Deposit Assessment in Sri Lanka

MAY 2011

Commissioned by
IFC
International Finance Corporation
World Bank Group

MicroSave
Market-led solutions for financial services

Ministry of Foreign Affairs

Commissioned by IFCs Access to Finance Advisory Department

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MicroSave has over a decade of experience in providing practical, client-responsive, market-led solutions to assist financial service providers and institutions working with low-income clients succeed and achieve their mission and business objectives. It has a history of working alongside financial institutions, telecom operators and FMCG companies, livelihood institutions and development agencies of varied institutional forms and sizes throughout Africa and Asia. It has undertaken assignments in Afghanistan, Bangladesh, Cambodia, Cameroon, China, Colombia, Egypt, Ethiopia, Ghana, India, Indonesia, Kenya, Malawi, Nepal, Nigeria, the Philippines, Sierra Leone, South Africa, Sri Lanka, Sudan, Tanzania, Uganda and Vietnam.

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ACKNOWLEDGMENTS

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This report is the result of the co-operation and hardwork of many people in many organisations, especially the microfinance institutions, community-based organisations, banks, donor agencies and industry experts who were a part of this study. *MicroSave* is also grateful to the sector experts who gave their time and support to the study. Above all, we thank the clients who patiently gave us their time during the extensive market research for the report. Their responses regarding savings products and services, and how they manage their finances without many options provided invaluable insight.

We hope and believe that the future for financial inclusion is bright, and that this report will play a role in forming the overall direction, products, and the delivery channels for broadening and deepening the outreach of formal financial systems.

MicroSave Team

ABBREVIATIONS	
IFC	International Finance Corporation
A2F	Access to Finance
CBSL	Central Bank of Sri Lanka
IMF	International Monetary Fund
GDP	Gross Domestic Product
GNI	Gross National Income
USD	United States Dollar
LKR	Lankan Rupees
HDI	Human Development Index
OECD	Organisation for Economic Co-operation and Development
HCI	Head Count Index
LCBs	Licensed Commercial Banks
LSBs	Licensed Specialised Banks
RFCs	Registered Finance Companies
CRBs	Co-operative Rural Banks
RRDBs	Regional Rural Development Banks
RDBs	Regional Development Banks
MPCSs	Multi-purpose Co-operative Societies
TCCSs	Thrift and Credit Co-operative Societies
PTCCSs	Primary Thrift and Credit Co-operative Societies
WDCs	Women's Development Co-operative Societies
RoSCAs	Rotating Savings and Credit Associations
ASCAs	Accumulating Savings and Credit Associations
CBOs	Community Based Organisations
NGO	Non-Governmental Organisations
MFIs	Microfinance Institutions
SBSs	Samurdhi Bank Societies
IBSL	Insurance Board of Sri Lanka
NDTF	National Development Trust Fund
JTF	Janasaviya Trust Fund
PAMP	Poverty Alleviation Microfinance Project
JBIC	Japan Bank of International Corporation
HNB	Hatton National Bank
NSB	National Savings Bank
FD	Fixed Deposit
GTZ	The Deutsche Gesellschaft für Technische Zusammenarbeit

1. BACKGROUND OF THE STUDY

IFC's Access to Finance (A2F) department caters to both policy- and project-related advisory work on financial markets, financial institutions and financial infrastructure. Microfinance is a core product of A2F and expanding small-scale deposits is a flagship initiative. Microfinance is well-established in South Asia, with numerous large, successful, and internationally known institutions in Bangladesh, India, Nepal and Sri Lanka. For a variety of reasons, however, most institutions focus on microcredit and the development of savings services has lagged seriously behind. This paper studies the current supply and demand for microdeposit services in Sri Lanka.

2. MACROECONOMIC ENVIRONMENT[1]

The Sri Lankan economy can best be described as resilient. After the introduction of liberalised economic policies in 1977, the country witnessed a bloody conflict which ended in 2009, a bankruptcy crisis in 2001, a devastating natural disaster in 2005 and a global economic meltdown in 2008. However, in spite of these detrimental factors, the economy has grown at an impressive average year-on-year rate of 4.88% from 1977 to 2009. Sri Lanka has only witnessed negative growth once after independence, due to the global economic slowdown and the pressures of the sustaining conflict in 2001.

Figure 1: GDP Growth (Annual %)

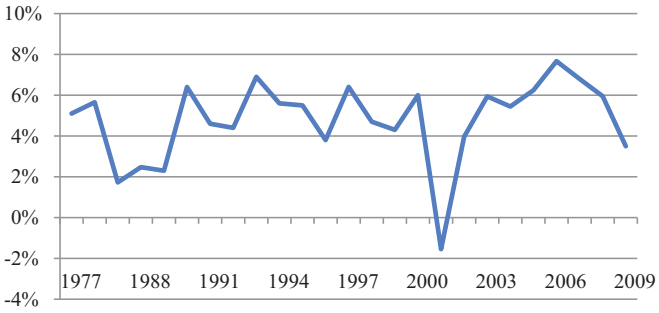


Figure 2: Per Capita GDP (at Current Prices in USD)

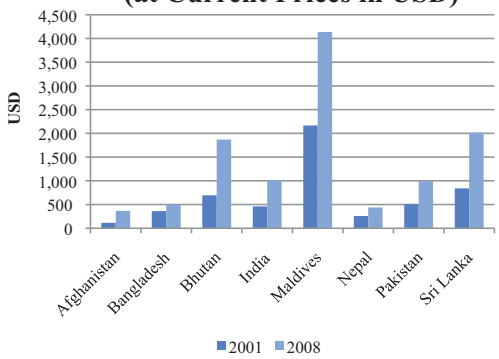


Table 1: Macroeconomic Indicators – Sri Lanka					
Macroeconomic Indicators	**2005**	**2006**	**2007**	**2008**	**2009**
GDP (at Current prices) in LKR Mn (USD Mn)	2,452,782 (21,706)	2,938,680 (26,006)	3,578,688 (31,670)	4,410,682 (39,033)	4,825,085 (42,700)
GDP Growth (%)[2]	6.2	7.7	6.8	6.0	3.5
Net Public Debt (as % of GDP)	90.6	88.7	85.8	90.0	N/A
National Savings Rate (as a % of GDP)	23.8	22.3	23.3	18.2	23.3
Domestic Savings Rate (as a % of GDP)	17.9	17.0	17.6	13.9	18.0
Investment (as % of GDP)	26.8	28.0	28.0	27.6	24.5

Source: Central Bank of Sri Lanka Publication E&SS-2010

1 All macroeconomic data in this section has been sourced from the Central Bank of Sri Lanka.
2 For 2008 and 09 from http://www.indexmundi.com/sri_lanka/gdp_real_growth_rate.html

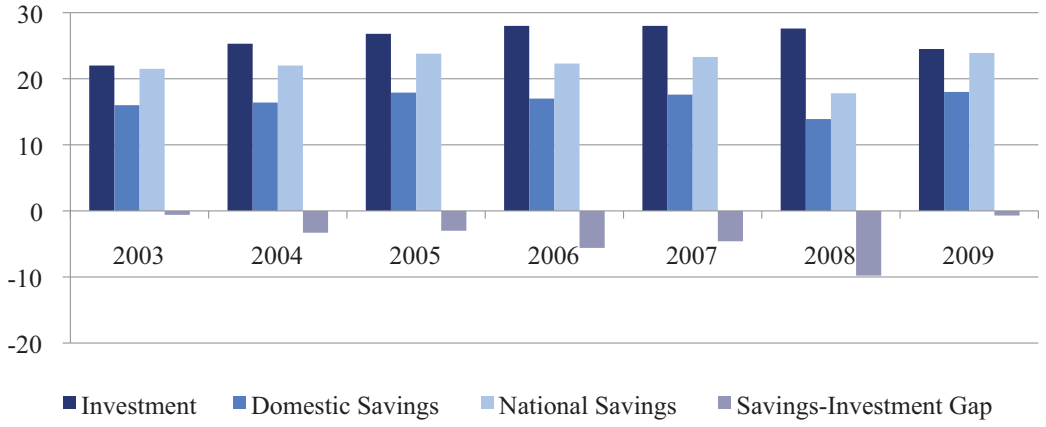
In the second half of the past decade, the Sri Lankan economy grew at an average of 6.04% before the global economic crisis, which pulled the growth rate to 3.5% for 2009. The per capita GDP of Sri Lanka, at USD 2,053 in 2009, is the second highest in the South Asia. (See *Figure 2*). Growth in per capita GDP during the last decade was 139%, much higher than most of its neighbours. In January 2010, Sri Lanka's status was upgraded from a "low-income country" to a "lower middle income country" by the IMF.[3]

Figure 3 below shows the trend in savings and investment in the Sri Lankan economy from 2003-09. In 2008, the national savings rate did decline to below 20% of the GDP, but readily rose to previous levels (23.3%) in 2009. The savings-investment gap that grew from 2004 to 2008 owing to the development work undertaken post the 2004 tsunami and the 2008 global slowdown, was covered by deficit financing.

"It took Sri Lanka more than 50 years to achieve a per capita income of USD 1,020. Reaching a per capita income of USD 4,000 by 2016 will be a feasible target with the encouraging economic environment."

- Mr. Mahinda Rajapaksa
President of Sri Lanka

Figure 3: Savings and Investment Trend in Sri Lanka



2.1 TRENDS IN THE BANKING SECTOR

High growth rates during the last decade also contributed to a period of high inflation. (See *Table 2*) After 2004, the country experienced double digit inflation for five consecutive years. This led to a significant increase in the rates set by the Central Bank of Sri Lanka with a peak in 2008 when the average bank prime lending rate was 18.5%. Though the monetary measures adversely affected the GDP growth, which fell to 3.5% in 2009, they did help rein in inflation to 3.4% by 2009.

Table 2: Currency, Inflation and Interest Rates - Sri Lanka

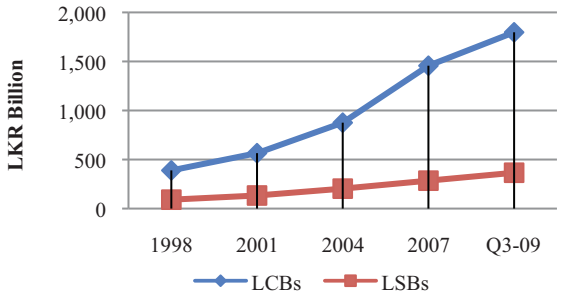
Macroeconomic Indicators	2005	2006	2007	2008	2009
Currency Stability (LKR – USD exchange rate)	100.5	103.9	110.6	108.3	114.9
Inflation (%)	11.0	10.0	15.8	22.6	3.4
Treasury Bill Yield Rate (91 days) (%)	10.1	12.8	21.3	17.3	7.7
Commercial Banks Average Weighted Prime Lending Rate (%)	12.2	15.2	17.9	18.5	10.9
Commercial Banks' Average Weighted Deposit Rate (AWDR) (%)	6.2	7.6	10.3	11.6	8.0

Source: Central Bank of Sri Lanka Publication E&SS-2010

3 *http://www.lankabusinessonline.com/fullstory.php?nid=1923230628*

As seen in *Figure 4,* during the last decade, licensed commercial banks (LCBs) mobilised savings far more rapidly than the licensed specialised banks (LSBs). There are several reasons for the success of LCBs over LSBs, like the number of outlets growing from 1,084 in 2000 to 2,214 in 2009 (versus LSB branches increasing from 305 to 504 over the same period). Other factors include the robust financial infrastructure and differences in regulations whereby commercial banks can provide more services, as discussed in section 3.1.

Figure 4: Banks Deposit Mobilisation Trend

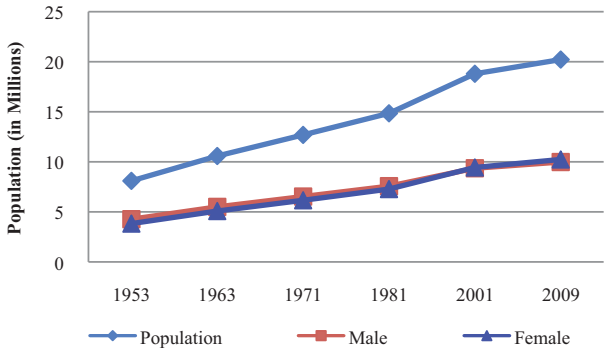


Source: Central Bank of Sri Lanka Publication E&SS-2010

2.2 DEMOGRAPHICS

Sri Lanka has a population of over 20 million people, composed of ethnic Sinhalese (74%), Sri Lankan Tamils (12%) and Indian Tamils (6%). These three communities represent 92% of Sri Lanka's population.[4] Seventy per cent of Sri Lanka's population is of the Buddhist faith,[5] while Hindus represent 15%, Christians 8% and Muslims 7%. Over half of the population is concentrated in small areas of the western, central and southern provinces, constituting only 23.2% of Sri Lanka's total land area.[6]

Figure 5: Gender and Population Growth



Source: http://www.statistics.gov.lk/page.asp?page=Population%20and%20Housing

Figure 5 shows that the population growth rate slowed in the last decade to 1.2%. Yet, the population increased from 18 million in 2001 to over 20 million in 2009. Sri Lanka's gender ratio favours women and more has changed significantly in the past 50 years from 897 females for every 1,000 males in 1953 to 1,025 females for every 1,000 males in 2009. Like most South Asian countries, Sri Lanka is also densely populated at 326 persons per km and ranks 35th in the world in terms of population density. Population density is highest in western Sri Lanka, especially in and around the capital, Colombo. Though Sri Lanka ranks in the lower half on the Human Development Index (HDI), at 102 out of 180 countries (see *Table 3*), the average life expectancy at birth has improved to over 75 years and the average literacy rate is 91.3%.

Table 3: Socio-Economic Overview of Sri Lanka – 2009

Population ('000) (mid-year)	**20,450**
Density of population (Persons per square km)	326
Average Household Size	4.1
Life Expectancy at Birth (years)	75.1
Average Literacy Rate (%)	91.3
Human Development Index (Rank)*	0.759 (102)
Poverty Head Count Index	15.2
Unemployment Rate(%)	5.8
**Figures are for 2007*	

Source: Central Bank of Sri Lanka Publication: Key Social Indicators 2009.

4 *http://news.bbc.co.uk/2/hi/south_asia/514577.stm*
5 *http://www.apcdfoundation.org/countryprofile/sri%20lanka/sri_lanka_intro.html*
6 *WHO Country Cooperation Strategy 2006-2011 Ch2,Pg 6: http://www.searo.who.int/LinkFiles/WHO_Country_Cooperation_Strategy_- _Sri_Lanka_Health_Development_Challenges.pdf*

Even in in 2010, Sri Lanka remains a predominantly rural economy with 84.9% of its population living in rural areas, including those involved in the estate sector, i.e., people who work on large, corporate plantations, such as tea, rubber, etc. Migration from rural to urban areas has grown after independence but in view of the country's total population, the rate remains low (as seen in *Figure 6*.

In the last decade, Sri Lanka's population has slowly become older, partially due to reasonably strong and sustained economic development, factors often related to a reduction in fertility and a rise in life expectancy (as seen in *Figure 7*). The percentage of senior citizens in Sri Lanka's population was 9.2% in 2000 and 11.2% in 2006, exceeding the average of all regions in the world except OECD countries, Eastern Europe and the former Soviet Union.

Driven by a declining fertility rate and increasing life expectancy, population projections indicate that the proportion of those aged 60 years or more will reach almost 20% of the total population by 2025 and 30% by 2050.[7] This demographic change will have an adverse impact on the Sri Lankan economy. However, the projection also underlines the importance of offering appropriate financial products and services, including savings and pensions, for all segments of the population.

