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# TOP CA CASE STUDY EXAMINATION

# DECEMBER 2013

# ADVANCE INFORMATION

**Serendib Bank Limited**

The history of Serendib Bank Limited goes back to year 1995. The bank was set up by the government after vesting the assets and liabilities of previously collapsed Millan Savings & Development Bank.

Breakaway management team led by Mr. Narayan Modi of Serandilan Bank Limited being the promoters, incorporated Millan Savings and Development Bank Limited in 1995. Serandilan Bank Limited commenced its business in the year 1983 soon after Nanik Bank Limited was set up by Dr. Vinod Sriprakashasan indigenous bank in Serendib (the country Serendib is located in the South Asian region with the currency being Serendib Rupees - SR). Serandilan Bank's founder chief executive officer/general manager -Mr. Narayan Modi also wanted the bank to run as an indigenous bank and had a vision of developing the bank as one of the leading non-government banks in Serendib. He was supported by his strategic management team of Mr. A.M. Dhaga, Mr. S.R. Khan, Mr. J.D.Muklish, Mr. D. Sharma and others. The team together expected development of a country wide branch network for Serandilan Bank within a reasonable period. However, as a result of successful strategy implementation, such a large branch network was established within a very short period. Mr. Narayan Modi's leadership was instrumental in the bank becoming one of the largest banks in Serendib. Mr. Narayan Modi's vision paved the way for the bank to have its own high rise headquarters building within a short time span. He was the pioneer in introducing some of innovative schemes to the banking industry of Serendib like Western Union, SAMBA money transfer, night banking, extended banking, banking assistants scheme etc. Mr. Narayan was a real charismatic leader in business. However, later, upon request by the board Mr. Narayan Modi's resignation took place in December 1993 and on the next Monday when news reached staff at head office many offered to resign along with him in a show of solidarity. Meanwhile Mr. Modi's deputy Mr. J. D. Muklish was appointed as the new chief executive officer/general manager of the bank. A newspaper advertisement that appeared subsequently said that Mr. Narayan Modi had been promoted to a higher position in the Serandilan Group in order to expand its operations internationally. However this did not happen. Serandilan Bank’s management team and staff were aware of the repercussions the bank could face in the absence of his dynamic leadership. Many were aware that his deputy was not in a position to administer the bank that had grown into a huge entity within a short period. The subsequent period saw Serandilan Bank going through a management and leadership crisis. This was evident with declining margins, rising bad debts and non expansion of the branch network. The bank's capital adequacy ratios had dropped below the stipulated levels during this period.

Meanwhile Mr. Narayan Modi who had the backing of bankers applied for a banking license from the Federal Bank of Serendib (FBS). Several staff members of Serandilan Bank resigned from their jobs in the bank even before Mr. Narayan Modi received the license to start his bank. Due to some mysterious circumstances the granting of the request for license by the Federal Bank of Serendib dragged for a considerable period. The license was obtained in 1995. However this license was only to operate a 'savings and development bank' and not a 'commercial bank' as Mr. Narayan Modi had originally envisaged. During this period the only savings bank that was incorporated in the country was Serendib Nation Savings Bank (SNSB) and that too was incorporated by a special Act of the parliament of Serendib. This Act stipulated the way the SNSB should operate. Thus there was no regulatory framework in place for savings banks operated by the private sector, even though the Federal Bank of Serendib had issued a license to commence the business of a 'savings and development bank' to Mr. Narayan Modi. So Mr. Modi was left in doubt as to the kind of financial and monetary responsibility exercised by the Federal Bank of Serendib (FBS) in this regard. FBS has not granted even the "parate execution" rights to board of directors of the new bank. While negotiation with FBS was taking place on these unresolved matters, Mr.Narayan commenced the business of new bank incorporating it as Millan Savings & Development Bank under the Companies Act. No. 04 of 1984. Initial minimum capital of SR. 300 million was contributed by Mr.Narayan, his wife and six other close friends of Mr.Narayan. Mr. Narayan and his wife (Narayan family) owned 64% of the total shareholding at the time of incorporation.

Within three years it was successful and grew considerably. By 1999, the bank had three branches with total asset base of SR. 4 billion and staff strength of more than 200. By that time, the bank deposit base had grown exponentially. This was mainly due to introduction of commission based deposit collection scheme by using appointed agents all over the country. Many agents enjoyed lucrative commissions for introducing new deposits. This strategy helped the bank to mobilize deposits base all over the country. During this period, the bank granted more than 50% of its deposits as loans. At the end of year 2000, the bank recorded the highest profit in its history which was SR. 750 million. Both the management level officers and other employees were lucky to receive five months salary as bonus. The bank has also declared interim dividend of SR. 5 per share.

Meanwhile in year 2001, FBS being a regulator of banks issued a direction that every bank (except government banks) must be listed as a PLC on the Serendib Stock Exchange, with the restriction that one individual shareholder and connected family members together cannot own more than 20% of a bank. Consequent to the FBS direction Mr. Narayan & family had to decrease their ownership allowing general public to participate in the share capital of the bank. But on the other hand, it gave Millan bank a chance to enhance its capital base and strengthen the liquidity position. After listing took place in December 2001, two new members were appointed to the board. Mr. N.R Kamaleshan representing XYZ Company being one of top ten shareholders of the bank and Mr. Deepak Gauraw as an individual investor.

