Sri Lanka Banking Report

June 2018

Issue 2
September 2018

Contents

Foreword

The banking industry is undergoing a time of significant change. From disruption caused by fintech and other digital challenges to an ever increasing regulatory burden and changing customer attitudes, bankers are under pressure on multiple fronts. Added to this, the changing dynamics of saving in high yielding deposits, financial and business implications of Sri Lanka Financial Reporting Standard 9 (SLFRS 9) and the volatility of the currency have thinned the margin for error to nonexistent levels on repricing strategy and increased the pressure on getting the product mix correct for bankers. In this light, we focus this issue on addressing some of the more pertinent implications of SLFRS 9 and how best to prepare for it as well as the importance of an effective Fraud Risk Management framework.

Fraud occurs every day all over the world and banks lose a lot of money due to fraud. Fraud Risk Management ("FRM") is an ongoing process that provides a bank with the tools to manage fraud risk in a manner consistent with the regulatory requirements as well as the bank's needs. A focused FRM scope should provide services that are aimed at helping clients prevent, detect, and respond to fraud and misconduct. We do this by working with our clients to assess , design, implement, and evaluate effective controls.

This is the second issue of the Sri Lanka Banking Report we have produced. We have discussed in detail the key issues which we feel could affect the sector in the second half (2H) 2018 of the year and have analyzed the industry performance through a challenging first half (1H) 2018. As always, we would be happy to discuss these themes in wider detail with you in the coming weeks and assist you to face the rest of the year.

Ranjani Joseph
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Executive Summary

We see the banking sector this year gearing up to strike a balance between meeting the new capital and leverage ratios imposed by Basel III regulation, incorporating Sri Lanka Financial Reporting Standards (SLFRS 9) while continuing with moderate loan growth. As mentioned in our last update, Basel III regulation introduced last year, fully effective beginning of 2019, led to more stringent regulation in capital, liquidity and leverage. In the past year, banks went for rights and subordinate debt issues to raise and strengthen the capital base.

During the quarter, we have seen banks in the path of refining their understanding and processes with respect to SLFRS 9. The new standard requires higher provisioning due to introduction of the expected credit loss model compared to the current incurred loss model. Hence the migration from LKAS 39 to SLFRS 9 is estimated to impact the total equity by 3% to 5%. Hence we expect 2018 to be a transition year with the future years absorbing the effect gradually in line with the quality of loan disbursements.

The banking sector was seen recording a moderate loan growth despite a challenging business environment, sustained by the tightened monetary policy and fiscal policy coupled with political uncertainty. However, we continue to expect the mid to large banks to move into sustainable loan growth in the backdrop of increasing regulation, competition and the present economic environment.

Furthermore the challenging business conditions also led to significant provisions being made for impairment which in turn had pressure on the bottom line. Moreover, we expect a further negative impact on capital base due to increasing non performing loans (NPLs). We expect pressure on impairment charges to continue in 2H 2018 as the business environment will continue to remain bleak.

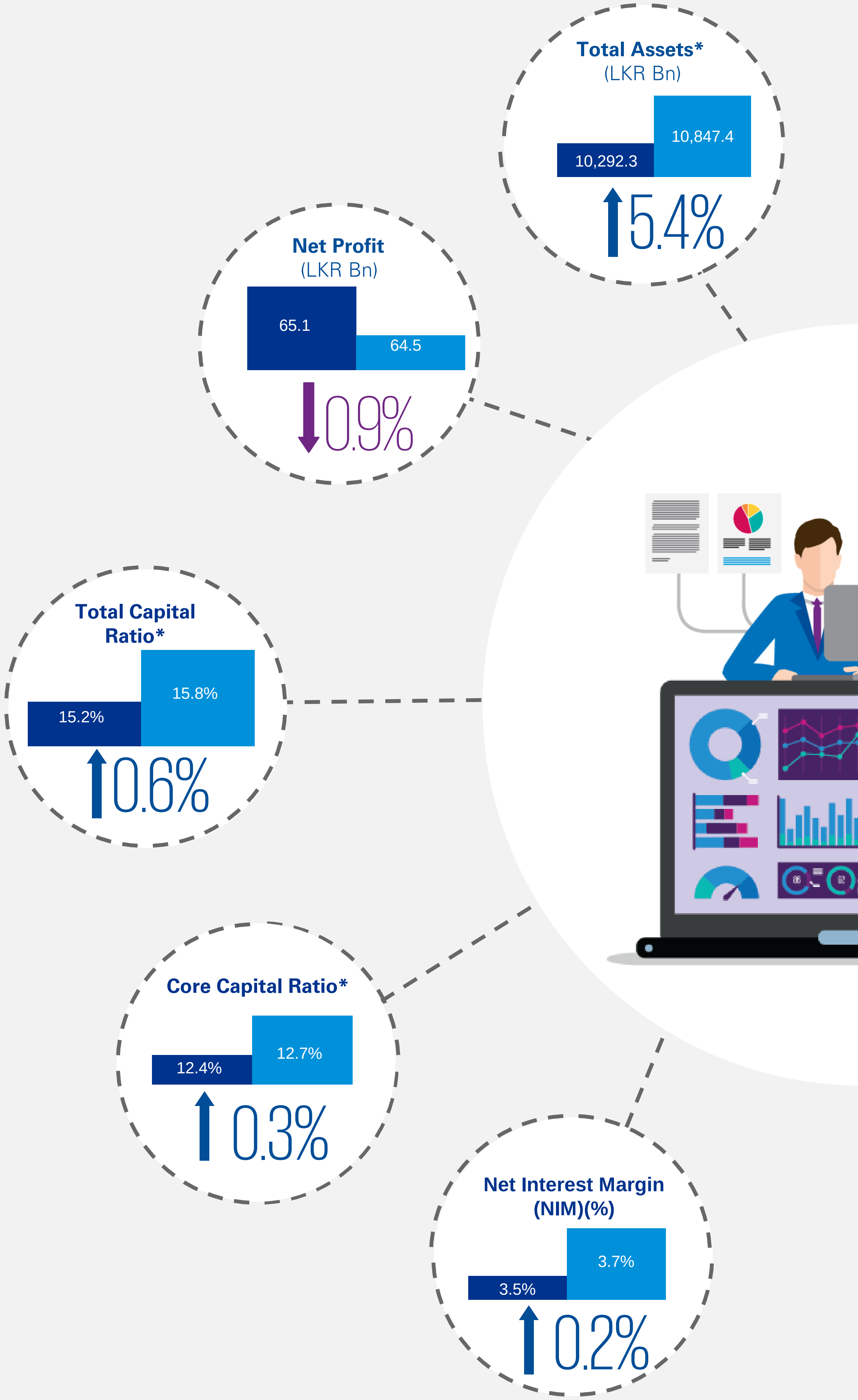
The major contributor in funding loans continued to be deposits in the first half (1H) 2018, despite equity and debt being raised in the recent past. However, low yielding CASA levels of banks are being witnessed to be on a short and long term downward trend with the shift towards high yielding fixed deposits. The local banks and foreign banks under review in the 1H 2018 recorded CASA levels in between 20.0% to 34.1% and 47.7% to 51.8% respectively.

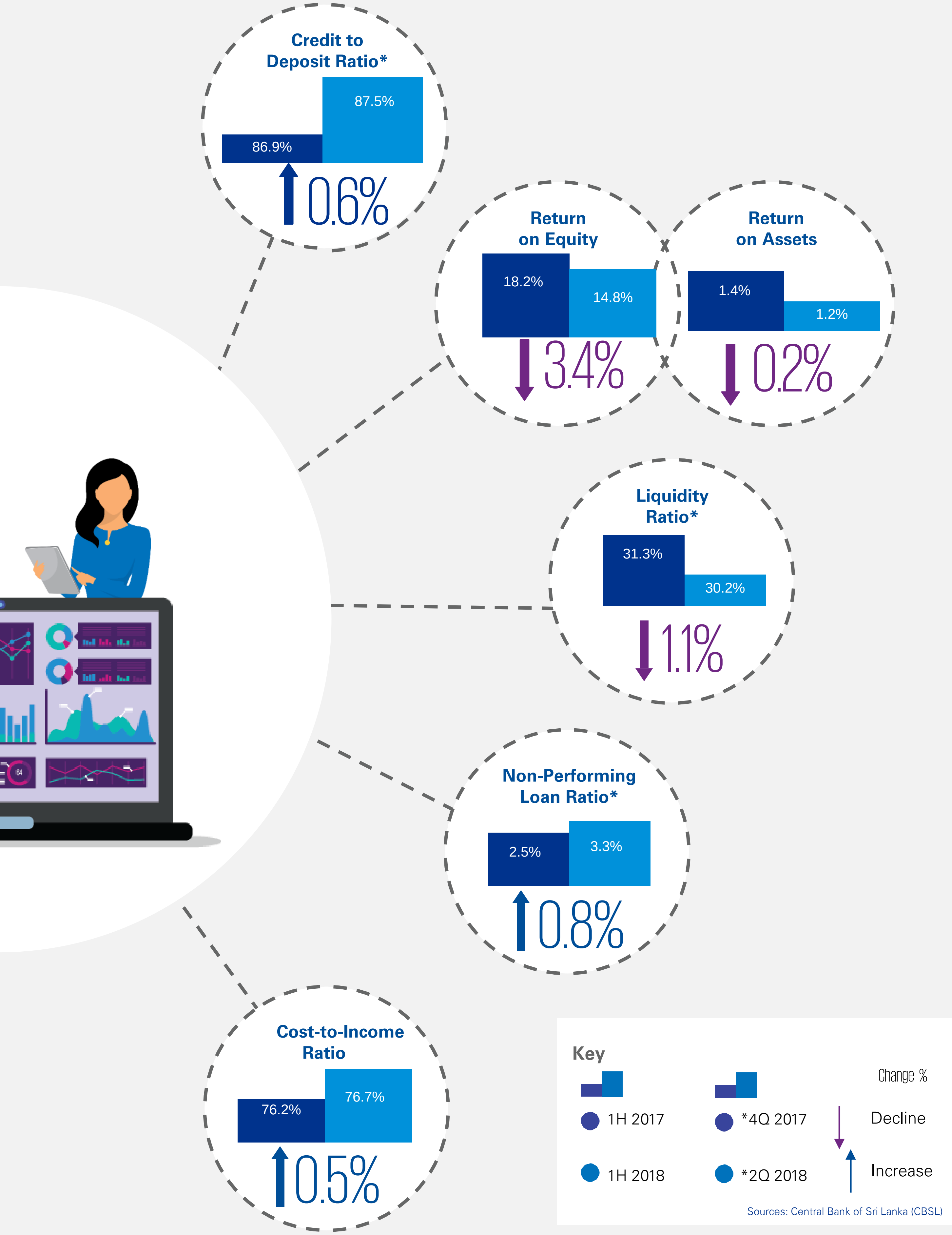
The effects of the Inland Revenue Act No 24 of 2017 (IRA) which became effective from 1 April 2018 had implications on the banking profits in the second quarter (2Q) 2018. This was mainly due to some tax exemptions being removed on various interest income sources such as USD denominated bonds, professional loans and SMEs and the removal of notional tax credit on treasury bills and bonds. Furthermore, the Government of Sri Lanka (GoSL) recently proposed a 7% Debt Repayment Levy on financial institutions. This levy effectively increases the VAT on financial services from 15% to 22%.

