CORPORATE GOVERNANCE AND RISK MANAGEMENT REPORT

LB FINANCE

CONTENTS

CORPORATE GOVERNANCE

INTEGRATED RISK MANAGEMENT REPORT

NAVIGATING THE FUTURE

At L B Finance even amid a challenging business terrain, we kept moving steadily towards making our goals a reality. As this report demonstrates our commendable performance amid a year of change and uncertainty, the L B Finance team continued to develop and share long-term value through strategically improved initiatives – all focused on strengthening our capital positions, enhancing our business model, and expanding our potential in the years ahead.

Today, we believe that our unmatched experience, expertise and understanding of our business will enable us to keep delighting thousands of stakeholders across the island through any eventuality. And now as we approach our 50th year of successful operations in 2021– we are leveraging our potential and resources to successfully navigate the next 50 years, with hopes of dominating the future of the financial services sector in Sri Lanka.

LB FINANCE
SINHAWALOKANAYA
Envisioning a century, availed by fifty years of excellence...

After reaching the summit of a mountain, a lion often looks back and ponders on the journey that led him to this point. It is a moment of enlightenment - one that gives him a deep awareness that it is indeed the past that drives him to aspire for an even more ambitous future.

Just like the mighty lion, LB Finance, having dedicated the past 50 years in service to the people of Sri Lanka, is now ready to embrace an even brighter vision. Our legacy spanning the past half century has enlightened us and given us the assurance to envision an even more vibrant future for all Sri Lankans for the next one hundred years and beyond.

COMPLIANCE WITH FINANCE COMPANIES DIRECTION

Compliance with the Finance Companies (Corporate Governance) Direction No. 3 of 2008 and amendments thereto as specified in Finance Companies (Corporate Governance-Amendment) Direction No. 4 of 2008,No. 6 of 2013 and No 05 of 2020 issued by Central Bank of Sri Lanka.

Rule No.	Principle and compliance	Complied
2	**RESPONSIBILITIES OF THE BOARD OF DIRECTORS**	
1)	**Strengthening the Safety and Soundness of the Company**	
a)	**Approving and overseeing strategic objectives and corporate values** The Board provided leadership, set strategic aims and ensures that the necessary financial and human resources are in place for the Company to meet its objectives; Board-approved strategic objectives and corporate values have been derived from the Company's Vision and Mission and it has been communicated throughout the Company. The Board ensures that obligations to shareholders and others are understood and met. The Company has established a Strategic Plan - 2020/21 to 2022/23 and approved by the Board. This has been communicated to all the Directors, DGMs, AGMs, Senior Managers and other managers relevant to different operations of the company.	✓
b)	**Approving overall business strategy including risk policy and management procedures** The Board approved the 'Strategic Plan' of the Company and established a framework of prudent and effective controls which enables risk to be assessed and managed; the Board reviews Company management performance at monthly Board meetings. The Risk Management Policy is with measurable goals, includes a well-developed risk appetite well-defined responsibility for risk management in particular and control functions in general and was reviewed and recommended by the Integrated Risk Management Committee (IRMC) and approved by the Board.	✓
c)	**Risk management** The Board is responsible for overseeing a strong risk governance framework. The Board takes an active role in defining the risk appetite and ensuring its alignment with the Company's strategic, capital and financial plans and compensation practices. Integrated Risk Management Committee identifies risks related to credit, market, liquidity and operations and ensures that appropriate actions are taken to manage risks. The Committee submits a Risk Assessment Report to the Board within seven days of each meeting. The Risk Management Report on pages 32 to 56 provides further insight in this regard.	✓
d)	**Communication with stakeholders** The Board-approved Communication Policy is available and ensures the effective internal and external communication of corporate information with all stakeholders including depositors, creditors, shareholders, borrowers and employees of the Company. The Company discloses information on a timely basis. In disclosing information, Company ensures the descriptiveness, detailed and forthcoming as possible, and avoids boilerplate disclosures.	✓
e)	**Reviewing Internal Control Systems and Management Information Systems (MIS)** The Board-ensures that the Management maintains a sound system of internal controls to safeguard shareholders' investments and the Company's assets. Internal controls are designed, among other things, to ensure that, each key operation has a policy, process or other measures, as well as a control to ensure that such policy, process or other measure is being applied and works as intended. A Board-approved Information System Security Policy is in place. Internal Auditors reviewed the integrity of the Management Information System and Internal Control. System and observations were monitored by the Board, which confirmed that the Internal Control System and the Management Information System provide a reasonable assurance over financial reporting.	✓

Rule No.	Principle and compliance	Complied
f)	**Key Management Personnel (KMP)** The Board-identified Key Management Personnel according to the Sri Lanka Accounting Standards and as per the Direction issued by the Central Bank of Sri Lanka on Corporate Governance and the latter includes the Board of Directors, DGM- Strategy & Risk, CFO, CRO, AGM- Treasury, AGM- Legal, AGM- Finance, Senior Manager- Treasury, Head of Gold Loan, Compliance Officer, Senior Manager Finance as Key Management Personnel (KMP). The Directors have been identified as KMPs as per the Accounting Standards.	✓
g)	**Authority and responsibility for the Board and Key Management Personnel** The Board sets out clearly the role, responsibilities, accountability and reporting relationships of Board and Key Management Personnel, and has these properly documented. The delegation of authority from the Board to the Key Management Personnel is formal and clear.	✓
h)	**Oversight of affairs of the Company by KMP** Oversight of the affairs of the Company by its Key Managerial Personnel takes place at the regular Board meetings and Subcommittee meetings and Key Management Personnel make regular presentations to the Board on matters under their Purview.	✓
i)	**Assess effectiveness of governance practices** **Selection, nomination, and election of Directors and appointment of KMP.** **Management of conflicts of interests.** **Determination of weaknesses and implementation of changes where necessary.** The Board has delegated the functions of selection and nomination of Directors to the Nomination Committee (NC). Directors' interests are disclosed to the Board at the start of every meeting. If a Director has an interest in a particular matter, he/she abstains from voting at such meeting and he/she is not counted in the quorum. The Board and the Board sub committees have a formal self- evaluation process annually in order to identify and rectify the weaknesses. A summary of these evaluation forms is submitted to the Board by the Company Secretaries for further recommendations.	✓
j)	**Succession Plan for KMPs** The Company has a Board approved one-to-one succession plan in place for the Key Management Personnel.	✓
k)	**Regular meetings with KMPs** The Key Managerial Persons regularly make presentations and participate in discussions on their areas of responsibility at the Board and its sub-committee meetings and progress towards corporate objectives is a regular agenda item for the Board where Key Management Personnel are involved regularly.	✓
l)	**Understanding the regulatory environment** The Board of Directors closely monitors regulatory compliances at monthly Board meetings by means of a regular monthly Board paper and presentations on compliance. Further, the Compliance Officer presents changes to the regulatory environment from time to time and any other necessary information to the Board. All Board members attend the Directors' and CEOs' forums arranged by the CBSL and the Management personnel of the Company maintain dialogues on an ongoing basis.	✓
m)	**Hiring and oversight of External Auditors** The Board Audit Committee is responsible for hiring and oversight of the External Auditors and on the recommendation of the Board. External Auditors are appointed by the shareholders of the Company at the AGM. External Auditors annually submit a statement confirming their independence as required by the regulatory authorities in connection with the external audit.	✓

Rule No.	Principle and compliance	Complied
2)	**Appointment of the Chairman and CEO and defining and approving their functions and responsibilities** The Board has appointed the Chairperson and the Chief Executive Officer (CEO) and there is a clear division of the documented functions and responsibilities of the Chairperson, CEO and Board to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making.	✓
3)	**Obtaining independent professional advice by the Directors** The Directors are able to obtain independent professional advice as and when necessary at Company expense and the Board approved procedure is in place. However, no such instances have occurred during the year.	✓
4)	**Managing conflict of interest** Article 97 of Articles of Association on 'Restrictions on Voting' evidences the procedure for a Director to abstain from voting on any Board resolution when there is conflict of interest and he/ she is not to be counted in the quorum. The Company Secretaries obtained disclosure of interest from Directors at every Board meeting and conflict of interest (if any) is managed based on this statement. Directors abstain from voting in such a situation and they are not counted in the quorum.	✓
5)	**Availability of formal schedule of matters specifically reserved for the Board** The Board has adopted a policy for a formal schedule of matters specifically reserved for the Board. Present agenda of meeting ensures that the direction and the control of the Company is under the Board's control and authority.	✓
6)	**Disclosure of probable solvency issues** The Board is aware of the need to inform the Director of the Department of Supervision of Non-Bank Financial Institutions and no such situation arose during the year and we do not visualise such situations in the foreseeable future.	✓
7)	**Publish Corporate Governance Report on compliance with the Direction in the Annual Report** The Annual Corporate Governance Report has been published by the Company in the Annual Report 2020/21 on page 208.	✓
8)	**Self-assessment of Directors** The Company has adopted a self assessment process to be undertaken by each Director annually.	✓

