C J P Siriwardana: Financial sector consolidation – why and how?

The Central Bank of Sri Lanka's 64th Anniversary Oration delivered by Mr C J P Siriwardana, Assistant Governor of the Central Bank of Sri Lanka, Colombo, 24 September 2014.

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The Chief Guest, Honourable Senior Minister of International Monetary Cooperation and Deputy Minister of Finance, Dr. Sarath Amunugama;

The Guest of Honour, Secretary to the Ministry of Finance and Planning, Dr. P B Jayasundera;

Governor of the Central Bank of Sri Lanka, Mr. Ajith Nivard Cabraal; Members of the Monetary Board;

Former Governors; Deputy Governors; Former Deputy Governors;

Members of the Consultative Committees of the Central Bank; Distinguished Guests;

Ladies and Gentlemen,

First of all, let me thank the Governor and the Organising Committee of the Central Bank Anniversary Oration for inviting me to deliver the oration on the 64th Anniversary of the Central Bank of Sri Lanka. I believe it is my great privilege to have this opportunity to speak to you today. As the Head of the Financial Sector Consolidation Unit of the Central Bank, I must thank the Governor and the Organising Committee for selecting "***Financial Sector Consolidation: Why and How?"*** as the topic for today because it gives due recognition not only to the current key policy reform in the financial sector that is being implemented in 2014, but also to all stakeholders who are committed to working with the Central Bank to make this major reform a success.

Ladies and gentlemen, the major components of our financial sector are banks and non-bank financial institutions (NBFIs), which together account for 65 per cent of the financial sector of the country. The financial sector consolidation programme is designed for the reforming of the institutions belonging to these two sectors. As the topic suggests, I will share with you ***why*** we wanted to consolidate the banking and NBFI sectors and ***how*** we are implementing the consolidation process. Accordingly, my oration is divided into two parts; in the first part, I will discuss the rationale for consolidation and in the second part explain the way we planned and executed the process.

With that introduction, let me now begin my oration.

Part I: Financial sector consolidation: why?

The financial sector of Sri Lanka has shown a high level of overall stability in the past, even during the post subprime global financial crisis period. This has been endorsed by the international and local rating agencies in their annual independent reviews. Since there has not been any significant crisis situation in our financial system except for some non-systemic failures of a few mismanaged financial institutions in the recent past, the question raised by many local and international agencies was why the Central Bank came up with this financial sector consolidation programme for a well-functioning stable financial system. The past global experiences show that all the consolidation programmes implemented to stabilise the respective economies' financial systems were introduced as a national policy to relove a crisis situation. Therefore, we have a duty to explain very clearly the factors that prompted the Central Bank to introduce the financial sector consolidation programme. Given the time constraint, I will present the main arguments for consolidation in six points.

Reason 1: Rapid transformation of the domestic economy and the need for a strong and stable financial system to steer future economic growth

We all know the conflict period of nearly 30 years was extremely challenging for our economy and the country. Nevertheless, with the country gaining peace and returning to normalcy from May 2009, we have been able to overcome many challenges and reach greater heights in economic performance. Social indicators and global rankings of our country have improved notably while regional disparities have reduced and the standard of living of the people has improved. Further, in the midst of the global economic downturn and the slower than expected recovery, we have been successful in delivering an oasis of tranquillity and stability.

The credit for this clear paradigm shift, elevating our economy into new heights, goes to our development strategy articulated under the "***Mahinda Chintana: Vision for the Future***", which was first introduced in 2005 and then redesigned in 2010, aligning strategies to overcome the challenges in the post-conflict economy. Our dream of transforming Sri Lanka into the "***Wonder of Asia***" is an important topic that is being broadly discussed among the academia, international agencies and many Heads of Governments. Ladies and gentlemen, I hope most of you can remember our 60th Anniversary Oration Series held in 2010. There, one of the eminent speakers was Dr. Ngozi Okongo-Iweala, then Managing Director of the World Bank and former Finance Minister of Nigeria. She spoke on the topic "***Becoming the Wonder of Asia: Accelerating the Inclusive Growth in Sri Lanka***". She had carefully studied the development plan of the Government, the "***Mahinda Chintana: Vision for the Future***" released in 2010, prepared just one year after the ending of the civil conflict. She was highly impressed about our development plan and explained the actions needed to make our vision a reality. She said, I quote, "***It's bold and ambitious. It's good to be ambitious. It is the right time for Sri Lanka to think big***". She further said, "***The vision is very clear and reminds us of a Japanese proverb 'A vision without action is a day dream; action without a vision is a nightmare'***". The idea behind this statement was that we should have an appropriate action plan to reach our vision, the target. In fact we did have a plan! Over the last 5 years, we have proved that our post-conflict policies and the strategies implemented under the "***Mahinda Chintana***" have produced desired results, enabling us to reach our expected targets. This was even endorsed by the Asian Development Bank Chief, Takehiko Nakao during his visit to Sri Lanka in June 2014. He said, I quote, "***Sri Lanka is on the path to becoming another Asian Economic Success Story***". Last year, we invited the well-known emerging market portfolio manager and eminent writer, Ruchir Sharma for the Central Bank's 63rd Anniversary Oration. He also highlighted the possibility of our economy becoming another "***Breakout Nation***" as he has already written in his book, "***Breakout Nations: In search of the Next Economic Miracles***" in 2012. The encouragement provided to the global investors by the renowned investment banking and equity markets specialist and investment Guru Fraser Dinnis to "***Sell Singapore, Buy Sri Lanka***" further reiterates the steady and impressive performance of our economy which has turned Sri Lanka around to a more attractive investment destination. Honourable Minister and distinguished guests, all above statements made by world renowned personalities prove that we are actively involved towards making our dream a reality.

Ladies and gentlemen, having raised our economy to greater heights in the post-conflict period, today, we are on the threshold of a new era for our country. Our economy is undergoing fundamental structural changes, which are expected to provide us with a robust new platform on which the nation can build up a sustainable economy to continue its drive forward. In line with the medium-term policy framework of the Government, per capita GDP is targeted to surpass USD 4,000 by 2016, entering the economy into an upper middle income category country. Further, our medium-term economic strategy projects surpassing USD 7,000 per capita level by 2020. The Governor of the Central Bank and the Secretary to the Treasury highlighted the potential of our economy to achieve this target at the ***"Sri Lanka Economic Summit"*** held in August 2014. We know that this would require greater efforts in all fronts – the Government, the Central Bank and the private sector – that would support the economy in the transition to drive through the middle income path towards the higher end of the upper middle income category. This new economic model should be able to overcome the rising "*economic gravity*", which would otherwise pull the economy into the "***Middle Income Trap***".