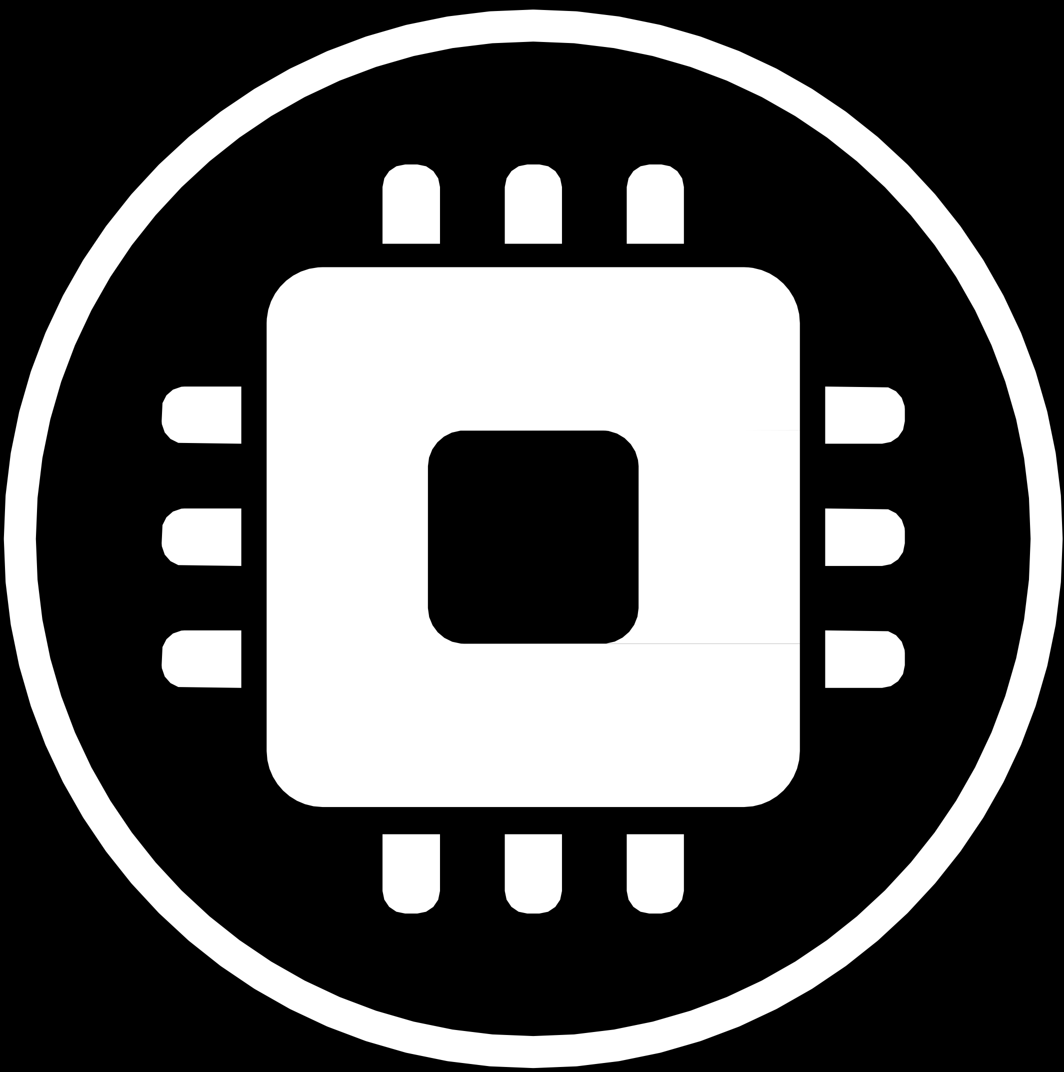
We observe that globally a wave of new fintech players have emerged with solutions covering most of the complex aspects of the banking value chain. Domestically, we see banks continuing to strengthen their resources and scale in the fintech space, by launching data analytics driven products and services to enhance customer experience and data security.

The banks will continue to face competition not only from peer banks and large finance companies but other fintech players, which may not be as highly regulated as the banks are. Moreover with high capital requirements to be met with scarce high quality capital, the smaller banks performance will be threatened over the medium term. Hence we expect consolidation in the sector to further strengthen the banking sector.

Performance Highlights




Credit to Deposit Ratio*
86.9%
87.5%
0.6%
Return on Equity
18.2%
14.8%
3.4%
Return on Assets
1.4%
1.2%
0.2%
Liquidity Ratio*
31.3%
30.2%
1.1%
Non-Performing Loan Ratio*
2.5%
3.3%
0.8%
Cost-to-Income Ratio
76.2%
76.7%
0.5%
Key
Change %
1H 2017
*4Q 2017
Decline
1H 2018
*2Q 2018
Increase
Sources: Central Bank of Sri Lanka (CBSL)

