,901	7,739	8,785		16,532	16,712	18,018		10,110	14,249	17,754
Total Assets	13,324	14,023	16,235	20,816		8,187	9,350	11,127		20,870	21,746	22,405		17,156	20,152	22,223
Return on Equity	8.50%	6.90%	-17.90%	1.30%		-5.50%	0.70%	2.10%		-29.82%	-16.36%	11.61%		0.33%	-6.13%	15.53%
Return on Assets	1.60%	1.30%	-2.70%	0.20%		-0.50%	0.10%	0.20%		-4.33%	-1.54%	0.91%		0.03%	-0.52%	1.08%
Gross NPA		6.40%	11.00%	24.90%		15.80%	18.60%	18.10%		34.60%	32.80%	10.60%		18.28%	12.77%	12.88%
Capital Adequacy Ratio (Tier 1)	12.78%	11.13%	11.66%	8.54%		4.60%	2.60%	5.70%		-3.90%	-5.60%	2.20%		1.83%	13.72%	14.98%
Gearing	4.2	4.2	4.8	7		13.1	10.8	9.8		5.89	9.65	11.75		7.88	9.2	11.49

PESTEL Analysis

POLITICAL

- Import restrictions on personal vehicles and the subsequent price hike resulted in a significant decline in vehicle leases.
- Reduction of policy rates and the SRR which injected ample liquidity into the market, lowered the cost of funding, enabled higher credit flows to the economy and smooth functioning of the finance system under the challenging circumstances caused by the pandemic.
- Tax concessions, debt moratoria and fiscal policy geared towards helping an ailing economy.

ECONOMICAL

- Covid-19 induced mobility restrictions, and financial distress caused economic activity to be subdued and demand for credit to be less.
- Inflation is high and disposable income has been eroded.
- Asset quality too has been reducing despite the debt moratoria provided.
- Low forex availability and the depreciating LKR has put pressure on importers.
- Increased prices of commodities, specially fuel has depleted the terms of trade and increased import spending despite import restrictions, worsening the forex crisis.

SOCIAL

- The pandemic influenced, health, job-security and living standards, lay-offs and pay cuts lowered disposable income.
- Income disparity increased further.
- SMEs, LFCs primary customers were the worst affected by the pandemic related financial stress.
- Changes in customer requirements and demand for greater convenience.
- Increased customer financial literacy and failures of few LFCs increased demand for transparency and accountability.

PESTEL Analysis

TECHNOLOGICAL

- Increased demand for online services during the Covid-19 pandemic, a change which is here to stay.
- Increased risk of cyber security threats with technological sophistication and increased usage of online platforms.
- Improvements in the digital front to obtain competitive advantage (e.g.- smart financing).

ENVIRONMENTAL

- Increased environmental consciousness in communities.
- Which has opened avenues for more sustainable, environmental friendly products, services and businesses (e.g. hybrid vehicle financing and renewable energy financing)

LEGAL

- Introduction of the Financial Sector Consolidation Master Plan (FSCMP) by the Central bank to create strong and stable LFC's to steer future economic growth and to safeguard the interest of depositors, thereby enhancing the overall credibility of the sector as a whole.
- Which has increased the minimum capital requirement, capital adequacy ratios and asset base to be achieved by given dates.
- Relief schemes and debt moratoria introduced by the CBSL for Covid-19 affected customers.