With the renewed acceleration in economic growth, we need to focus our attention on the next phase of economic development beyond 2016 and transforming the economy to achieve a sustained, inclusive and balanced growth. Sri Lanka's drive beyond 2016 will largely depend on the strength and the dynamism of the financial sector. As we strive to reach these new milestones, our current macroeconomic indicators are bound to undergo a massive transformation. As a part of this transformation, the greater challenge would be to make Sri Lanka a popular, emerging financial centre in the region, where setting up a financial hub in Sri Lanka would be a key task. To strengthen and expand the dynamism, the financial sector will have to possess technology-leveraged financial services to improve operational efficiency while diversifying funding sources by tapping the international capital markets to mitigate risks and improve cost efficiency. Further, expanding delivery channels and business networks beyond domestic territories, enabling them to grow and exploit opportunities while addressing external vulnerabilities and spillovers are also essential. Meanwhile, a stronger capital base, a high quality pool of human capital and a high level of corporate governance to meet the enhanced regulatory framework are required in the financial system to steer the country towards attaining a sustained growth. To facilitate accomplishing this task, it was identified that the financial sector of the country has to be strengthened and stabilised further by implementing an appropriate set of policies in a timely manner.

Reason 2: Necessity of maintaining stability in the local financial system amidst the growing complexity in the global financial system

Ladies and gentlemen, we all accept that a stable financial system is a crucial element for a conducive business environment supportive of sustained economic growth. However, in the present day, Central Bankers and other policymakers around the world are confronted with a number of challenges in maintaining financial system stability due to the high contagion effect resulting from the increased complexity and connectivity in this hyper-connected world. Although globalisation can allocate savings and investments more efficiently worldwide than in the past and the net benefit of financial globalisation for developing countries can be large, the financial crises the world encountered over the last 80 years, ranging from ***Wall Street Crisis*** during 1929–33 to ***Subprime Crisis*** in 2008–09, have shown us how large, costly and disastrous the spillover effects could be and how they have made the financial system deteriorate while spreading fast to other economies. Recently, US Fed Chairperson Janet Yellen said, I quote, "***No economy is immune from financial instability and the adverse effects on employment, economic activity, and price stability that financial crises cause***". However, since there is no universally governed law or standard for defining or measuring financial system stability, we have to understand our own circumstances and find tailor made solutions that are appropriate for us to sustain the stability in the financial system.

The main benefit of financial globalisation for developing countries is the improvement of their financial system through positive spillover effects from more complete and stable, deeper and better-regulated financial markets. A smooth functioning deep financial system with capital buffers and an effective level of credit expansion and risk mitigation capacities are crucial for developing nations as they foster economic growth. If the right infrastructure is not in place or not properly designed, the integration, interconnectedness and complexity in the global financial system may hamper the health of the local financial system as economies become exposed to external shocks and crises, not only generated in the countries that directly relate to them, but also through contagion effects. Therefore, the main challenge for countries like us is managing financial globalisation in such a way that we take full advantage of the opportunities it generates while minimising its adverse impact on the domestic financial sector by properly putting in place the right infrastructure.

Reason 3: Avoidance of any possible financial distress

Ladies and gentlemen, our financial system has also experienced a few non-systemic financial distresses in the past mainly due to the companies' own mismanagement practices including poor credit management, non-viable investments made in their group of companies, unsatisfactory accounting systems and revenue recognition practices, inadequate internal controls, and high volume of related party transactions. However, some financial institutions have failed due to reasons such as their inability to adapt to the rapidly changing economic conditions. Small financial institutions not complying with corporate governance principles, capital and liquidity requirements were also a reason for some past crises, which have resulted in exerting pressure on the stability of the financial system of the country.

During 1988–90, 13 Licensed Finance Companies reported serious distress, of which 2 companies were revived by infusing new capital while 11 companies were liquidated. You may remember that there was a small Licensed Specialised Bank called Pramuka Bank, which failed in 2002. It was only in 2007 that the deposits of the Pramuka Bank were transferred to a new Savings Bank. In 2009, 8 financial institutions faced liquidity problems, mainly due to the collapse of the parent company of a particular group. Most of those financial institutions are still undergoing restructuring, as agreed with the Central Bank. In 2013, another small NBFI, namely, CIFL faced liquidity problems mainly due to mismanagement and non-commitment to corporate governance. The Central Bank is now in the process of restructuring this company under the consolidation programme. The important message that I want to share with you is that although the NBFI that failed in 2013 accounted for only 0.35 per cent of the assets of our financial sector, the publicity it created resulted in a huge uproar in the financial market and the economy.

You can clearly see that transmission of information has become speedier in the recent years and such information is easily and widely accessible now compared to the past. The Managing Director of the IMF, Christine Lagarde also highlighted this fact when she recently spoke on ***"New Multilateralism for 21st Century",*** from which I quote "***We are living through a communications revolution, because information travels at lightning speed from limitless points of origin. Since linkages are deep and dense, even the tiniest tensions can be amplified, echoing and reverberating across the world – often in an instant, often with unpredictable twists and turns. Because of this, the global economy can become even more prone to instability***". Therefore, given the complexity and interconnectedness in the current economic activity and the high level of involvement of media in the present day, we must take all steps to avoid the eruption of even a small shock in the financial system as it can create a bigger impact on the economy and on social and political fronts, thereby deteriorating market confidence and increasing overall uncertainty. We believe the consolidation process would avoid, if not, at least minimise such impact.

Reason 4: Addressing the fragmentation issue in the financial sector

Currently our banking and non-banking sectors are highly fragmented and operate in a skewed manner reflecting the dominance of a few large banks and NBFIs. Continuation of this situation is risky because the small financial institutions are generally more exposed to internal and external shocks and tend to threaten the stability of the entire financial system of the country.

Our banking sector constitutes 34 banks, of which 22 are domestic banks and 12 are foreign banks. The assets of the banking sector amount to approximately Rs. 6.3 trillion with only 5 banks, each maintaining an asset base of over Rs. 500 billion, accounting for a share of 66 per cent. Meanwhile 6 medium size banks, including 2 foreign banks, hold assets between Rs. 100 and 500 billion, accounting for a share of 23 per cent. The balance 23 banks individually hold assets less than Rs. 100 billion and account for only 11 per cent.