Figure 6: Rural Urban Population

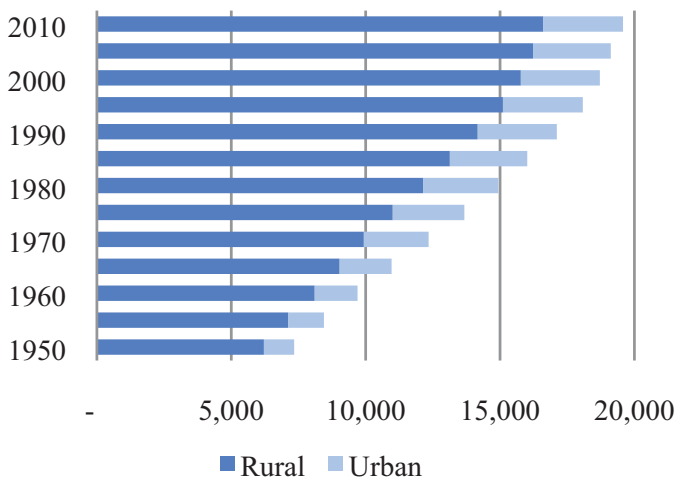
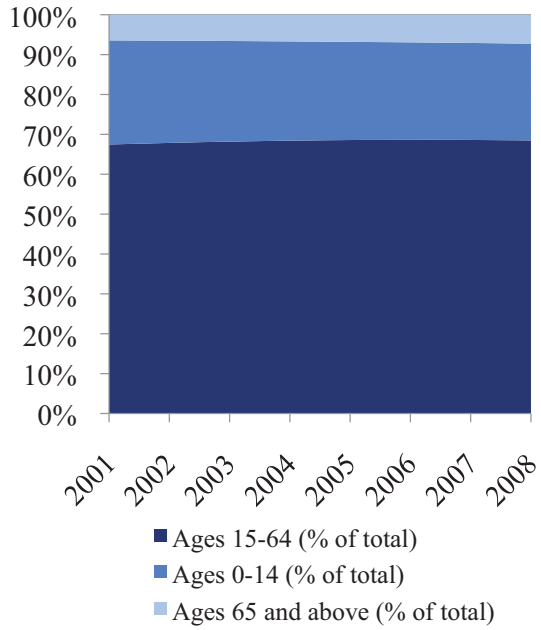


Figure 7: Population Age Groups



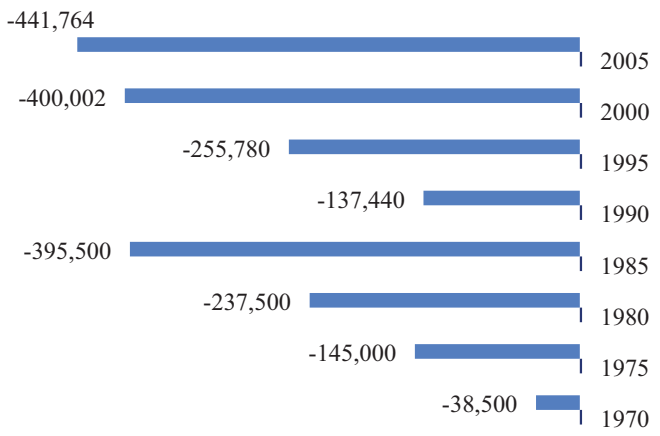
2.2.1 Migration Figures and Trends

The graph in *Figure 8* (below) shows that a growing number of Sri Lankans are migrating to other countries. The number of people migrating out of the country increased substantially between 1995 and 2000, at a time when the political disturbance was at its peak. More recently, there has been a trend among workers to migrate to the Middle East for

7 *Report No.43396-LK "Sri Lanka Addressing the Needs of an Aging Population", World Bank, Retrieved from: siteresources. worldbank.org/INTSRILANKA/.../LKAgingFullRep.pdf*

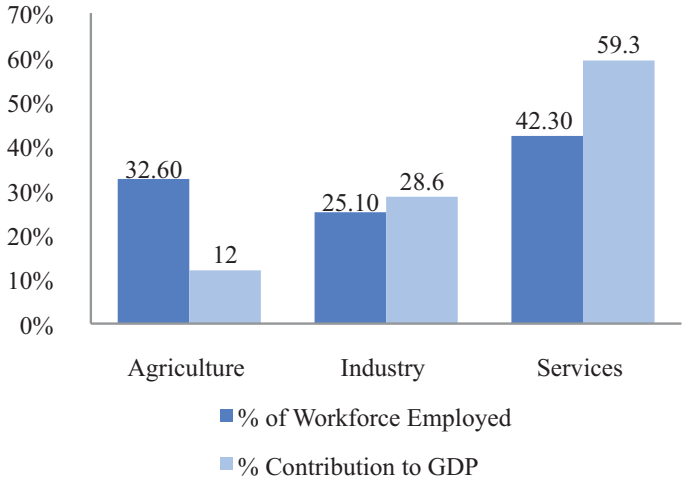
employment. It is estimated that there are about 1.5 million Sri Lankans working abroad, sending home more than $2.9 billion a year. In 2009, foreign employment as a percentage of total work force was 24.2%, of which more than 51% were women.[8]

Figure 8: Trends in Migration (No. of Persons)



Source: http://data.worldbank.org/country/sri-lanka

Figure 9: Distribution of Workforce across Different Sectors



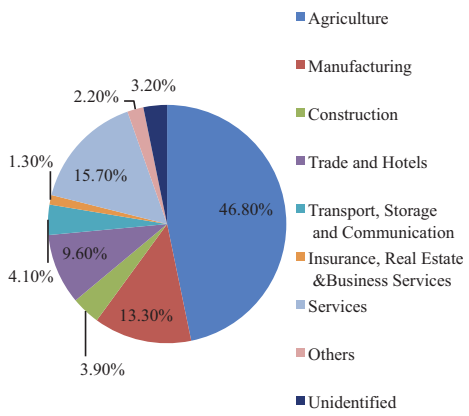
Source: www.statistics.lksri-lanka

2.2.2 Employment Figures and Trends

The labour force of Sri Lanka was 8.29 million in 2008 with an unemployment rate of 5.8%, which has decreased over the past decade due to the strong economic growth. According to the estimates made available by the Central Bank of Sri Lanka in its Sri Lanka Socio Economic Data-2008, the country had a total workforce of 7.4 million, out which 94.2% were employed. Despite a large number of people (32.6%) employed in the agriculture sector, as seen in *Figure 9*, its contribution to the total GDP stood at 12%. The services sector, including tourism, hotels and financial and business services, is the largest contributor to the national GDP of Sri Lanka with a share of 59.3%.[9, 10] What is most interesting in this trend is that though over 80% of the population lives in rural areas, only 46.8% of them work in agriculture and allied services. This means that a significant portion of the rural population is involved in the kind of jobs which are often reserved for urban areas, such as services and manufacturing, etc., as seen in *Figure 10*.

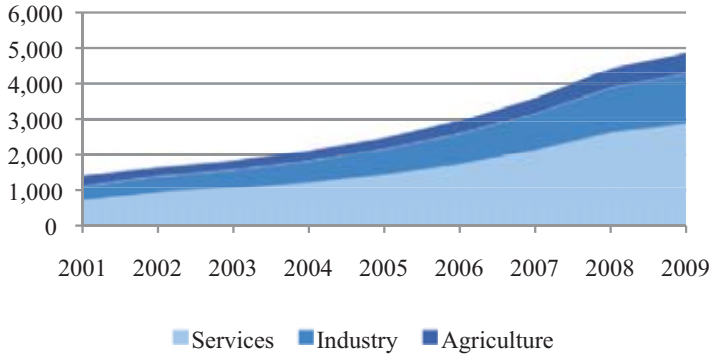
8 *Sri Lanka Bureau of Foreign Employment*
9 *Sri Lanka Socio-Economic Data 2008, Central Bank of Sri Lanka, June, 2008*
10 *Figures pertain to the year 2007*

Figure 10: Occupations in Sri Lanka



Source: http://www.statistics.gov.lk/samplesurvey/index.htm

Figure 11: GDP Composition



Source: Central Bank of Sri Lanka Publication E&SS-2010

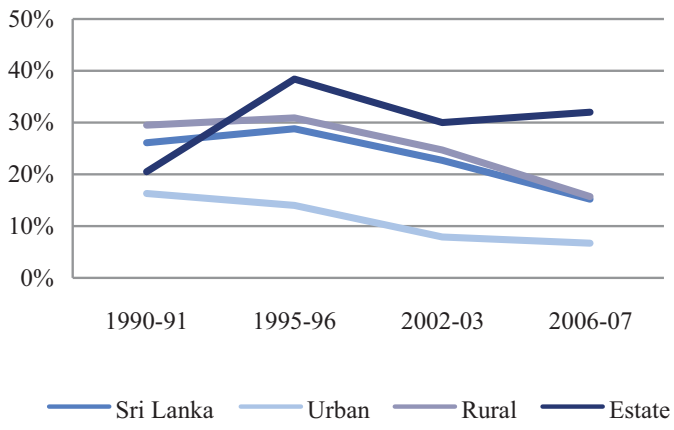
Figure 11 shows how Sri Lanka's GDP has grown over the last decade. The services sector has shown consistently strong growth from 53.1% in 2001 to 59.3% in 2009, due to growth in tourism and transportation industries. Industry's contribution relatively remained the same with a marginal increase from 26.8% to 28.6%, and agriculture declined from 20.1% in 2001 to 12% in the GDP of 2009. [11]

2.2.3 Poverty Trends and Figures

The population living below the National Poverty Line was officially 15.2% in 2007, halving from almost 30% in the mid-nineties (the World Bank estimates poverty to be 34%, based on the $2/day level). This improvement can be primarily attributed to the 36% reduction in the rural sector's poverty levels from 24.7% to 15.7% (80% of Sri Lanka's population resides in rural areas). *(*See *Figure 12).*

However, poverty in the estate sector, which constitutes 5.5% of the total population, touched a new high as the population living below the poverty line jumped from 30% in 2002 to 32% in 2007. The urban sector had the lowest poverty rate with a Head Count Index (HCI) of 6.7% (only 6.6% of overall poverty). Among the different provinces (*refer to Figure 13*), the Uva and Sabaragamuwa provinces are the poorest with HCIs of 27% and 24%, respectively[12]. The western province is the richest with an HCI of 8.2%, but accounts for 16.8% of the poor, as it represents

Figure 12: Trend in Poverty Headcount Index



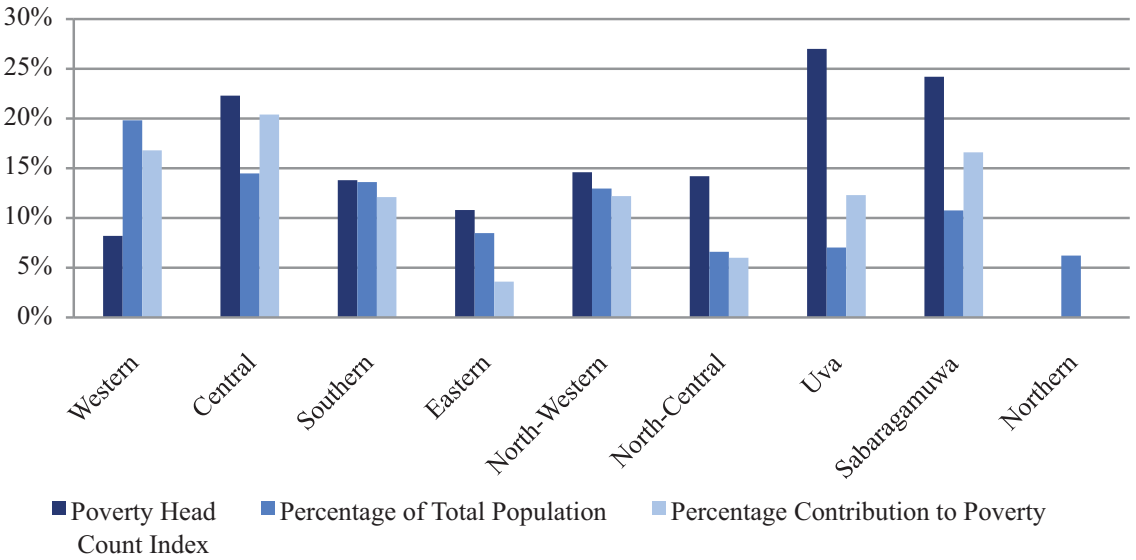
Source: http://www.statistics.gov.lk/poverty/index.htm

11 *Central Bank of Sri Lanka's publication E&SS 2010*

12 *Poverty Head Count Index survey was not conducted in the northern province and a large part of the eastern province due to the conflict. These provinces are considered to be more poor*

20% of the total population. Colombo is the richest district in the country with a poverty headcount ratio of only 5%. The Nuwara Eliya District has the highest poverty headcount ratio of 34%, followed by Monaragala District at 33%, both of these are located in central parts of the country.

Figure 13: Distribution of Poverty Across Provinces



Source: http://www.statistics.gov.lk/poverty/index.htm

2.3 BUSINESS ENVIRONMENT IN SRI LANKA

Sri Lanka began opening its economy in the late 1970s with a focus on promoting the private sector. The following policies and procedures are conducive for attracting foreign direct investment:

- Total foreign ownership is allowed in almost all parts of the country.
- The safety of foreign investment is guaranteed by the Constitution.
- The legal and regulatory framework covers intellectual property law; settlement of disputes and other laws define the policies for foreign investors ensuring ease and transparency in operations.
- Equal treatment for foreign and local investors under the investment and general laws of the country.

Sri Lanka ranks 105 out of 183 countries in the overall ranking of ease of doing business. In South Asia, Pakistan is ranked first, followed by the Maldives and Sri Lanka is ranked third. Sri Lanka ranks 41 in the ease of starting a business, while it is 166th when it comes to paying taxes (see *Table 4* below). Sri Lanka scores the lowest in terms of dealing with construction permits and time taken for registering property, ranking 168 and 148, respectively. Starting and closing a business in Sri Lanka is relatively easy and one needs to only follow 4 procedures, compared to the South Asian

average of 7.3. In terms of financial services, Sri Lanka does fairly well—71st with getting credit and 73rd for protecting investors—although this is much lower than India and Bangladesh, which rank 30th & 41st and 71st & 20th, in both categories.

Table 4: Doing Business Rankings (June 2008- May 2009)

Economy	Ease of Doing Business	Starting a Business	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Enforcing Contracts	Closing a Business
Sri Lanka	105	41	96	148	71	73	166	137	45
Bangladesh	119	98	124	176	71	20	89	180	108
Nepal	123	87	148	26	113	73	124	122	105
India	133	169	104	93	30	41	169	182	138

Source: http://www.doingbusiness.org/ExploreEconomies/?economyid=174

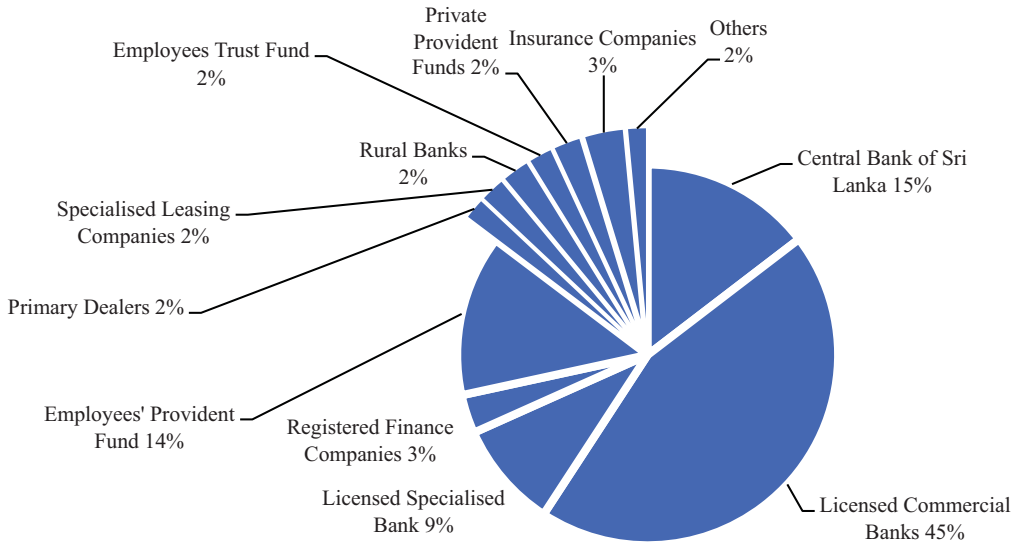
3. LEGAL AND REGULATORY FRAMEWORK

3.1 INSTITUTIONS ACCEPTING DEPOSITS OR PROMOTING DEPOSIT-LINKED PRODUCTS

The apex institution in the banking sector in Sri Lanka is the Central Bank of Sri Lanka (CBSL), which is responsible for the governance of banks and the financial sector.

The Sri Lankan financial system consists of institutions, such as licensed commercial banks (LCBs), licensed specialised banks (LSBs), registered finance companies (RFCs), specialised leasing companies (SLCs), insurance companies, co-operative rural banks (CRBs), major financial markets (such as the foreign exchange market, money and capital markets), and the payment and settlement systems. *Figure 14* shows the percentage of total financial assets is split between various players in the formal financial system of Sri Lanka. LCBs dominate the financial sector, holding 45% of the total assets, and LSBs and RFCs hold 9% and 3%, respectively.