With the new board, there were a few changes in the senior positions of the bank including the introduction of newly created positions. Four AGM positions for Credit, HR, Operations and Finance were created as new positions and professionals having experience in the relevant fields were recruited. But there were doubts as to the competence and experience of a few of such recruits specially with regard to AGM Credits. Mr. N.R. Kamaleshan became the chairman of the credit committee. During this period, there was a significant growth in loan disbursements. Total gross loan portfolio stood at more than SR. 2.5 billion as of 30$^{th}$ June 2002. But internal control weaknesses were observed in granting a few loans of which the amount was relatively significant. One of the new corporate customers – M/S Markland (Pvt) Ltd was granted a facility of SR. 500 million for a proposed new building complex of Markland Company during mid 2002. The land together with the proposed new building were mortgaged for the granted credit facility. But the credit quality of the loan granted was questionable and the audit committee has discussed the matter and reported to the board as well. Non compliances with FBS regulations were also observed in granting the said credit facility but the facility was disbursed and reported in the bank's books in such a way that there was no issue regarding regulatory compliances.
However, unofficially, the matter was known to employees of the bank and they talked about the bad repercussions that the bank would face in future.

Early morning on 23rd December 2002, Mr. Narayan called all the members of the board and requested an urgent meeting on the evening of the same day. After the board meeting, he had a meeting with other senior management and discussed the status of bank's operations. Urgency in meeting short run liquidity gap was one of the major topics that was discussed for more than an hour at the meeting. The bank's inability in meeting the minimum limits of regulatory compliances such as capital adequacy, liquidity, loan to deposit ratio etc, was also discussed and it was emphasized that these matters should be somehow resolved on an urgent basis. Mr. Narayan and two other directors and the finance manager held a separate meeting on the same day. This was regarding FBS monthly/ quarterly reporting on regulatory compliances. Matters discussed at the meeting were not revealed to any other party. But after the meeting, finance manager seemed to be highly disappointed. One week after the meeting, the finance manager gave his resignation letter claiming that this was due to personal matters. Within a month's time, a few other important senior managerial positions of the bank were also vacant due to the sudden resignation of incumbent officers. While these problematic situations were going on at back office level of the bank, supervisory team from the bank supervision department of FBS arrived for a special investigation with short notice during the 1st week of January 2003. The team investigated all important banking operations and interviewed/ questioned many of the bank officials and employees. Special consideration was devoted to accuracy and completeness of FBS regulatory reporting. Further, detailed analysis of loan portfolio was performed while comparing actual management information against information reported to FBS by the management of the bank. The team spent two weeks on field work. One week after the visit by FBS team, CEO and all the heads of departments of the bank were called for a meeting by the director - bank supervision of FBS.

Unofficial information sources revealed that the meeting ended with severe warning for CEO and the management team of the bank by the director-bank supervision. It also came to light that Mr. Narayan had sent an official letter to the director - bank supervision asking for just one credit line of SR. 500 million for the revival of the bank and the management of the bank was confident that the Federal Bank would approve the proposal.

Meanwhile, on March 18, 2003, one of headline banners in all national newspapers was regarding the suspension of business of Millan Savings & Development Bank. According to the detailed news of the captioned heading, it was noticed that "*the Federal Bank of Serendib (FBS) announced that the Monetary Board examined a report by its Director of Bank Supervision that unsound, improper and imprudent practices and mismanagement by those responsible for the affairs of the Millan Savings & Development Bank (MSDB) has resulted in the bank being insolvent; gave an opportunity to the chairman and the board of directors of MSDB to respond to these findings; concluded that the directors and shareholders did not show a meaningful and practical commitment to revive the MSDB; and therefore, had no option but to cause the director of bank supervision to take action to suspend the MSDB under the Monetary Law Act and to cancel the license issued to it under the Banking Act*."

When the suspension took place, there were 16,493 depositors of whom 3,700 had accounts amounting to less than SR. 100,000. State institutions had deposited around SR. 450 million in the bank.

**The period with no business**:

Once the FBS announced the suspension of MSDB, all the assets and liabilities were taken into the custody of FBS. Bank supervisory division appointed a separate committee to administrate the matters related to defaulted MSDB. But the committee did nothing to recover non-performing loans from debtors. Four years lapsed since the suspension of MSDB business. Depositors of the defaulted bank had taken several actions claiming their money. A group consisting of many depositors of the defaulted bank was established by year 2004. The group was named "Millan Depositors Association". The chairman and other leading personalities of the association pressurized the government and FBS to take necessary action to repay their deposits. This was done in different ways such as using media and picketing etc. However, no justice was done for these innocent depositors until year 2008. But at the end of 2008, the first news which was favorable to depositors was published in a newspaper. The news related to opening up a new bank to protect MSDB depositors.

**A new bank to help depositors of defaulted bank**

With continuous protests by MSDB depositors association and regular comments/news published by media, during early 2008, President of Serendib government instructed top officials of FBS to come up with a proposal to re-pay MSDB customers. Further, in March 2008, Ministry of Finance & Planning suggested that it would be better to open up a new bank to provide justice for the innocent depositors of MSDB. But in the proposal, there was no clear indication as to how the bank should be established and how to raise the required capital to meet minimum capital requirement. What the finance ministry suggested was that by converting all deposits government institutions had made in MSDB, to shares of the new bank, the government can become the owner of the new bank. After several negotiations between relevant ministers, president and officials of FBS, it was decided to establish a new bank by the government after vesting all assets and liabilities of defaulted MSDB. But the matter of injecting funds as share capital remained unresolved until the new bank was established converting only the deposits government institutions had made in MSDB to share capital of the new bank.

