

28 November 2006

To : All Authorized Dealers

DIRECTIONS TO COMMERCIAL BANKS ON LKR BASED FX OPTIONS

All Commercial banks appointed to act as Authorised Foreign Exchange Dealers are hereby informed that offering of Rupee (LKR) based cross currency options to domestic corporate clients is allowed subject to the following conditions:

1. The LKR based FX Option can be used only in respect of transactions of current nature permitted in terms of current exchange control regulations¹.
2. Only the Authorised Dealers engaged in Derivative Market Maker deals are allowed maintaining open exposures and such exposures shall be subject to the exposure position limits specified by the Central Bank of Sri Lanka (CBSL). Authorized Dealers who are qualified under 4.1 of these directions and those who wish to engage in LKR based FX Options shall obtain the consent of the International Operations Department of the CBSL by informing in writing their interest to engage in such transactions together with an undertaking by the management on the adequacy of internal risk management system in place to engage in FX options. These transactions will be subject to the supervision and scrutiny of the CBSL.
3. **Transaction Types**
Authorized Dealers engage in Option transactions in following main forms:
 - (a) Transactions executed by authorized dealers with its customers with intention of making a spread. In these transactions the commercial bank does not take any market risk on its own books and covers the transaction on the same day on back-to-back basis. These types of transactions are known as **Non-Market Maker** deals (NMM).
 - (b) Transactions those involve derivative trading services to customers and require financial institutions to quote prices to other customers/institutions while taking the market risk on bank's own books. Such transactions are known as **Derivatives Market Maker** deal (DMM).
4. **Eligibility and Permissible Activity**
 - 4.1. Only the commercial banks with capital adequacy ratio of more than 11% are permitted to engage in LKR based FX Options. This Capital Adequacy Ratio is inclusive of LKR based FX Option positions. The directions of the Director Bank Supervision (DBS) on risk weighted capital should be followed in determining the Capital Adequacy Ratio.
 - 4.2. Authorized Dealers should ensure that each LKR based FX Option is made only in respect of risk or exposures arising from permitted underlying current transactions which normally qualifies for forward foreign exchange contract such as payment and receipt in foreign exchange in respect of goods and services on trade.
 - 4.3 Under any circumstances, LKR based FX Option should not be permitted through a bank abroad or a correspondent foreign bank to its customers in Sri Lanka in respect of any

¹ Regulations/directions issued by the Exchange Control Department under the Exchange Control Act No.24 of 1953

foreign currency exposures or risks arising from currency deposit/export earnings kept outside Sri Lanka.

- 4.4. The notional principal amount of the LKR based FX Option shall not exceed the outstanding amount of the foreign currency obligations.
- 4.5. Authorized Dealers shall offer option contracts only in respect of a transaction, which normally qualifies for forward foreign exchange contract.
- 4.6. The transaction shall be based on individual transactions and not on pooling several into one currency option.
- 4.7. The parties involved are free to use any publicly available benchmark rate on mutual agreement.

5. Eligible Foreign Currencies

Transactions relating to the LKR based FX Options are limited to the following currencies. – USD, GBP, EUR, JPY, CAD, AUD and CHF.

6. Risk Management

- 6.1 The Authorized Dealers shall be required to ensure that adequate measures are taken to mitigate credit risk, market risk and operational risk and also its compliance with the provisions of the minimum capital adequacy requirement permitting to LKR based FX Options. Appropriate policy limits approved by the management of the bank should be in place. All positions arising from these transactions shall be marked to market daily and the relevant values shall be captured in the Profit & Loss Account and the Balance Sheet.
- 6.2 All Transactions need to be covered on back-to-back basis on the same day without allowing them to carry any open exposures as they may result in increased market risks to the bank. However in order to cover its foreign exchange position, Authorised Dealers are allowed to trade in Vanilla Foreign Currency Options.
- 6.3 Such foreign currency options need to be included on a net delta weighted basis in the net foreign exchange exposure position reporting and shall be within such limits specified for the bank.
- 6.4 Customers may unwind or sell back hedge if they consider such hedge is no longer required. However the Option contracts offered/designed as cost effective risk reduction structures or packaged contracts shall not result in any net inflow of premium to the customers or increase in risk in any manner.
- 6.5 Option contracts cannot be used to hedge contingent or derived exposures.
- 6.6 A customer may enter into a hedge with any DMM irrespective of the exposure being booked in that DMM or not.
- 6.7 DMM shall obtain an undertaking from customers that their total value of hedges do not exceed the value of the risk that is being hedged.
- 6.8 Banks should put in place necessary systems for marking to market the portfolio on a daily basis.
- 6.9 Banks should train their staff adequately and put in place necessary risk management and internal control and processing systems before undertaking any of these transactions.

7. Tenure

The maturity period of LKR based FX option shall not exceed ten (10) years or the remaining life of the underlying transactions, whichever is less.

8. Reporting

- 8.1. Authorized Dealers are required to report to the International Operations Department of the CBSL on a monthly basis the transactions undertaken within the month indicating the amounts, rates, maturities, currency, details of counterparty and details of underlying transactions/exposure etc.
- 8.2. Bank must make adequate disclosures in their Audited Annual Accounts with regard to such transactions that they have undertaken during the financial year under review at least to the extent required in the Sri Lanka Accounting Standards (SLAS) or International Financial Reporting Standards (IFRS).

9. Documentation

The bank shall ensure the use of the International Swap Dealers Association (ISDA) agreement with the counterparty for the interest of both parties in all possible instances.

10. Miscellaneous Requirements

- 10.1. Authorized Dealers shall obtain an undertaking from customers interested in using the LKR based FX Option that they have clearly understood the nature of the product and its inherent risks.
- 10.2. Authorized Dealers shall provide adequate information on the transaction especially with regard to the conditions and clauses to be incorporated into the product-determined benchmark interest rate, strike price, premia and risks involved to their customers and ensure highest level of transparency.

These directions will be effective from 1st December 2006.

Mrs. P Liyanage
Director of International Operations

D.Wasantha
Controller of Exchange

21 December 2005

To : All Authorized Dealers

DIRECTIONS ON FINANCIAL DERIVATIVE PRODUCTS (REVISED)

This circular revises and supersedes our circular on Directions on Financial Derivative Products dated 12th August 2005. The revised directions will be effective as from 1st January 2006, and will be in force regarding all matters relating to the derivative transactions in foreign exchange (not involving LKR) that are permitted by CBSL for commercial banks appointed to act as Authorized Foreign Exchange Dealers. These directions shall be read together with the explanatory note to the directions annexed herewith.

1. Permitted Products

Derivative transactions permitted under these direction include:

- 1.1 Interest Rate Swaps (IRS)
- 1.2 Interest Rate Options (IRO)
- 1.3 Forward Rate Agreements (FRA)
- 1.4 Cross Currency Swaps (CCS)
- 1.5 Currency/Commodity Options (CCO)

- 2. The above products can be used only in respect of transactions of current nature and in the case of capital transactions, those permitted in terms of current exchange control regulations¹.

3. Purpose of Permitted Derivative Products

Permitted derivative products shall only be used for the purpose of hedging the risks arising from its own assets or liabilities or for altering its risk profile but not for speculative purposes. Only the Authorised Dealers are allowed to maintain open exposures and such exposures shall be subject to the exposure position limits specified by the Central Bank of Sri Lanka (CBSL). Authorized Dealers who are qualified under 4.1 of these directions and those who wish to engage in derivative transactions shall inform the International Operations Department of the CBSL, their interest to engage in derivative transactions. These transactions will be subject to the supervision and scrutiny of the CBSL.