The non-banking sector is highly fragmented and constitutes 58 NBFIs, of which 48 are Licensed Finance Companies while the balance 10 are Specialised Leasing Companies. The total assets of the NBFI sector amount to Rs. 750 billion. Similar to the structure of the banking sector, 13 large NBFIs, each holding assets over Rs. 20 billion, account for 74 per cent of the NBFIs market share. Meanwhile 13 per cent of the market share is accounted for by 8 NBFIs holding assets between Rs. 8 and 20 billion. The remaining 37 small companies, each holding assets less than Rs. 8 billion, account for only 13 per cent of the NBFI sector. Since the fragmented financial system is highly vulnerable to external shocks, consolidation would help to build a strong and stable financial system.

Reason 5: Repositioning the financial sector for delivering a cost-effective service

Ladies and gentlemen, as Sri Lanka is moving towards a higher growth trajectory, we will need a more focused financial sector with a higher contribution, particularly from the banking and non-banking sectors. Intermediation by the financial sector in a more productive manner is crucial for achieving a balanced and inclusive growth in the country. Recently, there was an interesting article in The Economist Magazine of 12 April 2014, captioned "***The Slumps that Shaped Modern Finance***". This article begins by raising the question "***What is mankind's greatest invention?"*** It says, ***"... it is nothing but 'Financial Contracts', merely because it has performed an indispensable role in human development, at least in the last 7,500 years, playing three important roles, the 'Economic Time Machine', the 'Safety Net' and the 'Engine of Growth'".*** In order to provide an efficient service, the financial institutions need to consider the strategic repositioning of their organisations and expand businesses in a cost effective manner while improving the service delivery to deepen the public trust and confidence.

Currently, most financial institutions are dependent on short term funding, which increases the rollover risks, and this has to be addressed with priority by gradually shifting to long term funding, which provides greater stability to the entire industry. Further, when financial institutions become larger and more stable, obtaining international ratings and raising low-cost funds from international capital markets would be easy. Other challenges faced by the sector are lack of new technology in most financial institutions to be competitive in the industry while lack of staff training has resulted in efficiency and hence productivity has been stagnant. Therefore, it is essential to reposition the financial sector to improve productivity and deliver a cost-efficient service.

Reason 6: Improving compliance and governance in the financial sector

As the regulator, the Central Bank also faces several challenges in regulating our highly fragmented financial sector today. Despite the continuous improvements we made to the regulatory framework in line with international best practices, non-compliance with Directions, rules and regulations, poor understanding of the regulatory framework, lack of prudent internal controls, absence of prudent risk management and dynamic strategic planning, and submitting unreliable information by some financial institutions have raised doubts in our minds about the corporate governance practices adopted by some companies. We believe consolidation programme will result in financial institutions being more transparent and be well-compliant with regulatory framework in the future.

Ladies and gentlemen, in order to address the concerns including the reasons I mentioned above, it was decided collectively by the Ministry of Finance and the Central Bank to strengthen the financial sector through consolidation. This is expected to be achieved by merging the financial institutions to create a sector with strong and dynamic institutions practicing good governance and catering to all sectors of the economy while being resilient to domestic and external shocks. Therefore, financial institutions need to put in place adequate capital and other buffers to prepare the Sri Lankan financial sector to further withstand business cycles without sacrificing investment potential in the future.

The move by Sri Lanka for financial sector consolidation at this juncture has been set out after careful consideration and assessment of the costs and benefits that would accrue to the country to achieve its national goal of accomplishing medium-term growth targets. As far as it has been established through research, a national policy on financial sector consolidation in other countries has been formulated and implemented only in response to a more damaging and widespread crisis in the past. However, the initiative by Sri Lanka to consolidate the financial sector is a unique paradigm, marking a record in global economic history, as this proposal is a prudent and forward looking regulatory move to prevent and minimise the costs of future crises. Recently, the Governor of the Reserve Bank of India, Dr. Raguram Rajan was in Colombo to attend the SAARC Governors' Conference and the Central Bank arranged a special evening presentation for him to deliver a lecture on the banking industry. There he reminded us, I quote, "***Regulators need to take right actions at the right time***". We believe the consolidation programme is the "***Right Action***" taken by the Central Bank at the "***Right Time***" to reform the Financial Sector in order to facilitate the rapid transformation of our economy.

Distinguished guests, the Government and the Central Bank believe the financial sector consolidation will result in cost efficiencies, productivity gains and improvements in corporate governance in the financial sector while enhancing the sector's contribution to uplift nationwide economic activity to facilitate the inclusive growth required for raising the country's per capita income to over USD 7,000 by 2020.

Part II: Financial sector consolidation: how?

Ladies and gentlemen, let me now move onto the second part of the oration. Before explaining how we designed and executed the consolidation process, I thought I should share with the distinguished audience, the basis and the background to this process, which was designed to re-organise the structure in the financial system within the existing legal framework, while taking into consideration some global experiences. In this regard, I will talk on four areas: the role of the Central Bank; evolution of our financial system; global experience in consolidation; and the transition of the burden of financial crises from shareholder to tax payer.

Basis 1: Central Bank's role in financial sector consolidation

I would like to begin by explaining the role of the Central Bank in this process. As you all know, securing financial system stability is one of the core objectives of the Central Bank. In terms of Section 5 of the Monetary Law Act, the Central Bank is empowered to ensure financial system stability in the country. The importance of maintaining a sound banking system was also emphasised in the "***Report on the Establishment of a Central Bank for Ceylon***" by the Central Bank's founding Governor, John Exter. There he said, I quote, "***Banking is an economic activity which affects the public welfare to an unusual degree, it touches in one way or the other almost every phase of the country's economic life. Sound banking is essential to a healthy and vigorous economic development***". Accordingly, the Monetary Law Act together with the subsequent enactments of the Banking Act and the Finance Business Act have empowered the Monetary Board to issue Regulations and Directions to the banking and NBFI sectors with a view to ensuring financial sector soundness, protecting the financial institutions from any mismanagement and failures, and maintaining public confidence. Hence, I believe you can understand that the Central Bank has a pivotal role to play in steering this consolidation process in line with its key objectives and responsibilities as the policymaker and the regulator of the financial system of the country.

In this regard, the Central Bank's role in the financial sector consolidation process will be that of a pragmatic systemic risk mitigator, and a guide that encourages innovation in order to ensure the overall goal of financial system stability. The Central Bank's policies are forward looking and designed to balance global policies and adjust to sudden volatilities, and to pre-empt, as much as possible, any possible financial distress or any possible failures in the financial sector in the future. Within this scope, the regulatory framework will be further improved to promote competition, develop sound and effective institutions, enhance operational aspects including IT and payment infrastructure, and foster a culture of innovation in the financial sector, thereby strengthening and maintaining financial system stability.