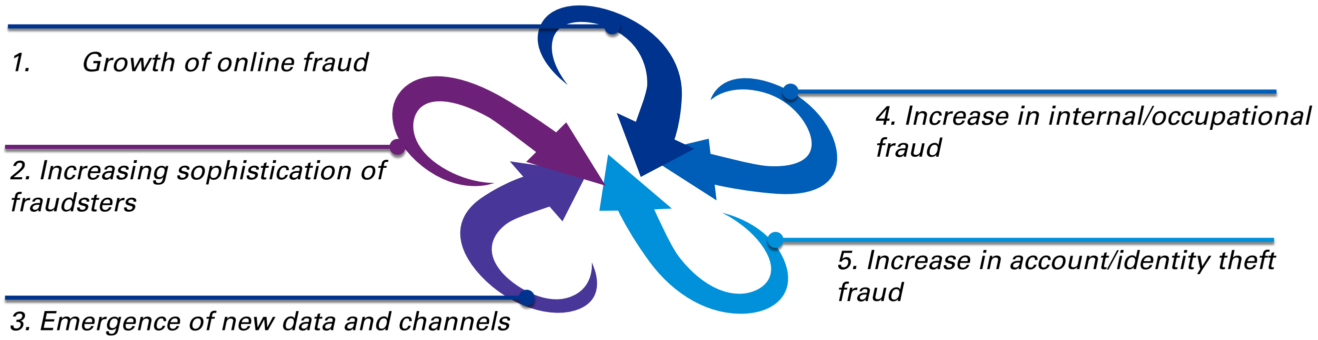


Fraud Risk Management

Fraud Risk Management

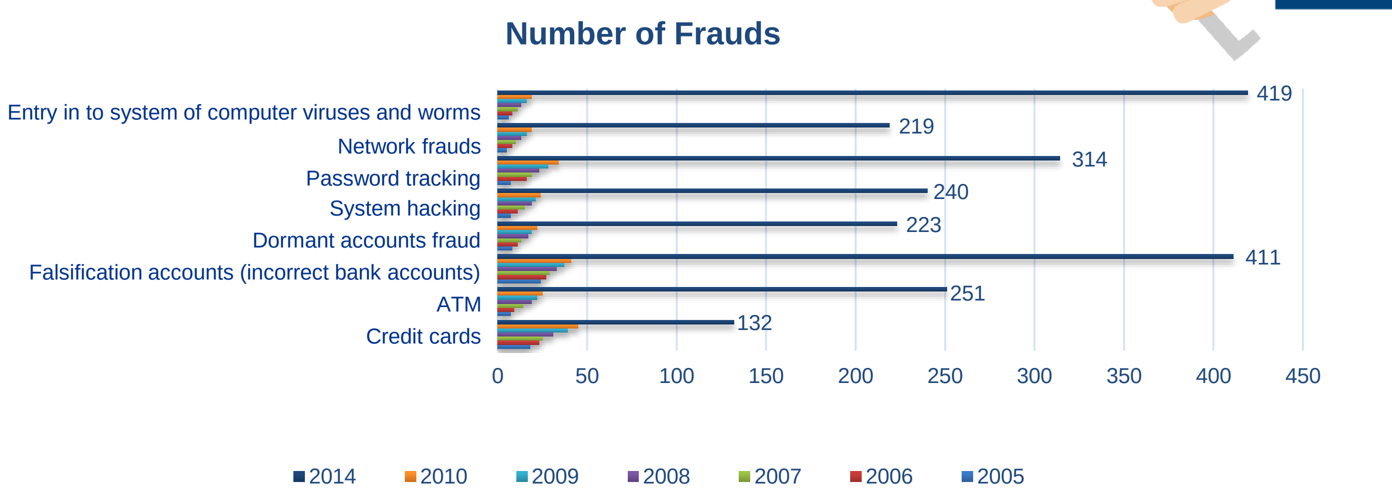
Fraud is an ever-present and growing risk. The sheer volume of transactions and level of complexities in products, services and technology platforms continue to expose the financial services industry to potential risks due to frauds, perpetrated both by outsiders as well as insiders.

Frauds increase the liability of financial institutions, resulting in loss of potential customers, crisis of confidence of public and in the long run may lead to cancellation of operating licenses by regulators. Financial institutions are thus challenged to prevent fraud, bribery, corruption and non-compliance to money laundering regulations in the current environment of heightened scrutiny from regulators across the globe.



Fraud as an issue is now not restricted to certain business units. It is prevalent across the institution, be it the core operations, sales, finance, lending or Information technology units etc. Compiling reliable statistics around frauds is not easy, due to inadequate identification of frauds, inaccurate reporting of frauds and treating the fraud losses as operational losses.

Most times fraud is not reported and misquoted to manage reputational risk and regulatory actions.
Recent trends of frauds in Sri Lanka have shown ATM skimming, text message scams, banking data hacking and leakage, land mortgage frauds and lottery scams as major types of frauds crippling Sri Lanka's banking sector.



Source : Bank frauds reports statistics Sources: CID, (2014) It is essential for the financial institutions in Sri Lanka to assess the frauds in the NPL category to understand the unscrupulous behavior prevailing amongst borrowers.

A relevant question that the institution often needs to assess is "How do these frauds occur?"

Financial institutions run a multitude of operational risks mainly due to the size of the organization, the complexity of processes, increasing customer expectations, changing regulatory requirements and the paradigm shift from document based banking to more technology driven banking. This requires institutions to develop and institute controls to prevent the occurrence of frauds. A report from the Association of Certified Fraud Examiners, USA, on a survey they conducted reveal that primarily internal control weaknesses, contribute to internal frauds in the Asia Pacific Region.

Managing the risk of fraud is the same in principle as managing any other business risk. It is thus inevitable for financial institutions to devise an effective strategy to assess their fraud risk management frameworks and implement fraud detection solutions across the financial institution to reduce the negative consequences of frauds.

Fraud management functions should be an integral part of the organization and all stakeholders should participate in this and make it an ongoing exercise through collaboration. This collaboration would result in reduced fraud losses and a more consistent customer experience. Since frauds are not a one-time event, both banks and NBFIs have begun implementing end to end fraud risk management solutions that encompass the whole gamut from logging incidents, to detecting fraudulent transactions in real and near real time across banking channels.

Fraud detection, alert and case management should be managed as a whole. Businesses must make meaningful investments in customer recognition tools that is delivered through advanced, multi-layered solutions with device intelligence or behavioral biometrics, tailored to the customer experience.

Banks in mature markets are now looking at Early Warning systems (EWS) that can assist in identifying accounts that have the potential to go bad or identifying employees who could become rogues. As part of prediction and prevention, banks would need to deploy tools that have the capability to avoid the occurrence of fraud and shift focus from investigations to prevention. An effective, mature and embedded fraud risk framework with both proactive and reactive measures is the key to success in managing the risks of fraud in the institution.

Technology helps both the fraudster and the organization that is combatting fraud. Organizations, could do much more by using technology as a tool to prevent, detect and respond to wrongdoing.

At present, data analytics, as one of the key anti-fraud technologies, can sift through millions of transactions, looking for suspicious items; but only 3 per cent of banks use proactive anti-fraud data analytics in detecting fraudsters.

Organizations can never rest as fraud threats are constantly changing and organizations need to conduct regular risk assessments, altering the way they essentially prevent and detect fraud.

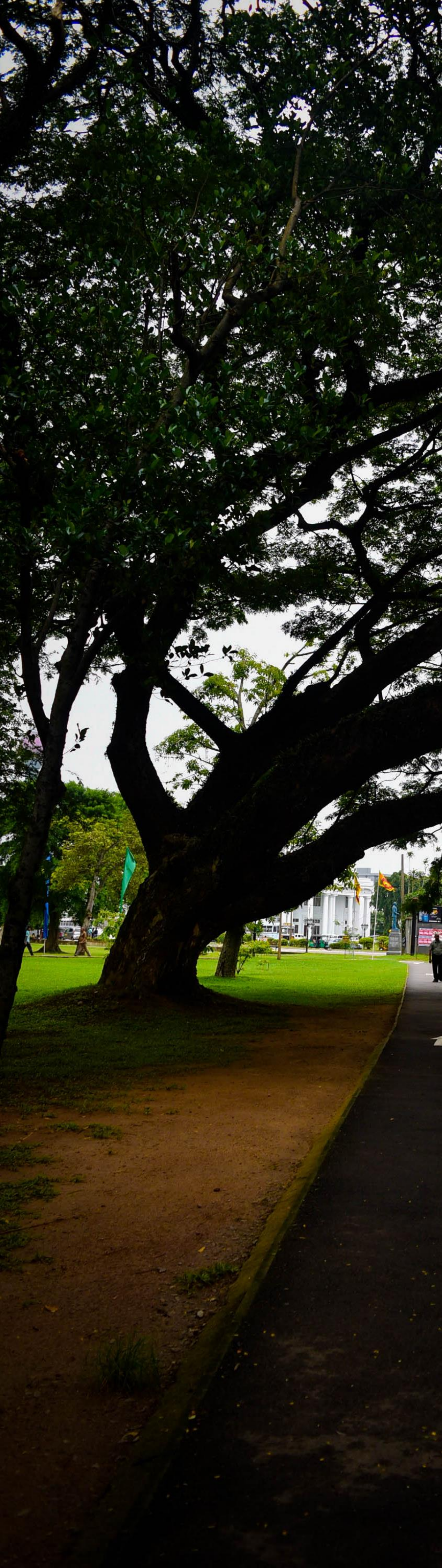
Suveer Khanna
Partner,
Forensic Investigations
KPMG in India

- Suveer has over 15 years of experience in conducting Investigations, AML testing and compliance reviews, fraud risk assessment, auditing and accounting.
- He has led investigations into allegation of money laundering by two publicly listed banks in India, an investigation at a global insurance provider on behalf of Financial Services Authority, UK (FSA), of the leading National Commodity Exchange which was commissioned by the regulator,
- Suveer also has assisted the regulators in their investigation in a leading PSU bank and an investigation which involved analysis of the investment portfolio of a hedge funds and identification of trades against the offering circular of the fund.
- He led the engagement team to perform current state risk assessment for Anti-Bribery and Corruption (ABC) exposure for global bank in India.

- Jagath is a Partner leading KPMG's Internal Audit and Risk Consultancy Services and the Forensic Services practice in Sri Lanka; a multidisciplinary team of professionals who advice clients on forensic investigation, strategic planning, Internal audit services, cost optimization, financial management, decision support, supply chain management , regulatory compliance, Media and advertising advisory, Corporate Intelligence, Forensic technology services, Fraud Risk Management, Major project advisory, sustainability, AML services, Anti bribery services, Corruption protective services and Compliance, Economic and regulatory services . He has over 25 years of experience in Sri Lanka, Maldives and in practice for numerous global and regional projects.
- Jagath presently heads the Internal Audit, Risk & Compliance Services, Forensic and Investigation Services and Sustainability practices of KPMG in Sri Lanka and KPMG in the Maldives in addition to leading the Maldives practice of the firm.

Jagath Perera
Partner, Internal Audit, Risk & Compliance Services and Forensic Services
KPMG Sri Lanka

IFRS 9



SLFRS 9

SLFRS 9, the new standard on Financial Instruments replaced the erstwhile standard LKAS 39 effective January 1, 2018. Transition to SLFRS 9 is expected to have a profound impact on the business of banks as it has a pervasive impact not only on accounting but also on the structuring of products, risk assessment of borrowers, capturing of newer and larger data sets, regulatory capital etc. This is primarily accountable to revised requirements with respect to classification and measurement of financial assets and moving from an incurred loss model to an expected credit loss model.

SLFRS 9 should be as much part of the CEO agenda as it is of the CFO/ Financial Controller's agenda as it is expected to significantly alter the KPIs and business ratios (cost to income ratio, NII, NIM, NPL ratios and provision coverage ratios) based on the choices made. Banks are advised to proactively reach out to internal and external stakeholders to highlight impacts of these changes.