Rule No.	Principle and compliance	Complied
3	**MEETINGS OF THE BOARD**	
1)	**Regular Board meetings** The Board meets regularly approximately at monthly intervals and special Board meetings are convened whenever necessary. The Board met on 12 occasions during the year 2020/21. The consent of the Board is usually obtained at meetings with due notice given with Board papers. Consent obtained by circulation has been kept at minimal.	✓
2)	**Directors to include matters and proposals in the agenda** All the members were given equal opportunities to include matters and proposals in the agenda and the procedures are in place for this. Monthly meetings are scheduled and informed to the Board at the beginning of each calendar year to enable submission of proposals to the agenda.	✓
3)	**Notice of Board meetings** Board meeting dates were agreed to by Board members in advance for the calendar year. Agenda and all Board papers are uploaded through a secure link to iPad for Directors to access seven days prior to the Board meetings.	✓
4)	**Attendance of Directors at Board meetings** All Directors have attended at least two-thirds of the meetings held during the year and no Director has been absent from three consecutive regular Board meetings during the year 2020/21. Directors' Attendance at Board and Subcommittee meetings, refer page 215 for details of individual Directors' attendance at Board meetings.	✓
5)	**Appointment of a Company Secretary** P W Corporate Secretarial (Pvt) Ltd., a company registered with the Registrar of Companies as a qualified secretary, handles the secretarial services to the Board and shareholder meetings and carries out other functions specified in related laws and regulations.	✓
6)	**Delegating responsibility to the Company Secretary** Preparation of the agenda is delegated to the Company Secretary and is approved by the Chairperson	✓
7)	**Access to service and advice of Company Secretary** A Board-approved procedure is in place to enable all Directors to access the Company Secretary with a view to ensuring that Board procedures and all applicable laws, directions, rules and regulations are followed. Directors have separate and independent access to the Company Secretary	✓
8)	**Maintenance of minutes of Board meeting** The Company Secretary maintains meeting minutes and circulates them to all Board members which shall be open for inspection at any reasonable time to any Director. Additionally, the Directors have access to past Board papers and minutes through a secure electronic link.	✓
9)	**Recording minutes of Board meetings in sufficient detail** The Company Secretary maintains detailed minutes of Board meetings to satisfy all requirements of this direction. Minutes are approved by the Chairperson and the other members of the Board after making required amendments, if necessary.	✓

Rule No.	Principle and compliance	Complied
4	**COMPOSITION OF THE BOARD**	
1)	**Number of Directors on the Board** The Company's Board comprised of 10 Directors during the year 2020/21 which is within the statutory limit required by the direction. The objective of the Company is to maintain a healthy balance between Executive, Non-Executive and Independent Directors.	✓
2)	**Period of service of a Director** The total period of service of all Non-Executive Directors does not exceed nine years.	✓
3)	**Appointment, election or nomination of an employee as a Director** Board balance was maintained throughout the year.	✓
4)	**Board balance and criteria for independence** There is a strong and independent element on the Board, with Independent Directors making up more than one-fourth of the Board. The Board comprised of 3 Independent Non-Executive Directors as per the definition of this Direction which complies with at least 1/4th of the Board. The Board evaluates independence of the Directors annually based on the Directors' self-declarations.	✓
5)	**Alternate Director** There were no Alternate Directors appointed during the year 2020/21.	✓
6)	**Skills and experience of Non-Executive Directors** Appointments are recommended by the Nomination Committee. The Directors including Non-Executive Directors are eminent persons with knowledge, expertise and experience to bring an independent judgment and their detailed profiles are on pages 40 to 43.	✓
7)	**Quorum at Board meetings** All Board meetings held during the financial year were duly constituted with one-half of the number of Directors present and one half of the number of Directors constituting the quorum being Non-Executive Directors.	✓
8)	**Disclosure of Independent Non-Executive Directors, Board composition in corporate governance communications and in the Annual Report** The Independent Non-Executive Directors are expressly identified in all corporate communication that discloses the names of all Directors of the Company. Composition of the Board of Directors including the category of Directors has been disclosed on pages 40 to 43 In addition to the disclosures on profiles of Directors on pages 40 to 43.	✓
9)	**Formal and transparent procedure for appointment of new Directors** The new appointments to the Board are based on the recommendations made by the Nomination Committee and there is a procedure in place for the succession of appointments to the Board. After this procedure the names are referred to the CBSL for approval prior to appointment.	✓
10)	**Re-election of Directors appointed to fill a casual vacancy** All Directors appointed to the Board are subject to re-election by the shareholders at the first Annual General Meeting after their appointment and there were no casual vacancies during the year.	✓
11)	**Disclosure of resignations/removal of Directors** Resignation of Directors and their reasons are duly communicated to the Director of the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka and other regulatory authorities. Appointment, removal or resignations of Directors are informed to shareholders, with immediate notification to the Colombo Stock Exchange (CSE). However, there were no such resignation or removal during the year.	✓

Rule No.	Principle and compliance	Complied
5	**CRITERIA TO ASSESS THE FITNESS AND PROPRIETY OF DIRECTORS**	
1)	**Age of Directors should not exceed 70 years (except Managing Director as per Amendment to CG Direction No 05 of 2020)** Age of all Directors' are in line with the given criteria as per the Direction and Amendment to the Corporate Governance Direction No 05 of 2020.	✓
2)	**Holding office as a Director of more than 20 companies** The total number of positions held as a Director or any other position in companies/entities/institutions inclusive of subsidiaries or associate companies of the Company is less than 20.	✓
6	**DELEGATION OF FUNCTIONS**	
1)	**Delegation of Board functions** As per the Articles of Association the Board may delegate any of their powers to the Board-appointed committees, Managing Director, Executive Directors and Key Management Personnel upon such terms and conditions. All delegations are made in a manner that it would not hinder the Board's ability to discharge its functions.	✓
2)	**Review delegation of Board functions on a periodic basis** Delegation arrangements are reviewed periodically to ensure that they remain relevant to the needs of the Company.	✓
7	**CHAIRMAN AND THE CHIEF EXECUTIVE OFFICER**	
1)	**Separation of roles of Chairman and CEO** There exists a clear separation of duties between the roles of the Chairperson and the CEO/Managing Director.	✓
2)	**Designation of an Independent Non-Executive Director as the Senior Director when the Chairman is not an Independent Non-Executive Director** Chairperson is a Independent Non-Executive Director.	✓
3)	**Disclosure of relationship between the Chairman, CEO and members of the Board** The Board has adopted a formal procedure to identify and disclose the relationships between the CEO and the Chairperson and among other Directors. Accordingly, the Board has declared that there are no material relationships [including financial, business, family or other material/relevant relationship(s)] between the Chairperson and Chief Executive Officer/Managing Director and among the members of the Board which will impair their respective roles. Details of the Chairperson and Chief Executive Officer are disclosed in the Annual Report on page 40.	✓
4)	**Role of the Chairman** **Provide leadership to the Board;** **Ensure that the Board works effectively and discharges its responsibilities;** **Ensure that all key and appropriate issues are discussed by the Board in a timely manner.** Board-approved list of functions and responsibilities of Chairperson includes 'Providing Leadership to the Board' as a responsibility of the Chairperson. The Board as a body worked effectively and discharged its responsibility as set out in the Annual Report. The annual self-assessment of the Board includes a criterion that evaluates the effectiveness of the Chairman in facilitating the Board's discharge of its responsibilities. All key and appropriate issues are discussed by the Board on a timely basis.	✓
5)	**Role of Chairman in the preparation of the agenda for Board meetings** Preparation of the agenda has been delegated to the Company Secretary who circulates a formal agenda prior to the Board meeting which is approved by the Chairperson.	✓