Basis 2: Evolution of the financial system of Sri Lanka

Ladies and gentlemen, now I would like to briefly take you through the evolution of our financial system. Banks in Sri Lanka have been in operation for over 160 years while the NBFI sector has been a part of the economy for the last 80 years. Before the economic liberalisation in 1977, NBFIs carried out hire purchase and leasing business using their own funds or personally borrowed funds. Since the owners of such companies prudently managed their businesses and were cautious in lending, NBFI failures during pre-1977 era were extremely limited. The new economic policies in the post-liberalisation period gave rise to higher demand for credit from the private sector, which led the NBFIs to raise public deposits. However, lack of controls and regulations during that period limited the ability of the Authorities to move directly into the affairs of NBFIs.

With the commencement of operations of the Central Bank of Sri Lanka in 1950, the Bank Supervision Department was set up, and has since been entrusted with the responsibility of supervision and examination of banking institutions. The scope of functions of the Bank Supervision Department was extended with the enactment of the Control of Finance Companies Act, No.27 of 1979, to include the supervision of NBFIs. The Bank Supervision Department was entrusted with the responsibility of providing the public with the required confidence in the financial system and protecting the interests of depositors. In order to achieve this objective, the Department was charged with the duty of continuous supervision and periodic examination of all banks and NBFIs in Sri Lanka.

During the period 1986–1988, several finance companies showed some distress due to mismanagement of funds. This required the Central Bank to bring in swift reforms to maintain overall stability and efficiency of the companies in the non-bank financial sector of Sri Lanka. Accordingly, the Finance Companies Act, No. 78 of 1988 was enacted and the Department of Supervision of Non-Bank Financial Institutions was established at the Central Bank in late 1988. However, with the continuous and rapid development in the NBFI sector, the regulations effected by the 1988 Act became futile, despite the amendments made in 1991. Ambiguities in the supervisory powers in respect of the Licensed Finance Companies and inadequate regulatory framework to deter unauthorised deposit taking persons and institutions that existed in the Act compelled the Authorities to introduce a more effective legislation. Accordingly, Finance Business Act, No. 42 of 2011 was enacted addressing all prevalent concerns and lacunas of the Finance Companies Act.

With regard to the banking sector, the Banking Act was also amended from time to time, inter-alia, to introduce more prudential standards such as the amendments made in 1990, 1995, 2005 and 2006. These banking laws and regulations are regularly updated in line with the best practices in the industry, both locally and internationally, covering requirements, principles and guidelines issued by the "*Basel Committee for Banking Supervision*" of the Bank for International Settlements (BIS).

Basis 3: International experience on financial sector consolidation

Ladies and gentlemen, I would like to share with you the global experiences of financial sector consolidation. In formulating a consolidation model for Sri Lanka, we studied several consolidation models of other countries, as they were useful for us to fashion our programme in an effective manner. In Asia, following the Asian financial crisis, many countries consolidated their financial institutions successfully. However, in the Western countries, mergers and acquisitions in the financial sector were largely one-off, market driven arrangements, and no consolidation was recorded as a pre-emptive national policy even after the series of crises reported in their financial sectors. Let me highlight a few success stories of financial sector consolidation that have taken place in the Asian region.

Malaysia: Following the Asian financial crisis in 1997, Malaysia realised the necessity of having a strong and resilient financial system and accordingly initiated a merger programme to consolidate the financial sector. Within one year of the merger programme, the non-bank sector was strengthened and the number of NBFIs was reduced from 39 to 8. By 2000, 50 out of 54 banking institutions were consolidated into 10 banking groups and as of today, all finance companies have been merged with commercial banks. Successful reforms of the financial sector have further reinforced the strong fundamentals supporting a sound financial sector in Malaysia. It was observed that overall confidence and stability in the Malaysian financial sector was preserved during the recent global financial crisis underpinned by a strong and well regulated financial sector.

Singapore: Singapore consolidated its banks, leading to bigger and stronger banks whose interests were aligned to the long term interests of the economy. In early 2000, Singapore launched its bank consolidation process, together with the liberalisation of the banking industry. A major move in the local banking sector was the consolidation of the 6 local banking groups into the present 3 main local banking groups, thereby strengthening banks' capabilities, building efficient management teams and enhancing operational effectiveness. This move strengthened the economic viability of all banks, and provided Singapore with better services and a competitive edge not only in the region but also in the global context.

Thailand: In Thailand too, financial sector consolidation was initiated after the Asian financial crisis with the objective of improving the efficiency and transparency while reducing the number of smaller financial institutions. A restructuring package was introduced to consolidate the commercial banks and finance companies that were unable to recover by themselves. Further, competition and cost cutting have also been reasons that promoted consolidation. As the final outcome, the number of participants in Thailand's banking sector is projected to shrink.

Similar financial sector consolidation has been observed in several other Asian countries such as South Korea, Indonesia and the Philippines after the Asian financial crisis. This initiative has helped them to protect themselves from the recent global financial crisis that affected most of the Western world.

Basis 4: Transition of the burden of financial crises from shareholder to tax payer

Ladies and gentlemen, the history of global financial crises taught us that nature of crises have been changing and along with that the burden of such crises have shifted from shareholders to tax payers. The history of systemic financial sector crises dates back to the 18th century, to the banking sector crisis named as the ***South Sea Crisis*** in UK in 1720s. After the inception of the formal banking system, USA has reported a series of crises in their banking system from 1792 to the latest, the ***Subprime Crisis*** in 2008. During initial periods, the impact of these crises was local and their spillover effects were negligible. With the evolution of the global banking business, banks have gradually started to link with the other banks in tandem with the improvements in global trade and capital market developments. With this interconnectedness, a crisis in one particular bank or banks in a particular country began to spread and create crises in the regional and global financial markets. The first ever global financial crisis erupted in 1857 in the US. However, until the world's biggest slump, the ***Great Depression*** during 1929–33, Governments wanted financial systems to become stable by themselves, while the Governments' involvement with banks was limited to raising funds from banks for developing infrastructure and other public spending. There was no lender of last resort to look after the crisis-ridden financial institutions. However, following the ***Great Depression***, new responsibilities were imposed on the Governments to ensure the stability of the financial system. As a result, since 1934, the burden of any financial crisis has fallen onto the tax payers of the country and involvement of Central Banks has increased in order to bail out failed financial institutions. This was aggravated further with the theory "***Too-Big-To-Fail***" (***TBTF***) popularised from early 1980s. In today's context IMF describes it as "***Too-Important-To-Fail***" (***TITF***), as most of the larger banks in the developed world became too important with their integration in global market, and making the impact of such failures unbearable to respective countries as well as to the global economy. This has prompted other countries also to take every effort to protect systemically important financial institutions in their countries. In Sri Lanka, when the consolidation programme was introduced, there was some opinion that too big institutions would exert an increased burden on the regulator and the Government if they face any crisis situation. However, we have taken into consideration that concern and fashioned the consolidation policy through a modified regulatory framework to minimise such systemic consequences.