Some of the significant potential changes in practices that are expected due to SLFRS 9 are as follows:

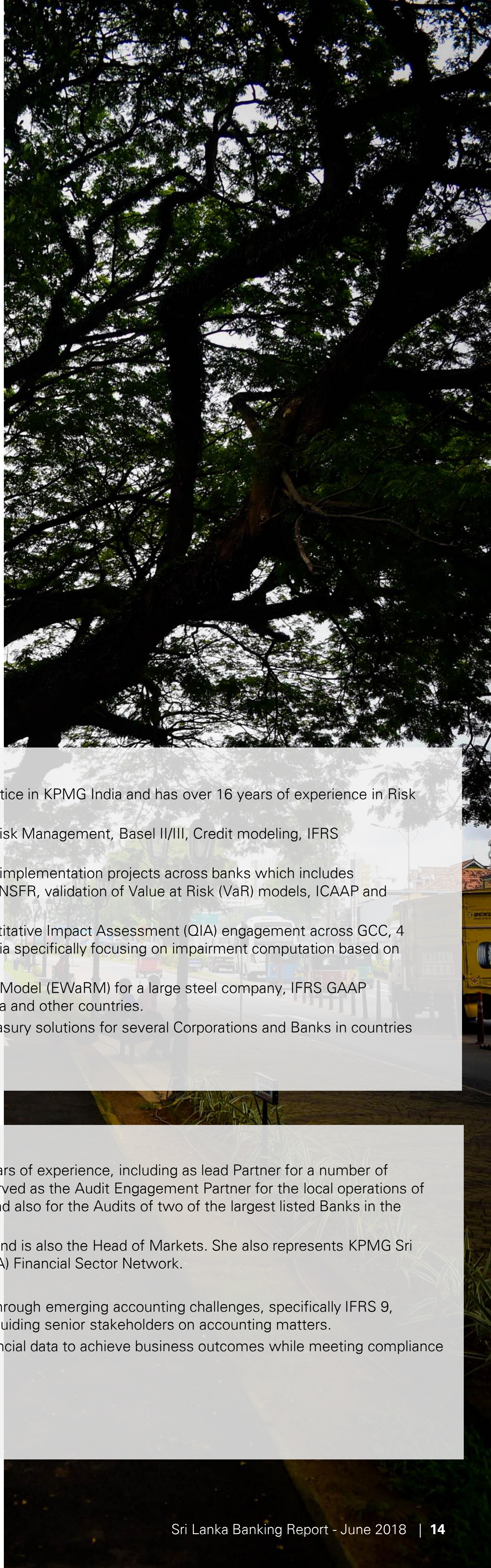
- SLFRS 9 brings in the concept of classification of financial assets depending on the business model test and cash flow characteristics, whereby the existing LKAS 39 categories of held-to-maturity (HTM), held-for-trading (HFT), available-for-sale (AFS) and loans and receivables (L&R) have been replaced with three principal classification categories: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

- Equity investments are required to be measured at fair value, with an option to irrevocably elect to measure fair value changes through OCI (without the ability to recycle). LKAS 39 had an exception to the measurement requirements for investments in unquoted equity instruments that do not have a quoted market price in an active market and for which fair value therefore cannot be measured reliably. Such financial instruments are measured at cost. IFRS 9 removes this exception, requiring all equity investments to be measured at fair value.

Thus, SLFRS 9 may have a significant impact on the way financial assets are classified and measured, resulting in changes in volatility within profit or loss and equity, which in turn are likely to impact the Key Performance Indicators (KPIs).

The new provisioning computation (forward looking credit losses) is likely to have a significant impact on the systems and processes of banks, due to its extensive requirements for data and calculations.

- SLFRS 9 replaces the 'incurred loss' model in LKAS 39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at FVTPL, including loans, lease and trade receivables, debt securities and off balance sheet exposures such as loan commitments (revocable and irrevocable), contingencies and financial guarantees. It does not apply to equity investments as they are accounted for either at FVTPL or FVOCI.



- For assets where there had been significant increase in credit risk since origination (Stage 2), i.e. when the facility is more than 30 days overdue, SLFRS 9 requires recognition of lifetime ECL as against 12 months ECL (Stage1). This will create a cliff effect and will be tantamount to a high impairment charge being recognized upfront. Hence, banks may now need to spend greater effort on early collections so as to avoid recognition of life time provisions.

- Further, for loans classified as Stage 3, interest income is recognized on accrual basis using the EIR method on loan balance, net of ECL loss provision, unlike under LKAS 39 where no such interest was being accrued.

The current environment where SLFRS 9 transition is being conducted has considerable ambiguity due to the lack of certain key regulatory clarifications and guidance. The treatment of SLFRS 9 transition adjustments on capital adequacy is also unclear, since there could be instances wherein the transition adjustments have a significant impact on the net worth of banks on transition. Making business decisions in such an environment may prove to be challenging. The banking industry will look forward to receiving inputs from the regulators like the CBSL to help companies achieve a smoother transition for both financial and regulatory reporting.

Rajosik Banerjee
Partner | Financial Risk Management
KPMG in India

- Rajosik leads the Financial Risk Management practice in KPMG India and has over 16 years of experience in Risk Management, Banking and Financial Instruments.
- He has in-depth knowledge in areas of Treasury Risk Management, Basel II/III, Credit modeling, IFRS implementation and Hedge accounting.
- Rajosik has led several Basel and treasury related implementation projects across banks which includes implementation of Basel III requirements of LCR, NSFR, validation of Value at Risk (VaR) models, ICAAP and implementation of treasury solutions.
- He is currently leading more than 30 IFRS 9 Quantitative Impact Assessment (QIA) engagement across GCC, 4 Banks in Sri Lanka and 14 IFRS conversions in India specifically focusing on impairment computation based on 'expected credit loss' for Banks.
- Rajosik has implemented Enterprise Wide at Risk Model (EWaRM) for a large steel company, IFRS GAAP conversion solutions for leading companies in India and other countries.
- He has extensive experience of implementing treasury solutions for several Corporations and Banks in countries like US, UK, Germany, Israel, GCC and India.

Ranjani Joseph
Partner | Head of Banking Services
KPMG in Sri Lanka

- Ranjani is an audit Partner and counts over 20 years of experience, including as lead Partner for a number of Multinational & local Banks. She most recently served as the Audit Engagement Partner for the local operations of three multinational banks operating in Sri Lanka and also for the Audits of two of the largest listed Banks in the Colombo Stock Exchange.
- She leads KPMG's Banking services in Sri Lanka and is also the Head of Markets. She also represents KPMG Sri Lanka in the KPMG Middle East South Asia (MESA) Financial Sector Network.
- Ranjani's responsibilities include: leading clients through emerging accounting challenges, specifically IFRS 9, advising on various accounting transactions, and guiding senior stakeholders on accounting matters.
- Her focus is on the integration of the risk and financial data to achieve business outcomes while meeting compliance requirements.

Key Banking Indicators

Sector at a glance

Companies in the banking sector- 30 June 2018			
Licensed commercial banks			
	Total asset base (LKR Bn)		**Total asset base (LKR Bn)**
State banks		**Foreign banks**	
1.Bank of Ceylon*	1,987	14.The Hongkong & Shanghai Corporation Ltd	405
2.People's Bank*	1,633	15.Standard Chartered Bank	184
Local banks		16.Citibank	43
3.Commercial Bank of Ceylon PLC*	1,213	17.Deutsche Bank AG	35
4.Hatton National Bank PLC*	1,000	18.Indian Bank	33
5.Sampath Bank PLC*	866	19.MCB Bank Ltd	26
6.Seylan Bank PLC	429	20.Habib Bank Ltd	8
7.National Development Bank PLC	417	Others	88
8.DFCC Bank PLC	361	21.Indian Overseas Bank	
9.Nations Trust Bank PLC	301	22.Axis Bank Ltd	
10.Pan Asia Banking Corporation PLC	150	23.State Bank of India	
11.Union Bank of Colombo PLC	114	24.Public Bank Berhad	
12.Amana Bank PLC	69	25.ICICI Bank Ltd	
13.Cargills Bank Ltd	36	26.Bank of China (Banking operations are yet to commence)	N/A
Licensed specialized banks			
	Total asset base (LKR Bn)		**Total asset base (LKR Bn)**
1.National Savings Bank*	1,078	5.State Mortgage & Investment Bank	43
2.Pradeshiya Sanwardhana Bank	171	6.Lankaputhra Development Bank Ltd	10
3.Sanasa Development Bank PLC	91	7.Sri Lanka Savings Bank Ltd	9
4.Housing Development Finance Corporation Bank of Sri Lanka	47		

**Domestic Systemically Important Banks (D-SIBs) – Banks with asset bases higher than LKR 500Bn*

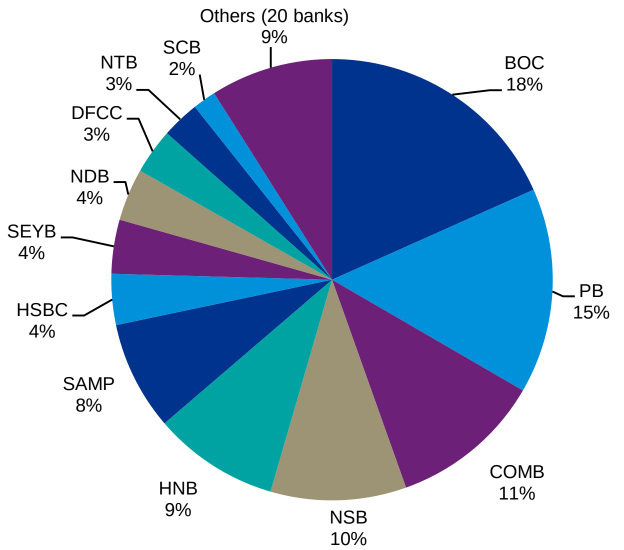
Introduction

The banking sector consisted of 25 Licensed Commercial Banks (LCBs), including 12 branches of foreign banks, and 7 Licensed Specialized Banks (LSBs) by end of June 2018.