Rule No.	Principle and compliance	Complied
6)	**Ensure that all Directors are informed adequately and timely of the issues arising at Board meetings** The Chairperson ensures that all Directors are properly briefed on issues arising at Board meetings through submission of agenda and Board papers with sufficient time prior to meeting.	✓
7)	**Encouraging all Directors to make an active contribution to Boards affairs** All Directors actively participate in Board affairs and the Board acts in the best interests of the Company.	✓
8)	**Encourage participation of Non-Executive Directors and relationship between Executive and Non-Executive Directors** Executive and Non-Executive Directors work together in the best interests of the Company. Non-Executive Directors participate in Board sub-committees. This process is further strengthened through the annual self-evaluation of the Board and Board Sub Committees where views of all Directors are canvassed in respect of the performance of the Board and Sub Committees as a whole.	✓
9)	**Avoidance of engaging in activities involving direct supervision of KMP or executive duties by the Chairman** Chairperson does not directly get involved in the supervision of Key Management Personnel or any other executive duties.	✓
10)	**Effective communication with shareholders** The Annual General Meeting of the Company is the main forum where the Board maintains effective communication with shareholders and they are given the opportunity to take up matters for which clarification is needed and also their views are communicated to the Board. Further, the Board-approved Communication Policy evidences the Company's process in this regard.	✓
11)	**Role of Chief Executive Officer** In terms of duties and responsibilities of the CEO, he is the apex executive of the Company who is responsible for day-to-day operations of the Company with the assistance of Executive Directors and members of the Corporate Management and is accountable to the Board to recommend the Company's strategy implementation and ensure appropriate internal controls are in place to assess and manage risks.	✓
8	**BOARD APPOINTED COMMITTEES**	
1)	**Establishing Board Committees, its functions and reporting** The following committees have been appointed by the Board and each such committee is required to report to the Board: 1. Remuneration Committee 2. Integrated Risk Management Committee 3. Nomination Committee 4. Audit Committee 5. Related Party Transactions Review Committee. Recommendations of these committees are addressed directly to the Board and minutes of meetings are tabled and discussed at the main Board meetings. The Company has presented report on the performance, duties and functions of each committee in the Annual Report.	✓
2)	**Audit Committee**	
(a)	**Chairman of Audit Committee** The Chairperson of the Audit Committee is a Non-Executive Director who is a fellow member of the Chartered Institute of Management Accountants of UK. Qualifications and experience are disclosed on page 43 of this Annual Report.	✓

Rule No.	Principle and compliance	Complied
(b)	**Composition of Audit Committee** All the members of the Audit Committee are Non-Executive Directors.	✓
(c)	**Functions of Audit Committee** **the appointment of the External Auditors.** **the implementation of the Central Bank Guidelines.** **the application of the relevant accounting standards; and** **the service period, audit fee and any resignation or dismissal of the Auditor;** The Audit Committee has recommended; The re-appointment of M/s. Ernst & Young, Chartered Accountants as External Auditors for audit services; The implementation of guidelines issued by Central Bank of Sri Lanka. The application of Accounting Standards in consultation with the AGM – Finance and External Auditors; The service period, audit fees, resignation or dismissal of an auditor, re-engaging the audit partner in line with the regulatory requirements. No resignation or dismissal of the Auditor has taken place during the year under review. The Committee ensures that the requirement of rotation of External Audit Engagement Partner, once in every five (5) years, is met.	✓
(d)	**Review and monitor External Auditor's independence and objectivity and the effectiveness of audit processes** The External Auditor has provided an independent confirmation in compliance with the guidelines for appointment of Auditors of Listed Companies. In order to safeguard the objectivity and independence of the External Auditor, the Audit Committee reviewed the nature and scope taking account of the regulations and guidelines.	✓
(e)	**Provision of non-audit services by External Auditor** The Audit Committee with the approval of the Board of Directors developed and implemented a policy for engagement of Auditors to provide non- audit services in order to ensure that the non-audit services do not impair the independence and objectivity of the External Auditors. The said policy addresses the skills and experience of the Auditor, threat to the independence, objectivity and fee for the non-audit services.	✓
(f)	**Determine scope of external audit** The Auditors make a presentation at the Audit Committee meeting with details of the proposed audit plan and the scope. Members of the Audit Committee obtain clarifications in respect of the contents of the presentation, if deemed necessary.	✓
(g)	**Review financial information of the Company by the Audit Committee** Quarterly Financial Statements as well as year-end Financial Statements are circulated to the Audit Committee. A detailed discussion focused on major judgemental areas, changes in accounting policies, significant audit judgments in the Financial Statements, going concern assumption and compliance with Accounting Standards and other legal requirements takes place and required clarifications are obtained in respect of all areas before being recommended for Board approval.	✓
(h)	**Discussion of issues, problems and reservations arising from the interim and final audits with the External Auditor** The Committee met the External Auditors without the presence of the Executive Directors and Corporate Management twice during the financial year 2020/21.	✓
(i)	**Review of External Auditors' Management Letter and Management's response** Upon receipt of the management letter, Auditors are invited to make a presentation at the Audit Committee with the responses of the corporate Management to discuss the significant findings which have arisen during the audit and instructions are given to Department Heads to take remedial actions, if necessary.	✓

Rule No.	Principle and compliance	Complied
(j)	**Review of Internal Audit function** The Audit Committee has establish a fully fledged internal audit department to provide independent assurance of the company affairs. The committee ensures the internal audit function is independent of the activities it audits and performed duties with due professional care. The Audit Committee has reviewed the information provided in the risk- based audit plan and concluded that scope, functions and resources of the Internal Audit Department are sufficient to carry out its functions. The Audit Committee has reviewed and approved the Internal Audit Program. The committee has reviewed the performance of chief internal auditor during the year.	✓
(k)	**Major findings of internal investigations and Management's response** Whenever a need arises, the Audit Committee assigns special internal investigations on certain matters to the internal audit department and reviews major findings with the management responses and ensures that the recommendations are implemented.	✓
(l)	**Participants of Audit Committee meetings** The Committee met twice with the External Auditors without the presence of Executive Directors. The Managing Director/CEO, Executive Directors, DGM - DFS & Strategy, DGM - IT, Chief internal auditor, Head of Risk, AGM – Finance, Compliance Officer, Chief Manager Treasury and Information System (IS) Auditor normally attend all meetings. Where it is deemed necessary, members of the corporate management may also attend meetings by invitation.	✓
(m)	**Authority and resources of the Audit Committee** The Audit Committee is guided by a Board-approved terms of reference which sets out authority and responsibility of the said Committee. The Audit Committee is authorised to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.	✓
(n)	**Meetings of Audit Committee** The Committee meets regularly and the audit reports were issued to its members in advance and the minutes of the meetings maintained by the Company Secretary. The Committee has met 13 times during the year and the attendance at those meetings is set out on page 233 in the Audit Committee Report	✓
(o)	**Disclosure in Annual Report** The Report of the Board Audit Committee is on page 233 and includes the detailed activities, meetings held during the year and the Directors attendance at the Audit Committee Meetings.	✓
(p)	**Recording and maintenance of minutes of meetings** The Company Secretary acts as the Secretary of the Audit Committee and records and maintains all minutes of the meetings.	✓
(q)	**Whistle-blowing policy and relationship with External Auditors** The Company has a Board-approved Whistleblowing Policy whereby employees of the Company are entitled to raise concerns in confidence about the malpractices in the Company.	✓
3)	**Integrated Risk Management Committee**	
a)	**Composition of Integrated Risk Management Committee** The IRMC consists of three Non-Executive Directors, four Executive Directors including Managing Director/CEO and other Key Management Personnel, namely AGM – Finance, Chief Manager – Treasury, Senior Manager Risk and Compliance Officer.	✓
b)	**Risk assessment** The Committee has a Board-approved Risk Management Policy which provides a framework for management and assessment of risk based on a rating linked to the risk score. According to that pre-established risk indicators are reviewed by the Committee on a quarterly basis. The Committee has a process to assess and evaluate the risk and the findings and reviews submitted to the Board quarterly.	✓