4. Eligibility and Permissible Activity

- 4.1. The commercial banks that have a capital adequacy ratio of more than 11% be permitted to engage in derivative transactions.
- 4.2. Authorized Dealer shall ensure that each IRS/IRO/FRA/CCS/CCO is made only in respect of a permitted underlying transaction or capital/current exposure.
- 4.3. Authorized Dealers shall ensure that each option, currency swap is made only in respect of a underlying current transaction such as payment and receipt in foreign exchange in respect of goods and services on trade, permitted capital transaction such as investment and foreign currency loans² and permitted foreign currency deposits³.
- 4.4. Importers are allowed to enter into derivative transactions to hedge their exposure arising out of underlying transactions relative to goods and services in trade or genuine balance sheet exposures.
- 4.5. Under any circumstances, IRS, IRO, FRA, CCS and CCO shall not be permitted through a bank abroad or a correspondent foreign bank to its customers in Sri Lanka in respect of any foreign currency deposit permitted to retain abroad.
- 4.6. In the case of permitted foreign currency loans, the notional principal amount of the IRS/IRO/FRA/CCS/CCO shall not exceed the outstanding amount of the foreign

¹ Exchange Control Department circular Nos. EC/06/94, EC/D/GL/1994/2 dated 18.03.1994

currency loan or the balance of the foreign currency deposit of the permitted persons/institutions.

- 4.7. Authorized Dealers can use the product for the purpose of hedging trading books and balance sheet exposure.
- 4.8. The currency of the hedge is left to the choice of the customer.
- 4.9. The notional principal amount of the CCO and CCS shall not exceed the outstanding foreign currency obligations.
- 4.10. Authorized Dealers shall offer option contracts only in respect of a transaction, which normally qualifies for forward foreign exchange contract and to hedge such risks arising out of genuine balance sheet exposures.
- 4.11. The Authorized Dealers shall take steps to hedge their risk exposure with their correspondent overseas banks or any other domestic bank.
- 4.12. Authorized Dealers are permitted to run open positions within the limits specified by the management of respective banks and approved by the CBSL.
- 4.13. The parties involved are free to use any Benchmark rate on mutual agreement.
- 4.14. All the conditions applicable for rolling over, cancellation and rebooking of forward contracts would be applicable to option contracts as well.

5. Eligible Foreign Currencies

Transactions relating to the permitted derivative products are limited to the following currencies. –

USD, GBP, EUR, JPY, CAD, AUD and CHF.

6. Tenor

The maturity period of a derivative instrument shall not exceed ten (10) years or the remaining life of the underlying transactions, whichever is less.

7. Risk Management

- 1 The Authorized Dealers shall be required to ensure that adequate measures are taken to mitigate credit risk, market risk and operational risk and also its compliance with the provisions of the minimum capital adequacy requirements permitting to derivative transactions.
- 2 Authorized Dealers are permitted to lend in foreign currency only to direct exporters, indirect exporters, enterprises approved by Board of Investment (BOI), enterprises with full exemption from the Exchange Control Act (ECA) and any other party approved by the Controller of Exchange (CE) for a specific purpose.
- 3 Foreign currency deposits are permitted to exporters, BOI companies, exempted from Exchange Control Law and any other party approved by the CE.

8. Reporting

- 8.1. Authorized Dealers are required to report to the International Operations Department of the CBSL on a monthly basis the transactions undertaken within the month indicating product type, amounts, rates, maturities, currency, details of counterparty and details of underlying transactions/exposure etc.
- 8.2. Bank must make adequate disclosures in their Audited Annual Accounts with regard to the derivative transactions that they have undertaken during the financial year under review at least to the extent required in the Sri Lanka Accounting Standards (SLAS) or International Financial Reporting Standards (IFRS).

9. Accounting Treatment and Valuation

Accepted accounting standards and mark to market valuation shall be done on a daily basis.

10. Documentation

The bank shall ensure the use of the International Swap Dealers Association (ISDA) agreement with the counterparty for the interest of both parties.

11. Miscellaneous Requirements

- 11.1. Authorized Dealers shall obtain an undertaking from customers interested in using the derivative products that they have clearly understood the nature of the products and their inherent risks.
- 11.2. Authorized Dealers shall provide adequate information on the transaction especially with regard to the conditions and clauses to be incorporated into the product-determined benchmark interest rate, strike price, premia if any and risks involved to their customers and ensure highest level of transparency.

Mrs. P Liyanage
Director of International Operations

H. A. G. Hettiarachchi
Controller of Exchange

EXPLANATORY NOTES ON SOME OF THE SECTIONS OF DIRECTIONS ON FINANCIAL DERIVATIVE PRODUCTS

These explanatory notes form part of the directions on Financial Derivative Transactions and shall be read together with the Directions.

1. Financial Derivatives

“Derivative contract under reference means” a financial contract of which the value is determined by reference to one or more underlying assets or indices. Derivative transactions permitted under these directions are Interest Rate Swaps (IRS), Interest Rate Options (IRO), Forward Rate Agreements (FRA), Cross Currency Swaps (CCS), Currency/Commodity Options (CCO) such as gold and other precious/industrial metals options.

2. Authorized Dealers

These directions include both Domestic Banking Units (DBUs) and Foreign Currency Banking Units (FCBUs) of commercial banks. Only the commercial banks authorized to act as authorized dealers under the Exchange Control Act are permitted to engage in DMM transaction specified in section 4(c) of this explanation.

When conducting Derivative Transactions, Authorized Dealers shall comply with all relevant regulations, such as foreign exchange regulations and other regulations issued, from time to time, by the Central Bank of Sri Lanka.

3. Permitted Products

(a) Interest Rate Swap is an agreement between two parties to exchange a stream of interest payments based upon a specified notional principal amount on multiple occasions during a specified term. The cash payments are based on fixed/floating or floating/fixed rates are exchange by the parties from one another. In either case, there is no exchange of principal.

(b) Forward Rate Agreement is an interest rate contract between two parties that allows an entity to position itself in the interest rate market. The parties enter into a contract at a rate for a notional principal amount. On the settlement date, the transactions are net settled against a predetermined benchmark or reference rate.

(c) Cross Currency Swaps: Cross currency swap is an agreement between two parties to exchange interest payments denominated in two different currencies for a specified term. One interest payment is typically calculated using a floating rate index such as USD LIBOR. The other interest payment is based upon a fixed rate or another floating rate index denominated in a different currency. Unlike a single currency swap, a Cross Currency swap sometimes (but not always) involves an exchange of principal. The initial principal exchange occurs at the beginning of the swap with a re-exchange at maturity. The principal amounts are based on initial spot exchange rates.

- (d) **Currency Option** are contract that give the buyer the right but not the obligation to exchange (buy/sell) an amount of currency for another at a specific price on or before a pre specified date. For this right, the buyer pays a premium. The right to buy is known as a Call Option while the right to sell is known as Put Option. If such right can be exercised only on a specific maturity date, the option is said to be a European Option. If such option can be exercised on any date prior to its maturity, the option is called an American Option.
- (e) **Interest Rate Options:** is an option where the underlying is not an asset but an interest rate. An interest rate Call Option is an option that grants the holder the right to make a fixed or known interest payment while an interest rate Put Option is an option that grants the holder the right to make a variable or unknown interest payment and receive a fixed or known interest payment. In an interest rate Cap for example, the seller agrees to compensate the buyer for the amount by which an underlying short-term rate exceeds a specified rate on a series of dates during the life of the contract. In an interest rate Floor, the seller agrees to compensate the buyer for a rate falling bellow the specified rate during the contract period. A Collar is a combination of a long (short) cap and short (long) floor, struck at different rates payment while an interest rate related to the change in an interest rate.
- (f) **Commodity Options** are similar to Currency Options and Gold, Copper and Oil are identified as commodities for possible derivative transactions.