The total asset base of the banking sector was recorded at LKR 10.8Tn by end of 2Q 2018 compared to LKR 10.3Tn by end 4Q 2017. The total asset increase recorded was 11.1% during the 1H 2018.

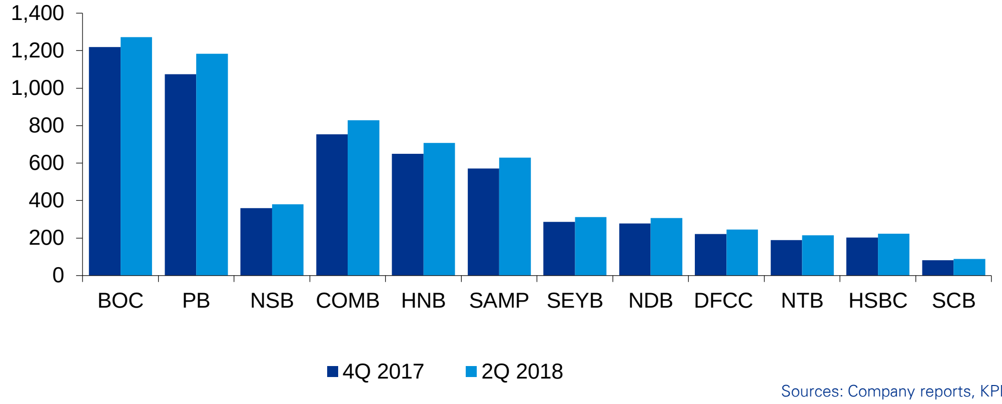
The report further analyses banks that currently account for total assets of more than LKR 175 Bn.

Composition of total assets of the banking sector (June 2018)



Sources: Company reports, CBSL

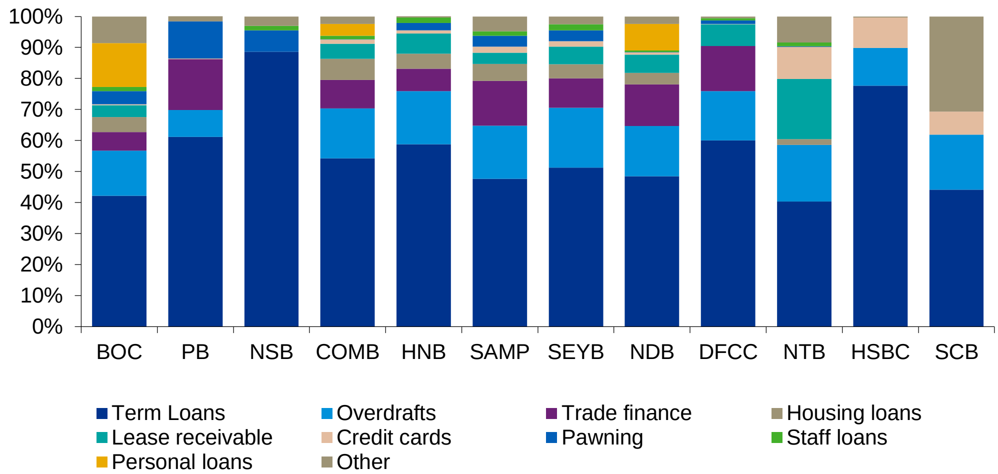
Gross loans and advances (LKR Bn)



Sources: Company reports, KPMG analysis

Total gross loans and advances of the banking sector increased to LKR 6.9Tn by end 2Q 2018 compared to LKR 6.4Tn as at end 4Q 2017. Banks witnessed this boost in new loans despite the challenging business environment.

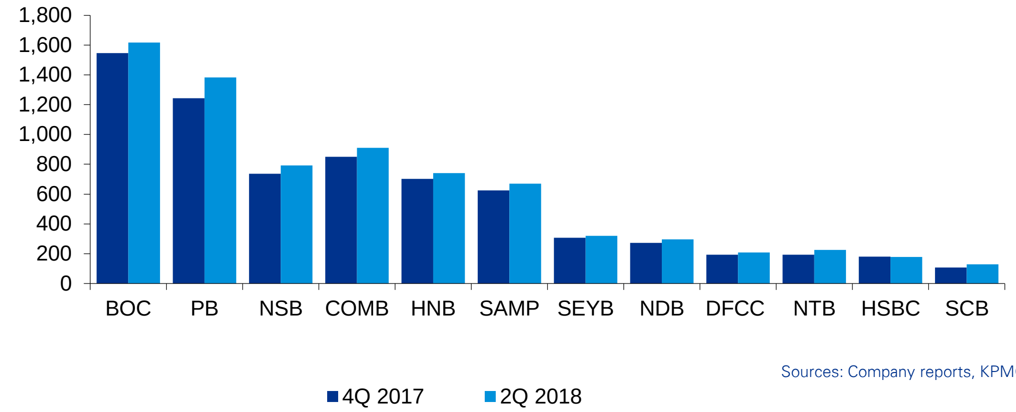
Composition of gross loans & advances (as at 30 June 2018)



Sources: Company reports, KPMG analysis

The composition of the gross loans and advances in the banking sector showed moderate changes in terms of term loans and overdrafts during 1H 2018. However, the recent credit demand from the new construction developments impelled the gross loans and advances to increase, thus posing the risk of over exposure to the sector. Credit cards played a similar role in aiding the growth of the asset portfolio, as many banks increased the number of credit cards issued over the past few years, which was a major contributor for non interest income. The growth in credit cards is expected to continue as banks aggressively promote credit cards to customers with different levels of income. In the light of SLFRS 9 this is a risky move as the repayments would need to be managed carefully not to incur higher provisioning.

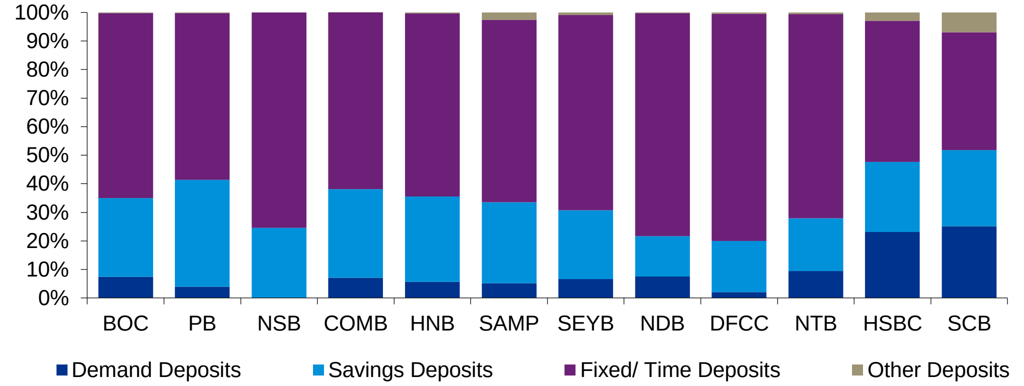
Total deposits (LKR Bn)



Sources: Company reports, KPMG analysis

Total deposits of the banking sector increased to LKR 7.9Tn by end 2Q 2018 compared to LKR 7.4Tn as at end 4Q 2017. Competition from non bank competitors led banks to offer attractive alternatives and offer better rates which aided the increase in total deposits over the period.

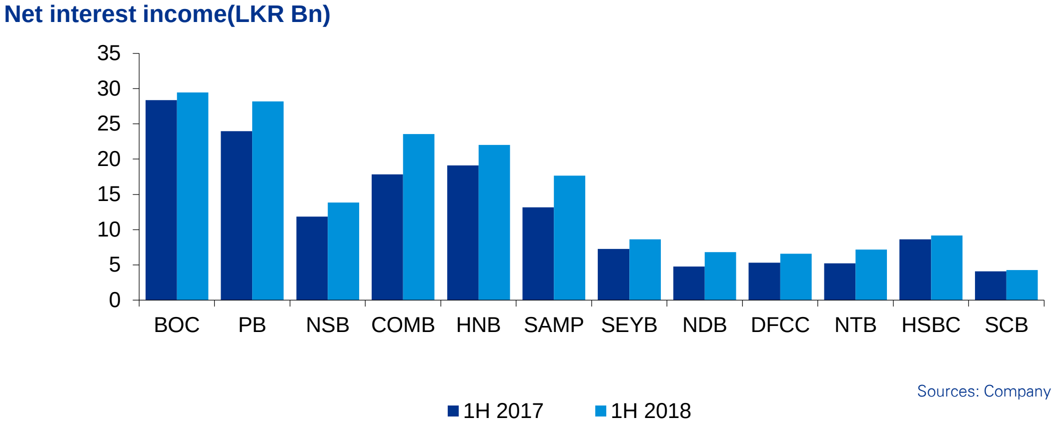
Composition of deposits (as at 30 June 2018)