Rule No.	Principle and compliance	Complied
c)	**Review adequacy and effectiveness of all executive level committees** The Committee reviews the adequacy and effectiveness in addressing specific risk and managing the same within the quantitative and qualitative risk limits set by such respective committees such as Asset and Liability Management Committee and Credit Committee.	✓
d)	**Corrective action to mitigate the effect of risks exceeding the prudent levels decided by the Committee** The risk indicators introduced have been reviewed against the benchmark and prompt corrective actions are taken to mitigate the effects of such risks that are at level beyond the prudent levels decided by the committee. Review of this process is minuted at the IRMC for their review and action if deemed necessary.	✓
e)	**Frequency of meetings** The Committee has met four times during the year to assess the risks of the Company.	✓
f)	**Action against officers for failure to identify specific risks and take prompt corrective action** Committee refers such matters, if any, to the HR Department for necessary action. However, the specific risk and limits identified by the Integrated Risk Management Committee and such decisions are taken collectively.	✓
g)	**Submission of risk assessment report to the Board** The Committee had kept the Board informed of their risk assessment of the Company by forwarding a risk report.	✓
h)	**Establish a compliance function** An independent compliance function is established as second line of defence. This function is responsible for, among other things, ensuring that the Company operates with integrity and in compliance with applicable, laws, regulations and internal policies. Dedicated compliance officer appointed with sufficient authority, stature, independence, resources and access to the Board.	✓
9	**RELATED PARTY TRANSACTIONS**	
2)	**Avoid conflict of interest** The Board appointed Related Party transactions Review Committee ensures that the transactions with Related Parties are in accordance with best practices. The Related Party Transactions Policy is in place which describes the related parties, types of related party transactions and stipulates that no Director shall participate in any discussion of a proposed related party transaction for which he or she is a related party, provided however he or she may participate in discussion to express, propose and providing information concerning to Related Party Transaction to the committee. A system for monitoring and reporting of data pertaining to such transactions has been established and through that system the Company ensures that no favourable transaction has been entered in to with such parties. Transactions carried out with Related Parties in the ordinary course of business (Recurrent transactions) are disclosed in the Financial Statements on 'Related Party Disclosures' under Note 6.1 on page 387 in Financial Statements.	✓
3)	**Related party transactions covered in the direction** A Board-approved process is in place to identify the related party transactions and the Related Party Transactions Review Committee ensures that all the transactions with Related Parties are on arm's length basis.	✓

Rule No.	Principle and compliance	Complied
4)	**Prohibit engaging in transactions with a related party in a manner that would grant such party "more favourable treatment"** **Granting accommodation in excess of prudent percentage of regulatory capital.** **Charging lower rate than the best rate on accommodation and paying upper rate compared to unrelated counterparty.** **Allowing preferential treatment compared to unrelated parties in the normal course of business.** **Providing or obtaining services without proper evaluation.** **Maintaining reporting lines and information flows that may give benefits to related parties other than performance of legitimate duties.** The Board-approved Related Party Transactions Policy contains provisions to ensure compliance and the Related Party Transactions Review Committee ensures that all the transactions with Related Parties are on arm's length basis. The Company has developed a separate system to monitor Related Party Transactions to ensure that related party transactions are not entered into on more favourable terms than those offered to others, and where applicable relevant approvals of the Related Party Transactions Review Committee/Board are obtained.	✓
10	**DISCLOSURES**	
1)	**Disclosure of financial statements** Relevant Financial Statements are prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards, and that such statements are published in the newspapers, in all three languages.	✓
2)	**Responsibility of the Board to ensure appropriate disclosure in the Annual Report**	✓
(a)	A statement to the effect that the annual audited financial statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures Compliance with applicable accounting standards and regulatory requirements has been reported under the 'Statement of Directors' Responsibility for Financial Reporting' on page 267.	✓
(b)	Report on Company's internal control systems Directors' Responsibility Statement on Internal Control Systems Over Financial Reporting is given on page 266.	✓
(c)	External Auditor's certification on the effectiveness of the internal control mechanism The Company obtained a certification from the External Auditors on the effectiveness of the internal control mechanism. The independence assurance report on effectiveness of the internal control report over financial reporting is given on page 268.	✓
(d)	Details of Directors, including names, transactions with the Company. A comprehensive biography of Board of Directors are given on page 40. Refer note 6.1.2 - Transactions, Arrangements and Agreements Involving KMPs and Their Close Members of the Family (CMFs) for transactions of Directors (only Directors without management)	✓
(e)	**Fees/remuneration paid by the Company to the Directors in aggregate** Refer tables given under point (f) below.	✓

Rule No.	Principle and compliance	Complied
(f)	Net accommodation outstanding in respect of each category of related parties as a percentage of the Company's capital funds	✓

Category of related party transactions	2019/2020 Rs. '000	percentage of the capital	2020/2021 Rs. '000	percentage of the capital
Directors	--	0%	-	0%
KMP				
Non-Executive Directors and their close family members	-	0%	-	0%
Key Management Personnel and their close family members (Includes the Executive Directors)	1,417	0.01%	1,814	0.01%
Subsidiaries	-	0%	-	0%
Joint Venture	-	0%	-	0%
Entities which Directors and their close family members have a substantial interest	-	0%	-	0%
Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka	-	0%	-	0%

Statement of Financial Position – Company

For the year ended	2018/2019 Rs. '000	2019/2020 Rs. '000	2020/2021 Rs. '000
Assets			
Loans and advances	9,590	1,417	10,298
Total	9,590	1,417	10,298
Liabilities			
Deposits	927,775	536,051	697,325
Securities sold under repurchase agreements	-	-	-
Debentures	-	-	-
Total	927,775	536,051	697,325

Rule No.	Principle and compliance	Complied
(g)	Aggregate value of remuneration paid to and transactions with KMPs	✓

Transaction with KMP

For the year ended	2018/2019 Rs. '000	2019/2020 Rs. '000	2020/2021 Rs. '000
Short-term employment benefits			
Directors	357,571	426,116	427,670
KMPS	47,153	51,048	50,828
Post-employment benefits			
Directors	-	-	-
KMPS	Not Paid	1,625	Not Paid
Total	404,724	478,789	478,498

Transactions, arrangements and agreements involving KMP and their Close Family Members (CFM).

CFM of a KMP are those family members who may be expected to influence, or be influenced by, that KMP in their dealings with the entity. They may include KMP's domestic partner and children, children of the KMP's domestic partner and dependents of the KMP or the KMP's domestic partner. CFM are related parties to the Company.

For the year ended	2018/2019 Rs. '000	2019/2020 Rs. '000	2020/2021 Rs. '000
Undrawn facilities	-	-	-
Total	-	-	-

Share-based transactions of KMP and CFM

For the year ended	2018/2019	2019/2020	2020/2021
Number of ordinary shares held (Average balance)	431,050	524,439	*2,255,568
Dividends paid (Rs. '000)	5,330	3,764	7,223

*The Company affected a sub-division of ordinary shares on the basis of a sub-division of every one ordinary share into four ordinary shares during the financial year.

Rule No.	Principle and compliance	Complied
(h)	Certification of compliance	✓
(i)	Non-compliance report There were no significant lapses in the Company's Risk Management or non- compliance with this Direction that have been pointed out by the Director of the Department of Supervision of Non-Bank Financial Institutions and/ or directed to be disclosed to the public by the Monetary Board.	✓
(j)	External Auditors certification of compliance The External Auditors has performed procedures set out in Sri Lanka Standards on Related Service 4750 issued by The Institute of Chartered Accountants of Sri Lanka (SLSRS 4750), to meet the compliance requirement of the Corporate Governance Directions. Their findings presented in their report addressed to the Board are consistent with the matters disclosed above and did not identify any material inconsistencies to those reported above by the Board. The recommendations made by the Auditors where relevant will be implemented in 2020/21 as done previously.	✓
11	**TRANSITIONAL PROVISIONS** Transitional and other provisions	✓

COMPLIANCE WITH CODE OF BEST PRACTICE ON CORPORATE GOVERNANCE

Compliance with the Code of Best Practice on Corporate Governance 2017 (The Code) issued by The Institute of Chartered Accountants of Sri Lanka