4. Transaction Types

Authorized Dealers engage in derivatives transactions in three main forms:

- (a) Transactions for the purpose of hedging the banks own assets or liabilities for altering its risk profile. These are known as **End User** deals (EUD).
- (b) Transactions executed by authorized dealers with its customers with intention of making a spread. In these transactions the commercial bank does not take any market risk on its own books and covers the transaction on the same day on back-to-back basis. These types of transactions are known as **Non-Market Maker** deals (NMM).
- (c) Transactions those involve derivative trading services to customers and require financial institutions to quote prices to other customers/institutions while taking the market risk on bank's own books. Such transactions are known as **Derivatives Market Maker** deal (DMM).

5. Eligibility and Permissible Activity;

- (a) Only the commercial banks with capital adequacy ratio of more than 11% are permitted to engage in derivative transactions. This Capital Adequacy Ratio is inclusive of derivative positions and the directions of the Director Bank Supervision (DBS) on risk weighted capital should be followed in determining the Capital Adequacy Ratio.
- (b) Authorized Dealers should ensure that each of the transactions covered under these directions is made only in respect of risk or exposures arising from permitted underlying transactions or genuine balance sheet exposures. This is mandatory for customer transactions.
- (c) Under any circumstances, derivative transactions covered under these directions should not be permitted through a bank abroad or a correspondent foreign bank to its customers in Sri Lanka in respect of any foreign currency exposures or risks arising from currency deposit/export earnings kept outside Sri Lanka.
- (d) Authorized Dealers should offer option contracts only in respect of a transaction and such risks arising from genuine balance sheet exposures. This includes forward contracts involving precious metals.
- (e) Authorized Dealers should take steps to hedge their risk exposure with their correspondent overseas banks or any other domestic bank.
- (f) In order to develop and add liquidity to the market, Authorized Dealers are permitted to run open positions with the limits specified by the management of the respective banks and approved by the CBSL.
- (g) At the initial stage the derivatives denominated only in foreign exchange (not involving LKR) will be allowed to be traded.

6. Risk Management

Authorized Dealers should be required to ensure that adequate measures are taken to mitigate credit risk, market risk and operational risk and also its compliance with the provisions of the minimum capital adequacy requirements pertaining to derivative transactions. Appropriate policy limits, approved by the Bank management should be in place. The net cash flow arising from these transactions should be booked as income and expenditure and reconciled as an exchange position wherever applicable. This is not always the case as all open positions should be marked to market and its value should be captured in the P& L and the Balance sheet.

(a) Applicable for Currency Options

- (i) All NMM and DMM transactions need to be covered on back-to-back basis on the same day without allowing them to carry any open exposures as they may result in increased market risks to the bank. However DMM, in order to cover its foreign exchange position, may be allowed to trade in Vanilla Foreign Currency Options.
- (ii) Such foreign currency options need to be included on a net delta weighted basis in the net foreign exchange exposure position reporting and shall be within such limits specified for the bank.
- (iii) DMM must cover all such transactions on a back-to-back basis. The transaction may be undertaken with a bank outside Sri Lanka, an internationally recognized option exchange or with another DMM in Sri Lanka.
- (iv) Option contracts offered/designed as cost effective risk reduction structures or packaged contracts shall not result in any net inflow of premium to the customers or increase in risk in any manner. Customers may unwind or sell back hedge if they consider such hedge is no longer required.
- (v) Option contracts cannot be used to hedge contingent or derived exposures except in case of exposures arising from submission of tender bids in foreign exchange or such risks arising from genuine balance sheet exposures

(b) For All the Derivative Products Covered Under the Directions

- (i) The notional principal amount and the maturity of the hedge shall not exceed the outstanding amount and/or unexpired maturity of the underlying asset/liability.
- (ii) A customer may enter into a hedge with any DMM irrespective of exposure being booked in that DMM or not.
- (iii) DMM can use these products for the purpose of hedging trading books and balance sheet exposures.
- (iv) All payments to be exchanged may be net settled i.e. only the difference between the payable and receivable amount is exchanged, provided such net settlement is allowed in the original agreement between the parties.
- (v) In case on insolvency, if the claim of the counterparty provides for the netting of the mutual transaction between the insolvent and the creditor. The amount payable by one party could be set off against the amount payable by the other party and only the net balance is paid or received.
- (vi) NMM and DMM shall obtain an undertaking from customers that their total value of hedges do not exceed the value of the risk that is being hedged.
- (vii) Banks should put in place necessary systems for marking to market the portfolio on a daily basis. Banks may agree upon a common industrial gathering such as SLFA to publish daily matrix of polled implied volatility estimates, implied zero, forward and swap rates, which market participants can use for marking to market their portfolio.
- (viii) Banks should train their staff adequately and put in place necessary risk management and internal control and processing systems before undertaking any of these derivative transactions.

To : All Licensed Commercial Banks

GUIDELINES TO COMMERCIAL BANKS ON FOREIGN EXCHANGE SWAPS (USD/LKR)

Commercial banks are hereby informed that offering of foreign exchange (USD/LKR) swaps to domestic corporate clients holding Exporters' Foreign Currency (EFC) Accounts is allowed subject to the following conditions:

- (a) Foreign exchange (USD/LKR) swaps being permitted only with exporters of merchandise who maintain their export proceeds in EFC Accounts with a commercial bank operating locally and such swaps being done only against funds lying in the EFC accounts;
- (b) Foreign exchange (USD/LKR) swaps being done by those who qualify to enter into forward contracts under the exchange control regulations. At least one leg of a swap arrangement must be based on a permitted underlying transaction with the amounts involved in that leg of the swap corresponding to the amounts involved in the underlying transaction;
- (c) The period of a foreign exchange swap not exceeding 120 days;
- (d) Both legs of swap transactions being reported to the International Operations Dept. daily in the "Daily Foreign Exchange Position Report" and they being within the exposure limits given to the banks;
- (e) Adequate internal control measures applicable to treasury operations being put in place to prevent operational risk; and
- (f) Banks maintaining adequate capital to meet the Capital Adequacy Ratio by risk weighting these exposures at 100% risk weight.

P Liyanage
Actg. Director, International Operations

ANNOUNCEMENTS

To : All commercial banks

LIMIT ON DAILY WORKING BALANCES IN FOREIGN CURRENCIES

Please be informed that the maximum amount of the working balances in all foreign currencies the commercial banks should have at the end of each working day has been revised with effect from 1 September 2003. This has been communicated to all commercial banks by our letter No.33/04/014/0009/001 dated 28 August 2003.

Y.M.W.B. Weerasekera

Director, International Operations

Operating Instructions No. : 01 / 2002

Ref. No.: 06 / 04 / 15 / 2001

Exchange Control Department

Ref. No.: 33 / 03 / 011 / 0013 / 001

International Operations Department
Central Bank of Sri Lanka
Colombo 1

20th February 2002

Operating Instructions To Commercial Banks

INTRODUCTION OF THE EUROPEAN SINGLE CURRENCY – THE “EURO”

Further to the Operating Instructions issued on 28.11.2001 signed by the Controller of Exchange and the Chief Accountant, we wish to provide you with the following information pertaining to the Euro Currency Cash Conversions.