Sources: Company reports, KPMG analysis

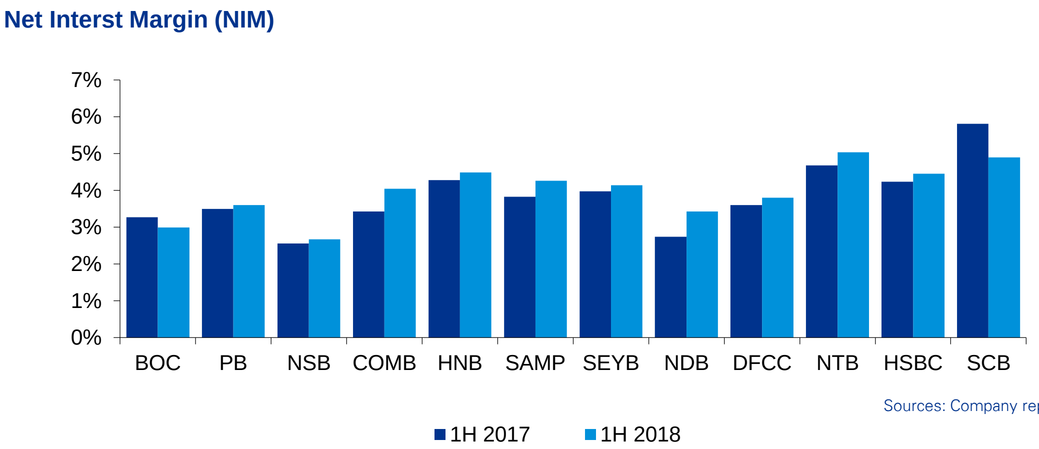
The sector witnessed a 9.6% YTD growth in time deposits, owing to attractive rates offered by the banks during the period as well as customers shifting towards bank deposits in the light of recent finance company failures and the adverse publicity surrounding them. Therefore the CASA ratio showed a slight decline over the sector.

Growth in interest earnings



Sources: Company reports

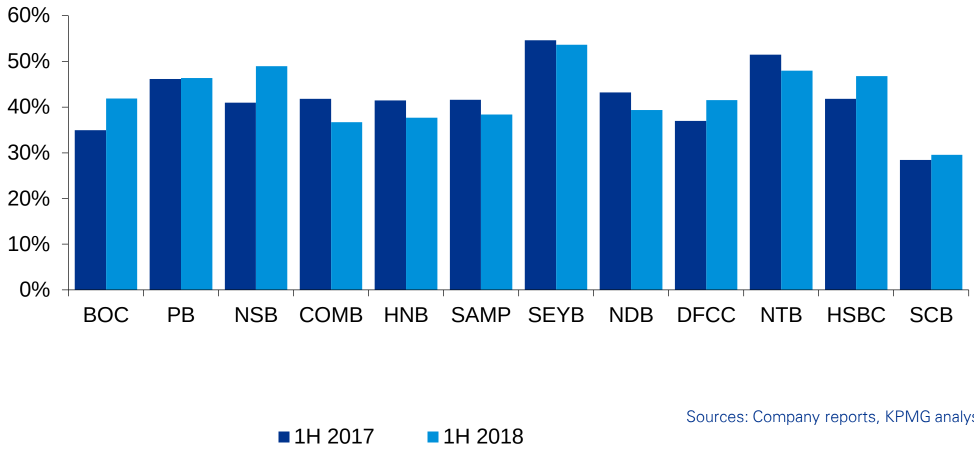
A 15.1% YoY growth in interest income along with a slower 13.7% growth in interest expense in 1H 2018 helped banks record a 17.8% YoY growth in net interest income (NII) over 1H 2018. This growth was fueled by the growth in loans and advances coupled with high interest rates that prevailed during the period. However, the interest income was affected the removal of notional tax credit of treasury bills and bonds with effect of the IRA from 1 April 2018 onwards.



Sources: Company reports

Overall NIMs in the banking sector improved to 3.7% in 1H 2018 compared to 3.5% in 1H 2017. The upward movement witnessed in the interest rates over the period coupled with the timely repricing strategies implemented by banks enabled banks to achieve the said growth in NIMs. It was observed that the larger portion of the NIMs is NII and we expect this trend to continue in the mid to long term. The NII is expected to moderately grow with interest rate pressure coming in towards the latter part of the year.

Cost to income ratio



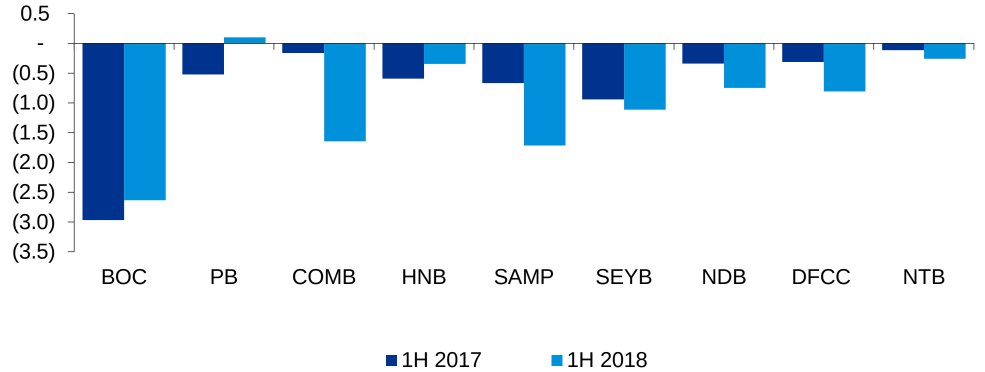
Sources: Company reports, KPMG analysis

Most banks managed to maintain their cost to income ratios supported by growth in total operating income, amidst increasing operating expenses due to new staff recruitments and annual remuneration increments for the staff. Increase in costs of maintaining the branch network also contributed to growth in operating expenses.

We expect banks to focus on forming alternative digital banking channels which will ease the cost to income ratios going forward.

Impairments

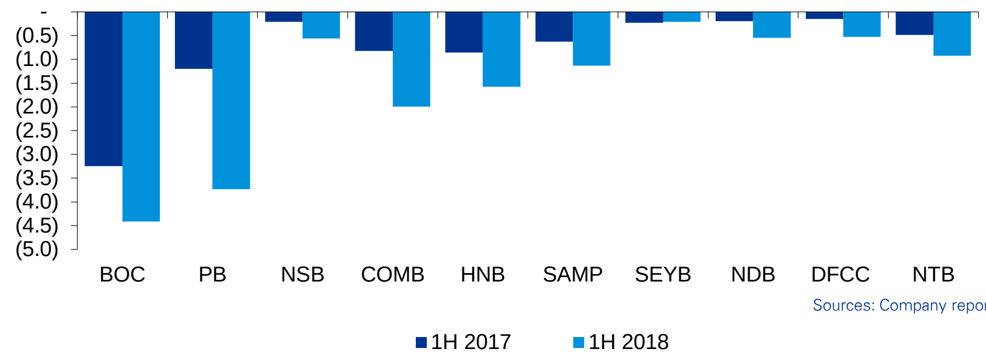
Individual Impairment (LKR Bn)



**No Individual impairment charge for NSB*

Sources: Company reports

Collective Impairment (LKR Bn)



Sources: Company reports

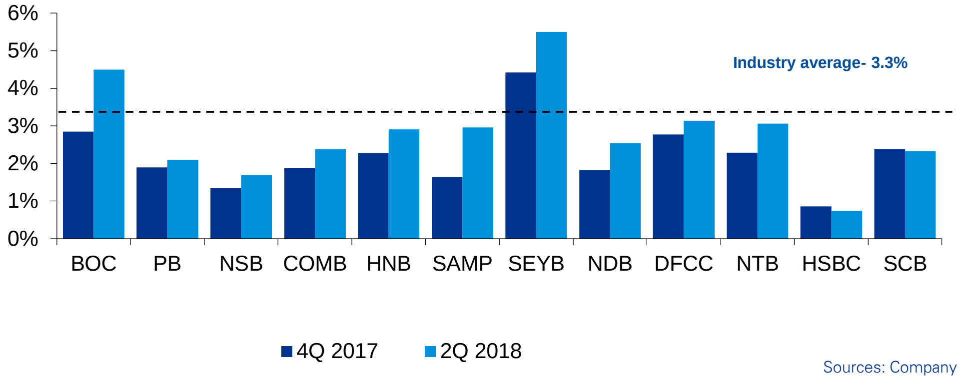
Note- HSBC & SCB individual and collective impairment breakdown is not publicly available. However HSBC and SCB total impairment charges as at 2Q 2018 amounted to LKR 317 Mn and LKR 63 Mn respectively.

Impairment charges of the banking sector increased drastically over 1H 2018 compared to 1H 2017 as banks made hefty provisions amidst deteriorating asset quality of the loan book. Higher NPLs recorded in agriculture, construction and SME sectors affected both individual and collective impairments.