Risk Analysis

Risk Analysis

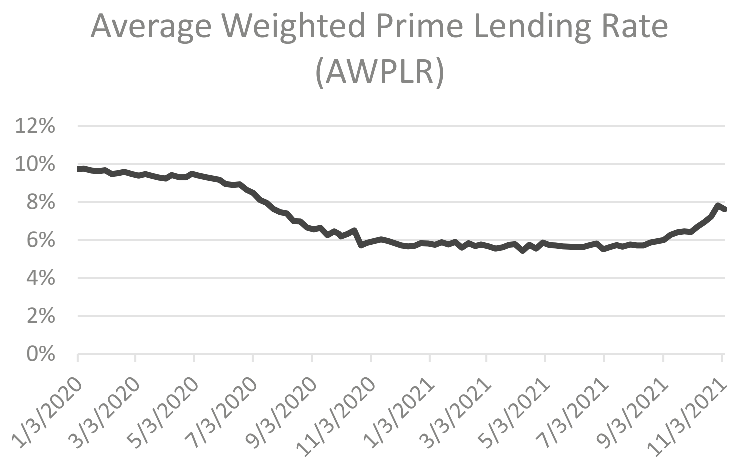
Credit risk

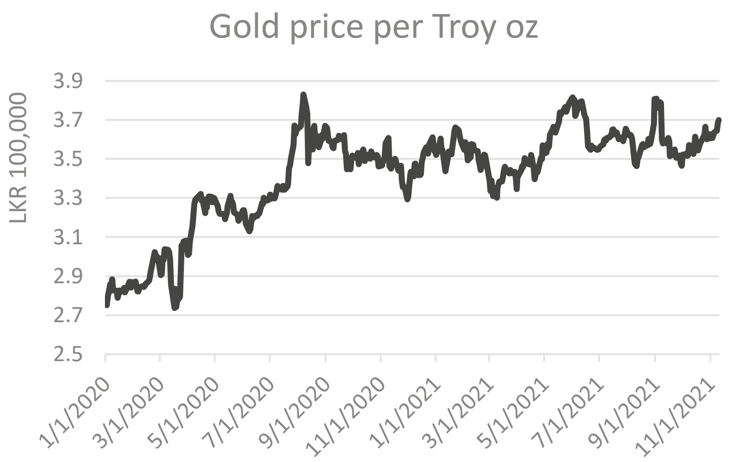
- Losses arising from the failure of obligators to meet their financial or contractual obligations as and when they fall due.
- The Company's credit risk arises mainly from different types of accommodation granted and could be identified as the most significant risk faced by the Company.
- Credit risk is addressed by granting credit according to approved policies and procedures. The credit approval process will define the lending authority, client selection and due diligence in line with the company's risk appetite.
- Customer creditworthiness is analyzed through rigorous customer evaluation initially and thereafter reviewing repayments.
- The NPL ratio is the salient measure in managing credit risk, and this is monitored regularly at branch, regional and company levels. Portfolio delinquency and loan impairments as well as portfolio quality are constantly monitored and exposures are reduced for the products with continuously high NPLs.
- 3-months overdue ratio and provisions coverage ratio are two other ratios that are used to evaluate credit risk.
- Product concentration too affects credit risk and therefore companies aim to maintain a satisfactory diversity among product range, industry sector and asset category. Concentration is monitored by the single/group borrower limit and the HHI index.
- Technology and business intelligence is used to improve automated processes focusing on delinquency management and recoveries through enhanced systems, processes and analytics.
- The Covid-19 pandemic posed difficulties in managing the credit risk. Customers' inability to meet debt obligations due to restrictions in economic activity increased NPLs/impairment charges. This was managed to a certain extent by moratoria provided by the CBSL, however NPLs could increase once these moratoria are discontinued.

Risk Analysis

Market risk

- Risk arising from fluctuations in market variables such as interest rates, exchange rates, equity prices, commodity prices such as gold.
- Since the industry involves granting of accommodation, accepting deposits and obtaining funding facilities, the movements in interest rates constitute the most important market risk.
- Excessive movement in market interest rates could bring volatility to the companies' net interest income and net interest margin.
- Interest rate risks are managed principally through minimizing interest rate sensitive assets and liability gaps.
- Company ALCOs closely monitor the interest rate movements and issue directions to lending and borrowing units on interest rate strategies.
- Interest rate stress tests, Interest rate sensitivity ratio and repricing gap ratio are some tools used to monitor market risk.
- In order to minimize the financial distress caused by the Covid-19 pandemic, the CBSL adopted an accommodative monitory policy stance reducing SDF and SLF rates by a total of 250 basis points during the CY20. It has since been raised by 5 basis points to 5.00 and 6.00 respectively.