Euro Legacy Currency Cash Conversion Timeline

- 01 January 2002 – Euro notes and coins acceptable as legal tender throughout the Euro-zone
 - Legacy currency notes and coins can be converted to Euro at Euro-zone banks

- 01 March 2002 – Legacy currency notes and coins will NO LONGER be acceptable as legal tender anywhere in the Euro-zone.

You may also refer to the attachment received from one of our counterparties with regard to the last dates for acceptance of legacy currencies and last dates for exchanging legacy currencies by individual member countries of Euro-zone. Further details can be obtained from the website of the European Central Bank at www.europa.eu.int.

Controller of Exchange

Director, International Operations

Operating Instructions No. 01/02/005/0018/22
Ref. No. 06/04/15/2001

Exchange Control Department

Ref. No. 01/04/001/0013/001

Banking Department

28 November, 2001

Operating Instructions to Commercial Banks

INTRODUCTION OF THE EUROPEAN SINGLE CURRENCY – THE “EURO”

1. Further to our operating instructions No. BD/03/98 and EC/03/98(D) dated 12.11.1998 on the above subject (copy attached).
2. All Licensed Commercial Banks are hereby informed that Euro currency which was introduced on 01.01.1999 would come into circulation as bank notes and coins on 01.01.2002. The Euro area national currency notes and coins that were in use in the Euro zone will be withdrawn from the system during the period 01.01.2002 - 30.06.2002. The period of dual circulation will last until 30.06.2002. Please note that all Euro area national currency notes and coins that were in circulation will be totally withdrawn from the system by 01.07.2002 and will no longer be treated as legal tender.
3. Please also note that on 01.01.2002, the Euro area national currencies will cease to exist as book entries, and all transactions and accounts and future contracts will be automatically converted into Euros from that date.
4. The commercial banks are, therefore, advised to take necessary early action to exchange their stocks of Euro area national currency notes and coins for Euros, and place orders for the requirements of new currency notes and coins through their respective agents. Commercial banks should also advise their customers who hold Euro area national currency notes and coins to make necessary arrangements to exchange the old currency notes and coins for new Euro currency notes and coins before 30.06.2002.
5. Since the Euro area national currencies will cease to exist, even as book entries from 01.01.2002, all such currencies will be withdrawn from the list of designated currencies for different foreign currency deposit schemes with effect from that date. All foreign currency accounts such as Foreign Currency Banking Unit (FCBU) Accounts, Non-Resident Foreign Currency (NRFC) Accounts, Resident Foreign Currency (RFC) Accounts, Resident Non-National Foreign (RNNFC) Currency Accounts, Exporters Foreign Currency (EFC) Accounts and any other special foreign currency accounts permitted to be maintained in such currencies will have to be maintained in Euros or any other designated currency other than Euro area national currencies which will be withdrawn from the list of designated currencies.

Controller of Exchange

Chief Accountant

CONFIDENTIAL

Ref. No. : 01/01/002/0035/001

Banking Department
22 January, 2001

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Dear Sir,

LIMIT ON DAILY WORKING BALANCES IN FOREIGN CURENCIES

You are hereby informed that in terms of the Provisions of Section 77 of the Monetary Law Act, the Monetary Board has determined, with effect from 23 January, 2001, a sum equivalent to US\$ mn. (US Dollars million only) as the maximum amount of the working balances in all foreign currencies your bank should hold at the end of each working day. Any amounts in excess of these limits at the end of each working day could be sold to the Central Bank.

2. Please continue to report to me the daily foreign exchange position of your bank at the end of each day, as set out in Annexure. Accuracy of such reports should be confirmed by a senior officer of your bank authorized for the purpose.

Yours faithfully,

Y.MW.B. Weerasekera
Chief Accountant

Circular No. : 4665

Banking Department
15th November, 2000

To : Treasury Managers of All Licensed Commercial Banks

DAILY INTER-BANK FOREIGN EXCHANGE TRANSACTIONS REPORT

Further to our Circular No. BD/FX/LIBT/90 dated 30.07.1990, please be good enough to report all your inter-bank FOREX transactions carried out until 4.00 p.m. each day to this department immediately after 4.00 p.m. the same day on fax number 346282/346284 with effect from 15.11.2000. Transactions done after 4.00 p.m. must also be reported on the same day as usual.

Your co-operation in providing this information on time is very much appreciated.

Yours faithfully,

Y.M.W.B. Weerasekera
Chief Accountant

Circular No. : 4634

Banking Department
Central Bank of Sri Lanka
P.O. Box 590
Janadhipathi Mawatha
Colombo 01.

7th August, 2000

To : All Licensed Commercial Banks

WEEKLY REPORT ON FOREIGN CURRENCY DEPOSIT LIABILITIES

Licensed Commercial Banks are hereby requested to submit with effect from 11 August, 2000 a weekly report on the total deposit liabilities denominated in foreign currencies converted into US Dollar, as at the close of business on Wednesday is a bank holiday, on the working day last preceding it, each week.

The Banking Department will intimate to all Licensed Commercial Banks on every Wednesday the US Dollar rates that shall be applied for conversion of various foreign currencies into US Dollar for the above purpose.

The above weekly report should reach the Chief Accountant, Banking Department of the Central Bank of Sri Lanka not later than 12.00 noon on Friday or last working day of each week.

The above information is required for the purpose of monitoring the external reserves position of the country and implementation of monetary and exchange rate policies more effectively.

Y.M.W.B. Weerasekera
Chief Accountant

Operating Instructions No. BD/03/98

Ref. No BD/FCBS/1/98

Banking Department

Ref. No. EC/03/98(D)

Exchange Control Department

12 November, 1998.

Operating Instructions to Commercial Banks

INTRODUCTION OF THE EUROPEAN SINGLE CURRENCY – THE “EURO”

1. The European Union decided to introduce a single currency called the “euro” for its member countries with effect from 01.01.1999, on which date the conversion rates of participating countries’ national currencies are expected to be locked irrevocably against the new currency. Eleven European countries, namely, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxemburg, Netherlands, Portugal and Spain have agreed to accept the proposed single currency against their national currencies. During the transition period from 01.01.1999 to 31.12.2001, the Euro will co-exist with the national currencies of the above participating member countries. From 01.01.2002, such national currencies will cease to exist.

2. On the eve of the introduction of the Euro, we would like to draw your attention to the need for commercial banks to examine their business processes in order to ensure they are ready to conduct normal business operations in the new currency from 1st January, 1999. Some important implications that need to be examined include those on deal conversion, redenomination, payment system, price sources and continuity of contracts. In this connection, a copy of the policy statement issued by the International Chamber of Commerce (ICC) is attached herewith. You are requested to closely follow the instructions contained in it as well as other statements issued by the ICC from time to time, with regard to the international practices arising from the introduction of the Euro.

3. In this connection, the Central Bank of Sri Lanka wishes to inform all commercial banks that it has no objection to –

- a) the opening and maintenance of Nostro Accounts in Euro currency by commercial banks operating in Sri Lanka to effect payments or receipts beginning from 01.01.1999; and
- b) the designation of the Euro as a foreign currency for Foreign Currency Banking Units (FCBU), Non-Resident Foreign Currency (NRFC) Accounts, Resident Non-National Foreign Currency (RNNFC) Accounts, Resident Foreign Currency (RFC) Accounts, Exporters Foreign Currency (EFC) Accounts with effect from 01.01.1999 for the purposes mentioned in our Circular Nos. FCBS 1/79 of 02.05.1979, BC/F-922/77 of 01.03.1978, and Operating Instructions Nos. EC/08/88(D) of 05.05.1988, EC/22/90(D) of 30.03.1990, EC/19/80(D) of 14.05.1980, EC/52/91(D) of 01.08.1991 and EC/41/93(D) of 29.03.1993.