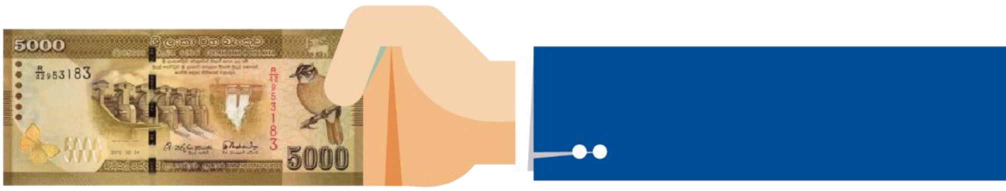
The implementation of SLFRS 9 which introduces the expected credit loss (ECL) model replacing the incurred loss model of LKAS 39 is expected to increase the total impairment provision. It is estimated that the increase in impairment provision based on ECL model due to transition will account to 3% to 5% of total equity. However, with respect to foreign banks under review, we do not expect significant consequences to occur due to their parent backing. Furthermore, we expect their migration to the new standard to be along with their regional peers, where timelines are expected to be confirmed by the end of this year.

Non performing loans and advances

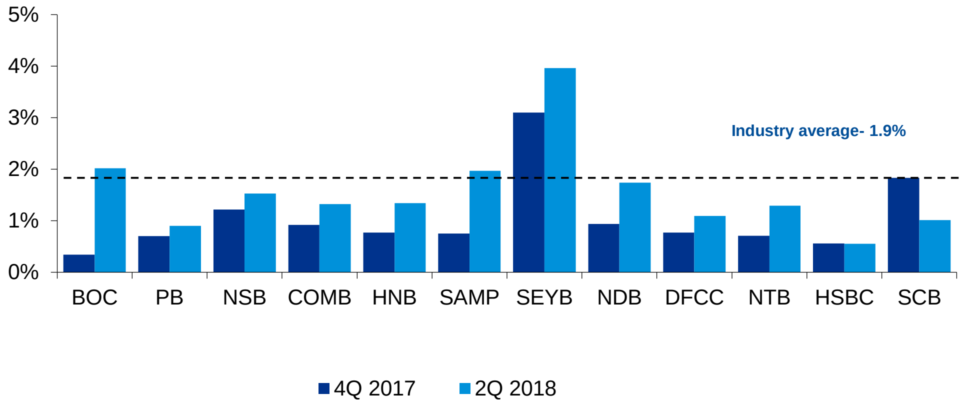
Gross NPL



Sources: Company reports



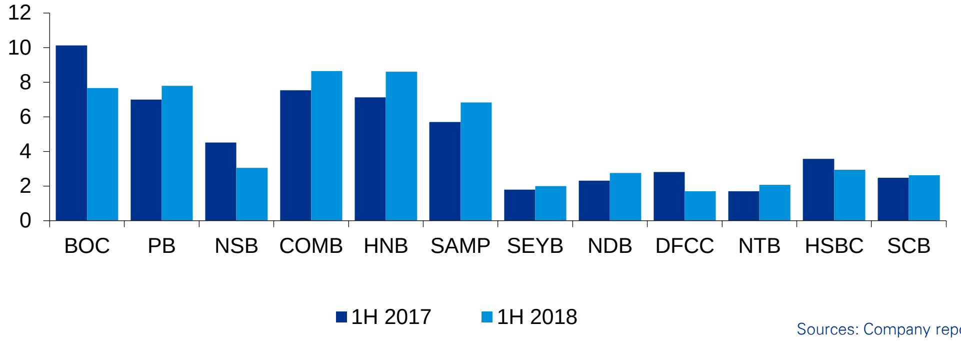
Net NPL



Sources: Company reports

The overall gross NPL ratio of the banking sector increased to 3.3% in 2Q 2018 compared to 2.5% as at end 4Q 2017, recording a 3 year high. However, it is to note that the gross NPLs were at a 10 year low in 4Q 2017. NPLs have significantly risen due to adverse weather conditions throughout the period under review, which hampered the performance of the agricultural sector. The construction sector was also affected due to the GoSL lagging on loan payments for most of the undergoing construction projects. We expect the NPLs to continue to follow the rising trend due to the challenging business environment, consumption related loan exposure and regulatory implications.

Profit after tax (LKR Bn)



Sources: Company reports

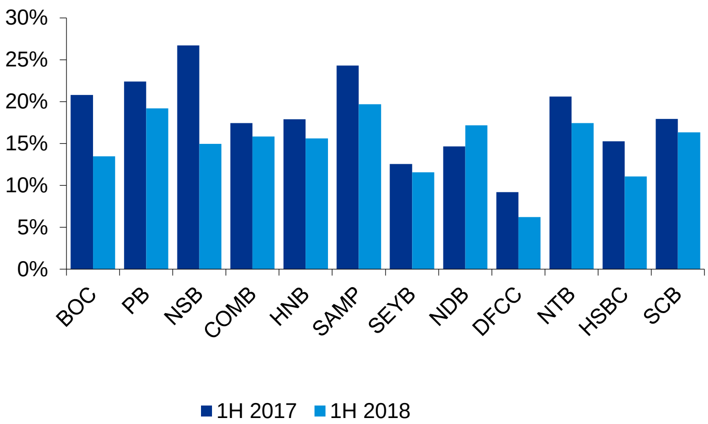
Net earnings of the banking sector deteriorated 0.9% YoY in 1H 2018 to LKR 65.1Bn. Higher impairment charges coupled with a higher income tax expense recorded over the period contributed towards this decline.

Inland Revenue Act No 24 of 2017 (IRA) effective from 1 April 2018 also negatively affected the banking profits in the 2Q 2018. The removal of tax exemptions on various interest income sources such as USD denominated bonds, professional loans and SMEs enjoyed by banks under the previous IRA saw the industry undergo a statutory income tax rate of 28%. Further the VAT and NBT on financial services coupled with the proposed debt levy of 7% would see the direct and indirect tax rate on banks increase from 45% to 52%*.

In addition SLFRS 9 will require banks to recognize losses early as it will no longer be suitable for banks to wait for an incurred loss event to maintain higher provisions, ultimately affecting their profitability.

*52% is composed of 28% income tax, 15% VAT, 2% NBT and 7% debt levy

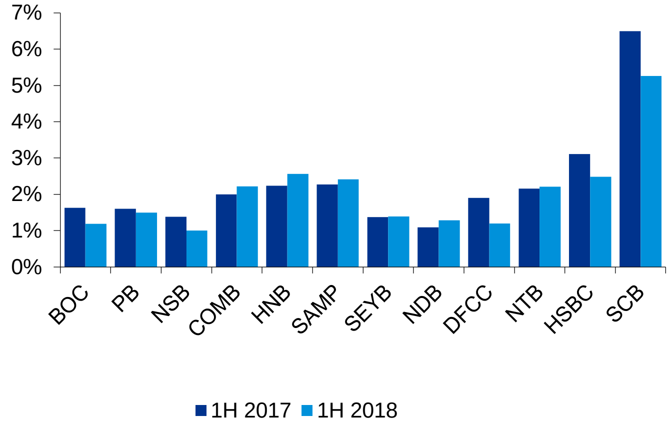
Return on Equity (ROE)



Sources: Company reports

Banking sector ROE decreased 341bps from 18.2% in 1H 2017 to 14.8% in 1H 2018. Due to the introduction of BASEL III, several banks raised rights issues in the recent past which impacted their ROEs during 1H 2018 compared to 1H 2017.

Return on Assets (ROA)

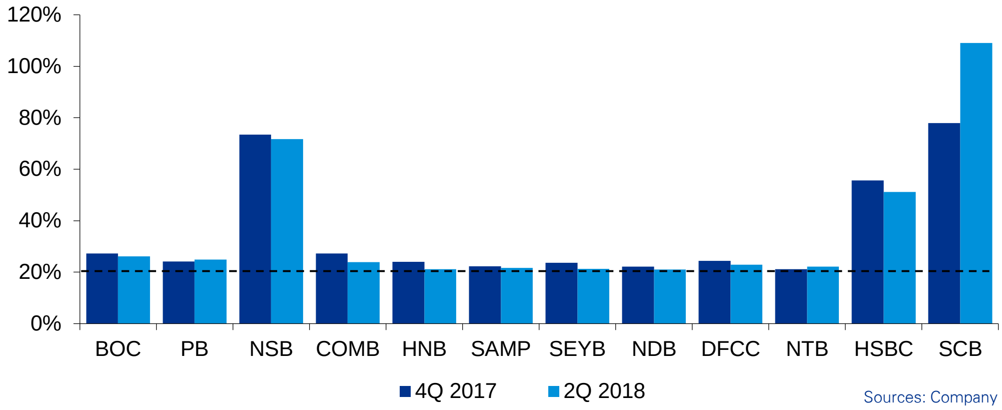


Sources: Company reports

Banking sector ROA affected by the largest bank, BoC declined by 18bps from 1H 2017 to 1.2% in 1H2018.