Figure 14: Structure of Financial System in Sri Lanka (% of Total Assets)



Source: http://www.cbsl.gov.lk/htm/english/05_fss/fss.html

In addition, there are also semi-formal institutions, like thrift and credit co-operative societies (TCCS) and informal mechanisms, like rotating savings and credit associations (RoSCAs), commonly known as *Seettus*, through which the poor also access financial services. For the purpose of this study, the service providers are grouped into 1) formal, 2) semi-formal and 3) informal institutions, based on the type of regulation by which they are governed. *Table 5* below shows the various types of institutions and the laws under which the service providers are regulated.[13][14][15]

Table 5: Regulatory Framework for Deposit Taking Institutions in Sri Lanka

Type of Institution	Regulating Authority	Governing Law/Act	Number of Entities
Formal Institutions for Deposit Mobilisation			
Licensed Commercial Banks (LCBs)	Central Bank, Ministry of Finance	The Banking Act – 1988	Public sector – 2 Local Banks – 9 Foreign – 12
Licensed Specialised Banks (LSBs)	Central Bank, Ministry of Finance	The Banking Act – 1988	Regional Development Banks (RDB)-6[13], Others – 9
Registered Finance Companies (RFCs)	Central Bank, (Department of Supervision of Non-Bank Financial Institutions)	The Finance Companies Act – 1982	36
Insurance Companies	The Insurance Board of Sri Lanka (IBSL)	The Regulation of Insurance Industry Act –2000	16
Semi Formal Institutions for Deposit Mobilisation			
Co-operative Rural Banks (CRBs)	Department of Co-operative Development	Co-operative Societies Law – 1992	1,805 CRBs.[14] Operated through 305 MPCSs[15]
Thrift and Credit Co-operative Societies (TCCS) – Sanasa	Department of Co-operative Development	Societies Ordinance	8,440 societies (of which only 1/3rd are active)[16]
NGO-MFIs	Ministry of Social Services	Voluntary Social Service Organisations Act No. 31 of 1980, amended by Act No. 8 of 1998 Companies Act -1982	2,993 Outlets/ Branches[17]
Samurdhi Societies*	Monetary Board	Samurdhi Authority Act – 1995 (as amended)	1,038 Samurdhi Bank Societies[18]

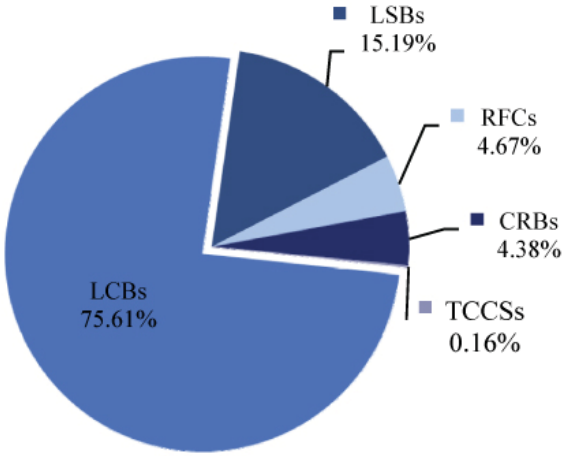
**The central bank does not include the deposits of NGOs and Samurdhi while calculating total deposits.*

13 *http://www.coop.gov.lk/info_English/index.asp-xp=924&xi=932.htm*
14 *Total number of societies registered in 2007 (Microfinance Institutions in Sri Lanka - GTZ study 2009)*
15 *Number of NGO-MFIs outlets (as per Microfinance Institutions in Sri Lanka - GTZ study 2009)*
16 *Number of registered SBSs in 2001 (as per Microfinance Institutions in Sri Lanka- GTZ study 2009)*

3.2 FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN SRI LANKA

Formal institutions include banks (both LCBs and LSBs) and finance companies (RFCs), which mobilise over 95% of total deposits in Sri Lanka *(*See *Figure 15)*. Formal institutions govern the market because of the wide outreach, government mandate and their long existence. (The Central Bank does not include the savings mobilised from NGO-MFIs and Samurdhi societies and other informal mechanisms when calculating total deposits).

Figure 15: Share of Deposits in Sri Lanka



Source: http://www.cbsl.gov.lk/htm/english/05_fss/fss.html

3.2.1 Banks

The regulatory and supervisory framework of the banks in Sri Lanka is guided by the Banking Act, Monetary Law Act and the Exchange Control Act.[17]

The Banking Act provides that no banking business shall be carried out except by a public company under the authority of a license issued by the Monetary Board of the Central Bank of Sri Lanka and with the approval of the Minister of Finance. The Central Bank issues licenses of two types, i.e. for LCBs and LSBs. The licensing requirement does not apply to registered finance companies under the Finance Companies Act, a co-operative society under the Co-operative Societies Law, a building society incorporated under the National Housing Act or any non-profit organisation established or registered under any written law which accepts deposits only from its registered members and has obtained permission in writing from the Monetary Board.

The country's formal financial system comprises of 23LCBs, 15 LSBs[18] and 32 RFCs.

(i) Licensed Commercial Bank (LCBs)

Under the Banking Act, a public company can act as a commercial bank and carry out banking activities only if it obtains a banking license[19] by meeting minimum capital requirements and getting an approval license issued by the Monetary Board of Central Bank of Sri Lanka, under Part IXA of the Banking Act. The minimum paid-up capital for local and foreign LCBs is LKR 2.5 billion (approximately USD 22 million).[20]

Foreign LCBs in Sri Lanka operate as branches of their parent bodies as opposed to being separate legal entities; consequently, such branches maintain capital in the form of 'assigned' capital from the parent body and are required to maintain additional deposits as specified by the Monetary Board.[21]

17 *http://www.cbsl.gov.lk/htm/english/05_fss/f_2.html*
18 *After the merger of the RDBs there are now 10 LSBs in Sri Lanka.*
19 *Section 2(1) of the Banking Act*
20 *http://www.cbsl.gov.lk/pics_n_docs/09_lr/_docs/licensing/bsd_licensing.pdf*
21 *http://www.cgap.org/gm/document-1.9.45846/Country%20Report_Sri%20Lanka%20Prudential%20Regulations.pdf*

LCBs can carry out the following activities as authorised and specified in its banking license under the Banking Act:[22]

(i) Opening, maintaining and managing deposits, savings and other similar accounts, including current accounts;

(ii) Borrowing, raising or taking up money;

(iii) Negotiating loans and advances;

(iv) Lending or advancing money, with or without security; and

(v) Any other activities incidental to the banking business (if authorised under the license).

(ii) Licensed Specialised Banks (LSBs)

LSBs are specially licensed banks for savings and development. The licensing requirements are similar to those of LCBs. The minimum paid-up capital for LSBs is presently LKR 2 billion (approximately USD 17.7 million). The main activities LSBs are allowed to undertake are contained in the Fourth Schedule of the Banking Act, and they include:[23]

(i) Accepting time and savings deposits, and opening, maintaining and managing deposits, savings and other similar accounts (excluding conducting banking business, as defined in the Banking Act, see sidebar).

(ii) Granting loans and advances or participating with other financial institutions in granting loans or advances to any enterprise.

Since LSBs are licensed for special purposes, the basic services an LSB may carry out are individualised and specific to the institution and authorised in its license. The LSBs may also be restricted from undertaking certain activities as per the license or other written law. LSBs are restricted from operating current accounts for their clients and from dealing in foreign currency and commodities such as gold.

In September 2010, the CBSL issued a press release which required LCBs and LSBs to increase their capital requirements. As per the press release, LCBs must have minimum capital of LKR 3 billion (USD 25.5 million approximately) by March 2011 and LKR 5 billion (USD 44.2 million approximately) by March 2015. LSBs must have minimum capital of LKR 2 billion (USD 17.7 million approximately) by 2011 and LKR 3 billion (USD 25.5 million approximately) by 2015. "Increased capital will further provide a cushion for banks to enhance their contribution to the new growth sectors of the economy and to absorb any unexpected losses," the CBSL stated.[24] The CBSL's focus in light of the collapse of the Golden Key credit card company, has been to strengthen the banking system by increasing capital requirements so as to mitigate risks better.

'Banking business' is defined

in the Banking Act as the business of receiving funds from the public through the acceptance of money deposits payable upon demand by cheque, draft, order or otherwise and the use of such funds either in whole or in part for advances, investments or any other operation either authorised by law or by customary banking practices.

--As defined in the Banking Act

Licensed specialised banks

(LSBs) differ from LCBs in that they are prohibited from opening and maintaining current (or "checking") accounts for its customers. The ability to deal in gold and foreign currency, available to LCBs (all of which have been appointed by Central Bank as authorised dealers in foreign currency) is also not available to LSBs.

www.microfinance.lk/pdf/1260785911.pdf

22 *http://www.microfinance.lk/pdf/1260785911.pdf*
23 *http://www.microfinance.lk/pdf/1260785911.pdf*
24 *Press release dated 07/09/2010, retrieved from: www.cbsl.gov.lk*

3.2.2 Registered Finance Companies (RFCs)

The Finance Companies Act governs the regulation and supervision of RFCs. The Department of Supervision of Non-Bank Financial Institutions of the Central Bank carries out the regulatory and supervisory functions for RFCs and ensures they comply with the minimum prudential requirements stipulated by the Central Bank. The directions and rules issued under the provision of the Finance Companies Act cover minimum capital adequacy and liquidity requirements, deposits, provisioning for bad and doubtful debts, single borrower limits and limits on equity investments. Matters relating to non-compliance with prudential requirements or any weaknesses and deficiencies in the financial condition, controls and systems of a finance company are brought to the notice of its Board of Directors by the Central Bank to ensure that corrective action is taken by the company. Finance companies are required to maintain core capital of LKR 200 million (USD 1.76 Million).

In a Nutshell

From a regulatory perspective, the commercial and specialised banks and registered finance companies are the most highly regulated entities in the Sri Lankan financial sector. The governing Acts for these institutions have been in existence for many years and have been improved and fine-tuned by various amendments, thereby establishing a well-defined set of guidelines for regulating and supervising the institutions.

The Central Bank is responsible for investigating into the affairs of institutions, which are allegedly engaged in finance business without legal authority. These unauthorised institutions may be taking money from the public either as deposits or in a manner akin to deposits by calling them other names, such as investments, credit, borrowings or placements. Due to various notorious incidents of 'fly-by-night' operators and failure of financial institutions, the Central Bank has taken actions for curbing unauthorised persons for accepting deposits and for spreading awareness among the masses.

www.microfinance.lk/pdf/1260785911.pdf

3.3 SEMI-FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN SRI LANKA

3.3.1 Samurdhi Bank Societies (SBSs)

"*Samurdhi*" in Sanskrit means prosperity and the word was used as the name of a government initiative to provide welfare services. The Samurdhi Authority of Sri Lanka Act No. 30 of 1995 (as amended by Act No. 02 of 1997) provided for the setting up of a Samurdhi Authority (as a corporate body with perpetual succession and the right to sue and be sued) to implement the national Samurdhi Programme for the improvement of economic and social conditions of youth, women and disadvantaged groups of the society. This was to be achieved through initiatives such as:

(a) Broadening opportunities for employment and enhancing income;

(b) Integrating people into economic, development and social activities;

(c) Linking family-level economic activities with community development projects at village, district, divisional and provincial levels;

(d) Mobilising people's participation in the planning and management of projects and schemes for their up-liftment;

(e) Fostering cooperation, promoting savings and assisting people to obtain credit facilities;

(f) Facilitating the delivery of inputs and services from government departments, public corporations, local authorities, private sector organisations and non-governmental organisations to beneficiaries of the programme;

(g) Implementing programmes and initiatives taken by the government for poverty alleviation.

The Samurdhi structure consists of a decentralised system operating at division and district levels. To manage and operate savings and credit schemes for beneficiaries under the Samurdhi Programme, committees are formed at the village level, centres at the village-cluster level and Samurdhi Balakayas or a youth force is created to implement all the Samurdhi programmes. The Samurdhi centres and *Balakayas* are responsible for setting up ground-level credit and banking facilities in conjunction with banks and other lending institutions, and deposit mobilisation for constituents of their respective *Grama Niladhari* divisions. The divisions are also empowered to plan and undertake infrastructure projects for the development of their villages.

The activities of the Samurdhi Authority are financed by a fund set aside under the Samurdhi Authority Act, for which money is allocated by the Parliament through funds received by way of gifts, grants, donations, etc.; as income from any property owned or administered by the Authority or money received by the Authority from any other source.

3.3.2 Co-operatives [25]

The Department of Co-operative Development is responsible for the supervision and governance of co-operatives registered under The Co-operative Societies Law No. 5 of 1972 (as amended by Act Nos. 5 of 1972, 37 of 1974, 11 of 1980, 32 of 1983 and 11 of 1992). The Co-operative Societies Law allows registration of societies working on principles of a co-operative for economic, social or cultural welfare of its members. The societies registered can be with or without limited liability.

The law also states that a registered co-operative society is only entitled to give loans or accept deposits from members or other registered societies (with approval of the Registrar of Co-operative Societies).

Co-operatives may receive loans or deposits from non-members only to the extent and under conditions explicitly allowed by the law. The two major forms of co-operatives

Societies Ordinance

The Societies Ordinance No. 16 of 1891 (as amended) makes provision for the registration of mutual, provident and other societies. As per the Societies Ordinance, the following societies may be registered:

"(a) Societies established with the object of promoting thrift, giving relief to members in times of sickness and distress, of aiding them when in pecuniary difficulties and for making provision for their widows and orphans;

(b) Societies for any purpose which the Minister, by notification in Gazette, has authorised as a purpose for which the powers and facilities of the Ordinance ought to be extended etc) ("specially authorised societies")"

-Adapted from Legal Study of microfinance sector of Sri Lanka (A GTZ study) *www.microfinance.lk/pdf/1260785911.pdf*

25 *GTZ Study on Microfinance Institutions in Sri Lanka-2009*

active in the microdeposit mobilisation space are the co-operative rural banks and the thrift and credit co-operative societies.

(i) Co-operative Rural Banks (CRBs)

CRBs owned by multi-purpose co-operative societies (MPCSs) are the second major players in the semi-formal sector dealing with rural finance. Many co-operative credit societies were formed by the government in the early decades of the 20th century against the framework of the Co-operative Credit Societies Ordinance No.7 of 1911. Subsequently, during World War-II, consumer co-operative societies were formed to facilitate food distribution. In the post-war period of the 1950s, these co-operatives were renamed multi-purpose co-operative societies and their scope of activities was widened. The MPCSs offer microfinance services through the CRBs, which are owned by them. These activities also cover women's development co-operative societies (WDCS). The umbrella institution for the WDCS was incorporated in 1991 as a district society and in 1998 upgraded to national level.

"CRBs suffer from poor management and governance. Though the numbers (of savings deposits) quoted by them are high, the actual number may be less as this money is misused by giving loans in a inappropriate manner or the deposits are put into other economic activities of the co-operatives which are not financially sustainable. So, there is a loss of the savings and no one is aware of this".

-Dr. Nimal. A. Fernando
Former Principal Specialist (Microfinance), ADB

Multi-purpose co-operative societies are member-owned organisations and operations are co-ordinated by the Board of Directors at the divisional secretariat level. In addition to this general representative body, each MPCS has its own board, which is responsible for all operations of MPCSs and CRBs owned by it. In addition to this, there is a bank union at the provincial-level which handles investment activities for MPCSs.

(ii) Thrift and Credit Co-operatives (TCCSs) - SANASA

SANASA, a Sinhalese acronym for a financial co-operatives network, is a network of thrift and credit co-operative societies (TCCSs). These co-operatives were introduced by the British colonial administration and were the first credit co-operatives to be set up in Sri Lanka. The TCCSs gradually became involved in a wider set of roles for procurement of inputs and distribution of products on behalf of the co-operatives by the 1930s. This function was subsequently taken over by the multi-purpose co-operative societies (MPCSs). During the 1970s, the TCCSs were in decline and the Department of Co-operatives was to wind up operations and close the remaining societies. However, under the leadership of P.A. Kiriwandeniya, the movement was revived and reorganised under the SANASA banner in the late 1970s. During the revival and reorganisation, the mission and vision of the SANASA movement was more precisely defined and the social dimension of the programme gained importance. The network orientated its focus towards poverty alleviation and started to increasingly target low-income groups at the village level. The PTCCSs network under SANASA has grown from 1,500 societies at the beginning of the 1980s to 8,440 registered PTCCSs in 2007. Only about one-third of these are now active.