Accordingly, the Serendib Bank Limited (SBL) as conceptualized by His Excellency the President Jayaram Kalam was established in June 2009 under the Banking Act and incorporated as a limited liability company. The assets and liabilities of defaulted Millan Savings and Development Bank Ltd (MSDB) were vested in the Bank with effect from July 1st, 2009 by the Monetary Board of the Federal Bank of Serendib. This was done by amending the Banking Act No. 10 of 1991. Establishing its first branch in the centre of the capital of Serendib, the Serendib Bank commenced business on September 12, 2009 as a state owned licensed specialized bank. The bank was established with a view to providing relief to depositors of defaulted MSDB.

However, as mentioned above, the initial capital requirement was not satisfied. The negative net worth of MSDB was SR. 2,690 million. (With the capitalization of deposits balances of government institutions and retained earnings of the bank, the negative net worth was brought down to SR. 2,225 million as at 31$^{st}$ December 2009.) The Secretary to the Treasury of Ministry of Finance & Planning issued a "Letter of Comfort" undertaking to provide additional capital when required. However, the FBS granted the license to SBL subject to the condition that the bank would meet required minimum capital after meeting the shortfall of capital within four years from the date of approval (i.e. September 1st , 2009).

The limitations in the articles of association and shortage of capital funds hampered the progress of the bank. i.e. the bank cannot perform any lending activities until it satisfies the minimum required capital. Accordingly, the major operations of the SBL are deposit mobilization, recovery of non-performing assets of MSDB and settlement of liabilities of MSDB depositors in terms of the scheme formulated by the Monetary Board of Federal Bank of Serendib. Further, additional cash flows are invested only in government securities and in fixed deposits in 100% government owned financial institutions.

Given below are extracts from an internal report drafted by an officer of the bank analyzing past performance and current position of the bank.

**Bank's overall corporate direction**

- To operate as a fully fledged licensed specialized bank in terms of Banking Act.
- To be a leading bank in the microfinance sector in Serendib.

**Capital adequacy ratio – negative capital**

The major intention of the bank since its inception has been to find a solution for the deficiency of capital funds. Therefore, in order to maintain the minimum capital requirements stipulated by the FBS, the bank needs a fresh capital infusion by the government treasury or by any other funding arrangement. Further, to grant new loans in future becoming a fully fledged licensed specialized bank, it is a must to meet minimum capital as stipulated by FBS direction. Now the question is whether bank would be able to meet its capital adequacy ratio.

**Recovery of MSDB - non-performing loans (NPL)**

At the time MSDB business was vested with SBL, the total gross non-performing loan portfolio was SR. 2,754 million. Even though a special recovery committee consisting of experienced retired bank employees was appointed, there have been no commendable recovery reported in the non-performing loan portfolio during the period under review. The bank was only able to bring down the non-performing loan balance to SR. 2,254.7 million at the end of 2012. More than 150 legal cases were filed against part of these NPL customers. But only two cases have been finalized as of 30th September 2013 of which one case related to a loan of SR. 120 million (**total outstanding**) was favorable to the bank.

**Current management and staff**

The bank is managed by a board consisting of 6 directors. (Profiles are given in appendix VI) The CEO of the bank is the GM who has been appointed by the board. GM is further assisted by Assistant General Manager. Activities of the bank were functionally divided under four main sections (Operations, Credit, HR and Finance) headed by senior managers. MSDB recoveries are done by a separate team of 10 members. Majority of the team represent retired employees from other government banks, those who joined SBL on contract basis. The AGM monitors activities of the recovery team. There are four management trainees who assist senior managers in performing activities in each department. In addition to the above categories, there are around 25 banking assistants including trainees who were recruited recently for head office branch.

**VAT on financial services (FS)**

The management of the bank considers that the recoveries of MSDB scheme are not liable to value added tax on financial services. Hence, the bank has paid VAT on FS only on interest income generated from investments. The VAT returns on FS for last two years of assessment have also been completed and filed based on the same facts. However, a notice of assessment from Inland Revenue was received by the bank for Y/A 2010/11, stating that the bank is liable to VAT on FS for recoveries under MSDB scheme as well.

**Opening balance- b/f profit continued from MSDB**

When the suspension of business of MSDB took place in 2003, there was a carried forward tax loss of SR. 550,065,064. SBL has considered that this can be carried forward by SBL on the ground of continuation of same business under tax law. Accordingly, income tax returns for last three years of assessment were also filed after claiming maximum possible c/f tax loss.

**Use of IT and accounting /financial reporting system**

A DOS based computer system provided by a local vendor is used to record daily transactions of the bank. There are only three isolated modules viz. deposits, loans and general ledger in this system. Accounting transactions are done by using three separate GL systems for Head office, MSDB and Branch respectively. Important accounting transactions/events such as classification of non-performing loans (NPL), accounting for provision for NPL, accounting for salaries, month end standard journal entries etc. are incorporated to the GL system by using manual journal entries. A trial balance for each department can be extracted but the system does not support extraction of a consolidated trial balance for the bank as a whole. Management and other financial statements are prepared by using spreadsheets. For this purpose, an employee in the finance department has to re-enter all trial balance data to spreadsheets manually because data in the system cannot be directly exported to a spreadsheet.