4. Commercial banks should take the full responsibility for maintenance, operation of relevant accounts and honouring of such contracts entered into with their customers in euro, or in national currencies of the participating member countries referred to above, and are required to provide details to the Central Bank of Sri Lanka on the current reporting schedules with regard to any operation in euro or national currencies of the participating member countries carried out by them.

Chief Accountant

Controller of Exchange

Policy Statement

THE IMPACT OF THE EUROPEAN ECONOMIC AND MONETARY UNION ON MONETARY OBLIGATIONS RELATED TO TRANSACTIONS INVOLVING ICC RULES

Prepared by the Commission on Banking Technique and Practice

The International Chamber of Commerce (ICC) is the world business organization, based in Paris. The ICC Commissions on Banking Technique & Practice, International Commercial Practice, and Insurance, develop and maintain uniform rules for international trade, including the Uniform Rules for Contract Guarantees (URCG 325), Uniform Rules for Demand Guarantees (URDG 458), Uniform Customs and Practice for Documentary Credits (UCP 500), Uniform Rules for Collections (URC 522), Uniform Rules for Contract Bonds (URCB 524), Uniform Rules for Bank to Bank Reimbursements (URR 525), (hereinafter referred to collectively as “ICC Rules”).

The introduction of the EURO, the European single currency, shall not have the effect of altering, discharging or excusing performance under any instrument subject to ICC Rules. This “Policy Statement” emphasized the need to correctly interpret and apply ICC Rules. Consequently, ICC National Committees and associated organizations are strongly urged to distribute this Policy Statement as widely as possible to help ensure the future smooth running of the instruments issued under ICC Rules. This Policy Statement does not amend any articles of ICC Rules in any way, but merely indicates the correct interpretation thereof.

1. General

- 1.1 As of 1 January 1999, the EURO will be substituted for the national currencies of those European Union member states participating in European Economic and Monetary Union (hereinafter “EMU-Participating States”) which are to be designated in May 1998. During the transitional period running from 1 January 1999 to 31 December 2001, the EURO (1 Euro - 100 Cents) will also be divided into the national currency units of the EMU-Participating States according to conversion rates which are to be irrevocably fixed by the Council of the European Union as of 1 January 1999 (“conversion rates”). The term “national denomination” as used below refers to the currency of any EMU-Participating State before 1 January 1999.

During the transition period persons are free to use either the EURO or the national denomination, but will not (unless otherwise agreed) be obliged to receive or make payment in EURO. However, any amount denominated either in EURO or in a national denomination of a given EMU-Participating State and payable within *that* state by crediting an account of the creditor, may be paid by the debtor either in EURO or in that national denomination with any necessary conversion being affected at the conversion rate.

As of 1 January 1999 the ECU will be replaced by the EURO at the rate of one EURO to one ECU.

- 1.2 As from 1 January 2002 the national denominations will cease to exist and the EURO will be the only legal currency in the EMU-Participating States; all payments must be in EURO.
- 1.3 Continuity of contract will not be affected by the introduction of the EURO.
- 1.4 The above principles affecting national denominations are legally binding in all member states of the European Union, and apply equally to payment to be made in a national denomination

by persons located outside the European Union, due to the generally accepted legal principle that the definition of what constitutes legal tender is governed by the law of the country whose currency is involved (sometimes referred to as the *lex monetae* principle).

2. Consequences of the introduction of the EURO on practice under various ICC Rules:

2.1 UCP 500 for Documentary Credits (including standby letters of credit)

Below are the different possible cases and the relevant rules of interpretation.

- 2.1.1. Documentary Credits issued and payable before 1 January 1999 in a national denomination – Payment must be made and documents denominated in the currency of the credit.
- 2.1.2. Documentary Credits issued before 1 January 1999 and payable before 1 January 2002 in a national denomination – Payment must be made in the currency of the credit, but documents may be presented either in the currency of the credit or in the EURO equivalent; however, where payment is to be made in the currency of an EMU-Participating State and by crediting an account located in such member state, payment may at the debtor's (e.g. issuing bank's) option be effected in the EURO equivalent.
- 2.1.3. Documentary Credits issued in a national denomination before 1 January 1999 and payable on or after 1 January 2002 - Payment must be made in EURO, but documents may be presented either in the currency of the credit or in the EURO equivalent (for documents issued on or after 1 January 1999); Documents issued on or after 1 January 2002 must be denominated in the EURO.
- 2.1.4. Documentary Credits issued and payable on or before 1 January 1999 and before 1 January 2002 in a national denomination or in EURO - Payment must be made in the currency of the credit but documents may be presented in the currency of the credit or in the EURO equivalent or in the equivalent cross value in the national denomination at the beneficiary's place of business; however, where the currency of the credit is a national denomination and payment is to be made in the currency of a particular EMU-Participating State by crediting an account located in such member state, payment may at the debtor's (e.g. issuing bank's) option be effected in EURO.
- 2.1.5. Documentary credits issued on or after 1 January 1999 but before 1 January 2002 in a national denomination or in EURO and payable on or after 1 January 2002 – Payment must be made in EURO, but documents may be presented either in the currency of the credit or, as the case may be, in EURO or in the currency of the beneficiary's place of business, provided always that documents issued on or after 1 January 2002 must be denominated in EURO.
- 2.1.6 For purposes of examples 2,3, 4 and 5 above, documents (including insurance documents) mentioned in UCP Art. 34(f) are not considered

as being inconsistent with one another, if, within a single presentation of documents, any documents are denominated in the currency of the credit and/or in EURO and/or the currency of the place of business of the beneficiary.

2.1.7 Documentary credits issued and payable on or after 1 January 2002- Credits cannot be issued in a national denomination and must be issued in EURO and payment must be made and documents (issued on or after 1 January 2002) denominated in EURO.

2.1.8 The guidelines set forth in this Policy Statement apply equally to transferable credits. Transferable credits issued in a national denomination and to be transferred during the transitional period – The transferring bank may convert the currency and amount of the credit into the Euro equivalent.

2.2 URCG 325/URDG 458/URCB 524 – Guarantees and Bonds

The principles set forth above also apply to guarantees and bonds

2.3 URC 522 Collections

Collections must be made in the currency stipulated in the collections instructions. However, if a collection instruction stipulates a national denomination of an EMU – Participating State, as of 1 January 1999 payment may be made in the EURO equivalent and as of 1 January 2002, payment must be made and accepted in the EURO equivalent.

2.4 URR 525 Bank to Bank Reimbursements

Reimbursement claims must be made and honoured in the currency of the reimbursement authorization or reimbursement undertaking. However, if such currency is the national denomination of an EMU-Participating State, as from 1 January 1999 they may be made and honoured in the EURO equivalent, and as from 1 January 2002 they must be made and honoured in the EURO equivalent.