Code Ref.	Requirement	Reference	Complied
A	**DIRECTORS**		
A.1	The Board	The Board comprised 10 Directors as at 31st March 2021, five of whom functioned in Non-Executive capacity, having the required professional competence, skills and experience in the fields of entrepreneurship, banking and finance, legal and marketing to lead and control the Company. The Board gives leadership in setting the strategic direction and implement sound control environment for the successful functioning of the Company. Directors are elected by shareholders at the AGMs with the exception of the Executive Directors who are appointed by the Board and remain as Executive Directors until retirement, resignation or termination of such appointment.	✓
A.1.1	Board Meetings	The Board usually meets at monthly intervals and special Board meetings are convened whenever necessary. The Board met twelve (12) times during the year. Attendance at meetings is summarized on page 215.	✓
A.1.2	Role & Responsibilities of the Board	The Board engages in providing direction in formulating a sound business strategy and closely monitors the implementation of the strategy effectively. A Strategic Plan has been developed covering three years from 2020/21 to 2022/23 and was approved by the Board.	✓
A.1.3	Act in accordance with laws and seek professional advice	The Board collectively and Directors individually, recognize their duty to comply with laws of the country. The Board of Directors ensures that procedures and processes are in place to ensure that the Company complies with all applicable laws and regulations. In order to preserve the independence of the Board and to strengthen the decision-making, the Board seeks independent professional advice when deemed necessary.	✓
A.1.4	Access to advice and services of Company Secretary	All Directors have access to the Company Secretary, a company registered as a qualified Secretary. Their services are available to all Directors and they advise the Board on corporate governance matters, Board procedures and applicable rules and regulations	✓
A.1.5	Independent Judgement	All Directors are responsible for bringing independent judgment on issues of strategy, performance, resources and standard of business conduct. Non-Executive Directors are responsible for providing independent judgment on the proposals made by the Managing Director and Executive Directors.	✓
A.1.6	Dedicate adequate time and effort Board pack	Every Director has dedicated adequate time and effort to the meetings of the Board and sub-committee meetings to ensure that the duties and responsibilities are satisfactorily discharged and all the Board papers are loaded through a secure link to the iPad at least seven days prior to the Board meetings for the Directors to access prior to the Board Meeting.	✓

Code Ref.	Requirement	Reference	Complied
A.1.7	If necessary, in the best interest of the Company, one-third of the Directors can call for a resolution to be presented to the Board.	Necessity did not arise during the year	✓
A.1.8	Board induction and training.	Every Director was given appropriate induction when first appointed to the Board with regard to the affairs of the Company and laws and regulations applicable to the Company. It is mandatory for the Directors to attend Director Forums organised by the CBSL. Further the Corporate Management and external experts make presentations with regard to the business environment to update the knowledge. The Board regularly reviews and agrees on the training and development needs of the Directors, to effectively discharge their duties.	✓
A.2	Chairman & Chief Executive Officer	The positions of Chairperson and the Managing Director/CEO have been separated in line with best practices with a view to maintain the balance of power and authority. The Chairperson is an Independent Non-Executive Director. Managing Director/CEO is conferred with executive authority to manage the business.	✓
A.3	Chairman's Role in Preserving Good Corporate Governance	The Chairperson provides leadership to the Board, ensures that the Board works effectively and discharges its responsibilities and ensures that all key and appropriate issues are discussed by the Board in a timely manner.	✓
A.4	Availability of Financial Acumen	The Chairperson of the Audit Committee is a Fellow member of The Chartered Institute of Management Accountants of UK and the Chairman of the Integrated Risk Management Committee and is also a Fellow member of The Institute of Chartered Accountants of Sri Lanka and a Fellow member of the CIMA-UK. Further the Non-Executive Director and an Executive Director are qualified finance professionals with experience in finance and management. The remaining members of the Board also possess experience in finance and banking thus there is sufficient financial acumen and knowledge within the Board to offer guidance on matters of finance. The profiles of the Board of Directors are given on page 40 to 43.	✓

Code Ref.	Requirement	Reference	Complied
A.5	Board Balance	**It is preferable for the Board to have a balance of Executive and Non-executive Directors as such that no individual or small group can dominate the Board's decision-taking.** **The Board should include at least two Non-Executive Directors or one-third of total Directors whichever is higher.** During the financial year under review, the Board comprised Five (5) Non-executive Directors and Five (5) Executive Directors facilitating the required balance within the Board. **Two or one-third of Non-Executive Directors whichever is higher should be independent.** The Board has determined three (3) out of five (5) Non-Executive Directors are Independent as at 31.03.2021 as per this Code. **Evaluation of independence of Non-Executive Directors.** The Board evaluates the Independence yearly using annual declarations submitted by the Directors according to the Code criteria. **Signed declaration of independence by the Non-Executive Directors** All Non-Executive Directors provided the signed declarations of independence for 2020/21 as per Schedule K of the Code. **Determination of the Independence and Non-Independence of each Non-Executive Director annually.** The Board has reviewed the declarations submitted by the Non-Executive Directors, and determined their independence. **If an Alternate Director is appointed by a Non-Executive Director such Alternate Director should not be an Executive Director and if an Alternate Director is appointed by an Independent Director, the person who is appointed also should meet the criteria of independence.** No Alternate Directors were appointed during the year. **Senior Independent Director (SID). Confidential discussion with other Directors by the SID.** The requirement to appoint a 'Senior Independent Director' does not arise under the Code in view of the roles of the Chairman and the CEO being held by two different individuals. Hence, no 'Senior Independent Director' was appointed during the year 2020/2021. **Meetings held by the Chairman with Non-Executive Directors, without the Executive Directors being present** The Chairperson held meetings with Non-Executive Directors, without the Executive Directors being present. **Recording of concerns of Directors in Board minutes where they cannot be unanimously resolved.** There were no instances where the Directors could not unanimously resolve matters and accordingly no such matters were recorded in the minutes.	✓

Code Ref.	Requirement	Reference	Complied
A.6	Provision of Appropriate and Timely Information	**The Board should be provided with timely information in a form and of quality appropriate to enable it to discharge its duties.** **Management should provide timely information to the Board. The Chairman should ensure that all directors are properly briefed on issues arising at Board meetings.** Timely and accurate information is provided by the Management to the Board generally seven days prior to the Board meetings. The members of Corporate Management make presentations to the Directors on important issues relating to the financial performance, strategy, risk, systems and procedures. **The minutes, agenda and papers required for a Board meeting should be provided before seven (7) days.** Board papers are uploaded through a secure link to the iPad for the Directors to access seven (7) days prior to the Board meeting.	✓
A.7	Appointments to the Board	**Nomination Committee.** The Nomination Committee makes recommendations to the Board on all new appointments to the Board. The Committee was set up pursuant to the Code of Best Practice on Corporate Governance. The report of the Nomination Committee is given on page 232 of the Annual Report. **Assessment of Board composition by the Nomination Committee.** The Nomination Committee reviews the new appointments and re-elections to the Board with strategic direction of the Company to attract and retain Board members with relevant experience and qualifications. **Disclosure requirements when appointing of new Directors to the Board.** Details of new Directors are disclosed to the shareholders at the time of their appointment by way of announcements made to the Colombo Stock Exchange as well as in the Annual Report. Prior approval for appointment of new Directors is obtained from the Director of Department of Supervision of Non-Bank Financial Institutions and notification is sent to Colombo Stock Exchange. All new appointments are reviewed by the Nomination Committee.	✓
A.8	Re-election of Directors	All Directors should be required to submit themselves for re-election at regular intervals and at least once in every three years. **Re-election of Directors.** At each Annual General Meeting one-third of the Non-Executive Directors for the time being who are subject to retirement, or, if their number is not a multiple of three, the number nearest to (but not greater than) one third, retire and seek re-election by the shareholders. The provisions of the Company's Articles of Association also require Directors appointed by the Board to hold office until the next Annual General Meeting and seek appointment by the shareholders at that meeting. **Resignation** There were no resignations during the year.	✓

Code Ref.	Requirement	Reference	Complied
A.9	Appraisal of Board & Sub Committee's Performance	**Appraisal of Board performance.** The Board annually appraises its own performance to ensure that it is discharging its responsibilities satisfactorily. This process requires each Director to fill Board Performance Evaluation Forms in line with this Section of the Code. The responses are reviewed by the Company Secretary who collates them and submits is to the Board for necessary action as appropriate as decided by the Board. **Annual self-evaluation by the Board of its sub-committees.** The appraisal of the performance of sub-committees was presented to the Board. **Review at the point of re-election of the Directors** The Board has a process to review the participation, contribution and engagement of each Director at the time of re-election. **Disclosure in the Annual Report about the Board's performance evaluation methodology.** Board approved procedure is in place.	✓
A.10	Annual Report to Disclose Specified Information Regarding Directors	**Shareholders should be kept advised of relevant details in respect of Directors.** **Annual Report disclosure in respect of Directors.** Profiles of the Board of Directors are given on pages 40 to 43 including other directorships held by the Directors and memberships of Board Committees. Directors' attendance is disclosed on page 215.	✓
A.11	Annual appraisal of the CEO	**The Board should be required, at least annually, to assess the performance of the CEO.** **Targets for CEO at the commencement of each financial year.** CEO/ Managing Director's performance targets are aligned with business strategies of the Company. Targets are set at the beginning of every financial year by the Board which is in line with the short- medium- and long-term objectives of the Company. Evaluation of the performance at the end of fiscal year. At the end of each financial year the Board evaluates the set targets and the actual performance.	✓