**Asset structure of SBL**

The asset profiles of the bank as at the end of last two years are as follow:

| | Amount -SR (million) | |
|---|---|---|
| | **31-12-2012** | **31-12-2011** |
| Liquid Assets | 1,458 | 1,265 |
| Loans & Advances (gross) | 2,254 | 2,456 |
| Fixed Assets (gross) | 146 | 122 |
| Investments in Securities (gross) | 68 | 42 |
| Other Assets | 234 | 226 |
| | **4,160** | **4,111** |

Gross loans and advances are the largest asset base of SBL. All these loans are classified as NPL as they were vested from MSDB. 100% provision has been made in respect of the NPL as required by FBS directions. SBL has faced numerous problems in recovering these vested loans and advances due to weak credit management of MSDB. Liquid asset base consists of cash in hand (SR 16 million - 2012), fixed deposits (SR. 1,025 million- 2012) and gilt-edged securities. Fixed assets consist of land, buildings, vehicles, furniture and fittings. The value of properties mentioned above is subject to depreciation and impairment. Market value of those properties is estimated to be more than SR. 350 million. All the land and buildings are residential properties. The vehicles comprise a 24 seat bus, five cabs, six cars, one wagon, one three-wheeler and eight motor cycles. Other fixed assets are computers, furniture etc. Other assets include interest receivables on investments in treasury bills/bonds and FDs (SR. 65 million - 2012).

**Liabilities & Equity**

The profile of liabilities & equity of SBL is as follows:

| | Amount -SR (million) | |
|---|---|---|
| | **31-12-2012** | **31-12-2011** |
| Deposits | 612 | 625 |
| Borrowings | 379 | 379 |
| Debentures | 1,402 | 1,309 |
| Development Fund | 195 | 195 |
| Tax Payable | 29 | 25 |
| Other Liabilities | 369 | 345 |
| | 2,986 | 2,878 |
| | | |
| Stated Capital | 445 | 445 |
| Negative Net Assets Vested from MSDB | (2,225) | (2,225) |
| Regulatory Reserve | 12 | 10 |
| Revenue Reserve | 265 | 255 |
| | (1,503) | (1,515) |

The deposit base has been declining since the inception of the bank due to settlement of deposit liabilities of MSDB. However, deposits mobilized by the bank have been increasing since the date of commencing business by SBL. Total deposits mobilized by the only branch of SBL as of 31$^{st}$ December 2012 was SR. 285 million.

MSDB has borrowed from investors by way of bonds and money market bills. These borrowings are settled in terms of a liability settlement scheme. Unsecured subordinate debentures also relate to MSDB and the interest applicable to these debentures is 5%. These debentures will be settled in terms of a liability settlement scheme formulated by the Monetary Board. The ministry of finance & planning has allocated SR. 195 million for development of the bank at the initial stage. These funds will be used to expand the business of the bank in rural areas. Other liabilities consist of interest payable to depositors amounting to SR. 252 million as of 31$^{st}$ December 2012 and miscellaneous payable items.

**Performance**

The last 3 years summarized income statements indicate the performance of the bank.

| INCOME STATEMENT | | | |
|---|---|---|---|
| **FOR THE YEAR ENDED DECEMBER 31** | **2010** | **2011** | **2012** |
| | **SR (Mn)** | **SR (Mn)** | **SR (Mn)** |
| | | | |
| **Income** | | | |
| Interest Income | 211 | 246 | 322 |
| Other Income | 115 | 180 | 185 |
| **Gross Income** | **326** | **426** | **507** |
| | | | |
| Interest Expenses | 36 | 25 | 115 |
| Personnel Expenses | 15 | 18 | 23 |
| Other | 51 | 66 | 63 |
| **Total expenditure** | **102** | **109** | **201** |
| | | | |
| **Profit before VAT on FS & Income Tax** | **224** | **317** | **306** |

Out of the total interest income, interest income from fixed income securities accounts for more than 75% in the last three years. Other income mainly consists of reversal of loan loss provision on MSDB recoveries. Such reversals for financial year 2010, 2011 and 2012 are SR. 110 million, SR. 170 million and SR. 175 million respectively.

## Serendib Trust Fund (STF) as a Micro Finance Organization

STF was established in 1987 as a company limited by guarantee and has been operating as a not for profit organization owned by the government. There is a specific gazette notification based on a cabinet approval restricting utilization of funds. Main function of STF is to take part in the rural sector financial development and uplifting of living standard of the under privileged of the country by various loan schemes with partner organizations. Partner organizations include following main categories.

- Rural Development Banks ( RDBs)
- Co-operative Rural Banks (CRBs)
- Thrift and Credit Co-operative Societies (TCCS)
- Community Based voluntary organizations

As per the articles, the primary objectives of STF are:

- ➢ To function on a non- profit basis to identify, develop, promote, catalyse and support sustainable income generating opportunities and a higher quality of life for the poor through a range of activities including productive self employment micro enterprises by the provision of assistance and services.

- ➢ To engage in the business of and to act as trustees, lenders, promoters and stimulators of innovative ideas for poverty alleviation, and set up effective management information systems for the regular and proper monitoring and evaluation of poverty alleviation activities and to act in the recovery of monies lent.