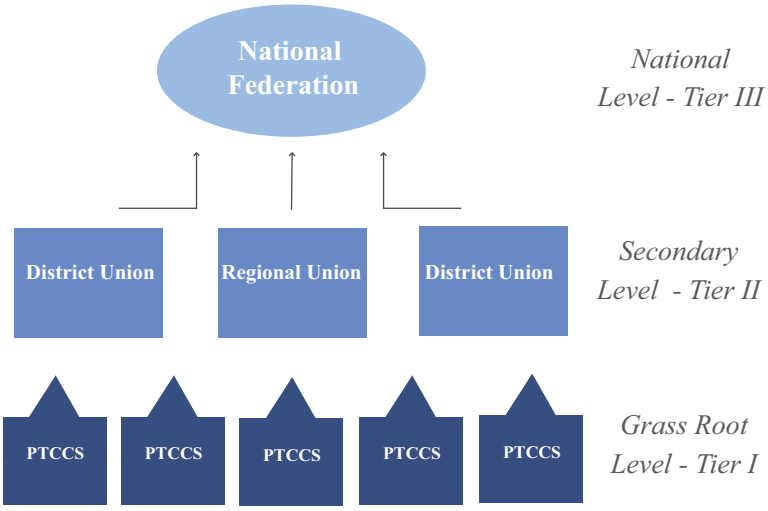
Organisational reforms were undertaken between 1978 and 1980 whereby the first seven district unions (DUs) were established (at present the number stands at 34) which subsequently united to form a national federation, giving SANASA its present three-tier structure. SANASA societies are regulated under the Co-operative Societies Law of 1972 (details provided above) and also the Societies Ordinance of 1891. PTCCSs

and DUs are registered and controlled by departments at the district-level, while the national federation is registered and controlled at the national-level. PTCCSs are also legally permitted to provide savings services to minors and to adult non-members.[26]

The key responsibilities of the Department of Co-operatives are:

- Carrying out yearly audits of registered co-operative societies;
- Replacing the board with an interim board and dissolving a troubled co-operative under certain conditions, and;
- Approving the expansion of a co-operative's activities geographically and authorising a merger.[27]

Figure 16



The Co-operatives Act is considered very restrictive by experts and is deemed responsible for some of the problems TCCSs are facing, including:[28]

- The requirement of permission for geographical expansion restricts the consolidation of TCCS. The Department of Co-operatives treats TCCSs as village-level institutions.
- The Department of Co-operatives does not have the capacity to carry out proper audits, this has resulted in financial weaknesses with the TCCSs.
- There are no prudential norms prescribed for regulating the TCCSs at national level. This has resulted in variations in the regulations at district level.

3.3.3 Non-Government Organisations - Microfinance Institutions (NGO-MFIs)

According to regulations, non-government voluntary social service organisations have two options:

1. Register under the provisions of the Voluntary Social Service Organisations Act No. 31 of 1980, amended by Act No. 8 of 1998. The Circular Letter of the secretary to the President, dated 26/2/1999, establishes that:

   a) International voluntary social service organisations and national ones operating with foreign funding or in more than one administrative district, have to register with the National Secretariat for NGOs under the Ministry of Social Services.

26 *Owen, Graham "Rural Outreach and Financial Co-operatives : Sanasa, Sri Lanka", IBRD, 2007*
27 *Ibid.*
28 *Ibid.*

b) Local NGOs operating in only one district are to register with the district or divisional secretary.

2. On the other hand, non-profit organisations can also be registered under Section 21 of the Companies Act No. 17 of 1982. With the enactment of the new Companies Act No. 7 of 2007, companies registered under the old Act have to re-register with the Registrar of Companies.

NGO-MFIs under the present regulations (either the Voluntary Social Service Organisations Act or Companies Act) are not allowed to mobilise deposits from their clients. However, in August 2010, the Central Bank issued a new Microfinance Regulations Draft for discussion and feedback of industry experts and stakeholders. The Microfinance Bill was tabled in Parliament in 2010.

***There has been 'benign neglect'** of the sector by authorities in the past".*

– J. Charitha Ratwatte
MD Sri Lanka Business Development Centre SLBDC, Former Secretary, Ministry of Finance

Highlights of Microfinance Draft

The Central Bank of Sri Lanka released a draft of Microfinance Act in July 2010. Highlights of the draft include:

- **As per the Act, microfinance business means accepting deposits and providing financial accommodation in any form and other financial services, mainly to low-income persons and microenterprises. (This clearly indicates that MFIs registered will be allowed to accept deposits, regarding which there is ambiguity at present).**
- **The Act provides for establishing an authority for licensing, regulating and supervising microfinance business and matters incidental to the same.**
- **This authority will be governed by a Board of Directors having representation from the Central Bank, the Ministry of Finance and professional accounting body and two people with relevant qualification and experience.**
- **The Act shall be applicable to companies, non-governmental organizations, societies and co-operative societies, carrying out microfinance business. (Licensed banks, registered finance companies, Samurdhi and farmer organisations have been left out).**
- **The authority will decide the core capital requirement from time to time and this is one of the eligibility criteria for registering as a microfinance service provider.**
- **The authority shall specify the operational area and regulations for the institutions during their registration.**
- **The Act defines the constitution, roles and responsibilities of the Board of the registered institution.**
- **The Act defines the accounting and reporting requirements for MFIs governed under it.**
- **The authority may take action to safeguard interests of the depositors through deposit insurance as the authority deems necessary.**
- **The Act defines the terms and conditions under which deposits may be accepted by such microfinance institutions, the maximum rates of interest payable on such deposits, the maximum period for which deposits may be accepted and the maximum amount that may be deposited with a microfinance institution in the name of one person in one or more accounts.**

- Based on the draft issued by the Central Bank of Sri Lanka

http://www.cbsl.gov.lk/pics_n_docs/09_lr/_docs/directions/nbsf/Draft_microfi_act.pdf

3.4 INFORMAL MECHANISMS FOR DEPOSIT MOBILISATION

ince informal institutions are not regulated, by definition there is no legal framework or set of regulations under which they are managed. The most commonly used informal mechanism in Sri Lanka is *Seettus* (the local name for RoSCAs), kitchen savings and piggy banks. These informal mechanisms are discussed in Section 4.4.

3.5 INSURANCE COMPANIES

The Regulation of Insurance Industry Act, No. 43 of 2000[29]
The Insurance Board of Sri Lanka was established under The Regulation of Insurance Industry Act, No. 43 of 2000. The Act is responsible for regulation and supervision of insurance activities. Insurance brokerage firms are required to register with the Insurance Board. Currently, there are 16 companies licensed under this Act and there is also a network of insurance agents, appointed and registered by insurance companies and insurance brokers, who play a key role in marketing insurance products.

The Insurance Board of Sri Lanka (IBSL) has been empowered to:

- Register as insurers persons carrying on insurance business (general, long-term or both);
- Register persons as insurance brokers;
- Advise the government on the development and regulation of the insurance industry; and
- Regulate business activities and affairs of registered insurers and insurance brokers.

3.5.1 Special Restrictions

- Only a public company incorporated in Sri Lanka can seek registration for carrying out insurance business;
- A registered insurer shall not carry on any form of business other than insurance, provided that a person may, with the written approval of the IBSL, carry out any financial service business which is ancillary or associated with the registered insurance business of such person.

3.5.2 Registration of Insurers[30] and Regulations Governing Insurance

The Insurance Act details all the requirements that a company must fulfil in order to become registered under the Act. Some of the key provisions are:

- Minimum capital of LKR 25 million (USD 258,000) is required in order to conduct long-term (life) insurance business, and LKR 50 million (USD 515,000) in order to conduct general insurance business;

29 *Conducive Environment - Role of Governments and Regulators by Sirisena S. Ratnayake*
30 *http://www.ibsl.gov.lk/insurance_legislations/insurance_act.pdf*

- Only limited (share) companies are allowed;
- Composite companies (doing both general and life business) are permitted;
- A qualified actuary must evaluate the funds annually;
- A minimum solvency margin in the long-term business of 5% of the actuarial value of liabilities is required (minimum solvency provisions for general insurance business are under discussion but not yet agreed upon);
- Insurance companies (only once) and brokers (annually) must be registered;
- Insurance companies may conduct only insurance business;
- Insurance agents are appointed by insurance companies or brokers and must be physical persons;
- 30% of the long-term funds of a life insurance business and 20% of technical reserves of general insurance must be invested in government securities and the balance in other investments as determined by the IBSL;
- Fire and workmen's compensation insurance are still subject to tariffs, but the motor insurance tariff was deregulated as on January 1, 2002;
- The Agriculture and Agrarian Insurance Board, the Export Credit Insurance Corporation and the Social Security Board are all exempted, and instead subject to special Acts in each respective area.

3.6 THE ROLE OF GOVERNMENT OF SRI LANKA IN DEPOSIT MOBILISATION

3.6.1 Governmental initiatives to improve financial inclusion

3.6.1.1 The National Development Trust Fund (formerly the Janasaviya Trust Fund)

The National Development Trust Fund (NDTF) was established in January 1991 by the Government of Sri Lanka in a loan agreement with the World Bank and Federal Republic of Germany, amounting to USD 52.8 million. The objective was to identify, develop, catalyse and promote sustainable income generating opportunities and a higher quality of life for the poor through a range of activities, including productive self-employment, microenterprise and rural work.

The NDTF provides lines of credit and support services to the poor, generally through partner organisations such as people's organisations, non-government organisations and co-operatives by promoting thrift, savings and an asset base amongst the poor, leading to self-reliant development. This mandate by the NDTF led to the growth of NGO-MFIs in the second half of the 1990s. The NDTF is the biggest wholesale lender for microfinance institutions in Sri Lanka.

NDTF aims to increase the number of partner organisations to 600 and help NDFT borrowers in reaching a per capita income of USD 5,000 by the end of 2016.

http://www.treasury.gov.lk/NDTF/Future%20Plan.htm

The NDTF was formally known as the Janasaviya Trust Fund (JTF) programme. The operations manual of the programme specified compulsory deposit mobilisation through a percentage deduction of each loan disbursed. This sum was credited to the savings account called a Group Contingency Fund, owned and managed by a group of sub-borrowers. The manual also specifies general savings mobilisation wherein the beneficiaries are required to participate in individual savings programmes. The savings mobilised must be deposited on behalf of beneficiaries in an interest earning account in approved financial institutions.

(ii) Poverty Alleviation Microfinance Project (PAMP I and II)
The PAMP projects were initiated by the Sri Lankan Government with support from the Japan Bank of International Cooperation (JBIC) to establish a cost-effective and sustainable microcredit delivery system for the poor and inculcate of habits of savings and thrift. The programmes are currently implemented through the Regional Development Department (RDD) of the Central Bank. PAMP I started on December 1, 1999, and continued until December 1, 2006, and PAMP II commenced in 2009 and will continue until 2013.

3.6.1.2 Specification of the PAMP Project

- Consists of four major components: credit, training, technical assistance and project administration.
- Short-term and medium-term credit is provided to eligible individuals for agriculture and non-agriculture microenterprise.
- Facilitation is carried out through the appointment of participating agencies, which function as *Deposit Taking Entities*.
- The participating agency must be an organisation registered under the Societies Ordinance or the Companies Act, with a minimum experience of two years, on-time repayment record of over 85% and also be active in small group formation, savings and microcredit.

3.6.2 INITIATIVES BY INSTITUTIONS (SUPPORTED BY GOVERNMENT OR OTHERWISE) IN MICROENTERPRISE DEVELOPMENT [31]

(i) Government Using Banks as a Channel to Fulfil its Objective of Achieving Social Welfare
Governments often use financial institutions as channels to direct their own programmes with the objective of achieving social welfare and microenterprise development. The Samurdhi Development Credit Scheme (SDCS), developed by the Ministry of Rural Development in Sri Lanka, has used two state-owned commercial banks—People's Bank and Bank of Ceylon—to distribute approximately LKR 500 million (USD 6 million). This scheme was intended to serve the rural community through village-level task forces called Samurdhi Task Forces, which operated as social intermediaries. The task force used its members called Samurdhi Niyamaka to select recipients of the subsidised loans

Governments often use financial institutions as channels to direct their own programmes with the objective of achieving social welfare and microenterprise development.

31 *http://www.bangladesh-bank.org/seminar/cpsrilanka.html*

ranging from LKR 2,500 to LKR 10,000 (approximately USD 22 to USD 88). The Samurdhi programme is largest microfinance programme in terms of outreach. *(Also refer to Section 4.1.5)*

(ii) Commercial Banks Focus on Microfinance for Microentrepreneurs
The Hatton National Bank (HNB) in Sri Lanka uses the concept of the Barefoot Banker to set up a number of village-level schemes (Gami Pubuduwa or village awakening) to distribute loans. The village-level officers or village awakening advisors function as intermediaries between the bank and rural entrepreneurs. Loans up to LKR 15,000 (USD 165) can be approved without formal collateral and this amount can increase to LKR 25,000 (USD 221) if the applicant is guaranteed by two villagers. The interest rate on loans ranges from 17-25%per annum. In some cases, NGOs are allowed to use deposits of its members in the bank to raise funds for further development of microentrepreneurs. In addition to HNB, the six regional development banks (RDBs) are also involved in disbursing loans to the rural poor.

(iii) Saving Products Through School Banking Units for Youth
The HNB and the NSB are two leading financial institutions in Sri Lanka that have been recognised for their children and youth savings efforts. Until 2009, HNB ran 200 student banking units in 200 schools across the country through 180 branches. For the last two decades, over 600,000 students have had a relationship with the HNB through its network of student banking units and the bank holds savings deposits up to nearly USD 40 million from these students.[32] In addition, NSB's youth savings program reached nearly 390,000 youth with a total savings of LKR 3.4 billion (USD 30 million) by the end of 2005.[33] The NSB currently operates 344 school banking units.[34]

A misconception exists
that as supervisor and regulator, the Central Bank guarantees the safety of all deposits and other investments of the public. It is the responsibility of the public to exercise utmost care and vigilance over the true affairs of the institutions in which they place deposits and other investments
-CBSL Guide to Financial Services
http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/pa/booklet/bl_2.pdf

3.7 PROTECTING THE CUSTOMERS: CONSUMER PROTECTION MEASURES IN SRI LANKA

Bank Deposit Insurance Scheme
There are various client protection laws in Sri Lanka to safeguard consumers' rights while using goods and services (including financial services), such as the Consumer Affairs Authority Act No. 09 of 2003 and various other related laws.[35]

A deposit insurance scheme has been in operation in Sri Lanka since 1987, but participation in the scheme is only voluntary to licensed banks and registered co-operative societies carrying out banking services.[36] The Central Bank of Sri Lanka had announced a new deposit insurance scheme in 2010. This scheme covers up to LKR 100,000 (USD 885 approximately) per depositor. This insurance coverage will increase over time as the insurance fund grows.[37]

Deposit insurance can be
in two forms: implicit deposit insurance, where there are no stated rules but depositors have assurances implied by governments' action either through precedence or stated intention; and under explicit deposit protection, where the terms and conditions of the scheme are explicitly stated in a statute. The scheme provides a legally enforceable guarantee on all, or a portion of the principal, and in some cases the interest, on a deposit.
http://www.jdic.org/depositinsuranceschemes.htm

32 *www.makingcents.com/.../HattonNational_Case%20StudyNo.1_September%202009.pdf*
33 *http://csd.wustl.edu/Publications/Documents/RP10-15.pdf*
34 *http://www.nsb.lk/Annual_Reports/Annual%20report%202009/data/supplementary/products.html*
35 *http://www.idpsrilanka.lk/html/SpecialProgrammes/DisasterResponse/Laws%20Related%20to%20Consumer%20Protection%202008.pdf*
36 *http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/pa/booklet/bl_2.pdf*
37 *http://www.lankabusinessonline.com/fullstory.php?nid=1392433552*

The Financial Ombudsman Sri Lanka[38]

The Financial Ombudsman Scheme commenced operation in December 2003 as a voluntary disputes resolution mechanism, but was restricted to banking industry. Later, the scheme was extended to registered finance companies and leasing companies. Currently only those financial institutions that are licensed by the Central Bank can be members of the scheme.

3.8 EDUCATING CUSTOMERS: FINANCIAL AWARENESS /LITERACY CAMPAIGNS

Due to scandals in Sri Lanka over the past few years, such as with the Golden Key credit card company, with unregulated deposit mobilisers like Sakvithis and Danduwa Mudalalis and with other finance companies, lack of financial literacy and awareness among clients has come to the fore. The Central Bank has been making public announcements (both through print and electronic media) to spread awareness among the masses regarding institutions authorised to accept deposits and to inform about other critical factors, such as interest rates, required documentation, etc. The major government-run programmes, such as Samurdhi and PAMP-I and II, have financial literacy as part of their agenda.

One admirable example of spreading financial literacy is the school banking initiative by the HNB. The bank has spearheaded many initiatives towards inculcating savings habits among the young generations by opening 154 school banking units throughout the country. Many NGO-MFIs include awareness programmes related to finance, health and sanitation, etc. as well.

3.9 PAYMENT SYSTEMS FOR BANKS

The Sri Lankan payments and settlements system (PSS) enables the transfer of money in accounts of financial institutions to settle financial obligations between individuals and institutions. The Central Bank of Sri Lanka is the authority responsible for promoting safety, efficiency and stability of PSS, and supervision through the Payment and Settlement Systems Act, No. 28 of 2005. The main payment, clearing and settlement systems in Sri Lanka are:[39]

- Cheque Imaging and Truncation System (CIT), the inter-bank cheque clearing system operated by Lanka Clear Ltd.
- Sri Lanka Inter-Bank Payment System (SLIPS) operated by Lanka Clear Ltd.
- Lanka Settle, comprising the Real Time Gross Settlement System (RTGS) and the Scrip-less Securities Settlement Systems (LankaSecure*)* operated by CBSL.