Code Ref.	Requirement	Reference	Complied
B.	**DIRECTORS' REMUNERATION**		
B.1	Remuneration Procedure	**The Company should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual Directors. No Directors should be involved in deciding his/her own remuneration.** **Setting up of Remuneration Committee.** The functions of the Committee include determination of compensation and benefits of the Managing Director/CEO and Executive Directors while ensuring that no Director is involved in setting his/her own remuneration. **Composition of Remuneration Committee.** Composition of Remuneration Committee is in line with the code. This committee consist of 3 Non-Executive Directors of which 2 are independent in accordance the code **Disclosure in the Annual Report about the Remuneration Committee members.** Remuneration Committee report is given on page 231 of the Annual Report. **Remuneration of Non-Executive Directors.** The Non-Executive Directors receive a fee for being a Director of the Board and additional fee whenever they serve on Board sub-committees and their fee structure is decided by the Board. **Remuneration Committee consults the Chairperson/ MD on matters relating to the Remuneration Committee, Executive Directors and access to the professional advice.** The Committee consults the Managing Director when recommending the remuneration of other Executive Directors and also has access to professional advice when deemed necessary.	✓

Code Ref.	Requirement	Reference	Complied
B.2	Level & Make up of Remuneration	**Level of remuneration of both the Executive and the Non-Executive Directors should be sufficient to attract and retain the Directors needed to run the Company successfully. A proportion of Executive Director's remuneration should be structured to link rewards to corporate and individual performance.** **Remuneration of Executive Directors.** Remuneration of Executive Directors consists of performance-based incentive payment to attract, retain and motivate them. **Remuneration packages in line with industry practices.** The Remuneration Committee reviews the information relating to competitors of the Company and due care is taken to ensure that remuneration is on par with industry standards. **Remuneration packages in line with other companies in the Group.** Size and scale of the Company's operations are not comparable with other Group Companies and therefore guidance could not be drawn from them. **Performance-related payments to Executive Directors.** There are performance-related elements of remuneration for Executive Directors with the objective of providing appropriate incentives to those Directors to perform at the highest level. **Executive Share Option.** There are no Share Option schemes offered by the Company. **Designing schemes of performance related remuneration.** In deciding the remuneration of the Managing Director, Executive Directors and Senior Management, the Company takes note of the provisions set out in Schedule E. **Early termination of service of Directors.** Consideration of termination of service of the Executive Directors will be in accordance with their contract of service. **Remuneration of Non-Executive Directors.** Non-Executive Directors are remunerated by the Company considering the time commitment, responsibilities of the role and the market practices. The Company has not offered any Share Option plans to either Executive Directors or Non-Executive Directors.	✓
B.3	Disclosures related to Remuneration in Annual Report	**Annual Report of the Company should contain a statement of Remuneration Policy and details of remuneration of the Board as a whole.** **Disclosure in the Annual Report about the Remuneration Committee members, statement of Remuneration Policy and aggregate remuneration paid.** Remuneration Committee report is given on page 231 which sets out the details on the composition of Committee and the remuneration policy. The aggregate remuneration paid to the Board of Directors is disclosed in Note 6.1.1 to the Financial Statements on page 387.	✓

Code Ref.	Requirement	Reference	Complied
C.	**RELATIONS WITH SHAREHOLDERS**		
C.1	Constructive use of the AGM & Other General Meetings	**The Board should use the Annual General Meeting (AGM) to communicate with shareholders and should encourage their participation.** **Adequate notice for the AGM to the shareholders.** The Annual Report including Financial Statements and the Notice of the Meeting are sent to shareholders 15 working days prior to the date of the AGM as stipulated by the Companies Act. **Separate resolutions for separate issues.** Separate resolutions are placed before shareholders for each substantial matters that require approval of shareholders at the Annual General Meetings (AGM). **Use of proxy votes.** The Company has recorded all proxy votes for each resolution prior to the general meeting. **Arrangement made by the Chairman of the Board that all Chairmen of Subcommittees make themselves available at the AGM.** The Board includes the Chairmen of the Audit, Remuneration, Integrated Risk Management and Nomination Committees, and they are available at the AGM to answer any questions. **Procedures of voting at general meetings.** Shareholders right to appoint a proxy for voting at AGM appears on Notice of Meeting and on the Form of Proxy. Voting procedures at general meetings appear on the Form of Proxy.	✓

Code Ref.	Requirement	Reference	Complied
C.2	Communication with shareholders	**The Board should implement effective communication with shareholders.** **Channel to reach all shareholders to disseminate timely information.** There are many channels of communication for engaging with shareholders. These include press releases and notices and required disclosures to the CSE which are published on the CSE website. The quarterly Interim Financial Statements are disseminated to the CSE within 45 days, the exception being for the last quarter of the financial year where the Company has 60 days to publish those accounts. Half yearly Financial Statements are published in daily newspapers in all three languages as per the Finance Companies Guidelines No. 2 of 2006. Notice of Annual General Meeting is circulated together with the Annual Report and Accounts which includes any other special business (if any) to be transacted at the AGM. Where necessary Extra Ordinary General meetings are convened after giving statutory notice to all shareholders. Annual General Meeting provides a platform for shareholders to discuss and seek clarification on the activities of the Company. **Policy and methodology of communicating.** The Company provides fair disclosure with emphasis on the integrity, accuracy, timeliness and relevance of the information provided. Refer Stakeholder engagement on page 52 in the Annual Report. **Implementation of the communication policy and methodology.** Shareholders receive the Annual Report from the Company either by way of a CD or in hard copy form. Shareholders may at any time elect to receive the Annual Report from the Company in printed form without any charge. **Disclosure of the contact person as per communication policy.** Shareholders may, at any time, direct questions and request for publicly available information from the Directors or Management of the Company. **Awareness of Directors on major issues and concerns of shareholders.** The Company Secretary maintains a record of all correspondence received and will deliver as soon as practicable such correspondence, which require Board attention to the Board or individual Director/s as applicable. **Contact person for shareholders in relation to shareholders' matters.** Company Secretary can be contacted for any queries of shareholders. **Process for responding to shareholders.** Company has a Board-approved communication policy addressing this.	✓
C.3	Disclosure of major and material transactions	Directors should disclose all proposed corporate transactions which would materially alter the net asset base of the Company Or the Group. **Major transactions.** During the year, the Company did not engage in or commit any major transactions which materially affected the Company's/Group's net asset base	✓

Code Ref.	Requirement	Reference	Complied
D.	**ACCOUNTABILITY & AUDIT**		
D.1	Present a balanced and understandable assessment of the Company's financial position, performance and prospects.	**The Board should present a balanced and an understandable assessment of the Company's financial position and prospects.** **Board should present interim and other price sensitive information to the public and reports to regulators.** The Company has reported a true and fair view of its financial position and performance for the year ended on 31st March 2021 and at the end of each quarter of the financial year and all price sensitive information has been disclosed in a timely manner. Company's Financial Statements are prepared inconformity with applicable accounting standards and gives true and fair view of the financial position and performance, risk management and effectiveness of the internal controls. **Directors' Report in the Annual Report.** Annual Report of the Board of Directors on the affairs of the Company is given on page 223 covering all areas of this section. **Annual Report disclosure stating Board's and Auditors' responsibility** Statement of Directors' Responsibility for Financial Reporting is given on page 267 and Auditors responsibility given in the Auditors' Report to the Internal Control is given on page 266 respectively. **Management discussion and analysis.** Management discussion and analysis is given on page 50 Information Required Page Industry structure and developments 88 Opportunities and threats 98 Risks and concerns - Risk Managment report 32 Internal control systems and their adequacy 266 Social and environmental protection activities carried out by the Company 176 Financial performance 116 Material developments in human resource/industrial relations and 154 Prospects for the future 20 **Disclosure of Related Party Transactions.** A detailed Board-approved documented process is available in the Company for monitoring and reporting of Related Party Transactions. The Company Secretary makes necessary disclosures of any Related Party Transactions which require disclosure as per the rules. All related party transactions as defined in Sri Lanka Accounting Standard – 24 (LKAS 24) on 'Related Party Transactions' are disclosed in Note 6.1 to the Financial Statements on pages 387.	✓

