

EVOLUTION OF BANKING SECTOR IN SRI LANKA

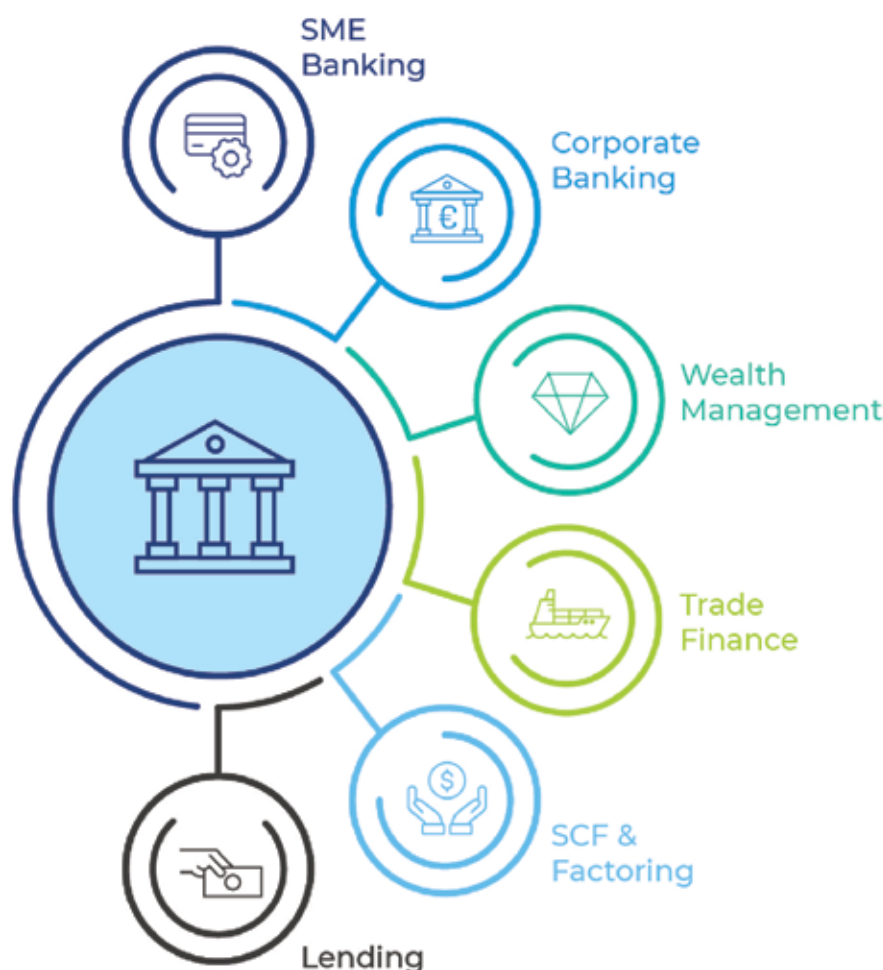


“IT IS WELL ENOUGH THAT PEOPLE OF THE NATION DO NOT UNDERSTAND OUR BANKING AND MONETARY SYSTEM, FOR IF THEY DID, I BELIEVE THERE WOULD BE A REVOLUTION BEFORE TOMORROW MORNING.”
- HENRY FORD

Banks and banking were aliens to the Sri Lankan financial system until the introduction of banks in British colonial era (1796 -1948). By the time foreigners held a monopoly with regard to trade, commerce and industry over the local traders,

which exerted power over the domestic financial system. Hence, there was a need to systemize the procedure by introducing a national level solution to facilitate the local as well as foreign financial intermediation. As a result, a national level bank; Bank of Ceylon was established following the approvals of the State Council of Ceylon in 1934 by Sir Andrew Caldecott, then Governor of Ceylon. Until the

independence the Monetary Authority to the country was the Currency Board System established under the Paper Currency Ordinance No. 32 of 1884. Yet, due to the inadequate policy guidelines to promote a growing independent nation the Currency Board System was dissolved by the post-independence government of Sri Lanka. With the support of the technical expertise from



“BANKS PLAY A CRUCIAL ROLE IN STABILIZING THE FINANCIAL AND ECONOMIC CONDITIONS OF THE COUNTRY. THEY ACCOUNT FOR ABOUT 60% OF THE GDP AND EMPLOYING ABOUT 40% OF THE TOTAL WORKFORCE. THE BANKING SECTOR CONTINUED TO DOMINATE THE FINANCIAL SECTOR, ACCOUNTING FOR ABOUT 62.4% (EXCLUDING THE CENTRAL BANK) OF THE TOTAL ASSETS OF THE FINANCIAL SECTOR AT END 2018.”