Ladies and gentlemen, having explained the basis and the background in which we fashioned our financial consolidation programme, let me now move onto explaining "How" we initiated, designed and executed the consolidation programme.

Step 1: Initiation of financial sector consolidation

The Central Bank initiated the planning of the consolidation programme several years ago, and since then, a number of things have been done to bring it into reality, with procedures being carefully articulated for smoother implementation. As a result, in 2013, the Central Bank officially informed the Ministry of Finance, through a Budget Proposal, of the need for a strong and dynamic financial sector, by consolidating the institutions in the banking and non-banking sectors in a prudent manner to ensure enhanced financial system stability and to spearhead economic growth.

To support this initiative, His Excellency the President, in his Budget Speech on 21 November 2013, proposed to grant special tax concessions for expenditure incurred by banks and NBFIs, if they merge with, or acquire one or more financial institutions. Further, in view of providing better financial services for the development activity of the country, His Excellency proposed that two development banks, that is, NDB and DFCC be merged, for which too, qualifying payment status would be granted.

Ladies and gentlemen, as the Central Bank is charged with the duty of securing financial system stability by its mandate, the major responsibility of implementing the consolidation programme announced by His Excellency the President was entrusted to the Central Bank. Further, in order to meet the funding requirements for the implementation of the consolidation programme, the Monetary Board approved a budgetary allocation from the Central Bank.

Step 2: Setting up the "Financial Sector Consolidation Unit" at the Central Bank

The "***Financial Sector Consolidation Unit***" of the Central Bank, in general referred to as the "***Consolidation Unit***" was formed to design a strategy to catalyze the consolidation process and to spearhead the structural changes necessary for strengthening the financial sector. The Consolidation Unit is headed by the Assistant Governor of the Central Bank in charge of financial system stability with high-ranking officers of Bank and Non-Bank Supervision Departments appointed as members. A Technical Assistance Team representing expertise in the areas of accounting, auditing, banking, legal and regulation was also appointed to assist the Unit.

The Consolidation Unit is responsible for drawing up the Road Map to facilitate the envisaged outcome, providing guidance to the banking and NBFI sectors to ensure that its implementation will be smooth, effective and generate synergies to the financial system. The Unit is expected to liaise with all other stakeholders, such as Ministry of Finance, Inland Revenue Department, Securities and Exchange Commission, Colombo Stock Exchange, Registrar of Companies and Panel of Auditors, to facilitate the expeditious implementation of the consolidation process. Further, the Unit is also required to submit papers to the Monetary Board to obtain necessary approvals for the consolidation model of each Bank and NBFI on a case by case basis and to apprise the Monetary Board on the progress of the consolidation programme on a periodic basis. In addition, the general public too is kept informed of matters relating to consolidation through regular press communiqués to ensure maintaining the transparency of such policy measures as well as the public confidence.

Meanwhile, the Technical Assistance Team is entrusted with several duties including evaluating the consolidation proposals, studying and recommending solutions on technical aspects, particularly on legal, accounting, banking and tax, formulating guidelines to facilitate the consolidation process and arranging funding through the "Sri Lanka Deposit Insurance and Liquidity Support Scheme" (SLDILSS). The service of this internal Technical Assistance Team is highly rewarding, since, if such assignments were to have been outsourced, it would have taken a longer time period in addition to having to incur exorbitant consultancy fees.

Step 3: Preparing the master plan for financial sector consolidation

The Master Plan on the financial sector consolidation was prepared by the Consolidation Unit with the objective of developing a strong banking and NBFI sector with enhanced resilience to internal and external shocks in order to cater to the growing demands of the economy. Let me now explain the key components of the Master Plan.

First: Institution-wise strategies

We have designed a comprehensive strategy for the banks and NBFIs to transform their institutions to cater to the future needs while maintaining the stability of the system. Under this broader strategy, we have sector-specific strategies, designed separately for state banks, other domestic private sector banks, foreign banks and NBFIs.

Banking sector

Under the consolidation programme, the bigger banks in the sector are permitted to benefit largely from organic growth while the mid-tier banks are expected to strengthen their financial viability and grow through consolidation. As larger banks grow, it will be difficult for smaller banks to remain competitive, and therefore, small banks are encouraged to merge with strong partners. The outcome of the consolidation in the banking sector is expected to result in a sector where at least 5 Sri Lankan banks will have assets of over Rs. 1 trillion with a stronger regional presence by 2016, while domestic banks, which hold assets less than Rs.100 billion now will have to increase their asset base above Rs.100 billion through consolidation by 2016. Further, as the Sri Lankan economy's investment ratio is expected to be maintained at over 30 per cent of GDP, there will be an increasing demand for investments within the country. However, the 2 banks with development banking focus in Sri Lanka, namely, the National Development Bank PLC and DFCC Bank with DFCC Vardana Bank Ltd., are still not as big as the economy requires them to be to cater to the current and future needs of the economy. Therefore, these 3 banks will be merged so that the resulting entity would be large enough to comfortably raise long-term capital from domestic as well as international markets and cater to the growing demand for investments by both the private and public sectors.

We believe the State Banks have to contribute more towards building a strong and dynamic banking sector. Therefore, the two large state commercial banks, Bank of Ceylon and People's Bank, are encouraged to operate with higher levels of capital and conduct private banking on a wider scale. Further, these banks are expected to strengthen their off-shore banking operations and grow and expand towards a stronger regional presence. We have encouraged the National Savings Bank to broad-base their banking activities to contribute to the economy on a larger scale while, the *Pradeshiya Sanwardhana Bank* (the regional development bank of the country) is encouraged to serve the niche market of microfinance, targeting inclusive growth in the provinces. Meanwhile the other smaller state owned banks are encouraged to merge with the bigger state banks or with one another, and play a more cohesive role, since at present these banks account for just around 1 per cent of the market share.