The major issues are the dominating role played by the two state banks within the financial system of the country; lack of financial literacy among the people of Sri Lanka and lack of clear directions from the government to the financial market has hampered improving efficiencies.

http://globip.com/pdf_pages/asiapacific-vol1-article4.pdf

"We are given training with which we can map all our finances for a year in the form of income, expense, and credit. [It] helped my husband realise that Rs 24,000 was spent on alcohol and less amounts were spent on child savings. This has changed him and he has started using money prudently".

–Lilawati

An MFI client on the benefits of financial education

38 *http://www.financialombudsman.lk/scheme.php*
39 *http://www.cbsl.gov.lk/htm/english/05_fss/f_1.html*

In recent developments, the Central Bank of Sri Lanka has drafted guidelines for mobile phone payment systems and called for public comments. Mobile payments will be allowed through accounts in licensed banks and registered finance companies as well as custodian account-based systems operated by non-bank service providers. Service providers can open e-money accounts for customers and issue e-money by accepting physical money.[40]

3.10 BUILDING CAPACITIES OF INSTITUTIONS

The highest need for capacity building is within the semi-formal sector in Sri Lanka. Though there are various players working in different capacities in this area, like the NDTF, GTZ, Stromme Foundation, and ADB, to name a few, the demand for capacity building is a lot higher than can be provided.

Networks: Lankan Microfinance Practitioners Association (LMFPA)
The Microfinance Practitioners Association which started operating in 2006 with assistance from the GTZ and Plan Sri Lanka gave a major boost to the sector and is the coordinating body for microfinance institutions in Sri Lanka.[41] The network delivers training programmes and seminars, shares information, and lobbies for the microfinance sector. Current membership includes 78 MFIs, out of whom 10 are national-level players.

Specialised Training Facilities
There are a limited number of institutions which offer CGAP recognised courses in microfinance, and all of them are concentrated in Colombo. ADB, through its Rural Finance Sector Development Project, is currently assisting the Central Bank's Bank Training Institute become a credible one, but this has not brought forward the results envisaged. SEEDS, Sanasa Development Bank and other leading agencies, both private and public, also conduct training programmes in the microfinance sector. Though limited progress has been made in this direction, there are some encouraging initiatives, such as the University of Colombo's six-month Diploma Programme in Microfinance.

Department of Economics,

University of Colombo, commenced the first-ever Diploma in Microfinance (DMF) Programme in Sri Lanka on October 11, 2008. The programme involves government and non-government organisations in the field of microfinance

http://old.nabble.com/Devfinance:-Diploma-in-Microfinance-td29482819.html

4. MICRODEPOSIT SERVICE PROVIDERS, PRODUCTS, METHODOLOGIES AND THEIR SCALABILITY

Sri Lankan providers of microfinance services and microdeposits, in particular, have grown to represent an array of institution types. Indeed, Sri Lanka is often characterised as one of South Asia's more saturated markets in terms of outreach of savings providers, as mentioned above. However, experts across the sector agree that coverage is not as extensive as it may appear in the statistics, as deposit accounts are more concentrated in the southern and western regions of the country, and many middle-class households actually access multiple accounts (implying double counting of the same household as deposit holders).

40 *http://investsrilanka.blogspot.com/2010/08/sri-lanka-central-banks-guidelines-for.html*
41 *http://lankamicrofinance.com/index.htm*

The low-income populations, especially those in remote rural areas (such as the plantation sector) and in the conflict-affected northern and eastern regions, have a very limited access. Nevertheless, until recent clarifications were given by the Central Bank, microdeposit service providers included a wide range of formal, semi-formal and informal institutions.

4.1 OUTREACH OF FINANCIAL SERVICES[42]

In 2009, the GTZ conducted a comprehensive study on the outreach of financial services in Sri Lanka. According to the study, and despite the realities mentioned above, outreach of financial services in Sri Lanka can be considered fairly extensive, with a reported 82.5% of households having access to financial institutions for their savings and credit needs. Furthermore, there is evidence of a strong savings culture in Sri Lanka with nearly 75% of households having saved in a financial institution (although many accounts are believed to be fairly inactive). However, the estate sector has relatively low levels of access (68.5%) compared to the rural and urban sectors in the rest of the country. Furthermore, the northern, eastern and northwestern provinces also display a lower savings rate of approximately 65%.

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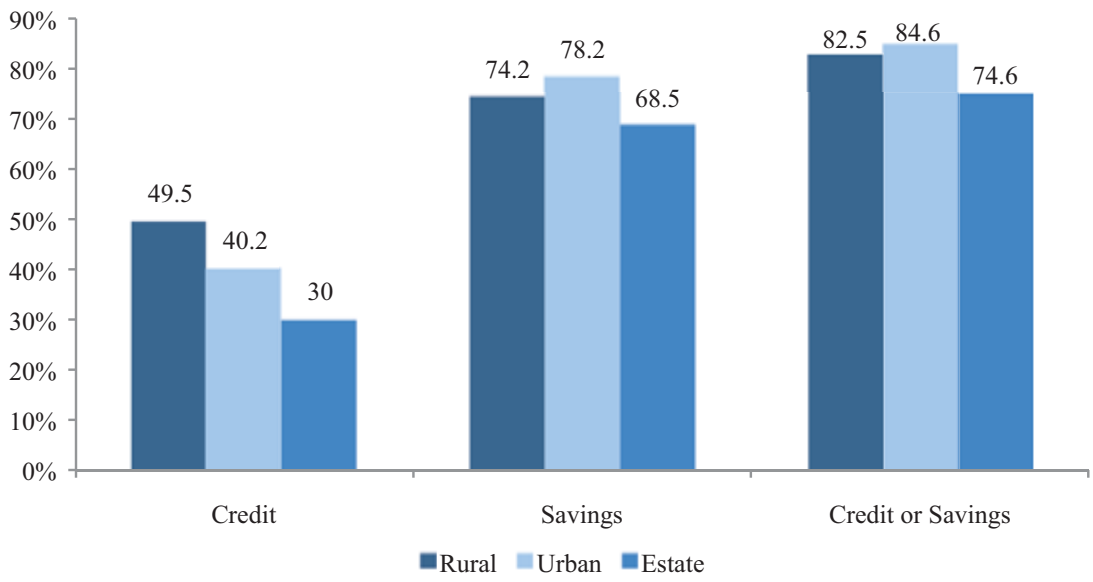
Figure 17 (below) shows the difference in outreach of financial services among rural, urban and estate sectors. The majority of the population resides in rural areas, and so by volume, the greatest number of households accessing financial services is in rural areas. The data reveals that in all financial sectors, savings is the dominant form of financial service utilised. The third bar displays access to savings and/or credit representing usage to financial services in at least one form.

Figure 17: Outreach of Financial Services (% of Total Population)



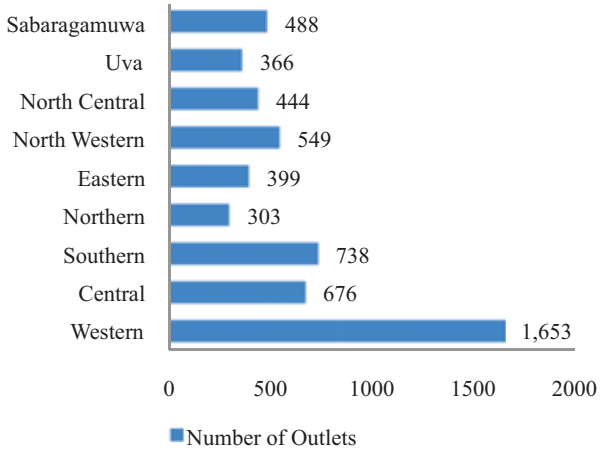
Source: GTZ study on outreach of microfinance in Sri Lanka -2009

42 *http://www.microfinance.lk/pdf/1227096039.pdf*

There is a large variance in household access to financial services across geographies. *Figure 18* indicates the distribution of bank outlets in the nine provinces. The districts with high outreach include Matale (95.8%) in central province, Matara (97.5%) in southern province, Polonnaruwa (98.3%) in north central province and even Jaffna (91.3%) in northern province, whereas lower access is evident in Puttalam (67.5%) in western province, Vavunia (66.7%) in northern province and Trincomalee (60.7%) in the eastern province.[43] This may be partially due to the latter being in the relatively poor, conflict-affected regions of the north and northeast. *Figure 19* indicates the number of households being served by each outlet on an average across the nine provinces.

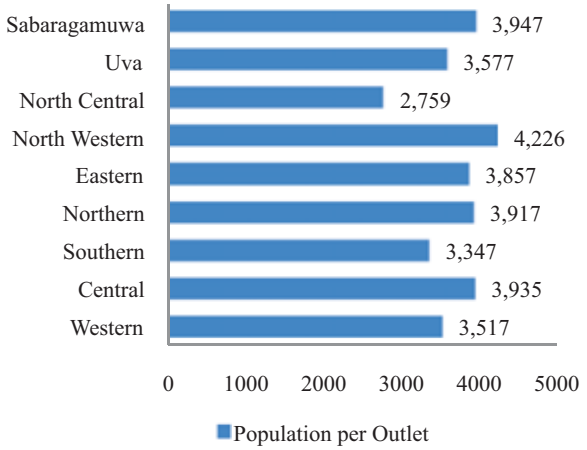
Another useful proxy for the relative household access to financial services is the number of financial institutions accessed by households. In terms of savings, the central and north central regions enjoy the most access to different providers, each with more than 50% of households accessing two or more institutions just to meet savings needs. Meanwhile, the northern and eastern regions lag behind, with less than 20% of all households surveyed accessing two or more institutions for savings, although 80% have at least accessed one such institution as indicated in the *Figure 17*.

Figure 18: Density of Bank Outlets



Source: http://www.cbsl.gov.lk/htm/english/08_stat/s_6.html

Figure 19: Households per Bank Outlet



Source: http://www.cbsl.gov.lk/htm/english/08_stat/s_6.html

4.2 FORMAL INSTITUTIONS

In Sri Lanka, the range of formal financial institutions include: commercial banks, finance and leasing companies, and development banks. However, commercial banks, both state-owned and private, play a dominant role in the provision of financial services and savings in particular. Formal financial institutions, which are regulated by the CBSL, presently mobilise 95.5% of the total deposits in the country. In terms of gender, males tend to access formal banks (state, private and regional) more than females.

43 *GTZ.'s study - Outreach of Financial Services in Sri Lanka. 2008*

4.2.1 LICENSED COMMERCIAL BANKS (LCBs)

Table 6: Branches, Total Deposits and Share of Deposits for LCBs

Commercial Banks	2005	2006	2007	2008	2009
No. of Branches	1,627	1,737	1,934	2,071	2,214
Total Deposits LKR (USD) Million	945,575 (USD 8,368)	1,121,403 (USD 9,924)	1,307,362 (USD 11,570)	1,410,568 (USD 12,483)	1,704,700 (USD 15,086)
Share of Total Deposits	75.59%	76.37%	76.63%	75.49%	75.61%

Source: Central Bank of Sri Lanka Publication E&SS-2010

State Banks

In Sri Lanka, state banks play a big role in the provision of savings accounts to low-income clients among formal providers. As seen in *Table 6*, according to GTZ's study on the 'Outreach of Financial Services in Sri Lanka, 2008', about 75% of households have deposits saved with state banks.[44] Among these, People's Bank and Bank of Ceylon are the two most dominant institutions in terms of scale and outreach. State banks have relatively equal penetration in urban, rural and estate sectors. They are generally considered to be trustworthy and operate primarily through a branch network and branch-based staff.

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Private Banks

Domestic private banks, meanwhile, are also a key source of savings services in Sri Lanka, particularly among urban and more affluent households who enjoy greater proximity and access to bank outlets. The GTZ study estimates that of households using financial services, 30.4% have used private banks for savings.[45] Chief among domestic players is Hatton National Bank (HNB), followed by Seylan Bank and Commercial Bank of Sri Lanka. Private banks also operate using a branch-based model.

a) Outreach

The outreach of the LCBs and LSBs is considerable. As of Q3 2009, the combined branches of LSBs and LCBs were 1,802, translating into an average of 11,349 people for every bank branch. However, there is significant variation across districts. Colombo has the highest bank density with an average of 5,590 people per bank branch while Mulaitivu and Killinochi (both fall in the conflict-affected north east zone) have the least banking density with an average of 38,500 people per bank branch. The number of bank outlets and the population per bank outlet across provinces are given in *Figures 18* and *19* above.

b) Products

Formal institutions in Sri Lanka – typically consisting of the state, commercial and licensed specialised banks – offer a wide range of savings products to the poor that essentially mimic offerings of other institutions and rely on promotions/incentives instead of any product development based on real market research. The range of products offered by formal institutions generally consists of general savings, fixed deposit and pensions, as well as savings accounts marketed to specific populations (e.g. senior citizens, children/youth and women). A more detailed description of bank products is included below.[46]

44 *Ibid.*
45 *Ibid.*
46 *Sources: National Savings Bank www.nsb.lk/products and Sanasa Development Bank http://www.sdb.lk/fam_s_s.asp*

Ordinary Savings: This is a popular, standard demand deposit product offered uniformly by most formal institutions but appeals to more of an upper-income strata of Sri Lankans. It offers an interest rate ranging from 4.5-5% (calculated on a daily basis and credited monthly) with an unlimited tenure and no restriction on deposits beyond a LKR 100 (USD 1) minimum balance. However, while there are no limits on withdrawals for passbooks, the amount that can be withdrawn from an ATM is capped at LKR 40,000 (USD 354) per day. The account holders may qualify for an ATM, master debit or shopping card and clients can transact with up to ten accounts. Furthermore, they may take loans amounting to 80% of the deposit amount. A Salary Earners Savings Account (SESA) facilitates salary earners to receive the salary on the same day the salaries are credited to their accounts. By joining a SESA, customers are entitled to competitive pawning advances to pay monthly bills, withdrawals and the purchase of cheques, and also entitled to various concessions on loans offered by the bank.

Pension Savings: Pension savings are open to all Sri Lankans above 16 years of age. Anyone is entitled to a pension, but generally there should be a minimum balance of LKR 100,000 (USD 885) in the account by the time the depositor reaches the end of the deposit period. Typically these accounts are characterised by a recurring average deposit of a minimum sum of LKR 500 (USD 4.42) per month for 10 years or more. Money can be deposited at any time, and pension savings give a return of 8.62% per year (for multiples of LKR 10,000/USD 88.5), and for the remaining amount at 5.25% per year. Withdrawals are restricted; the depositor should reach the age of 55 in order to draw the pension amount saved unless there are special circumstances. S/he can postpone the date of drawing the pension up to 60 years, if needed. If pension savings account holders wish to obtain a loan, those who regularly deposit a fixed amount every month in the account may obtain fairly large loans against mortgages on immovable assets. Like many other accounts offered by banks, those with pension savings can access of a range of additional benefits:

- Life coverage up to LKR 1 million (USD 8,850) according to the account balance;
- A minimum contribution of LKR 50,000 (USD 442) will result in eligibility to claim medical expenses up to LKR 1 million on critical illnesses every 5 years;
- Discount of 50% on the processing fee charged on loans;
- Rebate on 1% of the group personal loans if the employers contribute on behalf of their employees.

Fixed Deposit: Most banks in Sri Lanka also offer fixed deposit (FD) accounts to individuals as well as institutions. These are generally geared for those over 16 years of age, individually or jointly (minors below 16 years of age can open accounts only with a parent/guardian). FD accounts usually offer interest rates of 7-12%, depending on the tenure of the account. Tenure on these accounts generally ranges from a minimum of three months to maximum of 60 months. However, a minimum LKR 1,000 (USD 9) are required for opening account if interest is paid at maturity or LKR 25,000 (USD 221) if interest is paid on a monthly basis. Restrictions are minimal; withdrawal of up to 80% of the FD (maximum of LKR 1 million or USD 8,850) is allowed at any time during the

FD tenure. In terms of benefits attached to these accounts, clients can avail loans up to 90% of the deposit amount, can nominate a beneficiary and can request an automatic renewal facility.

