

# *Microfinance Technical Note*

A series of technical notes related to microfinance  
in Sri Lanka by GTZ PROMIS



## **Key Features of the Finance Companies Act No 78 of 1988 (amended by Act No 23 of 1991)**

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Ministry of  
Finance and  
Planning



**gtz**

## **About GTZ worldwide**

The German Technical Cooperation (GTZ) is an international cooperation enterprise for sustainable development with worldwide operations. For 30 years, it has been providing viable, forward looking solutions for political, economic, ecological and social development in a globalised world. GTZ supports complex reform and change processes, often working under difficult conditions. Its corporate objective is to improve people's living conditions on a sustainable basis. The main client of GTZ is the German Federal Ministry for Economic Cooperation and Development (BMZ).

## **About PROMIS**

Promotion of the Microfinance Sector (ProMiS) is a comprehensive programme implemented by the Sri Lankan Ministry of Finance and Planning in partnership with the German Technical Cooperation (GTZ) on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ).

**The initial project phase (September 2005 to November 2009)** focused on broadening and strengthening the sustainable access to microfinance services to poorer sections of society and to micro and small enterprises. This comprised capacity building for microfinance institutions (micro level), the development of a microfinance service sector (meso level) and advices to the government to develop a framework for a microfinance policy and legislation (macro level).

**In the follow-on phase (December 2009 to November 2012)**, ProMiS continues working on the meso and micro level to further strengthen the sustainability of the microfinance sector in Sri Lanka. Additionally we strive for an inclusive financial system, in which marginalized groups are included into society and hence gain social security beyond welfare or charity. Through a wide range of modern and appropriate financial and non-financial products for marginalized parts of the society, microfinance contributes to the peaceful development of the country.

During this phase, the project's activities are geared more to the meso and micro level. The new goal is to reintegrate marginalised parts of the population into society in order to support a favourable environment for the peaceful development of the country.

A steering committee, led by the Ministry of Finance and Planning and consisting of important stakeholders of the sector, guides the project to achieving its overall goal.

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## **Key Features of the Finance Companies Act No 78 of 1988 (amended by Act No 23 of 1991)**

To carry on business as a Finance Company, it is necessary to

- Be registered as a public company under the Companies Act.
  
  - Be registered under the provisions of the Finance Companies Act after making an application to the Monetary Board of the Central Bank of Sri Lanka and receive a license to operate. An annual license fee of Rs. 50,000 is payable.
  
  - Have a minimum issued and paid up capital of at least Rs. 200 million and submit evidence of this to the Monetary Board.
  
  - Documents to be submitted with the application for registration:
    - Manual of Operations
    - Certified copy of the Auditor's letter to the Board of Directors of the company on completion of the audit of the last financial year
    - Memorandum and Articles of Association\*
    - Certificate of Incorporation\*
    - Latest Forms 13, 36, 48 and 63\*<sup>1</sup>
- \*(each certified by the Registrar of Companies)
- Projections of deposits, lending and profit and loss for the first 3 years
  - Feasibility report on establishing the company
  - Organization Chart
  - Confirmation from Auditors on the availability of capital
  - Declaration from the Board of Directors that the company has met all regulatory and statutory requirements
  - Tax clearance certificate
  - Experience and qualifications of the Board of Directors and senior management

### **Operational matters**

The Monetary Board has the authority to give directions to finance companies or to any group or category of finance companies (e.g. finance companies engaged in microfinance) regarding the manner in which various aspects of their business are conducted<sup>2</sup>; in particular

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<sup>1</sup> These are forms of the Registrar of Companies and the numbers have changed with the introduction of the new Companies Act in 2007. The corresponding new numbers are: 11,13, 20 and 15.

<sup>2</sup> There were some similar clauses contained within the draft MFI Act and when objected to by practitioners, the Central Bank reply was that these clauses are also included in the Finance Companies Act but it is rarely, if ever, that these powers have been exercised by the Monetary Board, especially with regard to interest rate setting.