Foreign banks operating in Sri Lanka are expected to demonstrate greater involvement, and make a useful contribution to the economy. Larger foreign banks are expected to further strengthen operations and display greater enthusiasm in private banking, off-shore banking, infrastructure financing and support emerging new economic areas of interest such as the

Strategic Hubs identified in the Government's development initiative. Meanwhile, smaller foreign banks are expected to develop new strategies to grow, and to increase participation in the domestic economic activity through expansion of the necessary skills and product development thereby enhancing their value addition in the economy.

Non-bank financial institution sector

One of the objectives of the consolidation plan is to fashion out an NBFI sector that comprises of a smaller number of strong NBFIs, which are fully compliant with the Central Bank's regulatory framework. On completion of the consolidation, we expect about 20 standalone NBFIs, of which at least 3 would specialise in microfinance business, and each NBFI would own an asset base of over Rs. 20 billion by 2016. Although there has been some criticism that this would lead to an oligopolistic market where lending rates would be high while deposit rates would be low, the post consolidation NBFI sector with the increased quality and quantity of capital is expected to have improved loss absorbency capabilities and enhanced resilience to internal and external shocks, and with such improvements, these NBFIs will be able to attract low cost, long term funds from the market in the form of deposits and debt. Further, in order to be competitive, NBFIs have to improve cost efficiencies, diversify their businesses, be ready to deal with market volatilities, and be able to manage risks in an integrated manner. Finally, following the consolidation, NBFIs are expected to have improved governance and fit and proper management teams capable of running the entities efficiently and competitively.

We all know our NBFI sector is highly fragmented. Therefore, the usual question posed to us is "***What is the ideal size and type that fits best for the industry to face future challenges***". To answer that, we carried out an assessment of the sector and accordingly all NBFIs were divided into two groups based on two quantitative criteria, i.e., the level of assets and capital base, and one qualitative criterion, i.e., compliance with the regulatory framework of the Central Bank. These two groups were named, "***Category A***" and "***Category B***". Accordingly, NBFIs with an asset base above Rs. 8 billion and a core capital above Rs. 1 billion, and are well-compliant with the regulatory framework are grouped into Category A, while, the rest of the NBFIs are grouped into Category B. Considering the criterion thresholds, Category A companies are believed to be NBFIs fit to continue in the industry. At the beginning of 2014 when such grouping was done, there were 19 NBFIs under Category A while Category B consisted of 39 NBFIs. Further, considering the groups of companies, as some groups were running with more than 1 NBFI, there were 13 groups of companies falling into Category A, while 36 groups were in Category B.

Under the consolidation approach for NBFIs as stipulated in our Master Plan, local banks and Category A NBFIs are encouraged to acquire upto 3 Category B NBFIs, while all Category B NBFIs are required to merge with local banks or Category A NBFIs, or merge among themselves, so that they fulfill conditions to become Category A NBFIs. Further, where groups of banks and NBFIs have multiple NBFIs in that group, we have requested such NBFIs to be merged so that only 1 NBFI would remain in the group. It was decided to permit banks to operate a newly acquired NBFI as a subsidiary considering the structural, operational and cultural differences that exist between these two types of financial institutions. Further, in the case that a bank or Category A NBFI acquires a negative net worth Category B NBFI and requires additional capital infusion, we will provide an equivalent amount of funding support to the acquiring entity through the SLDILSS.

Second: Capital enhancement plan

Ladies and gentlemen, one of the key factors underpinning the stability in the financial sector is capital, which needs to be maintained at adequate levels to absorb unexpected losses. Capital is required to be increased gradually in order to ensure that sufficient buffers are built during good times to strengthen resilience of the financial sector for such capital to be drawn down during bad times. Also, under the Basel III requirements in the run-up to 2019, the quantity and quality of capital needed to be maintained is higher to meet the regulatory requirements of core capital and leverage ratios.

Under the capital enhancement plan, the Central Bank will increase the entry capital requirement for new banks incorporated in Sri Lanka from its current level of Rs. 5 billion to Rs. 10 billion, commencing 2016. Meanwhile, for existing banks incorporated in Sri Lanka, commencing 2016, minimum Tier I capital requirement will be increased for Licensed Commercial Banks and Licensed Specialised Banks from Rs. 5 billion in 2015 to Rs. 10 billion, and from Rs. 3 billion in 2015 to Rs. 5 billion, respectively. However, branches of Foreign Banks operating in Sri Lanka are excluded from the capital enhancement requirement as they have backup funding arrangements from their parent banks. Similarly, the NBFIs are required to enhance the core capital from Rs. 400 million in 2014 to Rs. 1.0 billion by 2015 and further to Rs. 1.5 billion by 2018.

Third: Human resources aspects

Ladies and gentlemen, managing the concerns of employees and winning their confidence and support for the consolidation programme is very important for the smooth execution of this process. The Central Bank has informed all financial institutions involved in the consolidation programme that this process should not adversely affect the staff of the respective financial institutions. In this regard, the Central Bank has ensured that staff will not be forcibly retrenched as a result of this process and that the salary of no employee will be reduced from that which prevailed at end 2013. Also, financial institutions were encouraged to appoint competent Human Resource Consultants to perform independent reviews on senior management, while the Central Bank decided to keep the staff unions informed of the consolidation process to minimise any confusion in the minds of the employees.

Fourth: Revival plan for cash-strapped NBFIs

In our consolidation strategy, a common merger and acquisition plan was designed for well-run financial institutions. However, there are few finance companies facing liquidity constraints. For such companies, we introduced revival plans on a case by case basis so that public confidence will be restored and financial system stability will be sustained. Under this revival plan, the Central Bank decided to provide supplementary long-term concessional funding facility through SLDILSS for any new investor or financial institution, which acquires or merges with any cash-strapped NBFI, so that operations of such NBFI could be revived and restructured without weakening the financial position of the acquirer. The liquidity support would be granted on a case by case basis after a careful assessment of the financial position and business restructuring plan of the cash-strapped NBFI by the Central Bank. In tandem with the SLDILSS, the Central Bank may direct the existing shareholders to infuse fresh capital, or invite a strategic investor to acquire a strategic stake in the financial institution through an infusion of new capital.

Step 4: Implementing the financial sector consolidation plan

Ladies and gentlemen, let me now take you through the implementation process of the consolidation plan. The implementation was structured under 4 phases, of which 2 phases have already been completed while the third phase is progressing now. Let me briefly explain to you the accomplishments made under the first 3 phases and our plans under the final phase of the programme.