My No. BD/FX/196
Banking Department
Central Bank of Sri Lanka
P.O.Box 883
Colombo 01

13 January, 1997

Dear Sir/Madam,

FOREIGN CURRENCY LOANS TO NON-BOI EXPORTERS AND INDIRECT EXPORTERS

Further to Circular Nos. ECD/02/97 (C & F) and No. ECD/03/97 (C & F) dated 03.01.1997 issued by the Department of Exchange Control, you are advised that the following guidelines are to be followed in granting foreign currency loans to Non-BOI exporters and indirect exporters by the Domestic Banking Unit (DBU) and the Foreign Currency Banking Unit (FCBU) of your bank.

1. The total of all outstanding credit to Non-BOI exporters and indirect exporters approved by the Controller of Exchange and granted from the FCBU, should not exceed the limit specified by the Central Bank from time to time. In the case of your bank, the maximum limit of such credit outstanding shall be US Dollars million.
2. The total of all outstanding foreign borrowings of the DBU including any borrowings from the FCBUs, should not exceed fifteen per cent (15%) of the capital funds, i.e. paid up capital plus reserves in the case of a commercial bank registered in Sri Lanka, and assigned capital plus reserves in the case of a branch of a commercial bank located in Sri Lanka, but having its head office abroad.
3. Separate accounts should be maintained in respect of foreign currency loans granted to Non-BOI exporters and indirect exporters from either the DBU or FCBU.
4. The following information should be furnished to the undersigned on a weekly basis, in the reporting format attached: such information should be made available not later than two working days following the week in respect of which the information is furnished:
 - i. Total value of foreign currency loans granted during the week
 - ii. Outstanding level of foreign currency loans at the end of the week

iii. Monthly statement giving the amounts of any non-performing advances arising from foreign currency loans so granted

5. Circular No. 4157 dated 27.12.1995 is hereby withdrawn

Yours faithfully,

M.B. Dissanayake
Chief Accountant

To : All Commercial Banks

Banking Department
Central Bank of Sri Lanka
PO Box 590
Colombo 01

27 December, 1995

Circular No. 4157

COMMERCIAL BANKS BORROWING FROM ABROAD

Commercial Banks are hereby permitted to borrow abroad from sources acceptable to the Central Bank of Sri Lanka up to a maximum of five per cent (5%) of their capital funds, i.e. paid up capital plus reserves, provided that the all inclusive cost of such borrowings will not exceed six months LIBOR plus 2 per cent per annum. The total of such loans outstanding and the overdrawn balances, if any, of their Nostro Accounts at any time should not exceed the five per cent of their total capital funds referred to above. The maturity period of these borrowings should not be more than six months.

2. The above borrowing is subject to prior approval of the Chief Accountant who will determine the limits of borrowing and the terms of the borrowing. The commercial banks shall follow the procedure given below in this regard –

- (i) Commercial banks shall submit an application to the Chief Accountant indicating the following information with regard to the proposed borrowing: –
 - a) Name and address of the lender
 - b) Amount of loan and the currency
 - c) Terms of borrowing, including interest rate and all other fees, repayment period, collateral and any other conditions.
 - d) Capital funds of the borrowing bank as at the last day of the previous month, i.e. paid up capital plus reserves in the case of a commercial bank registered in Sri Lanka and assigned capital and reserves in the case of a branch of a commercial bank located in Sri Lanka but registered abroad.
- (ii) After the borrowing has been permitted, the commercial banks shall submit the following information with regard to the borrowing to the Chief Accountant on a daily basis :–

- a) Capital funds as on the reporting date
- b) Amount of loan/loans borrowed during the month
- c) Overdrawn balances in the Nostro Account
- d) Amount outstanding of the loans permitted as on the reporting date
- e) Terms of repayment and interest rate applicable for the respective borrowings
- f) Due date/s of repayment/s

3. The Central Bank of Sri Lanka reserves the right (a) to reject any application for borrowing without giving any reason therefor, and (b) to amend, revise, delete or withdraw any part or part thereof this circular at any time without prior notice.

M.B.Dissanayake
Chief Accountant

A.S.Jayawardena
Governor

Ref : FCBS/11/93/BOF1049/79

Banking Department
Central Bank of Sri Lanka
P.O. Box 590
Colombo 01

November 24, 1993

Operating Instructions No. BD/15/93

To : All Commercial Banks

FOREIGN CURRENCY BANKING SCHEME – DESIGNATION OF CURRENCIES

Please refer to our Operating Instructions No. BC/29/79 dated September 28, 1979, No. BD/40/79 dated January 10, 1980, No. BD/23/84 dated November 13, 1984 and BD/01/89 dated January 31, 1989.

In terms of Section 14 of Circular No. 380 (FCBS/1/79) dated May 2, 1979, the following currency is hereby approved as designated currency for the purpose of Section 4 of the circular:

Norwegian Kroner

Chief Accountant

BD/FX/LIBT/90 30th July 1990

Dear Sir/Madam,

INFORMATION ON LOCAL INTER-BANK FOREIGN EXCHANGE SPOT TRANSACTION

I refer to letter No. ER/IF/KF/4 dated May 17,1990 addressed to you by the Director of Economic Research of the Bank on the above subject.

In view of the useful information that have been obtained from the returns made available by commercial banks in response to our request, the Central Bank has decided that information be obtained from commercial banks on a continuous basis to cover Cash, TOM and Spot Foreign Exchange transactions in the local inter-bank foreign exchange market against Sri Lanka Rupees. Accordingly, the format of the daily report which was furnished to the Central Bank from commercial banks from May 21, to June 21, 1990 have been amended to include Cash and TOM transactions, in addition. (Please see annexed form).

It would be necessary for the daily report in the amended form be completed and furnished to the office of the Chief Accountant of the Central Bank by 5.00 p.m. on the day of transaction in order to facilitate the processing of the information as early as possible. Such information could, therefore, be forwarded on the Telefax machine (No 540353) or by delivering to the Banking Department, so that any delays could be avoided.

It is proposed that the reporting on the annexed form commence on August 01, 1990.

If you have any queries or clarification regarding the information requested, please contact Mr. R. G. Jayarathne, Deputy Chief Accountant (Telephone: 422654) or Mrs. P. Liyanage, Chief Dealear (Telephone: 26952) of the Banking Department.

I seek your fullest co-operation in obtaining this information on a regular basis in the future to enable the Central Bank to make effective use of such information.

Yours faithfully,

N.A.Dharmabandu
Chief Accountant

Ref No. 10/89 – BC/F 1049/79

Operating Instructions No. BD/01/89

To : All Commercial Banks

FOREIGN CURRENCY BANKING SCHEME - DESIGNATION OF CURRENCIES

Further to our Operating Instructions No. BC/29/79 dated 28 September, 1979, No. BD/40/79 dated 10 January, 1980, No. BD/23/84 dated 13 November, 1984.

In terms of Section 14 of Circular No. 380 (FCBS/1/79) dated 02 May, 1979, the following currencies are also approved as designated currencies for the purpose of Section 4 of the above circular.