Federal Reserves of USA, a new body was established to administer and regulate the entire money, banking and credit system of the country. Accordingly, the Central Bank of Ceylon was established by the Monetary Law Act (MLA) No.58 of 1949 and commenced operations on August 28, 1950. It was renamed the Central Bank of Sri

Lanka (CBSL) in 1985.

Throughout the past few decades the financial sector continued to grow widening the depth and breath of the Sri Lankan banking industry. As of today, Sri Lanka has a fairly well diversified banking system which includes 26 Licensed Commercial Banks (LCB); 13 domestic banks and 13

foreign banks, 7 Licensed Specialised Banks (LSB); a national level savings bank, 2 housing financial institutions, a regional development bank and 3 licensed specialised banks. Citibank N.A. is the only U.S. bank operating in Sri Lanka. Accordingly, there are 6,881 total bank branches island wide and 5,031 Automated Teller Machines situated as of 2018 end. Banks play a crucial role in stabilizing the financial and economic conditions of the country. They account for about 60% of the GDP and employing about 40% of the total workforce. The banking sector continued to dominate the financial sector, accounting for about 62.4% (excluding the Central Bank) of the total assets of the financial sector at end 2018.

The service provided by the banks been extended from traditional banking to a diverse area. For instance, apart from the traditional services such as money deposits and lending; merchant and investment banking, financial and marketing consultancy services, leasing, insurance, hire-purchase, factoring, bill discounting, pawn broking, underwriting are few services extended by the commercial banks. They have also changed from manual systems to computer-based systems and now to internet-based systems and with especially the new entrants to the field playing a major role in introducing or making use of state-of-art technology to deliver their products. Thereof, online banking facilities, mobile applications, tele banking have become an essential portion of the banking service. The non-bank financial institutions have also increased in number and sophistication with leasing and insurance companies posing a larger challenge.



Dr. Indrajith Coomaraswamy, Governor of Central Bank of Sri Lanka emphasized the importance of new trends in the banking industry and the measures taken to regulate such innovative facilities by the CBSL at Asia Banker Finance Sri Lanka Conference on September 2019. In accordance, he described the rapid development of financial technology (fintech) along with electronic payments and funds transfer systems have emerged as the twin pillars of modern banking development. He further noted, the development of fintech using smartphones has become the global attention. As the trend shift from payment cards to mobile-based application such as e-money, QR code-based payments, near field communication (NFC) contactless payments etc. Such innovations will lead to another paradigm shift in the banking industry while introducing new banking models. As a result, there are new non-banking institutions who are competing to grab a portion of the banking value chains.

Similarly, partnerships between banks and fintech companies are rapidly growing widening the banking facilities further at an improved efficiency and lesser transaction cost.

Above all, new technologies introduce new risks that are complex and difficult to deal with, whereas the existing risks may not be eliminated. Therefore, fintech cannot justify lenient regulations. As the regulator, CBSL has to revisit their roles and responsibilities to fit with the current spread in technological advancements in the banking industry. Appropriately, CBSL has to achieve their objectives of financial system stability while confirming the customer protection and safety. Dr. Coomaraswamy further elaborated key points and future considerations in terms of improving the banking industry; implementation of Basel III Capital Requirement and adoption of SLFRS 9 to ensure high quality capital, strengthening the regulatory framework further inline with

Basel Core Principles and the drafting of New Banking Act, introduction of Bank Sustainability Rating Indicator (BSRI) as a means of enhancing the bank examination methodology, improvement to technology risk resilience to deal with increased risk in cyber security. A proper balance between the regulation and innovative digitalization may facilitate the growth in banking services.



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