Source - Central bank of Sri Lanka

Risk Analysis

Liquidity risk

- Risk arising from failure to maintain or generate sufficient cash resources to meet day-to-day obligation.
- Management of mismatches in the timing of cashflows, effective management of liquidity is considered of utmost importance in order to ensure smooth functionality of the companies' operations. Proper liquidity management provides critical defense against other risks such as financial, reputation and compliance.
- Monitoring liquidity risk indicators helps asses the efficacy of the comfort provided by liquid assets. Key ratios to focus on :
  - liquid asset ratios
  - maturity mismatch ratio
  - funding mix
  - exposure to bulk deposits
- Liquidity stress testing, based on different worst case scenarios and liquidity contingency plans are helpful in managing liquidity risks.
- The CBSL reduced the Statutory reserve ratio (SRR) by 300 basis points in CY20, in order to inject ample liquidity into the market enabling smooth flow of the financial system. Current SRR is 4.00%.
- The overall regulatory liquid assets available in the sector indicated a surplus of LKR 89.0 bn as against the stipulated minimum requirement of LKR 50.7 bn in December 2020.

Source - Central bank of Sri Lanka, Company annual reports

Future Outlook

- According to the World Economic Outlook published by the IMF in October, the global economy is expected to grow at 5.9%. Supply chain disruptions, the spread of new variants and rise in prices of certain commodities have been cited as the major influencing factors for this estimation.
- LRA expects the economy of Sri Lanka to grow at 3.6% in the year CY21. After being under the pressure of the delta variant of the Covid-19 virus for nearly 5 months, the country has opened up, and economic activity has resumed to a great extent. While the threat of the virus is still hovering above, the people have adopted the new normal and are more than glad to put the past behind them and face the future.
- The vaccination drive has been quite successful, tourism too has resumed, and if the Covid-19 virus does not raise its head again, the upcoming festive season is expected to get the economy going.
- Still however, economic prospects are mixed since the fiscal sector and the external sector have been under-performing. High commodity prices and Sri Lanka's depreciating terms of trade have caused the trade deficit to widen despite import restrictions. Also concerning is the mounting debt and debt serviceability which will exert pressure on the currency, interest and inflation.
- The CBSL has provided debt moratoria and other concessions for individuals and businesses affected by the pandemic. Even with these concessions, credit quality has been low, and non-performing assets could increase once the relief measures are lifted.
- The CBSL also continued to review and monitor the key prudential indicators and introduced several regulatory and supervisory frameworks to strengthen the business functionality of certain weak LFCs in order to support and revive them.

Future Outlook

- The role of financial institutions in a recovering economy encompasses assisting customers in adversely affected sectors to stay afloat while also supporting growth in thriving sectors of the economy.
- However, financial difficulties caused by the pandemic, and drop in repayment capacity of corporates and individuals may lead to defaults which will result in financial institutions showing reluctance to lend. Such decline in credit will in turn lead to an economic downturn creating a feed-back loop between the economy and the financial sector.
- Leasing of vehicles which constitutes a major part of credit given by LFCs has been affected by the import restrictions of private vehicles. This has caused a surge in demand for second-hand vehicles in the market inflating prices by up to 50% sometimes depending on the type of the vehicle.
- The higher prices have supported loan recoveries from repossession, but the unaffordability has lowered the demand for leases. Once the ban on vehicle imports are lifted, the depreciating rupee would have a material effect on the price of vehicles imported, which too could reduce demand for leases.
- The CBSL's LFC consolidation plan too could alter the dynamics of the sector, with amalgamations and ceasing of operations due to take place.
- The pandemic has changed certain aspects of the trade and some of these changes are here to stay. Customers of LFCs are now demanding the convenience of conducting their financial services from the comfort of their homes, and hence many companies are looking to upgrade their technological capabilities.
- The use of technology results in operational efficiencies and enhanced customer experiences which will drive profitability and as a result the financial services industry will gradually gain its attractiveness to investors.