Women's Savings: Women in Sri Lanka (typically those over 16 years of age) can apply for a women's savings account with a minimum deposit of LKR 250-500 (USD 2-4). While they may receive slightly higher interest rates (from 4.5-6%), these accounts resemble ordinary savings accounts in every other way, from unlimited tenure and no restrictions on withdrawal, to ability to avail loans up to 60% of the deposit amount. However, where the account differs is in the benefits available to women opening these accounts:

- Half sovereign gold ring when maintaining a balance of LKRs 100,000 (USD 885) for 12 months prior to the marriage;
- Scholarship opportunity for 'A' Level (senior secondary school/ grade 12) students;
- Household accident cover for 6-month balance of LKR 25,000 (USD 221);
- 1% reduction in interest on loans with 6-month balance of LKR 10,000 (USD 88.5);
- 1% reduction of interest on pawning for all customers;
- Mothers who maintain a balance of LKR 100,000 (USD 885) for 12 months before childbirth will be given a minor's savings account and the bank would deposit LKR 500 (USD 4.4) every month for the first year

Child Savings: Most Sri Lankan families value preserving and passing on family wealth to their children, thus protecting and ensuring a good life for their children. Child savings accounts can be opened for children below 18 years with a minimum of LKR 250 (USD 2), thereafter any amount of money can be deposited. Parents or guardians can open an account on behalf of their child by providing the child's birth certificate. These accounts require a minimum balance of LKR 1000 (USD 9) and offer an interest rate between 4.5% and 6% per year, but have unlimited tenure and deposits are not restricted. There are a variety of gimmicks and benefits to encourage parents to open these accounts. For example, they receive:

- No cap for an account opened with LKR 1000 (USD 9);
- School bag for an account opened with LKR 5000 (USD 44);
- Accident insurance coverage for the child and the parent/guardian;
- Special rewards for outstanding performances of account holders at year 5 (scholarship, etc.).

Senior Citizen Savings: Most banks offer special benefits to attract senior citizens above the age of 55 or 60 years. These savings accounts generally resemble fixed deposits with a one-year tenure and offer 9-10.5% interest per year. However, senior citizens can open an ordinary savings account as well while earning an interest rate of 3% above the existing rates for non-seniors. The minimum/maximum deposit ranges from LKR 25,000 to 1.5 million (USD 221 – 13,275).

TIME FRAME	INTEREST
Withdrawal before 3 months	Nil
After 3 months but before 6 months	5% p.a.
After 6 months but before 12 months	6% p.a.

In terms of access to credit, loans against deposits can also be approved up to a maximum of LKR 100,000 (USD 885). As a special benefit available only to seniors, account holders who maintain an account balance of LKR 100,000 (USD 885) or more have the option of joining a group insurance scheme under which they are entitled for a reimbursement on surgical and hospital expenses up to a maximum of LKR 20,000 (USD 177) per year, per member.

c) Methodology and Strategies

Commercial banks generally use individual lending methodologies and branch-based savings, and target men as the microfinance clientele they service. They operate primarily through branch-based networks, have short processing times and maintain rigorous control over portfolio risk through computerised MIS. As stated above, formal banks clearly form the backbone of the financial structure in Sri Lanka. The operations of the RDBs cover all districts of Sri Lanka except those of the conflict-affected northern province and some districts of the eastern province which have been similarly affected.

4.2.2 Licensed Specialised Banks (LSBs)

Table 7: Branches, Total Deposits and Share of Deposits for LSBs

Licensed Specialised Banks	2005	2006	2007	2008	2009
No. of Branches	393	403	444	527	561
Total Deposits LKR (USD) Million	230,979 (USD 2,044)	258,920 (USD 2,291)	284,609 (USD 2,519)	317,985 (USD 2,814)	342,400 (USD 3,030)
Share of Total Deposits	18.46%	17.63%	16.68%	17.02%	15.19%

Source: Central Bank of Sri Lanka Publication E&SS-2010

National Savings Bank (NSB)[47]

Table 8 : Branches, Total Deposits and Share of Deposits for NSB

National Savings Bank	2005	2006	2007	2008	2009
No. of Branches	130	130	136	163	177
Total Deposits LKR (USD) Million	202,424 (USD 1,791)	212,258 (USD 1,878)	235,304 (USD 2,082)	259,542 (USD 2,297)	312,988 (USD 2,770)
Share of Total Deposits	16.18%	14.45%	13.79%	13.89%	13.89%

Source: Central Bank of Sri Lanka Publication E&SS-2010

47 *http://www.nsb.lk/Why_bank_with_us.php*

The National Savings Bank was established by merging the erstwhile Ceylon Post Office Savings Bank and National Savings Movement with the objective of mobilising savings of the Sri Lankan people and inculcate saving habits among them. The other objective was to channel people's savings for the development of the country. The speciality of the bank is that all savings deposited with the bank are guaranteed 100% by the Sri Lankan Government.

'The repayment of the monies deposited in the bank and of the interest thereon and the payment due on the surrender of a savings certificate shall be guaranteed by the Government of Sri Lanka.' (NSB Act No. 30 of 1971, Section 18: Guarantee by the Government of Sri Lanka).[48]

The Bank has a network of 158 branches, 19 postal banking branches, six loan centres and one Ridee Rekha centre, second only to commercial banks in terms of the number of branches. The products offered by the bank are similar to products offered by commercial banks.

NSB and Postal Banking

The NSB also operates through 4,055 post offices and sub-post offices, which function as mini-branches/agents, providing deposit and withdrawal facilities. *MicroSave* market research reveals that post offices have lost their popularity to other banks and MFIs primarily due to the problems of withdrawing cash. The increased outreach of the commercial banks has also led to the reduction of the use of the post office as a channel for savings.

Regional Development Banks (RDBs)[49]

Each of the six RDBs covers a unique and different geographical region (Kandurata, Rajarata, Ruhunu, Sabaragamuwa, Uva and Wayamba). The RDBs are uniformly spread throughout 8 of the 9 provinces in Sri Lanka, with a slightly higher concentration in the southern (20.5%) and central provinces (14.9%).[50]

While there is a stated focus on low-income populations – including women, farmers and youth – RDBs tend to serve higher income clientele of the microfinance market as well as the small and medium enterprise (SME) sector to some degree.

a) Products

RDBs offer an array of products, from deposits, loans, pawning and to some degree leasing and pension schemes. Majority of their savings deposits are small enough to be considered microdeposits and the product range reflects a standard mix of voluntary and fixed deposit accounts as well as accounts targeting women, youth and senior citizens.

b) Methodology and Strategy

Compared to other institutions, RDBs are generally more decentralised and operate 36 branches each in their respective regions.[51] While there is a stated focus on low-income populations – including women, farmers and youth – they tend to serve, on average, the higher income clientele of the microfinance market as well as the small and medium enterprise (SME) sector to some degree. This is reflected in the reliance on more individual

48 *Ibid.*

49 *The Government of Sri Lanka has merged the six RDBs into one RDB in July 2010. The data and the information presented in the report are prior to the merger.*

50 *GTZ.'s study - Microfinance Institutions in Sri Lanka. 2009*

51 *Ibid.*

lending methodology for credit clients. Advertising relies heavily on leaflets, banners and posters, with some institutions using print medium, like newspapers or magazines to reach prospective clients.

4.3 SEMI-FORMAL INSTITUTIONS

Semi-formal institutions – mainly consisting of co-operative rural banks and thrift and credit co-operative societies – remain relatively small players by virtue of official amounts of deposits. As shown in *Table 9*, they have a large member base and strong outreach among low-income population living in the remote areas of Sri Lanka, both rural and estate. Over 50% of households accessing financial services have used one of the semi-formal institutions listed below, underlining their critical importance. [52] Normally, women tend to dominate the clientele of semi-formal institutions, accounting for around two-thirds of the members of NGO-MFIs, co-operatives, Samurdhi, etc.[53]

4.3.1 Co-operatives and Co-operative Rural Banks

Table 9: Branches, Total Deposits and Share of Deposits for Co-operatives

Co-operative Rural Banks	2005	2006	2007	2008	2009
No. of Banks	1,650	1,608	1,628	1,763	1,805
Total Deposits LKR (USD) Million	23,570 (USD 209)	25,312 (USD 224)	32,010 (USD 283)	33,042 (USD 292)	103,877 (a) (USD 919)
Share of Total Deposits	1.88%	1.72%	1.88%	1.77%	4.38%

Source: Central Bank of Sri Lanka Publication E&SS-2010
(a) Provisional data for year end 2009, Central Bank of Sri Lanka

The co-operative sector focused on microfinance consists of over 1,805 co-operative rural banks[54] (CRBs), women's development co-operatives, and others, all of which are generally owned by multi-purpose co-operative societies (MPCS). These member-owned societies are registered with the Department of Co-operative Development and are just behind the TCCSs in importance to the co-operative sector. While quality and governance of these societies varies widely across Sri Lanka (experts cite many defunct groups), they nevertheless possess a substantial deposit base and presence throughout the country – particularly in rural and estate areas and among low-income clients. The strongest areas of outreach are the south and west, whereas the eastern provinces appear, on the basis of the limited data available, to have the least CRB presence, mostly in conflict-affected areas. The deposit base of the CRBs has shown a significant increase from USD 292 million to USD 919 million as per the official statistics. The reason for this sudden growth is not clear. In addition to the CRBs and the TCCSs, there are other co-operatives such as the Womens Development Co-operatives which operate across the country.

a) Products

The CRBs and MPCSs generally offer credit, savings and pawning products. Savings products offered by CRBs and MPCSs include voluntary, compulsory and fixed deposits. They generally mobilise small sums, possibly indicating that these institutions reach lower income clientele.

52 *GTZ's study- Outreach of Financial Services in Sri Lanka. 2008*
53 *Ibid.*
54 *GTZ's study. Microfinance Industry Report Sri Lanka. 2009*

b) Methodology and Strategies

CRBs employ both individual lending and joint liability methods for offering credit. They use inspection and field visits to identify clients, as well as past performance and word of mouth. They also rely on referrals from the non-finance activities of MPCSs. Loan processing varies widely (from 1 day to 25 days) but savings accounts can be opened in one day.[55] Monitoring of their portfolio is done manually. The marketing efforts of CRBs rely on leaflets, banners/posters, and word of mouth. Branches remain the primary channel for delivery of savings and loan facilities.

4.3.2 Thrift and Credit Co-operative Societies

Table 10: Branches, Total Deposits and Share of Deposits for TCCSs

Thrift And Credit Co-operative Societies	2005	2006	2007	2008	2009
Total No. of TCCS	8,440	8,440	8,440	8,440	8,440
Total Deposits LKR (USD) Million	3,731 (USD 33)	3,936 (USD 35)	3,870 (USD 34)	3,565 (USD 32)	3,700 (USD 33)
Share of Total Deposits (%)	0.30%	0.27%	0.23%	0.19%	0.16%

Source: Central Bank of Sri Lanka Publication E&SS-2010

TCCSs are among the oldest providers of microdeposit services in the country. They can be divided into Sanasa (federated TCCSs) and non-Sanasa (also federated, but independent of Sanasa and existing mainly in the north) and are regulated by the Department of Co-operative Development. On the whole, TCCS clients are typically low-income and can be found equally in rural and urban areas. The performance of Sanasa TCCSs has declined, resulting in recent movements to modernise and strengthen the societies.[56]

a) Products[57]

Sanasa and TCCSs generally offer credit and savings products, with many offering pawning and a few offering insurance products. A variety of savings products –including those for men, women and children – are offered by Sanasa societies, including standard voluntary savings and time deposits ranging from six months to three years. Some PTCCSs offer a pension product that requires 10 years of monthly pay-ins and then provides payouts for the remainder of a client's life. Insurance products, offered through the Sanasa Insurance Company, range from savings and loan insurance to life, personal accident, property and theft insurance.

b) Methodology and Strategies

Operated as independent, self-sustaining entities, PTCCSs and secondary units act in a generally participative manner to set goals and interest rates. The main channel for products and services remain the societies themselves. Sanasa societies generally rely on some paid staff (management and accounts), but many activities are carried out by volunteers, thus staff capacity remains low. Data on TCCSs indicate that they tend to target women, farmers and low-income groups as well as those with household incomes

55 *Ibid.*
56 *Ibid.*
57 *Owen, Graham. Rural outreach and Financial Co-operatives – SANASA Sri Lanka,. World Bank. 2007.*

generally between LKR 3,000 and 10,000 (USD 26.5-88.5).[58] While promotion by Sanasa members is important, other strategies include field visits and previous history with co-operative societies.

4.3.3 SAMURDHI BANK SOCIETIES

Samurdhi bank societies (SBS) are part of a larger government poverty alleviation programme that originated in 1996 and was aimed at disadvantaged communities. SBSs are meant to encourage savings habits and income-generating activities among the poor. Despite being technically regulated by the Auditor General's Department, SBSs are largely self-regulating and lack deposit insurance. As SBSs operate a huge number of savings accounts (though at smaller volumes) among the poor throughout the country, the lack of proper regulation leaves the savings of the poor at risk.[59]

In terms of outreach, an estimated 21.1% of households using financial services have utilised Samurdhi societies for savings making it the third most commonly utilised formal or semi-formal source.[60] However, due to political interference and heavy subsidisation, SBSs may not remain a viable player in the microfinance space without continued government support. Like most other microfinance service providers in Sri Lanka, Samurdhi societies are concentrated more in the western, central and southern regions. Notably, 94.6% of all SBSs are located in rural areas of the country.[61]

Due to political interference and heavy subsidisation, SBSs may not remain a viable contender in the microfinance space without continued government support.

a) Products

SBSs offer members a range of savings and credit products. However, whereas loans can only be availed by members of the Samurdhi Society, savings are actually open to both members and non-members. Deposit accounts consist of compulsory (required to access a loan) and voluntary products, with special schemes for women, students and children.

b) Methodology and Strategies

Samurdhi is one of the few institutions with large-scale outreach that have an almost exclusive focus on the poor (those with household incomes below LKR 1,500 (USD 13) a month), having originated as part of a larger programme that targeted marginalised populations and youth and women in particular. Thus, Samurdhi also serves as a village-based channel for distribution of government benefits (grants, food stamps, etc.) in addition to financial services. This may confuse recipients and account for its relative lack of viability as a reliable and long-term vehicle for deposit mobilisation for the poor. They also provide larger loans at lower interest rates than many of the other semi-formal institutions. Most of the poor are often members of an SBS in addition to whichever other financial provider they may access. In addition to government handouts, Samurdhi also attracts members with training opportunities and health insurance, as well as periodic payouts based on profits.

At the field-level, SBS branches and Samurdhi Development Officers (SDOs) are the primary mechanism for reaching poor women. Members are recruited by SDOs and

58 *GTZ -.'Microfinance Institutions in Sri Lanka., 2009'*
59 *Conroy. John. D. "Sri Lanka", The Role of Central Banks in Microfinance in Asia and the Pacific, Vol. 2: Country Cases. 2000*
60 *GTZ's report. 'Outreach of Financial Services in Sri Lanka. 2008'*
61 *GTZ's report Microfinance Institutions in Sri Lanka. 2009*

through word of mouth, and generally make a share contribution. An SBS generally consists of five members who provide a mutual guarantee to take loans. Loan processing generally takes 14 days (with approval taken by a credit committee at the regional level), whereas turnaround on a savings account opening can be as little as one day. SBSs, in turn, are consolidated into Maha Sangam, administrative units with about 10 SBSs, from which audits can occur.

SBSs are financed through the Banking Finance Division of the Samurdhi Authority, a division of the Central Government, and have a highly centralised and hierarchical structure (e.g. zonal, divisional, district, national levels). Strategic decisions, such as interest rates, target client or human resources, are generally taken by persons in the responsible ministry. Meanwhile, the Board of the Samurdhi Authority is responsible for setting operational policies.

4.3.4 Non-Governmental Organisations MFIs (NGO-MFIs)

There are substantial numbers of microfinance activities being run by local or international non-governmental organisations. These institutions are not supervised, although they must be either registered with the Department of Social Services or established as a company. They are no longer legally allowed to mobilise savings, although many continue to do so informally or through compulsory savings, which may be characterised as a security deposit for a loan. Some of the major NGO-MFI actors in Sri Lankan microfinance include SEEDS, Women's Development Federation (WDF) and the Arthacharya Foundation. Out of the seven NGO-MFIs which reported to the Mix Market in 2009, five NGO-MFIs mobilised savings in some form or the other. These NGOs mobilised close to USD 30.4 million from 271,690 depositors.[62]

a) Products

NGO-MFIs and other semi-formal institutions typically offer clients a compulsory savings product (now characterised as a security deposit) known as group savings account. The CBOs promoted by some of the NGOs also offer products like mother's savings accounts, children's savings accounts, etc. These accounts are maintained at the CBO level and are not offered by the parent NGOs.

Group Savings: Group members in semi-formal institutions are typically the ones eligible for this basic group savings product. Minimum deposit amounts range from LKR 20-250 (USD 0.18-2.21), indicating a significantly lower income target than the formal institutions' products mentioned above. These deposits are collected every week at group meetings or, in some cases, through the group's treasurer. Typically, group members must save the same amount to earn an average interest rate of 4% on their savings. These accounts do have restrictions, such as loanee members cannot withdraw until after repaying the whole outstanding balance. There is also a LKR 50 (USD 0.44) penalty for closing the account early.