Code Ref.	Requirement	Reference	Complied
D.2	Process of Risk Management and a sound system of internal control to safeguard shareholders' investments and the Company's assets	**The Board is responsible for formulating and implementing appropriate processes for risk management and internal control systems to safeguard shareholder investments and assets of the Company.** The Integrated Risk Management Committee (IRMC) assists the Board in discharge of its duties with regard to risk management and the Board Audit Committee assists the Board in discharge of its duties in relation to internal control of the company. A process has been setup to provide reasonable assurance on reliability of internal controls over financial reporting process. The Board Audit Committee annually reviews the effectiveness of internal controls and risk management process through internal audit department to ensure effective discharge of their duties. The responsibilities and functions of the Board Audit Committee are given in Audit Committee Report on page No. 233. The IRMC is supported by the Risk Management Department of the company and a comprehensive report of how the company manages risk is included on pages 32 to 56 and the is given on page 236.	✓
D.3	Audit Committee	**The Board should establish formal and transparent arrangements for considering how they should select and apply accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the company's Auditors.** **Composition of the Audit Committee.** The Audit Committee comprises with three Non-Executive Directors of whom majority are independent. **Reviewing the scope and results of the audit and its effectiveness and independence and objectivity of the Auditors.** The Audit Committee periodically reviews the scope and results of the audit and its effectiveness. Further independence and the objectivity of the Auditors are also reviewed periodically. The Committee would consider independence when providing non- audit engagements to the External Auditor. It is also responsible to make recommendations on the appointment, reappointment and removal of Auditors. **The terms of reference of the committee** The Board approved Audit Committee charter is in place. The committee acts according to the charter and assists Board in discharging its duties. **Disclosures made in the Annual Report about Audit Committee.** Board Audit Committee report is given on page 233 of the Annual Report	✓
D.4	Related Party Transactions Review Committee	Procedure to ensure that the company does not engage in transactions with related parties in a manner that would grant "more favourable treatment" to such parties. The Board has established a Related Party Transactions (RPT) Review committee consisting three Non-executive Directors of whom majority are independent. RPT review committee has written terms of reference, dealing clearly with its authority and duties which should be approved by the Board. Report on Related Party Transaction Review Committee is given on page 239.	✓

Code Ref.	Requirement	Reference	Complied
D.5	Code of Conduct and Ethics	**The Board should include this in the Annual Report setting out the manner and extent for it to be complied.** **Disclosure of corporate Governance Compliance** The requirement is met with the presentation of this Corporate Governance Report from pages 206 to 222 of the Annual Report.	✓
D.6	Corporate Governance Disclosures	**The Board should disclose the extent of compliance with good corporate governance principles and practices.** **Disclosure of Corporate Governance Compliance.** The requirement is met with the presentation of this Corporate Governance Report from pages 206 to 222 of the Annual Report.	✓
E/F	**INSTITUTIONAL AND OTHER INVESTORS**		
	Encourage voting at AGM – institutional and other investors	The company has 3,590 ordinary voting shareholders of which above 80% are institutional shareholders. We have a regular structured dialogue with the large institutional shareholders and any concerns of these institutional shareholders expressed at the meetings is communicated to the Board as a whole. All shareholders are encouraged to participate at AGM and cast their votes. Investor relations hotline/email is open for any investor to reach out to the CEO/Director if required. From the Company's perspective, the AGM provides a forum for the Board to inform the shareholders what the Company does and how it has performed during the year. For investors, it provides a forum to learn more about the business and ask questions from the Directors and to use their votes responsibly.	✓
G.	**INTERNET OF THINGS & CYBERSECURITY**		
G.1	Identify connectivity and related cyber risks	Please refer page - Risk Managment report 53 Integrated Report 166	✓
G.2	Appoint a CISO and allocate budget to implement a cybersecurity policy	Please refer page - Risk Managment report 53 Integrated Report 166	✓
G.3	Include cyber security on Board agenda	Please refer page - Risk Managment report 53 Integrated Report 166	✓
G.4	Obtain periodic assurance to review effectiveness of cybersecurity risk management	Please refer page - Risk Managment report 53 Integrated Report 166	✓
G.5	Disclosures in Annual Report	Please refer page - Risk Managment report 53 Integrated Report 166	✓
H.	**ENVIRONMENT, SOCIETY & GOVERNANCE**		
H.1	ESG Reporting	Please refer page 176, 196	✓

COMPLIANCE WITH LISTING RULES

Compliance with the Rules 7.6 and 7.10 of Listing Rule – Section 7 (Continuing Listing Requirements) issued by the Colombo Stock Exchange.

Rule No.	Principle and compliance	Complied	Page reference
7.6	**CONTENTS OF ANNUAL REPORT**		
7.6 (i)	Names of persons who were directors of the Company during the financial year	✓	40
7.6 (ii)	Principal activities of the Company and its subsidiaries during the year	✓	14
7.6 (iii)	Information on 20 largest shareholders at the end of the year	✓	141
7.6 (iv)	The public holding percentage	✓	142
7.6 (v)	Directors' and Chief Executive Officer's holding in shares	✓	143
7.6 (vi)	Information pertaining to material foreseeable risk factors	✓	32 - 56
7.6 (vii)	Details of material issues pertaining to employees and industrial relations	✓	154
7.6 (viii)	Information on buildings/land holdings and investment properties as at the end of the year	✓	342
7.6 (ix)	Number of shares representing the stated capital as at the end of the year	✓	358
7.6 (x)	A distribution schedule of the number of holders in each class of equity securities and related information	✓	141
7.6 (xi)	Ratios and market price information on equity, debt, change in credit rating	✓	398, 138, 143
7.6 (xii)	Significant changes in the Company's or Subsidiaries' fixed assets	✓	343
7.6 (xiii)	Details of funds raised through a public issue, Rights Issue and a Private Placement during the year -There were no share issues, rights issues or private placements during the year	✓	-
7.6 (xiv)	Information in respect of Employee Share Ownership or Stock Option schemes - The Company does not have any Employee Share Ownership or Stock Option Schemes at present.	✓	-
7.6 (xv)	Disclosure pertaining to Corporate Governance practice in terms of Rules 7.10.3, 7.10.5 c and 7.10.6 c of Section 7 of the Listing Rules	✓	28
7.6 (xvi)	Related party transactions exceeding 10% of the Equity or 5% of the total assets of the entity - The Company did not have any Related Party Transactions exceeding this threshold during the year.	✓	-

Rule No.	Principle and compliance	Complied
7.10	**CORPORATE GOVERNANCE**	
7.10.1	**Non Executive Directors**	
7.10.1 (a)	**Two or one-third of the Directors, whichever is higher, should be Non-Executive Directors.** As at 31st March 2021 The Board comprised five Non-Executive Directors out of a total of 10 Directors which is 50 as a percentage	✓
7.10.1 (b)	**The total number of Directors is to be calculated based on the number as at the conclusion of the immediately preceding Annual General Meeting.** The Board comprised 10 Directors as at the conclusion of the immediately preceding AGM.	✓
7.10.1 (c)	**Any change occurring to this ratio shall be rectified within ninety (90) days from the date of the change.** The cessation and the appointment of the Directors as disclosed in 7.10.1 (b) complied with the requirement.	✓

