MONETARY BOARD
CENTRAL BANK OF SRI LANKA

30 November 2018 **BANKING ACT DIRECTIONS** **No. 11 of 2018**

FOREIGN CURRENCY BORROWINGS BY LICENSED BANKS

Foreign currency borrowings are an important source of funding for banks. However, excessive and unregulated foreign capital flows are likely to cause unwarranted macroeconomic and financial stability concerns in a country.

The Monetary Board introduces a policy framework for foreign currency borrowings of licensed banks with the objectives of addressing the high dependence on foreign currency borrowings and the resulting exposure of licensed banks to foreign exchange risk and minimising the pressure on the reserves and exchange rate of the country arising from large borrowings in foreign currency.

Accordingly, the Monetary Board issues Directions to licensed commercial banks (LCBs) and licensed specialised banks (LSBs) as follows:

1. Empowerment under the Banking Act	1.1	In terms of Sections 46(1) and 76J(1) of the Banking Act No. 30 of 1988, in order to ensure the soundness of the banking system, the Monetary Board is empowered to issue Directions to all or any LCB and LSB, respectively, regarding the manner in which any aspect of the business of such bank or banks is to be conducted.
2. Applicability	2.1	These Directions shall be applicable to all foreign currency borrowings made from local and foreign sources by LCBs and LSBs, hereinafter referred to as licensed banks, covering Domestic Banking Units and Off-Shore Banking Units.
3. Tenure	3.1	Foreign currency borrowings with a remaining maturity of: (i) 1 year or less will be considered as short-term borrowings; and (ii) more than 1 year will be considered as long-term borrowings.
4. Limits on Foreign Currency Borrowings	4.1	The maximum outstanding amount of foreign currency borrowings obtained by a licensed bank shall be determined as a percentage of total assets as per the latest annual audited accounts or interim accounts certified by the External Auditor of the licensed bank.

4.2 The percentage of foreign currency borrowings of a licensed bank shall be based on the sum of scores assigned for each licensed bank based on the external long-term credit rating and the total capital adequacy ratio of the bank as given in Tables 1 and 2 below:

Table 1 – Calculation of the Score

Bank's Credit Rating	Bank's Total Capital Adequacy Ratio	Score Assigned to Each Cell
AAA to AA- or equivalent	>14.0%	3
A+ to A- or equivalent	13.6% - 14.0%	2
BBB+ to BBB- or equivalent	12.5% - 13.5%	1
Below BBB-	<12.5%	0

Table 2 - Borrowing Limits as a Percentage of Total Assets

Sum of Score	Short-Term	Total
1 - 2	1.5%	5.0%
3 - 4	2.0%	7.5%
5 - 6	2.5%	10.0%

5. Approval of the Monetary Board

5.1 Any foreign currency borrowings in excess of limits specified in Direction 4 above shall be undertaken with the prior written approval of the Monetary Board, under exceptional circumstances of national interest.

5.2 The Monetary Board may grant such approval to exceed the applicable limits of foreign currency borrowings of a licensed bank by 5% of assets, on a case-by-case basis, subject to terms and conditions it may deem fit, taking into consideration of the macroprudential aspects.

5.3 Borrowings approved by the Monetary Board under the Direction 5.2 above shall be undertaken within 3 months from the date of the approval of the Monetary Board.

6. General Terms and Conditions

6.1 (i) All foreign currency borrowings of a licensed bank shall be approved by the Board of Directors of the licensed bank or the regional monitoring office or the management committee operating under delegated authority of the Board of Directors of foreign banks.

(ii) The Board of Directors or the relevant authority as specified above, may establish a pre-approved limit for foreign currency borrowings as an alternative to approving each borrowing.

6.2 Licensed banks shall comply with all prudential requirements at all times, including, but not limited to, minimum capital adequacy ratio under Basel III, Statutory Liquid Assets Ratio, Liquidity Coverage Ratio, Net Stable Funding Ratio, and Net Open Position.

6.3 Licensed banks shall hedge interest rate and foreign exchange risks and manage the maturity mismatch arising from foreign currency borrowings.

6.4 Hedging with an international counterparty is encouraged where the foreign currency borrowed is converted to another foreign currency.

6.5 Licensed banks shall put in place internal policies and procedures approved by the Board of Directors for management of foreign currency assets and liabilities along with appropriate foreign currency maturity mismatch limits.

6.6 Licensed banks shall prove their ability to service repayments of foreign currency borrowing in a timely manner.

7. Eligible Foreign Currency Borrowings

7.1 Lender should have a good track record as a stable financial institution. Possible lenders are:

(i) Multilateral development banks,

(ii) Lending institutions with international repute,

(iii) Foreign Government owned or affiliated agencies,

(iv) Head Office and branches of foreign banks,

(v) Licensed banks in Sri Lanka.

7.2 Interest rates (inclusive of all related costs) of the borrowing shall be competitive.

7.3 Borrowings shall not be settled prior to the initial specified date of settlement unless the loan agreement provides for an accelerated prepayment mechanism.

7.4 Licensed banks shall mitigate the impact of bunching effect.

7.5 Borrowings shall not result in excessive credit growth.

8. Utilisation of long-term Foreign Currency Borrowings

8.1 Long-term foreign currency borrowings shall be utilised for lending/investment purposes to:

(i) fund exports, import substitution, infrastructure, government development projects and small and medium enterprises;

(ii) settle or retire current foreign currency loans;

(iii) invest in Sovereign Debt of the Government of Sri Lanka and fund the Government of Sri Lanka for activities of national importance;

(iv) fund viable overseas business expansions of local corporates; and

(v) fund viable projects or businesses of overseas entities in Sri Lanka or overseas.

9. Application to be submitted

9.1 Licensed banks may submit a written request with the following details to obtain the Monetary Board approval under Direction 5 above:

(i) Profile of the Lender,

(ii) Features of the Loan,

(iii) Specific purpose/objectives with targets,

(iv) Performance status of existing foreign currency loans,

(v) Proposed risk management mechanism.

10. Exclusion from the maximum limits

10.1 Foreign currency borrowings from the Head Office or its branches operating outside Sri Lanka of an LCB incorporated outside Sri Lanka will be exempted from the limits specified in Direction 4 above, provided the proceeds are used for the intended purpose the borrowing is obtained.

10.2 Borrowings utilised for investments in Securities issued by the Government of Sri Lanka.

11. Interpretations

11.1 Total assets shall be the amount as per the latest annual audited accounts or interim accounts certified by the External Auditor of the licensed bank.

11.2 Foreign currency shall mean any designated foreign currency.

12. Implementation

12.1 These Directions shall come into effect from the date of issue of these Directions.

13. Transitional Arrangement

13.1 Any licensed bank which has obtained foreign currency borrowings in excess of the maximum limit specified under Direction 4 above shall not be permitted to borrow further, until such time the outstanding amount of foreign currency borrowings falls below the maximum limit.

14. Revocation

14.1 The following Direction and Circular are hereby revoked.

(i) Banking Act Direction No. 7 of 2017 on Foreign Currency Borrowings by Licensed Banks.

(ii) The Circular No. BD/FX/196 dated 13 January 1997 issued by the Chief Accountant.

Dr. Indrajit Coomaraswamy
Chairman of the Monetary Board and
Governor of the Central Bank of Sri Lanka