These deposit accounts are available for any length of time or for tenures of one, two and three years and generate an average of 4% annual interest on the savings amount. Monthly

62 *http://www.mixmarket.org/mfi/country/Sri%20Lanka*

deposits of at least LKR 20-50 (USD 0.18-0.44) are required, and like the group savings product, loanee members cannot withdraw their savings until they have repaid the entire outstanding loan amount. The monthly deposit amount that each member agrees to pay depends on the loan amount, although members can save according to their capacity to some extent. As a special feature, some institutions offer money transfer facilities.

b) Methodology and Strategies

NGO-MFIs typically have specific target clientele, trending towards low-income households and women. According to a recent GTZ study, about 50% of NGO-MFI clients make under LKR 3,000 (USD 26.55) per month.[63] The branch structure of many NGO-MFIs actually consists of village-level women's societies, which are effectively community-based organisations (CBOs). Clients are recruited by word of mouth and village-level promotional meetings led by the institution's field officers. Transactions typically take place either at the branch (loan disbursement) or village/society level (savings/loan repayment), often with a group leader or treasurer as an intermediary. These institutions, particularly those that are member-owned or operated, enjoy high level of trust, strong customer service, doorstep delivery and higher interest on savings. However, they may also have rigid policies/requirements (compulsory savings), lengthy processing times and lower loan amounts.

4.4 INFORMAL SAVINGS MECHANISMS

Informal savings mechanisms are not governed or monitored by any law. These mechanisms are used in parallel to the formal sector and semi-formal sectors but are not accounted for (and therefore no concrete data is available regarding the size of the informal sector for savings). In the course of conducting qualitative market research for the study, the *MicroSave* team tried to ascertain the use of various informal savings mechanisms used in Sri Lanka. These are broadly:

When asked what

they would do if they received an unexpectedly high amount of money, buying jewellery was the most common answer given by clients.

- *Saving by investing in gold and jewellery (non-cash based)* serves the dual purpose of having an asset that is put to use and is relatively liquid and ideal for meeting emergency requirements. This is one of the most highly accepted and widely used methods of saving in Sri Lankan society. In all geographies, pawn brokers are commonplace, and even state banks provide pawning services. During marriages and right-of-passage ceremonies, daughters are usually gifted jewellery. When asked what they would do if they received an unexpected high amount of money, buying jewellery was the most common answer given by clients.

- *RoSCAs and ASCAs*, also known as Seettus in the local language, are also one of the most widely used informal savings mechanism for the poor. The Seettus are highly popular due to the ease of transactions, and they help the poor set aside small sums of money, turning them into reasonably useful large sum or assets. It is common to find people saving with more than one Seettus as the purpose and functioning of different Seettus may vary. More than 95% of the over 350 clients in the *MicroSave* market research were members of Seettus, many using more than one Seettus and in some cases having as many as five to six Seettus running parallel at one time.

63 *GTZ. Microfinance Institutions in Sri Lanka. 2009*

- *Funeral societies* are also commonly used as an insurance instrument. Members contribute a fixed sum on a monthly basis, which is handed over to members who have a death in the family. At the end of the year, the balance may be refunded or carried forward to the next year.

- *Kitchen savings* refer to women's practice of saving a handful of food grain every time they cook and store it separately. This extra grain is contributed to the group and then combined and handed over to one person with/without cost. This helps gain economies of scale and meet emergency requirements as and when they arise. This is widely used, but is more common in the southern part of Sri Lanka.

- *Piggy banks* are another very common method of household savings and helps inculcate the habit in young people. They are popular for their accessibility, flexibility of time and amount of saving.

- *Single-purpose credit societies* are arranged by a group of people who jointly collect a fixed sum of money periodically in order to accumulate a fund sufficient to disburse loans to members to meet financial requirements for emergencies, social or religious functions.[64] These societies are not very popular due to operational problems.

- *Multi-purpose saving and credit societies* undertake socio-cultural development work, such as spreading awareness, education, etc., in addition to providing savings and credit facilities. These societies are not very independent, as most activities are undertaken through NGOs and MFIs.

- *Money guards,* it seems, are not prevalent as the team did not come across a single respondent who used them.

The overall and general purpose of most of these informal options is to help create reasonably large sums from tiny and yet frequent savings. The informal savings methods/institutions vary widely and are generally considered costly, particularly because they fail occasionally; while some have inflexible terms (RoSCAs/ASCAs) others have some limitations on liquidity (gold/jewellery). However, they also provide the poor with the benefits of flexible product offerings to meet multiple needs, timely services to address unpredictable income fluctuations, trustworthiness (if among members of the same community) and accessibility, thus making these options prevalent in all corners of Sri Lankan society.

4.5 INSURANCE

The sector is dominated by the state insurance company, Sri Lanka Insurance Corporation Limited (SLICL), which controls 40%[65] of the total assets of all insurance companies in Sri Lanka. Currently, there are 15 insurance companies operating in Sri Lanka.

64 *Informal Markets for Financial Services in Sri Lanka. UNDP*
http://www.undp.org/legalempowerment/reports/National%20Consultation%20Reports/Country%20Files/23_Sri%20Lanka/23_6_Sri_Financial_Sector.pdf

65 *http://www.ibsl.gov.lk/industry_performance.htm*

Insurance penetration in Sri Lanka is low at around 10%[66] of the population and field observation suggests even lower penetration among low-income population. Microinsurance is still more of an idea, offered only through two companies - HNB Assurance and Sanasa Insurance Company Limited. Experts feel that insurance education is very poor in the country and insurance companies need to make a more earnest effort to educate people.

Products and Delivery Methodologies[67]
The following savings linked insurance products are currently available:

Endowment Product: Insurance companies provide a number of endowment products as savings and investment related products. The term of these products vary from 5-20 years and the allowed age range of policy holders is from 18-65 years. Common products involve a flexible premium payment methodology, which can be monthly, quarterly or annual. The payouts are also flexible, with facilities of partial payments after completion of a certain time period, typically 40-50% of the total term period.

Children's Education Plan: As with the banks and co-operatives, products for children are very popular. Children's education plans are offered by most insurance companies and typically involve a term of 10-18 years. There is often an option for family cover, and partial payments of up to 50% are allowed after five years.

Insurance companies predominantly use the agent model for distribution, yet it is rare to find an insurance company partnering with MFIs to sell their products. HNB Assurance has partnered with SEEDS to offer a life insurance policy under the name "Sathkara" to members. Sanasa insurance company offers insurance products to Sanasa co-operative society members, but most of these products are pure term-life insurance products or credit-linked insurance products (i.e. not used for savings). All members of Samurdhi societies have compulsory life insurance coverage, issued by the Samurdhi authority.

5. UNDERSTANDING CLIENTS' NEEDS AND PREFERENCES[68]

5.1 OUTCOMES OF CASE STUDIES

A detailed study of four organisations was undertaken to understand the product delivery mechanisms, the client segments, promotion strategies and challenges faced in serving the low-income segment. The four organisations included a mix of three NGO-MFIs and one LSB.

The major learnings from the institution studies were:

- Banks, NGO-MFIs and TCCSs have much better outreach among the low-income clients. The community-based institution model is the most prevalent form for delivering financial services.

66 *http://sundaytimes.lk/100613/BusinessTimes/bt26.html*

67 *The products analysed were of three insurance companies Sri Lanka life insurance corporation, Amana Takaful and HNB Assurance. The following sites were referred:*
http://www.takaful.lk/family_takaful/education_plan/index.php
http://www.srilankainsurance.com/lifeins.asp
http://www.hnbassurance.com/links/scholar.html

68 *Please note that MicroSave conducts qualitative research primarily; therefore the reader will find that the findings are only discussed in relative terms to one another and not in absolute terms (numbers, rankings, percentages, etc.)*

- All service providers offer a variety of products. The most popular products among these were general savings accounts and children savings accounts.
- Promotion strategies are weak, especially when promoting products to low-income clients.
- Product development is either not done in a systematic manner, or it is not a focus at all. Products are most often pure imitations of other organisations' products.
- Most non-bank MFIs (NGO-MFIs and co-operatives) have limited capacities to manage savings programmes.
- The northern and eastern provinces are relatively underserved areas in the country, and they provide an excellent opportunity to expand operations.

5.2 EXPERT OPINIONS

During the course of the study, the *MicroSave* team met a number of industry experts and practitioners to understand their opinion on the current state of the microdeposit mobilisation sector and the way forward:

- Access to financial services is the not the prime issue in Sri Lanka due to the expansion of the banking sector and NGO-MFIs.
- NGO-MFIs have a role to play in deposit mobilisation since banks cannot downscale beyond a point to provide quality financial services for the low-income segment.
- NGO-MFIs must be allowed to mobilise deposits, but they must be regulated to weed out those not capable of doing so in a professional and secure manner.
- NGO-MFIs must explore new models of delivering financial services. The existing model of village-based institutions has many limitations. Some experts feel a large number of CBOs and co-operatives fail to keep savings safe, but no one knows the extent of losses due to poor management systems within these NGO-MFIs and co-operatives.
- Co-operatives have significant potential to offer savings services to the poor, but poor regulation and political interference have limited their scope.
- Financial education of customers is the need of the hour and banks and MFIs must take the lead.
- The next big leap in financial services for the low-income segment may come from mobile banking technology.

Considering the socio-cultural and economic conditions prevalent in Sri Lanka, regions within the country and the institutions (and their products) mentioned above, the section below provides insight into the actual mechanisms used by the poor for saving.

***"In Sri Lanka the** customer service record of financial institutions (both formal and semi-formal) has been very poor and there is an enormous disregard for consumer rights".*

-Dr. Nimal. A. Fernando
Former Principal Specialist (Microfinance), ADB

***"There is a strong** need for regulation (of NGO-MFIs) but it should be development friendly and with a heart".*

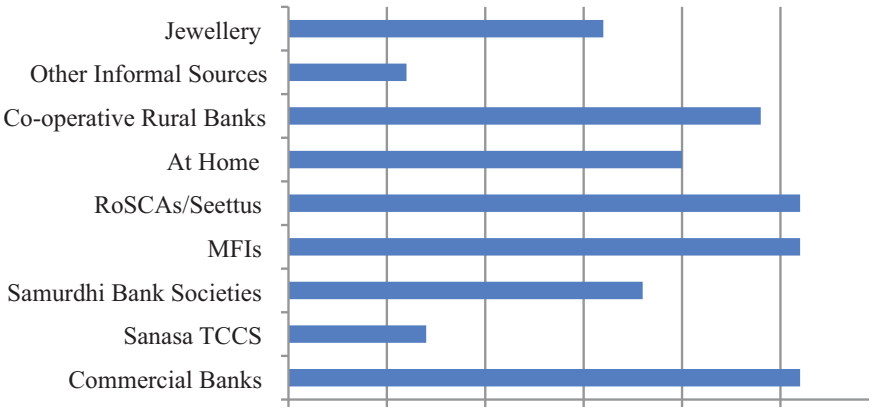
– J. Charitha Ratwatte
Former Finance Secretary

These include cash-based saving mechanisms and non-cash mechanisms, both modern (banking, insurance, etc.) and traditional methods (grain banks, livestock rearing, etc). This is followed by an attempt to understand the preference of the clients with regard to institutions and the products offered by them.

5.3 USE OF EXISTING SAVINGS PRODUCTS[69]

There are a host of players operating in the Sri Lankan market and access to financial services providers, both formal and informal, is relatively high. The trend across the urban, semi-urban and rural areas reflect this fact. Commercial banks, Seettus (RoSCAs) and NGO-MFIs, all have high penetration in each of these areas. However, the extent of NGO-MFIs' penetration may be biased as the respondents selected were already NGO-MFI clients.

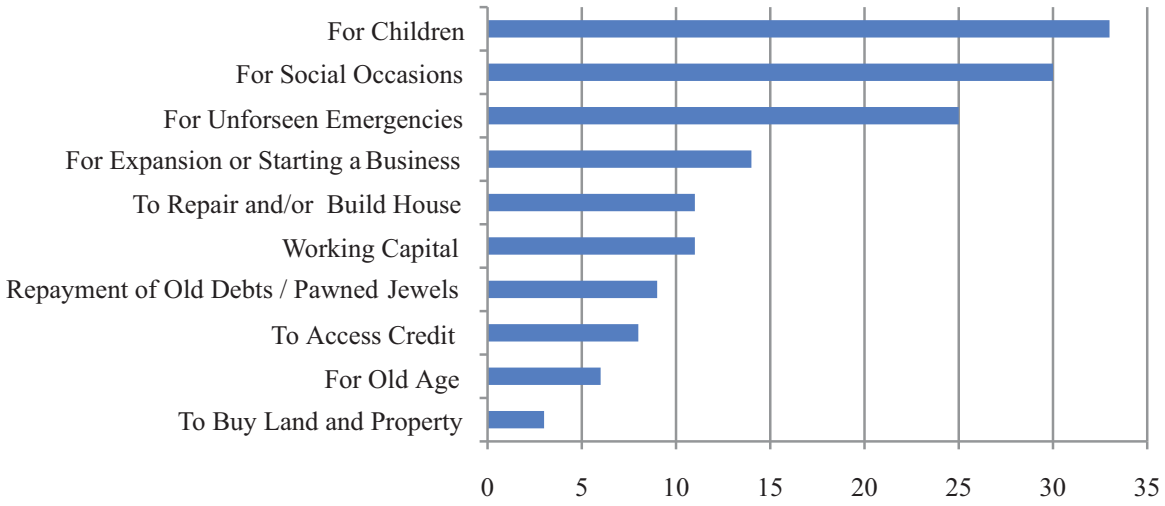
Figure 20: Savings Options and Their Usage



5.4 REASON FOR SAVINGS

Among the sample of people that *MicroSave* interacted with, the major reasons driving savings were children and social occasions like festivals, rites of passage functions, funerals and alms giving. (See *Figure 21).*[70] Clients felt children's savings was critical in order to ensure access to a solid education and to prepare for marriage, especially in the case of girls. Social occasions are also very important as clients generally do not have a choice because of social compulsion. Unforeseen emergencies, like accidents and hospitalisation, were the third most important reason to save. Business expansion and starting a new business, were the other important reasons for clients to save. In addition to these, other reasons mentioned included meeting working capital needs of a business, for old age, for inheritance to children, to buy land and property and to meet medical expenses.

Figure 21: Reasons for Savings



69 *MicroSave conducted a market research in 6 districts of Hambantota, Monaragala, Galle, Colombo, Polonuruwa and Nuwara Eliya. A total of 330 respondents (all exisiting microfinance clients) participated in the research. Sections 5.3 to 5.7 are based on the market research findings.*

70 *The graph indicates the frequency of how many times the particular purpose was brought up during focus groups with clients.*

5.5 SEASONALITY OF SAVINGS

As most of the population in Sri Lanka lives in rural areas and depends on farm-related income, savings' seasonality revolves around the *Maha* season (October-January), which is one of the key cultivation seasons with the highest rainfall levels. Harvesting and sales of produce generally occur in March and April every year. A second *Yala* season (April-August) also results in a second harvest and selling is done in September and October. However, there are variations across the country for the harvest season; in some areas, the harvest might be late by a couple of months. The harvest seasons are the months of high savings. In April, however, savings levels are less than other seasons due to important festivals such as the Buddhist New Year and the birthday of Lord Buddha.

For the fishing sector, the seasonality of income generally follows the agriculture sector, meaning surplus months are generally December through April. Urban incomes also have erratic seasonality elements due to the unpredictable nature of the manufacturing and service sectors and the economy at large. It is difficult to pinpoint specific or predictable periods.

5.6 CLIENT PRIORITIES WHEN CHOOSING SAVINGS MECHANISMS

This section examines the attributes which are important for clients in an SSP and its services. *Figure 22* shows the list of these attributes in the order of importance and a brief description of each is provided. The top two to five attributes are consistent with *MicroSave*'s own experience in examining the savings needs of the poor: ease, trust, staff behaviour and proximity. Interest rates on savings products normally do not come out on top in terms of priorities for the poor, as most are simply happy to have a secure place to save. However, in the context of Sri Lanka with its many SSPs, it is not surprising to note that interest rates rank the highest, as many, including the poor, have significantly more choices than the poor do in other countries.

- *Interest Rates*: The rate of interest offered by financial institutions on the savings made.
- *Ease of Transactions:* The formalities required and the time taken for each transaction, focusing on the fact that many poor people need to make frequent transactions.
- *Trustworthiness*: The trust and feeling of security the clients have towards the savings service provider.
- *Staff Behaviour:* The perceptions of staff attitudes and behaviour.
- *Proximity*: The physical distance of the outlet or the place of delivery of the services.
- *Privacy:* The privacy or the confidentiality offered by the service provider.