Agriculture sector development is the main concern of STF. Agriculture is the main income source of rural sector economy. During past period, 45% of total loans disbursed were for the agriculture purposes. Small and cottage industries were granted around 38% and balance for miscellaneous purposes.

According to the annual report for the year 2012, chairman of STF mentioned that:

"*Micro enterprises play a critical role in alleviating poverty. The importance of financing these enterprises is recognized by the government and other development agencies worldwide. However, access to finance remains uneven and micro-enterprises are heavily dependent on informal funding, causing heavy financial cost which critically effect the sustainability of micro enterprises. It has become necessary to improve access to financial services by small and micro enterprises since most of these enterprises are conducted by the people in low income groups and the contribution made by those enterprises to national income is significant. One of the cost effective solutions to extend credits to small and micro enterprises in remote and rural areas is selecting community based grass-roots level organizations for loan disbursement and to carry out pre- and post –credit supervision activities. Even though these organizations are semi-formal, they have a fair knowledge in identifying, evaluating and conducting due diligence and maintaining close contact with the micro borrowers*"

**Business model/ operating model**

STF acts as an agency for the government of Serendib in various community development projects funded by different international bodies such as ADB, KFW, EU etc. STF receives funds through the government from these organizations and disburses to the community through community based grass roots level organizations. At present STF have 285 partner organizations scattered all over the country. The company continues its main objective of strengthening living standards and profit criteria is not set out in the articles of association.

**Governance responsibility**

The fund is managed by a board of directors. The board of directors of the fund presently comprises fifteen non executive directors and one executive director. Proper systems and procedures have been designed, implemented and supervised to ensure that operations of the fund are directed and controlled effectively and efficiently by the management. The fund has a specific objective-periodically review the operations of the company, and reporting responsibilities have been established to ensure that accountability is maintained with regard to the various stakeholders.

**Loan disbursment**

By 2012,the STF had granted more than SR. 7 billion to partner organizations from 2008. But these disbursments are done by way of a revolving scheme. Interest receivable balance as of 30th Sepetember 2013 amounted to SR 2.5 million. However, more than SR. 1 million of this has been transferred to interest in suspense account. Upto 30th September 2012, the Trust has disbursed SR. 1.9 billion to partner organizations. Following table depicts the annual disbursment of the fund for the past few years.

| Year | Disbursement ( SR. million) |
|---|---|
| 2009 | 1,586 |
| 2010 | 1,102 |
| 2011 | 1,402 |
| 2012 | 1,862 |

**Loans outstanding**

Loan outstanding balance represents loan receivable from partner organizations. The gross amount due from partner organizations as at 30th September 2013 is SR. 2,058 million. The loan outstanding balances of last four years are as follows.

| Year | Loan Outstanding ( SR. million) |
|---|---|
| 2009 | 1,480 |
| 2010 | 1,352 |
| 2011 | 1,409 |
| 2012 | 1,557 |

**Loan installments in arrears**

Amounts in arrears for more than 6 months are categorized as non performing loans. As at 31st December 2012 the balance categorized as non-performing is SR. 14 million. The corresponding amount as at 31st December 2011 is SR 13 million. However compared with loan outstanding balance, loan in arrears is immaterial and it is less than 1%.

## Appendix I

**Microfinance sector lacks regulation and governance**

**(An extract from a recent newspaper article)**

The rapid development of microfinance in the last decades, characterised by the increasing value of assets and extensive outreach has raised significant regulation, ownership and governance issues according to PROMIS, the Promotion of the Microfinance Sector, a Not for Profit Organisation (NPO).

According to a survey conducted on the sector by PROMIS, interference of political interest in the appointments of directors and senior management and in the day to day management of microfinance institutions can endanger their viability. The results from the survey found that microfinance activities in the case of a large number of institutions are intertwined with other types of activities which can result in conflict of interests and objectives.

The PROMIS survey found that one of the major challenges within the microfinance industry is outreach to lower income groups. The same ranking in terms of outreach to the lower income group is maintained even if the threshold income level is raised to SR.5,000. In the current scenario, only a small share of the microfinance clients falls within the definition of lower income groups.

Banks and other financial institutions involved in microfinance have the lowest outreach among the poorest layer of clients where only 7% of their customers have a monthly household income below SR. 3,000. The survey found that even in the case of NGO microfinance institutions, only half of their clients have a monthly household income not exceeding SR.3,000.

The survey also found that many microfinance providers focus extensively on savings and do not fully exploit the resources mobilized to extend credit to finance the income generating activities of their clients. The Serendib microfinance market, to a certain extent, seems to be more focused on the proliferation of variations of the same traditional products, lacking innovative approaches which could overcome the inherent barriers in access to microfinance.

According to the survey, the majority of the microfinance practitioners interviewed do not have an adequate mechanism in place to monitor the financial performance of their activities. The lack of comprehensive performance monitoring is a significant barrier to the achievement of long term sustainability.

Although the survey concludes that microfinance providers have an extensive network in the country with over 10,800 outlets covered during the survey, the sector is characterized by significant fragmentation and lack of coherence. The operating microfinance institutions, especially in the cooperative sector, have a large unexploited potential which could be channeled in the right direction through the adoption of an articulate development strategy.