- terms and conditions under which deposits may be accepted, including maximum rates of interest payable on deposits, maximum period for which deposits can be accepted, maximum amounts that can be deposited in one or more accounts and conditions applicable to withdrawal of deposits before maturity
- terms and conditions under which loans or any type of credit facility may be granted, including maximum rates of interest that can be charged, maximum loan periods and the type and amount of security that may be required for different types of loans (since microfinance usually does not involve the provision of physical collateral, would this mean that the Monetary Board might require MFIs registering under this Act to change their operating methodology and what impact could this have?)
- the Monetary Board can also prohibit registered Finance Companies from increasing the amount of their loans and set limits on the amount by which the loans or other credit facilities granted by them may be increased within a specified period. They also have the authority to ask the company to decrease the amount of their loans to specified limits within a specified period
- maximum rates which can be charged as fees, commissions, etc or granted as discounts
- conditions under which leasing and hire purchase business is carried out and conditions under which investments may be made by the company
- the types of activities that may be carried on by Finance Companies
- minimum liquidity requirements such as the ratios of liquid assets to total deposit liabilities and cash balances to total deposit liabilities
- the opening of new branches, shifting of existing branches and the closure of existing branches. All these require the prior approval of the Central Bank of Sri Lanka. The maximum number of branches that may be opened is linked to the core capital of the company.
- form and manner in which books of accounts and other records or documents are maintained
- the 1991 amendment to the Act gives the Monetary Board authority to give directions to registered finance companies regarding the remuneration and other payments made to directors or employees by way of salary, allowances, perquisites and reimbursement of expenses
- the above amendment to the Act also permits the Monetary Board to make rules and conditions in respect of any prospectus or advertisement issued by a finance company relating to any aspect of finance business. (Note: For example, the disclosure of effective interest rates).

- the Monetary Board is permitted to intervene and issue directions to a Finance Company if it is of the opinion that the company is “following unsound or improper financial practices detrimental to the interest of its depositors “ and/or “carrying on its business in a manner detrimental to the interests of its depositors”.

### **Deposit Insurance**

The Act contains provision for the Central Bank to require registered finance companies to insure their deposits either with a scheme that may be established and managed by the Central Bank or any insurance company specified by the Monetary Board.

### **Shareholding**

The Monetary Board may give directions as to the maximum percentage of the share capital of a finance company that may be held by a company, incorporated body or individual and related parties.

### **Reporting**

The audited financial statements of the company prepared in a specified form and containing specific disclosures regarding provisioning for bad and doubtful debts, diminution in the value of fixed assets, etc, have to be provided to the Supervision of Non-Bank Financial Institutions Department of the Central Bank which is the department responsible for implementing the Act. The financial statements must be provided to the Central Bank and published within six months of the close of the financial year.

### **Regulations, Directives and Guidelines issued under the Finance Companies Act**

The website of the Central Bank of Sri Lanka contains all the directives issued under the Finance Companies Act. (see [http://www.cbsl.gov.lk/info/09\\_lr/\\_popups/SNBFI.htm](http://www.cbsl.gov.lk/info/09_lr/_popups/SNBFI.htm)).

### **Points for consideration**

- The Monetary Board has the authority under the Finance Companies Act to order the winding up or divesting of finance business<sup>3</sup> carried out by any individual or body, and the settlement of its deposit liabilities, if it is not registered under this Act. While this has not yet been used on Microfinance Institutions there is a possibility that attention may soon be focused on the microfinance sector, given recent developments in the financial sector where unregistered institutions collapsed or suddenly shut down, resulting in depositors losing their money.
- The Act gives the Monetary Board power to take action against registered finance companies which are “not carrying on finance business”. While this specifically refers to registered finance companies which subsequently cease to carry on finance business, presumably it could also mean that for MFIs which carry on microfinance plus other business (“credit-plus”) there would be a need to separate the microfinance business through a legal, accounting and operational separation, prior to seeking registration under the Act.

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<sup>3</sup> Finance business is defined in the Act as “the business of acceptance of money by way of deposit the payment of interest thereon and a) the lending of money on interest; or b) the investment of money in any manner whatsoever; or c) the lending of money on interest and the investment of money in any manner whatsoever;”

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