Phase I (from 17 January to 31 March 2014)

Action 1: Unveiling of the master plan and meetings with the Boards of Directors

As the starting point to the execution of the consolidation programme, the ***Master Plan on Consolidation of the Financial Sector*** was unveiled by the Governor on 17 January 2014, giving the necessary guidance to the banking and NBFI sectors on the way forward. This special forum was attended by the Chairpersons and the Chief Executive Officers of all banks and NBFIs, and all other stakeholders. The Central Bank requested all banks and NBFIs to continue a close dialogue with the Central Bank and obtain guidance if the need arises and also to submit their preliminary proposals regarding the consolidation plan by 31 March 2014.

Following the above forum, the first round of one-on-one meetings were held between 17 and 23 January 2014, with the Boards of Directors and senior management of banks and NBFIs, chaired by the Governor, to discuss their business plans under the newly announced plan and further clarify specific issues pertaining to particular institutions.

Action 2: Communicating the mandate and time frame

In line with the objectives of the financial sector consolidation programme, we provided the banks and NBFIs with a mandate to form internal steering committees to ensure a strategic fit by choosing a suitable partner and to ensure smooth transition to the new arrangement so that the process would ultimately generate synergies in the industry. Further, the relevant banks and NBFIs were requested to align their immediate future business expansion, new recruitments and other capital expenditure with the new developments and to submit periodic progress reports to the Consolidation Unit. We also requested the banks and NBFIs to formulate strategies to work in line with the time frame suggested by the Central Bank, which basically requires all consolidation plans to be submitted by 30 June and completed by end of 2014. Although this time frame was subject to criticism by some, we simply know by practice that unless we have a reasonable deadline, no plan would be effective. However, we maintained some flexibility in the time frame for the completion of mergers and acquisitions that are of a complex nature.

Action 3: Setting the system to manage confidentiality

We all know that consolidation involves mergers and acquisitions of financial entities, which require clear understanding about the partnering entity. Since financial information of individual entities is highly sensitive and confidential, the Central Bank designed a set of legal documents for such entities to maintain the confidentiality of the information. Accordingly, several legal documents pertaining to the consolidation plan were drafted. These legal documents were then approved by the Monetary Board and were subsequently put in use in proceeding with the consolidation plan.

Action 4: Communication policy and public awareness programmes

The success of the consolidation programme would largely depend on the public confidence in the same. Since the media plays a very active role today, we decided to issue press releases on a monthly basis commencing January 2014 to update all stakeholders involved in the consolidation process as well as the general public. In addition, the Governor, the Consolidation Unit and the senior officials of the Central Bank participated at many knowledge sharing events and conducted presentations on the subject of consolidation.

Outcome of phase I

Under the first phase, all domestic banks and NBFIs submitted their initial consolidation plans as agreed by end March 2014. In addition, all foreign banks too submitted their respective medium-term business expansion plans within the stipulated timeframe.

Phase II (from 1 April to 31 July 2014)

Action 1: Appointment of panel of auditors for conducting independent valuations

The most critical and sensitive task that had to be undertaken during the initial stage of the consolidation process is the preparation of an accurate status and valuation report of all Category B NBFIs. To fulfill this task, the Central Bank appointed 9 qualified external audit firms, referred to as “Panel of Auditors”, to conduct independent and professional audits and to undertake and complete information memoranda (IMs), due diligences (DDs) and valuation exercises in respect of the financial institutions that are to be merged or sold. Such reports are expected to be prepared under the highest standards in terms of professionalism and ethics, accepted norms and best practices. In order to ensure independence and objectivity of such reports, the Central Bank has decided to meet the expenses on professional fees to the auditors. Valuation of business were done based on 3 agreed methods, namely, price to earnings, price to book value and residual income approach which is for negative net worth companies. In addition, ***"Dispute Resolution Committee"*** comprising 4 members from the Panel of Auditors was appointed to resolve issues relating to DDs and valuations.

Action 2: Making available the IM, DD and valuation reports to prospective buyers

To facilitate making investment decisions, the IMs, DDs and valuation reports that were prepared by the Panel of Auditors for Category B NBFIs were made available to prospective buyers, after signing the Non-Disclosure Agreements (NDA). Based on the company valuations carried out by the Panel of Auditors, the Consolidation Unit prepared a methodology to arrive at a realistic and reflective average price multiple, which was informed to the potential investors. We also advised them that a premium or a discount may be applied to this multiple depending on the strengths and weaknesses of the selling NBFI. Further, we informed the Panel of Auditors to continue their service for transaction management and finalisation of deals. In addition, the Panel of Auditors was requested to arrange data room facility for prospective buyers to get more information and clarifications on the DDs and to assist them in their decision making process.

Action 3: Preparation of guidelines on the proposed tax benefits

His Excellency the President in his Budget Speech 2014 granted special tax concessions for financial institutions involved in the consolidation process. Accordingly, the Inland Revenue (Amendment) Act, No. 8 of 2014 and Value Added Tax (Amendment) Act, No. 7 of 2014 have been enacted by the Parliament giving effect to the budget proposal on financial sector consolidation. In terms of these amendments, the Central Bank has been empowered to issue guidelines to provide tax concessions on cost of acquisitions. Accordingly, the Central Bank has drafted the guidelines in consultation with the Ministry of Finance, the Inland Revenue Department and the Panel of Auditors. These draft guidelines were approved by the Monetary Board, and have been submitted to the Ministry of Finance and Planning for their concurrence.

Action 4: Regulatory coordination

There are several public institutions involved in the merger and acquisition process of listed and unlisted financial institutions. Therefore, the Central Bank had several discussions with all such institutions including the Securities and Exchange Commission of Sri Lanka, Colombo Stock Exchange, Inland Revenue Department and Registrar of Companies to facilitate the companies in the consolidation programme to fast track the process.

Outcome of phase II

Most of the banks and NBFIs submitted their respective confirmed merger proposals by 30 June 2014, while only a few financial institutions did not have firm plans due to certain reasons and were in need of additional time to finalise their respective plans. In order to resolve issues related to these banks and NBFIs, the second round of one-on-one meetings, chaired by the Governor of the Central Bank, were held between 11 and 22 July 2014. At these meetings, matters relating to the delays in arranging mergers and acquisition were discussed and financial institutions were provided with appropriate guidance to manage the consolidation process. Accordingly, all NBFIs who had not confirmed their consolidation plans were requested to submit their final plans at their earliest.