**Appendix II**

BANKING INDUSTRY AND REGULATORY FRAMEWORK

Financial sector of Serendib expanded steadily during last year despite challenges in the global and domestic environment. Federal bank implemented regulatory and macro prudential policies to strengthen risk management frameworks of banks and financial institutions. Draft guidelines were also issued by the Federal Bank of Serendib on statutory reporting under SAS 32, 39 and SFRS 07. (*SAS and SFRS refer to Serendib Accounting Standards corresponding to IAS and Serendib Financial Reporting Standards corresponding to IFRS, respectively*) This adoption transits financial reporting of the Serendib banking sector to internationally accepted accounting practices.

Developments in the financial sector contribute to faster economic development in the country. The financial sector at present consists of Licensed Commercial Banks, Licensed Specialized Banks, Registered Finance Companies, Primary Dealers, Leasing Establishments, Merchant Banks, Savings and Loan Associations, Venture Capitals, Unit Trusts, Contractual Serving Institutions such as Employees Provident/Trust Funds and Insurance Companies.

In 1956 two state banks played dominant role in the country. Initially, these two banks held around 70% of deposits in the country. However due to start of other banks in the country the proportion of these state banks declined and competition from other banks started in the banking industry. The state banks deposits share acquired by new banks and financial institutes started after 1983. The share of loans and advances held by state banks also declined from 85 percent in 1980 to 50 percent in 2012. Open economic policies implemented after 1983 encouraged entry of domestic private banks and foreign banks which have contributed to increase the share of loans and advances by other banks. The open economic policies also have resulted in increase in activities in many areas of the economy following a credit expansion by the private sector banks.

Rapid competition in the financial sector influences the access of firms and households to financial services and external financing which affect the economic development in the country. High competition promotes institutions and their services, rendering wider benefits to customers. Financial institutions with integration to international markets currently offer a wide range of services compared to a limited number of services that had been offered 40 years ago. The key driver for these developments was the opening of the financial sector by allowing international banks to operate in the country with the initiation of the FBS and the Government contributing to improve institutional competition and sophistication of the industry products. Other main factor to increase the services by bank and financial institutions is technology. Technological developments associated with those services have enabled financial institutions to improve efficiency and quality of services offered to customers.

Listed below is an extract of rating information relevant to banks published by independent rating agency in Serendib.

| **Ratings of Banks** | **Ratings** | **Stability** |
|---|---|---|
| Citibank N.A. –Combilo Branch | AAA(srd) | Stable |
| HSBC Combilo Branch | AAA(srd) | Stable |
| Serendib Nation Savings Bank | AAA(srd) | Stable |
| Standard Chartered Bank, Combilo Branch | AAA(srd) | Stable |
| Bank of Seren | AA+(srd) | Stable |
| Community Bank | AA(srd) | Stable |
| Commercial Bank of Serendib PLC | AA(srd) | Stable |
| FDCC Bank | AA(srd) | Stable |
| Nation Development Bank PLC | AA(srd) | Stable |
| FDCC Vardhana Bank Ltd | AA−(srd) | Stable |
| Hatton Nation Bank PLC | AA−(srd) | Stable |
| Valuable Bank PLC | AA−(srd) | Positive |
| National Trust Bank PLC | A(srd) | Stable |
| Serandilan Bank | A−(srd) | Stable |
| Area Development Bank | BBB+(srd) | Stable |
| FCHD Bank | BBB+(srd) | Stable |
| Air Asia Banking Corporation PLC | BBB(srd) | Stable |
| United Bank of Combilo Ltd | BB+(srd) | Negative |
| Serendib Bank Ltd | BB+(srd) | Stable |

**Appendix III**

# FEDERAL BANK OF SERENDIB

**Communications Department**
**30, President Road, Combilo 1, Serendib.**

**Tel : 2477424, 2477639,2477420      Fax : 2346257, 2477739**
**E-mail:dcommunications@fb.sr; communications@fb.sr**

# PRESS RELEASE

**Date:** 2009-06-25
**Issued By:** Bank Supervision Department

## The Federal Bank handed over the business of Millan Savings and Development Bank Ltd. to Serendib Bank Ltd.

In terms of a policy decision, the Government established a state bank, "Serendib Bank Ltd" to take over the business of the Millan Bank and amended the Banking Act to provide for the vesting of the business of Millan Bank in a state bank. According to new provisions of the Banking Act, the Monetary Board of the Federal Bank has two functions to fulfill in this regard, i.e., issuing the order for vesting of the business of Milian Bank in the state bank and formulation of a scheme for meeting the claims and demands of creditors and depositors of Millan Bank by the new state bank. The Monetary Board has now accomplished those tasks as indicated below.

- The Monetary Board issued the order vesting the business of Millan Bank in Serendib Bank Ltd. with effect from July 1, 2009. Accordingly, all properties, assets, liabilities, rights, contracts, etc. relating to the business of Millan Bank will be a part of the business of Serendib Bank Ltd. In addition, Serendib Bank Ltd. which is a bank licensed by the Monetary Board, will carry on the business of accepting time and savings deposits from the public and investing such funds in government securities.

- The scheme for meeting the claims and demands of creditors and depositors of Millan Bank formulated by the Monetary Board taking into consideration the suggestions made by the Board of Directors of Serendib Bank Ltd. has been forwarded to the bank. This scheme will be published in the national newspapers for information of the public in due course once the Board of Directors of Serendib Bank Ltd. gives its consent.

