



 THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

## Regulatory aspects of Finance and Leasing Companies



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## Relevant Legislation

- Licensed Finance Companies - 47 Finance Business Act No 42 of 2011 (FBA)
- Specialized Leasing Establishments - 12 Finance Leasing Act No 56 of 2000 (FLA)



## Authority to issue

### Section 12 of the FBA - Monetary Board

- 28 Directions
- 4 Rules
- 3 Guidelines

### Section 34 of the FLA – Director SNBFI

- 18 Directions
- 3 Guidelines



## Basis for issuance of

To mitigate risks and to enhance resources available to do so

- Credit Risk / Asset Quality
- Liquidity Risk
- Operational Risk
- Reputational /Governance Risk
- Capital related directions



## Directions on Credit

- Finance Companies (Provision for Bad & Doubtful Debts) Direction No.3 of 2006
- Finance Companies (Single Borrower Limit) Direction No.4 of 2006
- Finance Companies (Lending) Direction No.1 of 2007.



## Cont.....

- Finance Companies (Writing off of Loans and Advances) Direction No.3 of 1991.
- Finance Companies (Register of Written-off Loans) Direction No.10 of 1991.
- Finance Companies (Accrued Interest) Direction No.15 of 1991.



## Directions on Other Assets

- Finance Companies (Transfer of Assets) Direction No.4 of 1991.
- Finance Companies (Fixed Assets) Direction No.11 of 1991.
- Finance Companies (Investments) Direction No.7 of 2006.



## Direction on Liquidity Risk

- Finance Companies (Liquid Assets) Direction No.1 of 2009.



## Directions on Operational Risk

- Finance Companies (Deposits – Incentive Schemes) Direction No.5 of 2001.
- Finance Companies (Deposits) Direction No.1 of 2005.
- Finance Companies (Closure of Office/s for Business) Direction No.4 of 2005.



## Cont....

- Finance Companies (Structural Changes) Direction No.5 of 2005.
- Finance Companies (Opening /Shifting / Closure of Branches/Offices) Direction No.6 of 2005.
- Finance Companies (Information System Security policy) Direction No.4 of 2012.
- Finance Companies (Interest) Direction No.6 of 2012.



## Cont.....

- Finance Companies (Advertisements) Rule No.1 of 2006.
- Finance Companies (Registration and Licensing - Amendment) Rule No.1 of 2010.



## Cont.....

- Finance Companies (Opening of Branches/Offices) Guidelines No.1 of 2006.
- Finance Companies (Maintenance of Savings Accounts for Minors) Guidelines No.1 of 2007.



## Directions on Capital

- Finance Companies (Capital Funds) Direction No.1 of 2003.
- Finance Companies (Risk Weighted Capital Adequacy Ratio) Direction No.2 of 2006.



## Cont.....

- Finance Companies (Minimum Core Capital) Direction No.1 of 2011.
- Determination on the Inclusion of Unsecured Debentures in the Capital Funds of Finance Companies.



## Directions on Corporate Governance

- Finance Companies (Corporate Governance) Direction No.3 of 2008.
- Finance Companies (Corporate Governance - Amendment) Direction No.4 of 2008.






## Cont.....

- Finance Companies (Assessment of Fitness and Propriety of Directors and Officers Performing Executive Functions) Direction No.3 of 2011.
- Finance Companies (Business Transactions with Directors and their Relatives) Direction No.2 of 2007.




## Directions on Reporting Requirements

- Finance Companies (Audited Accounts) Direction No.16 of 1991.
- Finance Companies (Reporting Requirements) Direction No.2 of 2011.
- Finance Companies (Publication of Half Yearly Financial Statements) Guidelines No.2of 2006.



**Directions on Overall Financial System Stability**

- Finance Companies (Stimulus Package Conditions) Direction No.3 of 2009.
- Finance Companies (Insurance of Deposit Liabilities) Direction No.2 of 2010.



**Need to submit web based returns periodically**

CBSL has not developed web based returns to cover all directions issued. Only a minimum number of returns are required to be submitted for the off site surveillance requirements.



## Effects of non compliances

If the Board, on the basis of a report made by the Director, is of the opinion that the LFC is carrying on or likely to carry on its business following unsound or improper financial practices which are detrimental to the interest of its depositors and other creditors or has contravened or failed to comply with any provisions of FBA, may under section 25:



## Actions by the Monetary Board

- Impose a penalty
- Issue cease and desist orders
- Publish the name of the company as a company with serious supervisory concerns
- Appoint a person to manage the affairs of such company



## Cont.....

- Restrain Directors/ Officers from carrying out any function
- Remove any Director, manager or an employee of the LFC
- Re organize the company by increasing its capital or reconstituting the Board of Directors
- Amalgamation of the LFC with another institution



## Cont.....

- If the Board on a report made by the Director of the opinion that any past or present director, chief executive officer, manager, employee agent or a contractor of a LFC has by any act or omission, has caused a wrongful gain for himself or wrongful loss to the LFC, may under Section 51 :



## Cont.....

- Require such party to repay, restore or compensate the LFC with interest
- If failed to do so to take actions to recover personal property through making an application to the relevant District Court for an order authorizing the seizure and sale of property



## Offences Section 52

- Any person who being a director, secretary, chief executive officer, manager, officer, employee or auditor of a finance company fails to secure compliance with the requirements of the Act, makes false entries in any book, maintains multiple sets of books shall be guilty of an offence.



## Penalties : Section 56

- Shall be liable to a fine not exceeding Rs. 3 mn or imprisonment for a term not exceeding three years or both.



## Issues /Areas to be focused by the industry and the auditors

- Poor Corporate Governance Culture of the organization
- Lack of integrity of directors and senior management
- Board oversight on Integrated Risk Management



## Cont....

- Negative attitude on the importance of risk management by the senior management
- Absence of knowledge among employees on operational risk mitigating techniques.



## Cont....

- Absence of effective internal audit function
- Over dependency of few individuals
- Concentrations maintained – Real Estate, Gold, Deposits



## Cont....

- Booking of fictitious assets in the balance sheet
- Seeking undue profit without a fundamental business model - Hiding the true financial position by overstating profits and assets.



## Cont....

- Low capitalization
- Bias/ non arms length related party transactions
- Transferring funds to related companies through intercompany “current accounts”
- Ever greening of accommodations





Thank you.