Phase III (from 1 August to 31 December 2014)

Action 1: Revisiting and modifying the regulatory framework

As we move onto a new platform of maintaining financial system stability with a set of relatively larger financial institutions under the transformation process of the domestic economy as well as the global economy, we feel that existing Directions, and Rules and Regulations that were used to assess the compliance of the banking and non-banking institutions too need to be revisited and modified in accordance with the financial sector consolidation programme. Accordingly, two internal committees have been officiated by the Departments of Supervision of Banks and Non-bank Financial Institutions to study the existing regulatory framework and propose changes in line with international best practices. The recommendations of these committees are expected to be submitted to the management of the Central Bank by end 2014.

Action 2: Reviewing consolidation plans and meetings with the Boards of Directors

In September 2014, the third round of meetings were held between the Consolidation Unit and the Boards of Directors of a few selected NBFIs to have a closer dialogue about their progress on the merger and acquisition plans. At these meetings, the Unit discussed in detail about the issues hindering their action in progressing with the consolidation programme, and provided them with necessary guidance for resolving the prevailing issues with a view to facilitating the expeditious implementation of their merger plans.

Phase IV (from 1 January to 31 March 2015)

In the fourth phase of the consolidation programme, we expect to complete the mergers and acquisitions by addressing post-merger issues. Further, we will assist and facilitate the parties to resolve any concerns that have emerged during the merger process. The modified regulatory framework too is expected to be issued at the beginning of 2015, and awareness programmes will be conducted to educate the key management personnel and staff of the financial institutions on the same.

Overall progress of the consolidation programme

From the inception of the financial sector consolidation programme in January 2014, the progress made so far by the banks and NBFIs is commendable. As of mid-September 2014, 8 Banks and 29 NBFIs have confirmed their merger and acquisition transactions under the consolidation programme while a few cash-strapped NBFIs are progressing under the restructuring process. In addition, 4 banks and 4 NBFIs are in the process of finalising their consolidation plans. The Consolidation Unit strongly believes that the Central Bank is in a position to meet the original time plan set for end 2014 for the completion of the consolidation process.

Conclusion

Ladies and gentlemen, let me now conclude my oration by emphasising on a few points. We all know that consolidating a diverse group of financial institutions is a very complex process and a challenging task. Sri Lanka has followed a very novel model in reforming the financial sector in a non-crisis environment, which gives us the comfort to resolve these complex issues smoothly. Today, our programme has gained commendable recognition from local as well as international agencies including IMF, World Bank, ADB and international rating agencies. The success of this financial sector consolidation is entirely dependent upon the proper planning, appropriate guidance, coordinated execution, uninterrupted support from all stakeholders and the extensive awareness campaigns conducted to educate all stakeholders including the general public.

We are now in the middle of the consolidation programme and the Central Bank intends to complete the programme by end March 2015. However, considering the complexity of the merger and acquisition models of some companies, flexibility would be granted on a case by case basis to ensure smooth transition. After the successful completion of the consolidation programme, the Central Bank expects to work more closely with the financial institutions in order to maintain the right balance in the regulatory system. Let me remind you of a very important advice given by the Central Bank's founding Governor, John Exter, I quote, "***Good Central Banking is less good law than good practice***". The same principle was endorsed in a different way by the Governor, Reserve Bank of India in his presentation made at the Central Bank last month, I quote, "***The more you punch on the regulatory parts of the Banks, the more risks will go to the shadow part of the financial system***". Therefore, let us continue our cordial relationship with the financial institutions as we may make our influence felt more effectively through the enhancement of usual interactions with financial institutions rather than through exercising all of the Central Bank's powers conferred under the Monetary Law Act. Members of financial institutions, we solicit your maximum attention to maintaining the stability of your own institution in order to ensure the overall stability in the financial system of the country.

Honourable Minister and distinguished guests, our financial sector consolidation programme is a forward looking programme designed to monitor, identify and track the sources of systemic risk over time to ensure financial system stability. This programme will change the financial landscape of the country by transforming the financial institutions to be stronger and more resilient institutions, which can support the expected ***quantum leap*** of our economy. At the same time we encourage them to penetrate regional and global markets. In addition, we expect to develop a vibrant offshore financial market in Sri Lanka and a reputed arbitration centre in Colombo on financial sector issues. By 2020, we expect at least 3 domestic banks exceeding Rs. 2 trillion in asset base and at least 5 banks operating in regional markets, setting the stage to take the economy to the next level of development by 2030. I would like to draw your attention to the invitation extended by His Excellency the President to all of us in his Policy Manifesto; "***Mahinda Chintana: Vision for the Future***", I quote "***Together, let us embark on this new journey to lead our beloved motherland to a brighter future***". I believe we all are with it.

Distinguished guests, I need your permission to extend my special thanks on behalf of our team at the Consolidation Unit to major contributors who are our partners in the success story of the consolidation programme. ***Firstly***, I wish to thank the Governor for his exceptional leadership and guidance given to us in planning the programme and its smooth execution from the beginning. ***Secondly***, I extend my sincere thanks to the members of the Monetary Board, Secretary to Ministry of Finance and Planning; Dr. P B Jayasundera and the Deputy Governors of the Central Bank for their continuous support and guidance, and in granting necessary approvals expeditiously. ***Thirdly***, I must thank all the members of the financial institutions including the board of directors, senior officials, all employees, members of trade unions, shareholders, borrowers, depositors and all other related parties for their positive contribution to the programme by understanding very wisely, the importance of this project to drive our future economy. Also, I wish to thank other institutions and various parties involved directly with the Central Bank and the financial institutions including the Ministry of Finance, Inland Revenue Department, Securities and Exchange Commission, Colombo Stock Exchange, Registrar of Companies, Panel of Auditors, legal and other consultancy firms for their valuable contribution to make this programme a success. ***Last but not least,*** my sincere thanks is extended to the directors and the staff of the two departments, the Supervision of Banks, and, the Supervision of Non-bank Financial Institutions, for their untiring contribution in making this programme one of the most successful projects carried out by the Central Bank in the recent past.

Once again, I wish to thank the Governor and the Organising Committee of the Annual Oration headed by Mr. D Wasantha, Assistant Governor of the Central Bank, for inviting me to share our thoughts on this important policy reform with this distinguished gathering today. Ladies and gentlemen, while thanking you for your patient listening, I invite each of you to be an active partner of this financial sector consolidation programme and stand by our vision, "***TO TRANSFORM SRI LANKA'S FINANCIAL SECTOR TO BE AMONGST THE TOP 5 WELL-MANAGED FINANCIAL CENTRES IN ASIA BY 2020***".

THANK YOU.