Accordingly, the general public and all customers of the Millan Bank are informed that Serendib Bank Ltd. will lawfully own and manage all assets of Millan Bank and take all action to recover any dues. Further, the bank will settle the liabilities of Millan Bank to depositors and creditors according to the above mentioned scheme which will be made known to the public in due course. The Serendib Bank Ltd. is located at 112, The Leela Business Park, Combilo 5.

## Appendix IV

**Millan Savings & Development Bank Limited**
**BALANCE SHEET (At the time of vesting)**
**AS AT**

| | **30.06.2009** | **31.12.2002** |
|---|---|---|
| | **SR.** | **SR.** |
| **ASSETS** | | |
| **Non Current Assets** | | |
| Cash and Short Term Funds | 405,159,336 | 194,004,045 |
| Amount Receivable from Air Asia Bank | 151,865,634 | 147,322,955 |
| Investment in Treasury Bills | 335,190,272 | - |
| Dispute deposits | 78,420,000 | 78,420,000 |
| Money Market Investment | - | 66,500,000 |
| Bills of Exchange | - | 183,618,000 |
| Loans and Advances (net) | - | 1,815,007,000 |
| Lease Rental Receivables | - | 31,614,000 |
| Interest Receivables | - | 17,751,000 |
| Other Receivables | - | 128,938,000 |
| Investment in Securities | - | 239,294,000 |
| Investment Properties | 8,538,200 | 8,538,000 |
| Property, Plant & Equipment | 114,599,865 | 181,356,000 |
| **TOTAL ASSETS** | **1,093,773,307** | **3,092,363,000** |
| | | |
| **Liabilities** | | |
| | | |
| Deposits From Customers | 2,267,745,000 | 2,267,745,000 |
| Borrowings | 1,277,186,865 | 865,130,000 |
| Interest Payable | 74,568,230 | 96,504,000 |
| Other Liabilities | 164,273,212 | 137,880,000 |
| **Total Liabilities** | **3,783,773,307** | **3,367,259,000** |
| | | |
| **Equity** | | |
| Share Capital | - | 307,094,000 |
| Reserve Fund | - | 2,446,000 |
| Revenue Reserve Vested from MSDB | (2,690,000,000) | (584,436,000) |
| Shareholders' Equity | **(2,690,000,000)** | **(274,896,000)** |
| **Total Equity & Liabilities** | **1,093,773,307** | **3,092,363,000** |

## Appendix V – Financial Information – Serendib Trust Fund

**Serendib Trust Fund**
**BALANCE SHEET**
**AS AT 31 DECEMBER**

| | Note | 2012 | 2011 |
|---|---|---|---|
| | | **SR** | **SR** |
| **ASSETS** | | | |
| **Non Current Assets** | | | |
| Property, Plant & Equipment | | 6,222,068 | 5,330,296 |
| Investments | | 137,447,500 | 45,523,720 |
| | | **143,669,568** | **50,854,016** |
| **Current Assets** | | | |
| Short Term Investments | 1 | 1,003,285,062 | 1,051,180,464 |
| Loans & Other Receivables | 2 | 1,557,012,408 | 1,409,328,823 |
| Cash & Cash Equivalents | | 39,667,814 | 18,012,622 |
| | | **2,599,965,284** | **2,478,521,909** |
| **Total Assets** | | **2,743,634,852** | **2,529,375,925** |
| | | | |
| **FUNDS & LIABILITIES** | | | |
| **Funds** | | | |
| Accumulated Fund | | 673,993,003 | 475,179,583 |
| Sinking Fund | | 41,400,000 | 41,400,000 |
| | | **715,393,003** | **516,579,583** |
| | | | |
| **Non Current Liabilities** | | | |
| Other Borrowing - Serendib Government | | 821,480,873 | 801,925,751 |
| Borrowing from Asian Development Bank (ADB) | 3 | 1,188,193,258 | 1,198,125,195 |
| | | **2,009,674,131** | **2,000,050,946** |
| **Current Liabilities** | | | |
| Amounts Due to Related Party | | 3,176,812 | 3,020,237 |
| Creditors & Other Payables | | 15,390,906 | 9,725,159 |
| | | **18,567,718** | **12,745,396** |
| **Total Funds & Liabilities** | | **2,743,634,852** | **2,529,375,925** |

Serendib Trust Fund

Notes to the financial statements

| | 2012 | 2011 |
|---|---|---|
| | SR | SR |
| **01. Short Term Investments** | | |
| REPO | 861,364,417 | 973,460,525 |
| Treasury Bills | 141,920,645 | 77,719,939 |
| | 1,003,285,062 | 1,051,180,464 |

| | 2012 | 2011 |
|---|---|---|
| **02. Loans and Other Receivables** | | |
| **2.1 Loans to Partner Organizations** | 1,557,836,333 | 1,402,894,139 |
| Less: Provision for Loan losses | (11,681,629) | (10,784,438) |
| | 1,546,154,704 | 1,392,109,701 |
| **2.2 Interest Receivable on Loans** | | |
| Interest Receivables on Loans to Partner Organizations | 2,529,117 | 1,805,168 |
| Less: Interest in Suspense | (1,008,523) | (298,159) |
| | 1,520,594 | 1,507,009 |
| **2.3 Interest Receivable on Investments** | | |
| Call Deposits | 242,136 | 102,565 |
| REPO | 7,773,911 | 13,376,774 |
| Treasury Bills | 783,863 | 373,774 |
| | 8,799,910 | 13,853,113 |
| **2.4 Other Loans & Advances** | 537,200 | 1,859,000 |
| | 1,557,012,408 | 1,409,328,823 |

| | 2012 | 2011 |
|---|---|---|
| **3. Loans - ADB** | | |
| ADB - RFSDP | 249,621,439 | 249,621,439 |
| ADB - Tsunami | 572,238,784 | 572,238,784 |
| ADB - TAARP | 254,165,066 | 339,265,062 |
| ADB - NECCDEP | 112,167,969 | 36,999,910 |
| | 1,188,193,258 | 1,198,125,195 |