Interest rates on savings

products normally do not come out as top priority for the poor as most are simply happy to have a secure place to save. However, in the context of Sri Lanka with its many SSPs, it is not surprising to note that interest rates rank the highest, as many, including the poor, have significantly more choices than the poor do in other countries.

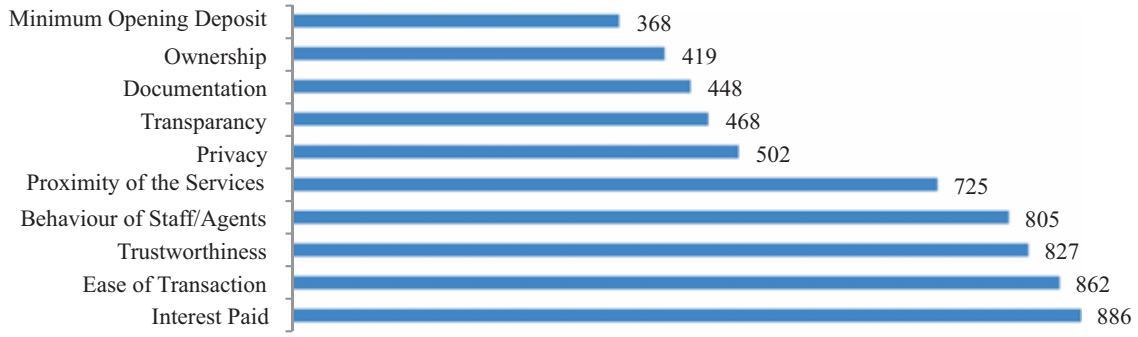
- *Transparency:* The transparency of the service provider in terms of interest rate calculations, penalty charges on minimum balances and other service charges levied on the client.

- *Documentation*: The ease of filling account opening forms and other documents required for opening of accounts and for other services, including credit.

- *Ownership*: The ownership which the client feels towards the organisation and the service provider.

- *Minimum Opening Deposit*: The minimum balance required to open the account.

Figure 22: Importance Given to Attributes for Selecting SSP



Other attributes that came up during the research included:

- Incentives/gifts offered for savings

- Ease of access to credit/pawning

- Value added services, like ATM cards and other facilities

- Minimum balance to be maintained in the account

5.7 PREFERENCE RANKING OF INSTITUTIONS (ALL TYPES)

The preferences of clients with regard to the various financial institutions were examined based on the attributes most important to them. The results are summarised in *Figures 23 and 24* below. The institutions, categorised on the basis of use by the low-income clients, include state-owned commercial banks, regional development banks (we encountered only Ruhunu Development Bank), co-operative rural banks, NGO-MFIs, the Samurdhi banking societies, thrift and credit co-operative societies (TCCS- Sanasa) and Seettus (RoSCAs).

Interest Rates

Interest rates consistently came out as one of the most important attributes for any savings product. In addition to the many NGOs, clients had many options to save - through commercial banks, Samurdhi societies, TCCS and informal sources. In this competitive environment, interest rates play a significant part in deciding which provider to choose. Interestingly, the state banks scored the highest in terms of best interest rates offered, indicating that clients' actual awareness of the interest they receive from state banks is very low. Most of them do not understand how the interest is calculated at the state banks. In one instance where the clients had ranked the banks higher on interest rates, it was found that the NGO-MFI was offering 8% p.a. while banks were offering 6% p.a. People may have scored the state banks higher since they trust these institutions over all other players, and therefore may feel they must be receiving the best interest rates possible.

> ***"We don't know the rate, but state banks calculate interest on monthly basis, whereas here in our MFI it is done quarterly."***
> ***-Market Research Respondent***

Samurdhi societies also score high on this attribute as clients often borrow at a much lower rate from them. The net gap between what clients are paid for savings and what they must pay for loans is low, so they perceive overall that they are receiving better interest rates.

Ease of Transaction

Ease of transaction mentioned by the clients mainly referred to the time taken for a deposit or withdrawal transaction to be completed and the documentation involved. The convenience of transacting, which deals with the convenience of saving in a particular institution, was the second most important attribute. Clients prefer NGO-MFIs and Seettus on this attribute. The informal nature of the group and the comfort they have in dealing with the group are the major reasons for ranking these informal mechanisms high on this attribute. Also, due to the group set-up and the personal bonding, the funds can be accessed at any time in case of emergencies and these groups allow depositing of small amounts. The commercial banks and the RDB scored the lowest on this attribute.

Trust

Sri Lanka has seen the collapse of a number of unregulated savings service providers in the recent past. Clients trust the state-owned banks the most due to their association with the Government. The NGO-MFIs also score high due to long-standing association with the community. Organisations like SEEDS, WDF and the Arthacharya Foundation have been in existence for over 15 years and clients trust them. Co-operative rural banks are considered relatively less trustworthy by clients in some areas due to issues of poor customer service. Clients generally trust them with the safety of their money.

> ***"We are paying a much higher rate than the state banks on similar savings products."***
> ***-NGO-MFI staff***

Behaviour of Staff

Behaviour of staff is also important for clients as this determining how frequently is a particular savings provider used. The NGO-MFIs and Seettus are the most preferred on this attribute. The staff of NGOs and the organisers of Seettus are generally from within the village and clients are more comfortable in dealing with them. Commercial banks and Samurdhi fare poorly on this attribute. People are still intimated by visiting a bank, as they are often treated poorly by the staff. This has also led to the general perception that the banks are only for the rich.

> ***"For visiting the MFIs we do not have to dress formally;- we can just visit them when we like."***

Samurdhi bank societies also have a very bad track record of dealing with communities; especially when it comes to the loan process, clients felt there were too many hassles and corruption involved.

> ***"In banks when we withdraw money we feel as if we are asking for their money".***

Proximity of Services

Banks are still considered inaccessible due to distances clients must travel to reach them. In hilly districts, this problem is even more pronounced. Seettus and TCCSs are the most accessible since they operate from within the village. Though NGOs operate within the village, the members sometimes have to visit the branch for getting loans or withdrawing funds for certain products, such as fixed deposits, etc.

Privacy

Privacy is an important attribute for the clients, especially when they want to save larger amounts. Commercial banks and RDBs scored higher over the others as they operate individual accounts for clients, helping them save large amounts from the proceeds of a harvest sale, sale of assets or salaries. Seettus and NGOs score relatively lower in this regard, as they operate on the group model and any amount saved in them is known to everyone else in the group.

Transparency

Transparency refers to a customer's knowledge of the method of interest calculation, the process of giving incentives for savings products (like lottery draws and gifts), penalty charges levied on the minimum balance, services charges, etc. Commercial banks fared poorly, as clients had little knowledge of the interest rate calculations and the penalty charges levied. A number of clients were not even aware of the minimum balance requirements in bank accounts. The NGO-MFIs fared better compared to banks.

> ***"Sometimes they [banks] charge some amount from the account and we don't even know why it has been deducted. Whereas, in our MFI we have complete access to the ledgers and know the status of every penny."***

Documentation

Documentation involves the paperwork required for opening an account, KYC requirements, etc. Seettus are the most preferred due to the light documentation involved. NGO-MFIs also fared well on this attribute as documentation for savings accounts is very minimal. Commercial banks were least preferred due to the lengthy documents required. Clients also pointed out that to withdraw money from a bank one needed to show a photo ID card every time they went, while it was not required with the NGO-MFIs, as the staff knew them on a personal level.

Table 11: Snapshot of SSPs preference on attributes

SSP	Attributes Preferred by Clients	Attributes Disliked by Clients
Commercial	Trust, privacy, interest rate	Proximity, behaviour of staff, transparency and ownership
RDBs	Trust, privacy, incentives offered (gifts, etc.) on savings products and interest rates	Proximity, behaviour of staff, transparency and ownership
Co-operative rural banks (CRBs)	Ease of transaction, minimum opening deposit, proximity and privacy	Staff behaviour, lack of trust due to poor customer service
NGO-MFIs	Ease of transaction, ownership, staff behaviour	Interest rate, incentives on savings products, etc.
TCCS	Minimum opening deposit, proximity	Trust
Samurdhi societies	Interest rates, minimum opening deposits	Staff behaviour, transparency
Seettus	Ease of transaction, documentation, staff behaviour	Interest rates, privacy

Figure 23: Relative Preference Ranking on Product Design Attributes

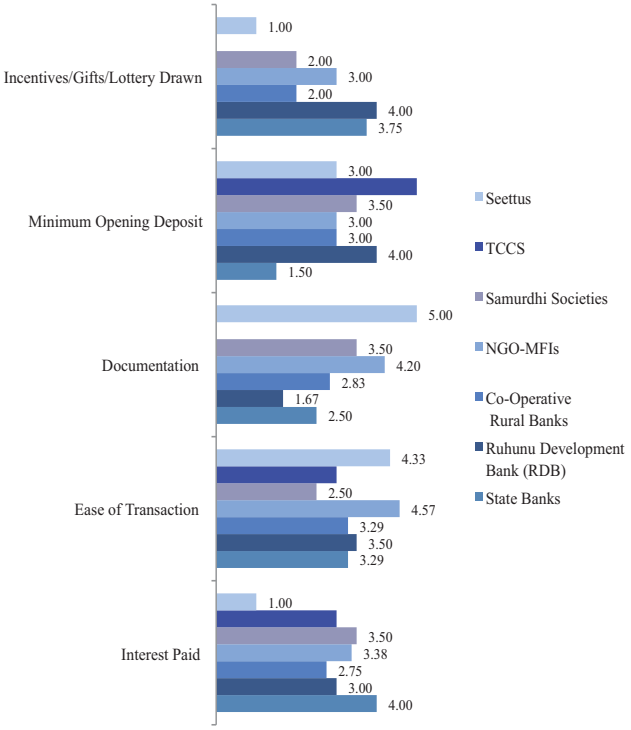
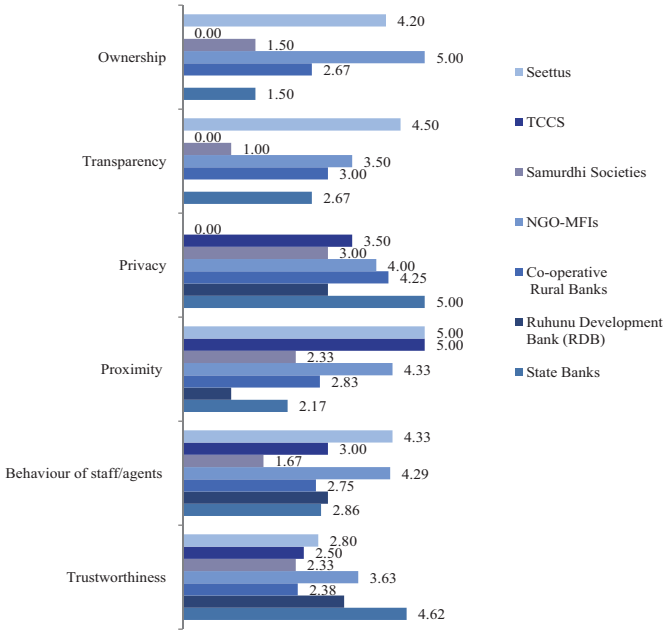


Figure 24: Relative Preference Ranking on SSP's Institutional Characteristics



Ownership

The NGO-MFIs ranked high in ownership as they form village-level societies, which are governed by the community. Even though CRBs are co-operatives, these institutions ranked poorly with regard to ownership.

Minimum Opening Deposit

Banks have a minimum opening deposit of LKR 500 (USD 4) to open a savings account. Clients felt this requirement was too high and they preferred the TCCSs since one can open an account with just LKR 10-50 (USD 0.44-0.89).

As can be seen in *Table 11* above, three types of organisations performed well with two of the five most important attributes: banks on interest and trust; NGOs on ease and staff behaviour; and Seettus on ease and staff behaviour. No organisation performed well with more than two attributes. Those that fared poorly on attributes important to poor people were banks, on proximity and staff behaviour; RDBs, on proximity and staff behaviour and cooperatives, on staff behaviour and trust.

6. CONCLUSION

The Sri Lankan economy is fast reviving after a 26-year-long ethnic war. The economy has shown resilience and continues to be on a growth path in spite of civil unrest and natural calamities. Sri Lanka as a country possesses the necessary factors to put the nation on an even higher growth trajectory and achieve improved social development. The country is rich in natural resources and has a young workforce with admirably high literacy levels and low gender disparity in terms of basic human development indicators.

However, economic development has been uneven in the country, and there is significant scope for improvement in some provinces, especially the war-torn northern and eastern provinces.

Access to financial services in Sri Lanka is relatively high due to the spread of a number of service providers. State-owned banks have achieved admirable outreach, partly due to the proactive steps taken by the Government and partly due to the varied services offered such as pawning, remittance accounts (local and foreign currency), children's savings accounts (including school savings centres), senior citizens accounts, etc. Experts believe that banks have downscaled fairly well to low-income client segments but there is a limit to this. Though the outreach is high in terms of the number of accounts, actual usage is not high. There are various reasons for this, such as the lack of access to credit, poor customer service, lack of proximity/accessibility and poor transparency.

Co-operatives, including CRBs and TCCSs, are the other strong contenders in the savings sector. They, too, have been able to penetrate the low-income segment quite effectively. However, they suffer from high politicisation and mismanagement. Regulatory oversight provided by the Department of Co-operatives is generally seen as inadequate. Unless these institutions are regulated better and steps are taken to de-politicise them, their survival in the long run is unlikely. The TCCS movement also suffers from some of the same weaknesses of co-operatives throughout the world, like poor financial management and governance.

The Seettus and other informal methods being used for savings, such as funeral societies, are used extensively across the country and are immensely popular amongst the poor. The most important purpose served by these informal mechanisms is consolidating smaller amounts into reasonably large useable lump sums. Also, these mechanisms inculcate the savings and thrift habits amongst people in a way that fits their needs: small and frequent amounts. However, Seettus, which particularly suffer from the limitation of not being able to handle larger savings amounts, generally rank lower on trust and have inadequate or no accounting system whatsoever.

NGO-MFIs have played an important role in providing financial services to low-income clients in Sri Lanka. The doorstep delivery of services, ability to deposit small savings amounts and better access to credit facilities, are some of the major reasons that have led to their popularity. However, as per the current regulations, deposit mobilisation activities by these NGOs are considered illegal and this has stifled them. Many NGOs also suffer from a number of capacity and governance issues that inhibit their ability to run a financially sustainable business. These often include poor portfolio quality, weak internal controls and financial management issues.

6.1 THE WAY AHEAD

Regulation: CRBs, TCCSs, Samurdhi societies and NGO-MFIs manage a substantial part of the small deposits in the country, but either have weak or no regulation at all. Regulation is needed to safeguard the deposits of the clients and also to filter out players with are not strong enough to handle deposit mobilisation programmes. The proposed microfinance regulation is a key step in this direction.

Products and Delivery Mechanisms: Outreach of financial services is high and clients generally have access to both formal and semi-formal financial institutions. The issue is improving the quality of the financial services to the poor. As discussed in the preceding section, there are many issues regarding the product attributes offered by the formal and informal financial institutions which force people to depend on informal sources. These need to be addressed to increase the use of these institutions.

In terms of providing deposit services to the poor, NGO-MFIs are in the best position to deliver the financial services due to their ability to offer flexible products and better customer orientation towards low-income client segments. However, unless there is legal clarity on the status of deposit mobilisation they cannot be used to further the cause of providing quality financial services to the poor. Banks, both the LCBs and LSBs, have achieved considerable success in providing financial services to low-income clients. However, the issues in their delivery mechanisms should be addressed. Mobile banking provides an exciting opportunity for banks to overcome delivery issues and increase their outreach by providing doorstep services. Proactive initiatives by banks may be undertaken to test new delivery mechanisms, and involving mobile banking technology might be the best possible way forward in this regard.

Mobile banking

provides an exciting opportunity for banks to overcome delivery issues and increase their outreach by providing doorstep services.

The next important area of focus should be on the northern and eastern provinces. These provinces have the highest incidence of poverty and lowest banking density, which provides an excellent opportunity for banks/co-operatives to extend their services. The existing popular products of voluntary general savings (providing liquidity) and children's savings accounts can be used initially to cater to these segments.

Improved Capacities of Players: Capacity building is still an area for improvement for all of the semi-formal players CRBs, NGO-MFIs, TCCSs, etc. The major areas of improvement demand: a scientific approach to enhance operational productivity, financial planning and risk management; research-based development of products/services and developing/maintaining human resources. Extensive steps are required to build the capacity as technical assistance to these organisational types is not adequate.

Financial Literacy: Steps should also be taken to improve the financial literacy of end clients regarding use of the formal financial services. The commercial and specialised banks must also be involved in this process to make their operations more transparent and customer friendly.

Deposit Assessment in Sri Lanka

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