

Consultation paper on Introducing Ownership Limits of the Licensed Finance Companies (LFCs)

1 Background

Over the past few years there has been an increase in the prominence of LFC sector in terms of its market penetration and its contribution towards financial inclusion of the country. However, due to various reasons there have been instances where several LFCs have either failed or become almost bankrupt during the last few decades.

2 Core banking principle on ownership (Basel)

The supervisor has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.

3 Failures in the LFC sector

In Sri Lanka, there have been several occasions where LFCs have failed due to financial distress resulted in bringing stress to many depositors. Most of the small financial institutions that had internal issues and led to crisis situation mainly due to the mismanagement of the company with the influence of the main shareholder.

4 Regulatory developments in the LFC sector in the area of ownerships of LFCs

- a) At present, there are no directions issued with regard to the ownership limits of LFCs while the section 12 (1) (n) of the Finance Business Act provides authority to the Monetary Board to issue ownership limits for LFCs.
- b) In the recent past, CBSL has taken many regulatory actions such as consolidation, direction on corporate governance and imposing listing requirement for LFCs.

5 Domestic and international best practices in the area of ownership limits

- a) As per the Banking Act, No.30 of 1988, an individual, partnership or corporate body or a nominee or acting in concert with any other individual, partnership or corporate body, is prohibited to acquire more than 10% of voting shares in a licensed commercial bank.
- b) In 2016 November, new listing rules were issued by Securities and Exchange Commission of Sri Lanka for the listed companies on the minimum public float.
- c) There are many international examples where limitations have been imposed on bank ownerships.

- 6 At present the LFCs ownership is mainly either dominated by a main shareholder or shareholders related to the main shareholder as detailed below in Table 1.

Table 1: controlling interest if LFCs

More than 50% is controlled by main shareholder	30 LFCs
More than 50% is controlled by main shareholder and related parties	8 LFCs
controlled by 2 shareholders	2 LFCs
Diversified ownership	3 LFCs

- 7 Based on the characteristics of ownership and the nature of the business model, finance companies sector could be clustered in to 4 categories and recommended action for each category are given in Table 2 below.

Table 2: Categories of LFCs and recommended action

Subsidiaries of banks	Exempt from the ownership diversification requirement. However, if a common act is introduced these would have to get consolidated with banks
Subsidiaries of another LFC	Complete the merger by end 2020
Subsidiary of a group or conglomerate	<ul style="list-style-type: none"> - Considering the strength of the holding company or the parent company, an exemption could be considered by allowing to hold the ownership of the LFC/SLC max up to 50.1% - However, the group structures can have risks to a financial institution. - Hence, Diversify the shareholding gradually by end 2025 up to 25%.
Owned by a single shareholder and related parties	Diversify the shareholding gradually by end 2025 up to 25%.
Distress and restructured companies	As separate restructuring plans are being implemented, this category to be exempted from the direction

8 The following is proposed on ownership diversification for LFCs.

a) Ownership limits of LFCs have been fitted into the following shareholding matrix:

Matrix of Shareholding Limits (%)

	2020	2021	2022	2023	2025
Natural person	80	70	50	35	25
Legal person					
Banks	100	100	100	100	100
Other entities	80*	70	50	35	25
Under special Circumstance	As permitted on a case to case basis allowing to go up to 30% for natural persons and other entities.				

* except for ownership in merging companies.

b) Sanctions for non-compliance

- i. Cease/suspend business activities
- ii. Cancellation of license