**Serendib Trust Fund**
**INCOME STATEMENT**
**FOR THE YEAR ENDED 31 DECEMBER**

| | **2012** | **2011** |
|---|---|---|
| | **SR.** | **SR.** |
| Income | | |
| Interest Income | 123,575,213 | 96,137,328 |
| Interest Expenses | (18,894,592) | (16,690,198) |
| Net Interest Income | 104,680,621 | 79,447,130 |
| Other Income | 149,859,957 | 173,260,821 |
| **Less: Operating Expenses** | | |
| Personnel Expenses | (12,756,172) | (13,136,423) |
| Administration Expenses | (21,922,321) | (17,621,339) |
| Finance Costs | (2,831,286) | (1,907,677) |
| Credit Operating Expenses | (929,256) | (5,970,677) |
| **Surplus/(Deficit) for the year before tax** | **216,101,543** | **214,071,835** |

## Appendix VI

**Serendib Bank Ltd – Profiles - Directors and Senior Management**

**Mr. Anita Kapur - Chairman**
*B.A., L.L.B., Attorney-at-Law, N.P., J.P, Commissioner for Oaths*

Mr. Anita Kapur (born on 25th January 1944) was nominated to the Board of Directors by the Secretary to the Treasury - Ministry of Finance & Planning from the incorporation date - 7th July 2009. He was appointed as the Chairman of the Board on the 24th July 2009.

**Mr. Selva Ganesh**
*Attorney-at-Law, N.P, J .P, U. M, Former Director, Serendib Electricity Corporation*

Mr. Selva Ganesh was appointed to the Board of Directors by the Secretary to the Treasury on 24th May 2010 and has served on the Board from that date as a Director. He is also a Panel Lawyer for Bank of Serandib, Nation Savings Bank and Community Bank. Mr. Selva Ganesh functions as a non-independent, non-executive director.

**Mr. Praveen Sharma**
*Attorney-at-Law, N.P*

Mr. Praveen Sharma was appointed to the Board of Directors of the Bank by the Secretary to the Treasury - Ministry of Finance & Planning with effect from 30th June 2010. He has been on the Board of the Coconut Cultivation Board (from 2000-2002). Mr. Praveen Sharma functions as a non-independent, non-executive director.

**Mr. Anuj Goyal**
*Attorney-at –Law, N.P, J.P, Commissioner for Oaths*

Mr. Anuj Goyal was appointed to the Board of Directors by the Secretary to the Treasury - Ministry of Finance & Planning with effect from 4th July 2007. Mr. Anuj Goyal functions as a non-independent, non-executive director.

**Mr. Amarajit Chopra**
*Master in Business Administration -Nanyang Technology University- Singapore*

Mr. Amarajit Chopra was appointed to the Board of Directors by the Secretary to the Treasury on 8th October 2012 as Treasury representative. Mr. Amarajit Chopra has been appointed as a non-independent, non-executive director.

**Mr. Sunil Chandra**

Mr. Sunil Chandra was appointed to the Board of Directors by the Secretary to the Treasury - Ministry of Finance and Planning with effect from 2nd April 2007. He has served on the Board from that date.

Mr. Sunil Chandra is the President of the Millan Bank Depositors Association and he represents the interests of the depositors and creditors of Millan Savings & Development Bank Limited. Mr. Sunil Chandra has been appointed to serve as a non-independent, non-executive director.

**Mr. Jitesh Khosala**

Mr. Jitesh Khosala was General Manager/CEO of the Bank from the commencement of the Bank on 10th March 2008 up to 25th April 2011. Mr. Jitesh Khosala has valuable experience in banking as he served at the Community Bank for a span of more than twenty five years. He currently acts as a non-executive director.

**Mr. B Ravi**
*MBA*
***General Manager/CEO***

Mr. B. Ravi was appointed by the Board of Directors as the General Manager/Chief Executive Officer of the Bank on 10th December 2011. He brings with him a wealth of knowledge in the banking industry from working for more than twenty years locally and in international commercial banks.

**Mr. Santosh Datta**
*B.Sc, AIB, Diploma in Bank Management*
***Assistant General Manager***

Mr. Santosh Datta joined on 1st August 2007 as Senior Manager-Recoveries and was appointed as Assistant General Manager with effect from 01st May 2011. He started his career at Bank of Serendib and served for ten years. Later he moved to Federal Bank of Serendib where he served for thirteen years in the capacity of Senior Assistant Director.

**Senior Management**

| **Designation** | **Qualification** | **Industry Experience** |
|---|---|---|
| Senior Manager Finance and Planning | *MBA, ACA* | Three years |
| Senior Manager Credit | *B. Com, Diploma Credit Mgt* | Four Years |
| Senior Manager Operations/ Compliance | *B. Sc Bus. Admin, DBF* | One Years |
| Senior Manager HRD & Establishment | *MBA , ACIS (UK)* | Eight Years |