Liquidity

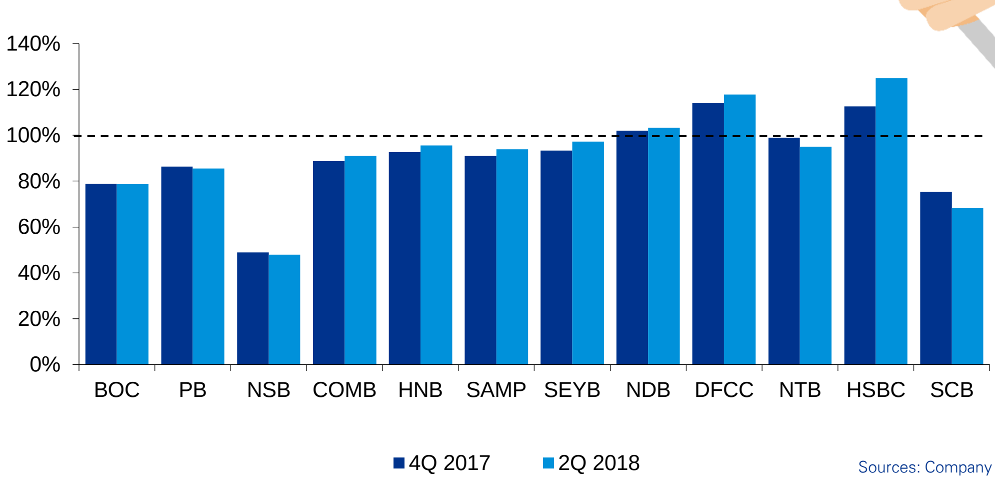
Statutory liquid asset ratio (domestic banking units)



Sources: Company reports

The Statutory Liquid Asset Ratio (SLAR) of domestic banking units reduced to 30.2% as at end 2Q 2018 compared to 31.3% as at end 4Q 2017. However the SLAR of the banking sector was significantly higher than the regulatory minimum of 20.0%.

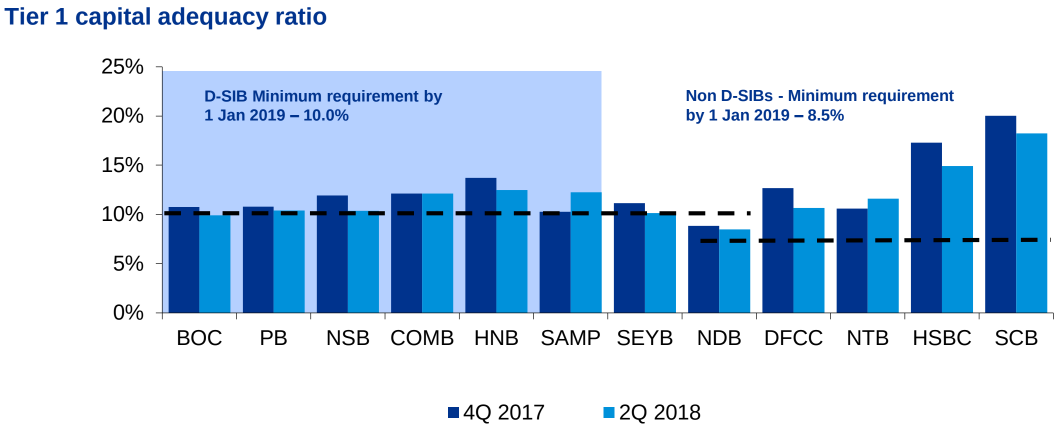
Credit to deposit ratio



Sources: Company reports

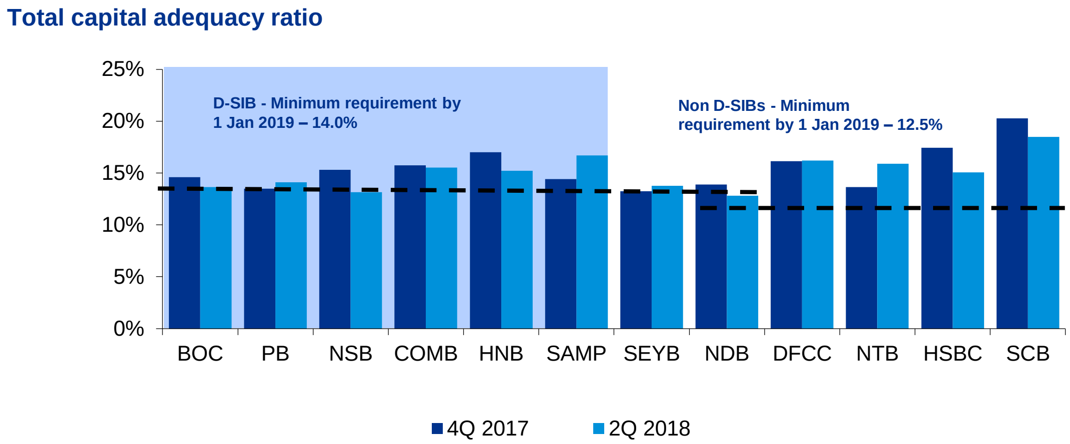
The credit to deposit ratio of the banking industry increased to 87.5% as at end 2Q 2018 compared to 86.9% as at end 4Q 2017. Local banks excluding NDB and DFCC (which transformed from being development banks into LCBs) maintained credit to deposit ratios below 100%.

Capital adequacy ratio



Shaded in blue – D-SIBs as at end June 2018

Sources: Company reports



Shaded in blue – D-SIBs as at end June 2018

Sources: Company reports

Capital adequacy requirements were introduced by the CBSL under Basel III with effect from 1 July 2017. The implementation is taking place where the full requirement will come into effect by 1 January 2019. To comply with Basel III, most banks have raised capital through rights issues over the period. This will further strengthen the equity base of the banks and thereby help achieve the required capital adequacy ratio.

To maintain and fulfil the Tier II capital requirement, banks have issued debentures during the reported period.

However, implementation of SLFRS 9, increasing impairment charges and tax increments are expected to put pressure on capital adequacy ratios, going forward.

KPMG at a glance

Office

Established in,

1897

The oldest Chartered Accountancy firm in the country

KPMG is expanded in,

6 districts

Part of KPMG global network

Celebrating,

120 years

Service

KPMG value proposition,

- **Our Values**
- **Our Credentials**
- **Proven Methodology**
- **Experienced Core Team**

Professional Service Provider

Audit **Tax** **Advisory**

People

18 Partners

1,150 People Locally

197,263 People globally

Lifelong learning

Is our global citizenship priority

Dedicated to Learning & Development

Committed to developing a continuous learning culture

- **Technical training,**
- **Coaching,**
- **Mentoring,**
- **Industry secondments and**
- **Skill-building programs**

Global Opportunities

3,000 people on Global Mobility assignments

Achievements

KPMG named **"Best Deal Advisory Firm in Sri Lanka 2015"**

by Global Banking and Finance Review

KPMG named **"The Best Advisory Firm – Sri Lanka 2016"**

by International Finance Magazine

KPMG named **"Tax Firm of the Year - 2017"** by International Tax Review, Asia Tax Awards 2017

KPMG named **"Tax Disputes & Litigation Firm of the Year – 2017"** by International Tax Review, Asia Tax Awards 2017

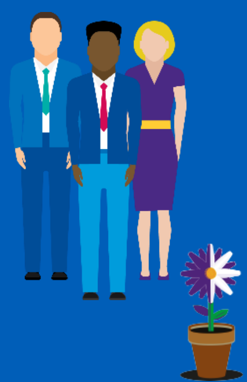
Most Respected 2017 - LMD

KPMG was ranked among the most respected in the latest LMD rankings becoming first in the financial service category

Customers

1,500+ Clients

KPMG Industry Base



KPMG service offerings

Audit

High quality, independent financial statement audits are essential to maintaining investor confidence.

Our audit professionals are committed to the public interest. They seek to challenge assumptions and unlock valuable insights based on a thorough understanding of an organization's business and industry, and innovative audit methodologies and approaches.

Understanding the financial performance of any business must be placed in the context of strategic priorities, risk appetites and competitive positioning. Our technology-enabled audit approach applies extensive data analytics to provide the necessary evidence confirming that critical controls and disclosures uphold the highest level of integrity.

- Audits of financial statements
- Audit-related services
- Audit data & analytics
- Accounting Advisory

Management Consulting

Our high capability teams offer deep industry and technical knowledge, and market-leading tools to deliver solutions across every business and industrial sector.

Our consultants assist clients to make better decisions that may reduce costs, enhance organizational effectiveness and develop appropriate technology strategies.

- People & Change
- Customer & Analytics
- Financial Management
- Operations
- Strategy & Economic Advisory
- IT Advisory
- Supply Chain

Risk Consulting

Our risk consulting practice combines the knowledge and expertise of over 50 partners, directors and professionals. We help organizations transform risk and compliance efforts into competitive advantage by applying a risk lens to corporate strategy. This improves risk intelligence and decision making, protects financial and reputational assets, and enhances business value.

- Forensic
- Business Process Management
- Accounting Advisory Services
- Internal Audit & Risk Compliance

Deal Advisory

Our experienced investment professionals skilfully assess how opportunities to buy, sell, partner, fund or fix a company can add and preserve value. Our teams combine a global mind-set and local experience with deep sector knowledge and superior analytic tools to support clients. From assisting to plan and implement strategic change to measurably increasing portfolio value, we deliver tangible results.

- Valuations
- Debt Advisory
- Transaction Solutions
- Mergers & Acquisitions
- Restructuring
- Real Estate Advisory

Tax

A business's approach to tax is increasingly subject to public scrutiny and is now a major reputation driver. From company set-up to cross-border and transfer pricing solutions, we work with a wide range of national and multi-national organizations to deliver effective tax solutions. Our tax professionals combine international experience with local knowledge to provide leading edge commercial tax strategies tailored to specific client needs.

- Inbound & indirect taxes
- Mergers, acquisitions and restructuring
- International tax services
- Transfer pricing
- Tax management consulting
- Global mobility services
- Automatic exchange of information

KPMG Leadership - Banking

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Managing Partner

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Suren Rajakarier
Partner, Head of Audit

Tax

Shamila Jayasekara
Partner, Head of Tax & Regulatory

Advisory

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