Danish Kroner

Canadian Dollar

Chief Accountant

N.A.Dharmabandu

Circular No. FCBS 1/79

FOREIGN CURRENCY BANKING SCHEME

1. Commercial Banks operating in Sri Lanka may participate in the Foreign Currency Banking Scheme (FCBS) set out in this circular.
2. Operations under the FCBS, shall be conducted only by a Foreign Currency Banking Unit (FCBU) of a commercial bank established for the purpose, and authorized by the Central Bank of Ceylon.
3. A commercial bank which wishes to operate under the FCBS, should apply to the Central Bank of Ceylon for authority to do so:
 - a) stating the names of the persons of executive status who will be employed in the FCBU, their educational qualifications and their banking experience and furnishing such other particulars as the Central Bank of Ceylon may wish to obtain;
 - b) forwarding, in the case of a commercial bank established outside Sri Lanka, an undertaking from its head office that specified currencies will be made available on demand to make up for any liquidity or other shortfall such as may occur in the FCBU.
4. An FCBU may –
 - a) accept time and demand deposits (but may not open savings accounts or accounts from which funds are withdrawable by cheque) from any non-resident in any designated foreign currency provided that in the case of time deposits, such deposits are not less than Ten Thousand United States Dollars (US\$ 10,000) or its equivalent;
 - b) borrow any designated foreign currency from any non-resident in any amount;
 - c) extend loans and advances to any non-resident in any designated foreign currency in any amount;
 - d) engage in any transaction in any designated foreign currency with any other FCBU;
 - e) engage in any other transaction such as may be approved by the Central Bank of Ceylon in any designated foreign currency.
5. (a) An FCBU may accept time and call deposits from any resident which is a commercial bank in any designated foreign currency, and may grant loans and advances to such resident in any designated foreign currency. Such deposits, loan and advances shall be

not less than such minimum amount or not be in excess of such maximum amount as may be determined by the Central Bank of Ceylon.

- (b) In respect of such transactions, FCBU should satisfy itself that a commercial bank including a commercial bank of which the FCBU is a part, is permitted under current regulations or procedures, to make such deposits or obtain such loans and advances.

6. An FCBU may:

- a) accept time and demand deposits (but may not open savings accounts or accounts from which funds are withdrawable by cheque) in any designated foreign currency from any resident who is a GCEC enterprise, provided that in the case of deposits made from the foreign currency receipts resulting from the export from Sri Lanka of goods and services, such enterprise is not prevented by any rule or regulation, or by any agreement entered into with the Greater Colombo Economic Commission (GCEC) from utilizing such export receipts for making such deposits.

For the purpose of (a) above, an FCBU should obtain from such resident a declaration specifying the nature of the export of the goods and services in question, the amount of export receipts and other particulars relating to such export including references to export documents including bills;

- b) grant loans and advances to a resident who is a GCEC enterprise in any designated foreign currency, in any amount, for the purpose only of the operations of such enterprise in Sri Lanka and for no other purpose whatsoever.

7. (a) An FCBU may accept time and demand deposits in any designated foreign currency (but may not open savings accounts or accounts from which funds are withdrawable by cheque) from, and may grant loans and advances in any designated foreign currency to, any other resident approved by the Central Bank of Ceylon, for such purposes as may be approved by the Central Bank of Ceylon;

- (b) Loans and advances granted under (a) above shall be not less than such minimum amount or shall not be in excess of such maximum amount, as may be determined by the Central Bank of Ceylon.

8. The total assets liabilities of an FCBU shall not exceed such limits as may be determined by the Central Bank of Ceylon from time to time.

9. An FCBU shall maintain books and records in respect of transactions carried on in terms of this circular separate from the books and records of other transactions carried on by the commercial banks of which the FCBU is a unit or department.

10. A commercial bank operating under the FCBS shall, if so required, furnish to the CBSL such statements or returns as may be deemed necessary in respect of any transaction carried on by such commercial bank in terms of this circular.

11. The Central Bank of Ceylon may, at its discretion, require any commercial bank operating under the FCBS to withdraw from the FCBS or restrict the transactions carried on by such bank in terms of this circular.
12.
 - (a) **“Commercial Bank”** has the same meaning as that contained in Section 127 of the Monetary Law Act.
 - (b) **“Foreign Currency Banking Unit” (FCBU)** means a unit or department of a commercial bank established for the purpose of this circular in the place of business or branch of such bank in the city of Colombo or in a location approved by the Central Bank of Ceylon.
 - (c) **“Foreign Currency”** means any currency other than the Sri Lanka rupee.
 - (d) **“Designated Foreign Currency”** means such foreign currency as may be approved by the Central Bank of Ceylon from time to time.
 - (e) **“GCEC enterprise”** means any enterprise with which the Greater Colombo Economic Commission, established by the Greater Colombo Economic Commission Law No. 4 of 1978, has entered into an agreement in terms of Section 17 of that law.
 - (f) **“Non-resident”** means any individual, company, body corporate or other juridical person or any unincorporated body not included in the definition of “resident” below.
 - (g) **“Resident”** means
 - (i) a citizen of Sri Lanka residing in Sri Lanka;
 - (ii) an individual who is not a citizen of Sri Lanka but who has resided in Sri Lanka for at least six months and continues or intends to so reside;
 - (iii) a company incorporated in Sri Lanka or a body corporate established under any written law or any unincorporated body;
 - (iv) a branch, subsidiary, affiliate, extension, office or any other unit of a company or other juridical person incorporated or established in, or under the laws of any foreign country operating in Sri Lanka.
13. The Central Bank of Ceylon may from time to time, modify, vary or revise the provisions set out in this circular.

14. The authority acting on behalf of the Central Bank of CEylon in the paragraphs listed below will be as follows:-

Paragraph	3	-	The Director of Bank Supervision
”	4 (e)	-	The Controller of Exchange
”	5 (a)	-	The Chief Accountant
”	7 (a)	-	The Controller of Exchange
”	7 (b)	-	The Chief Accountant
”	8	-	The Director of Bank Supervision
”	10	-	The Director of Bank Supervision and the Director of Economic Research
”	11	-	The Director of Bank Supervision
”	12 (b)	-	The Director of Bank Supervision
”	12 (d)	-	The Chief Accountant
”	13	-	The Controller of Exchange

Chief Accountant

Controller of Exchange

To : All Commercial Banks

Banking Department
Central Bank of Ceylon
PO Box 590
Colombo

March 01, 1978

Ref . No. BC/F922/77

Operating Instructions No. BC 6/78

NON-RESIDENT FOREIGN CURRENCY ACCOUNTS FOR SRI LANKA NATIONALS

The attention of all commercial banks is invited to letter No. D/255 dated January 5, 1978 issued by the Controller of Exchange authorizing the maintenance of Non-Resident Foreign Currency Accounts (hereinafter called "NRFC Accounts") for Sri Lanka Nationals.

2. Subject to paragraph 5 below, transactions involving NRFC Accounts should not be reported to the Central Bank on the Daily Return forms DR1 and DR2 or on the Non-Resident Return forms NR1 and NR2. The balance of NRFC Accounts may be held in commercial banks working balances abroad within the prescribed limits.

3. Banks may sell to the Central Bank foreign currency notes accepted for deposit of proceeds to NRFC Accounts. The Central Bank will buy such notes at its buying rates for such currency notes prevailing on the date of purchase. The rupee proceeds of such sales to the Central Bank should be converted into US Dollars or Pound Sterling at the Central Bank's spot rates prevailing on the same day (if necessary, by actual purchase from the Central Bank) for the purpose of crediting the NRFC Accounts. This may result in a credit to an NRFC Account being less than the face value of the currency notes received from the account holder. The shortfall should not be made good by the acceptance of Sri Lanka Rupees in an amount equivalent to the balance required to bring the foreign currency deposit to the face value of the foreign currency notes received. In this connection, please see the Controller's letter, which stipulates that, apart from interest payable on funds deposited, credit to NRFC Accounts should be confined to the proceeds of inward remittances in foreign currency and the proceeds of foreign exchange brought into the country and declared on Customs "D" forms.

4. On the last working day of June and December each year, commercial banks may, if they wish buy from the Central Bank at its spot rates for that day such amounts of foreign currency as they require for the purpose of crediting interest to NRFC Accounts held by them. When, in order to close an NRFC Account, it is required to credit interest to that account on any day of the year other than the last working day of June or December, a commercial bank may, if it wishes purchase the necessary foreign currency from the Central Bank at the Central Bank's spot rate prevailing on that day.

5. The purchases (from account holders) of foreign currency notes accepted for deposits to NRFC Accounts and the sales (to the Central Bank) of such notes, referred to in paragraph 3 above, should be reported to the Central Bank in the manner in which purchases and sales of foreign currency notes are now reported.

6. As at the end of each month, every commercial bank should send a statement to the Chief Accountant, Central Bank of Ceylon, Colombo, showing, in the following form, aggregate figures relating to the NRFC Accounts held by it.

To : The Chief Accountant
Central Bank of Ceylon

NON-RESIDENT FOREIGN CURRENCY ACCOUNTS (MONTH)

Return for end 19... (Operating Instructions No. BC/6/78)

CURRENCY (1)	NO. OF ACCOUNTS (2)	TOTAL OF BALANCES IN FOREIGN CURRENCY AFTER APPLICATION OF INTEREST, IF ANY (3)	RATES OF INTEREST PAYABLE IF ANY (4)	TOTAL AMOUNT INTEREST CREDITED DURING THE MONTH (5)
US Dollar				
Pound Sterling				

H.Premaratne
Chief Accountant

Copy to: Controller of Exchange

28 November 2006

To : All Authorized Dealers

DIRECTIONS TO COMMERCIAL BANKS ON LKR BASED FX OPTIONS

All Commercial banks appointed to act as Authorised Foreign Exchange Dealers are hereby informed that offering of Rupee (LKR) based cross currency options to domestic corporate clients is allowed subject to the following conditions:

1. The LKR based FX Option can be used only in respect of transactions of current nature permitted in terms of current exchange control regulations¹.
2. Only the Authorised Dealers engaged in Derivative Market Maker deals are allowed maintaining open exposures and such exposures shall be subject to the exposure position limits specified by the Central Bank of Sri Lanka (CBSL). Authorized Dealers who are qualified under 4.1 of these directions and those who wish to engage in LKR based FX Options shall obtain the consent of the International Operations Department of the CBSL by informing in writing their interest to engage in such transactions together with an undertaking by the management on the adequacy of internal risk management system in place to engage in FX options. These transactions will be subject to the supervision and scrutiny of the CBSL.
3. **Transaction Types**
Authorized Dealers engage in Option transactions in following main forms:
 - (a) Transactions executed by authorized dealers with its customers with intention of making a spread. In these transactions the commercial bank does not take any market risk on its own books and covers the transaction on the same day on back-to-back basis. These types of transactions are known as **Non-Market Maker** deals (NMM).
 - (b) Transactions those involve derivative trading services to customers and require financial institutions to quote prices to other customers/institutions while taking the market risk on bank's own books. Such transactions are known as **Derivatives Market Maker** deal (DMM).
4. **Eligibility and Permissible Activity**
 - 4.1. Only the commercial banks with capital adequacy ratio of more than 11% are permitted to engage in LKR based FX Options. This Capital Adequacy Ratio is inclusive of LKR based FX Option positions. The directions of the Director Bank Supervision (DBS) on risk weighted capital should be followed in determining the Capital Adequacy Ratio.
 - 4.2. Authorized Dealers should ensure that each LKR based FX Option is made only in respect of risk or exposures arising from permitted underlying current transactions which normally qualifies for forward foreign exchange contract such as payment and receipt in foreign exchange in respect of goods and services on trade.
 - 4.3 Under any circumstances, LKR based FX Option should not be permitted through a bank abroad or a correspondent foreign bank to its customers in Sri Lanka in respect of any

¹ Regulations/directions issued by the Exchange Control Department under the Exchange Control Act No.24 of 1953

foreign currency exposures or risks arising from currency deposit/export earnings kept outside Sri Lanka.

- 4.4. The notional principal amount of the LKR based FX Option shall not exceed the outstanding amount of the foreign currency obligations.
- 4.5. Authorized Dealers shall offer option contracts only in respect of a transaction, which normally qualifies for forward foreign exchange contract.
- 4.6. The transaction shall be based on individual transactions and not on pooling several into one currency option.
- 4.7. The parties involved are free to use any publicly available benchmark rate on mutual agreement.

5. Eligible Foreign Currencies

Transactions relating to the LKR based FX Options are limited to the following currencies. – USD, GBP, EUR, JPY, CAD, AUD and CHF.

6. Risk Management

- 6.1 The Authorized Dealers shall be required to ensure that adequate measures are taken to mitigate credit risk, market risk and operational risk and also its compliance with the provisions of the minimum capital adequacy requirement permitting to LKR based FX Options. Appropriate policy limits approved by the management of the bank should be in place. All positions arising from these transactions shall be marked to market daily and the relevant values shall be captured in the Profit & Loss Account and the Balance Sheet.
- 6.2 All Transactions need to be covered on back-to-back basis on the same day without allowing them to carry any open exposures as they may result in increased market risks to the bank. However in order to cover its foreign exchange position, Authorised Dealers are allowed to trade in Vanilla Foreign Currency Options.
- 6.3 Such foreign currency options need to be included on a net delta weighted basis in the net foreign exchange exposure position reporting and shall be within such limits specified for the bank.
- 6.4 Customers may unwind or sell back hedge if they consider such hedge is no longer required. However the Option contracts offered/designed as cost effective risk reduction structures or packaged contracts shall not result in any net inflow of premium to the customers or increase in risk in any manner.
- 6.5 Option contracts cannot be used to hedge contingent or derived exposures.
- 6.6 A customer may enter into a hedge with any DMM irrespective of the exposure being booked in that DMM or not.
- 6.7 DMM shall obtain an undertaking from customers that their total value of hedges do not exceed the value of the risk that is being hedged.
- 6.8 Banks should put in place necessary systems for marking to market the portfolio on a daily basis.
- 6.9 Banks should train their staff adequately and put in place necessary risk management and internal control and processing systems before undertaking any of these transactions.

7. Tenure

The maturity period of LKR based FX option shall not exceed ten (10) years or the remaining life of the underlying transactions, whichever is less.

8. Reporting

- 8.1. Authorized Dealers are required to report to the International Operations Department of the CBSL on a monthly basis the transactions undertaken within the month indicating the amounts, rates, maturities, currency, details of counterparty and details of underlying transactions/exposure etc.
- 8.2. Bank must make adequate disclosures in their Audited Annual Accounts with regard to such transactions that they have undertaken during the financial year under review at least to the extent required in the Sri Lanka Accounting Standards (SLAS) or International Financial Reporting Standards (IFRS).

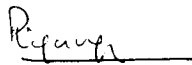
9. Documentation

The bank shall ensure the use of the International Swap Dealers Association (ISDA) agreement with the counterparty for the interest of both parties in all possible instances.

10. Miscellaneous Requirements

- 10.1. Authorized Dealers shall obtain an undertaking from customers interested in using the LKR based FX Option that they have clearly understood the nature of the product and its inherent risks.
- 10.2. Authorized Dealers shall provide adequate information on the transaction especially with regard to the conditions and clauses to be incorporated into the product-determined benchmark interest rate, strike price, premia and risks involved to their customers and ensure highest level of transparency.

These directions will be effective from 1st December 2006.



Mrs. P Liyanage
Director of International Operations



D. Wasantha
Controller of Exchange