Rule No.	Principle and compliance	Complied
7.10.2	**Independent Directors**	
7.10.2 (a)	**Two or one-third of Non-Executive Directors, whichever is higher, should be independent.** The Board has determined that three Directors out of five Non-Executive Directors are Independent.	✓
7.10.2 (b)	**Each Non-Executive Director should submit a declaration of independence/non-independence in the prescribed format.** All Directors have submitted annual declarations in respect of the year under review.	✓
7.10.3	**Disclosures Relating to Directors**	
7.10.3 (a)	**The Board shall make determination of Independence/Non- Independence annually and Names of Independent Directors should be disclosed in the Annual Report.** Please refer pages 40 to 43 of the Annual Report	✓
7.10.3 (b)	**In the event a Director does not qualify as independent as per the rules on Corporate Governance but if the Board is of the opinion that the Director is nevertheless independent, it shall specify the basis of the determination in the Annual Report.** Not applicable	✓
7.10.3 (c)	**A brief resume of each Director should be published in the Annual Report including the areas of expertise** Please refer pages 40 to 43 in the Annual Report.	✓
7.10.3 (d)	**A brief resume of any new Director appointed to the Board should be provided to the Exchange for dissemination to the public.** Please refer page 43 in the Annual Report.	✓
7.10.4	**Criteria For Defining of Independence**	
7.10.4 (a-h)	**Requirements for meeting criteria to be independent.** All Independent Directors of the Company met the criteria for independency specified in this Rule.	✓
7.10.5	**Remuneration Committee**	
7.10.5 (a)	**A listed Company shall have a Remuneration Committee. The remuneration committee shall comprise a minimum of two Independent Non-Executive Directors or of Non-Executive Directors a majority of whom shall be independent, whichever shall be higher.** Board appointed Remuneration Committee is in place. Please refer page 231 of the Annual Report. All the Directors in the Remuneration Committee comprised independent Non-Executive Directors. Mr. Ashane Jayasekara who is an Independent Non-Executive Director is the Chairman of the Committee.	✓
7.10.5 (b)	**Functions of Remuneration Committee shall be to recommend the remuneration of the Chief Executive Officer and the Executive Directors.** Please refer the Report of the Remuneration Committee on page 231 of the Annual Report.	✓
7.10.5 (c)	**The Annual Report shall set out;** i. The names of the Directors that comprise the remuneration Committee; ii. A statement of remuneration policy; iii. Aggregate remuneration paid to Executive and Non- Executive Directors. Please refer the page 231 of Remuneration Committee Report.	✓

Rule No.	Principle and compliance	Complied
7.10.6	**Audit Committee**	
7.10.6 (a)	Composition **The Audit Committee shall comprise a minimum of two Independent Non-Executive Directors or a majority of Independent Non-Executive Directors whichever is higher.** **One Non-Executive Director shall be appointed as Chairman of the Audit Committee by the Board.** **The Chief Executive Officer and Chief Financial Officer shall attend Audit Committee meetings.** **The Chairman or one member of the Committee should be a member of a recognise professional accounting body.** All the members of the Audit Committee are Independent Non- Executive Directors. Mrs. Yogadinusha Bhaskaran is the Chairperson of the Committee who is a Non-Executive Director. Both the Managing Director and the Chief Financial Officer attend the meetings by invitation. The Chairperson of the Audit Committee is a fellow member of The Chartered Institute of Management Accountants of UK. Please refer page 40 to 43 of Directors' profiles and Mr. A Jayasekara, a member of the Committee is also a Fellow Member of The Institute of Chartered Accountants of Sri Lanka.	✓
7.10.6 (b)	Function **The functions of the Audit Committee shall be as set out in section 7.10 of the Listing Rules.** The Audit Committee shall oversee financial reporting, compliance function, risk management and make recommendations to the Board on matters relating to the external auditor. Please refer Audit Committee Report on page 233 of the Annual Report.	✓
7.10.6 (c)	Disclosure in the Annual Report **Annual Report shall set out;** **The names of the Directors who comprise the Audit Committee.** **The Audit Committee shall make a determination of the independence of the Auditors and disclose the basis for such determination.** **A report by the Audit Committee setting out the manner of compliance of the functions set out in section 7.10 of the Listing Rules.** Please refer the Audit Committee Report' on page 233 for the required disclosure.	✓

INTEGRATED RISK MANAGEMENT REPORT

As a large financial institution, the success of our business depends on striking the right balance between risk and return. L B Finance PLC's (LBF) risk management approach aims to ensure the effective management of key risks at all levels of the business in order to support the achievement of strategic objectives and safeguard the Company's stability and reputation in the financial sector now and in the future.

LBF'S RISK MANAGEMENT APPROACH

RISK UNIVERSE

LBF's risk universe represents the key (Quantitative and Qualitative) risks that the Company may be exposed to as a result of the environment in which it operates. What we consider to be our key risks are those that can have an impact on the Company's business model, ability to achieve its strategic objectives or sustainable growth of the Company.

Quantitative Risks	Qualitative Risks	Emerging Risks
Credit risk	Operational risk	Travel restrictions
Liquidity risk	IT and Information Security risk	Strict health and safety regulations
Market risk	HR risk	Risks associated with working from home
Strategic risk	Legal risk	Uncertainty in economic policies
Capital management	Reputational risk	Socioeconomic stress due to pandemic
RISK MANAGEMENT PROCESS	**RISK GOVERNANCE STRUCTURE**	**RISK GOVERNANCE FRAMEWORK**

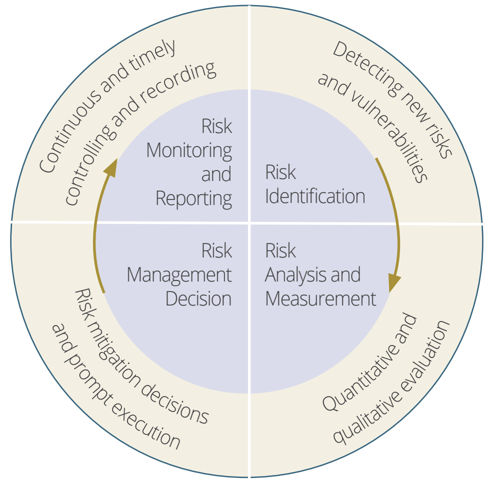
LBF's strong risk foundations ensured the Company's performance for the FY 2020/21 was consistent with the expectations. The Company's overall risk profile remained stable in the FY 2020/21. All key risks continued to be well managed during the year in line with the board-approved risk appetite. However, the notable exception was the higher default risk attributed to the economic uncertainties stemming from the COVID-19 pandemic. Taking action to address the situation at the outset itself, credit risk protocols were tightened with special emphasis on managing default risk and concentration risk.

Ashane Jayasekara
Chairman
Integrated Risk Management Committee

RISK MANAGEMENT PROCESS

We apply a comprehensive Risk Management Process to ensure key risks within the LBF's risk universe are well managed at all times. Covering all aspects from identification and measurement to risk mitigation and risk reporting, the Risk Management Process underpins our efforts to manage enterprise-wide risks and to promote responsible risk taking at all levels of the business.

All material risk types, including credit risk, liquidity risk, market risk, strategic risk, operational risk and reputational risk are managed via this Risk Management Process.



Risk Identification

How we identify and review our risks

The identification of risks is an essential element of our early warning system. All existing risk categories, their sub-risks as well as their risk sources within the Company's business are determined and clearly distinguished from each other on an ongoing basis.

We follow a two-pronged approach; a top-down risk assessment to determine significant events in our immediate operating environment as well as the broader operating context and how they may impact the strategic direction of our business over the medium and long term. This is paired with a bottom-up evaluation to identify operational risks that may impact the course of our day-to-day business activities.

This process has also proven to be a vital source for identifying new emerging frontier risks that have the potential to affect our business over time.

SIGNIFICANT EVENTS THAT HAD AN IMPACT ON LBF'S RISK UNIVERSE IN FY 2020/21

Event	Impact on Key Risk Categories				
	Default Risk	Concentration Risk	Liquidity Risk	Market Risk	Operational Risk
Economic downturn induced by the COVID-19 pandemic	M	L	L	L	M
Debt Moratorium and concessionary interest rates for COVID-19 affected businesses and individuals			M	M	
Ban on vehicle imports		H			
Threat on IT security due to Working from Home					M
Low interest rate environment	L	L	L	L	
Rise in world gold prices and subsequent increase in gold loans portfolio pushed by high demand		M		L	

H High M Medium L Low

Impact of COVID-19 on LBF's Risk Universe

The single most significant risk event detected in all of the FY 2020/21, was the economic and social impact of the COVID-19 pandemic. The pandemic-induced global economic downturn had a cascading effect on the Sri Lankan economy causing some major challenges amidst dwindling export markets and severe disruptions in global trade activity. Moreover, restrictions imposed by the government including the 2-month island-wide lockdown, the closure of the airport for over 10 months, isolation orders and inter-district mobility restrictions issued from time to time, collectively led to muted economic activity in turn applying severe pressure on almost all key sectors of the economy. This has subsequently caused financial stress among the retail, SME and corporate clients which has led to elevated levels of credit risk in the short term. For LBF, this meant having to contend with a higher default risk when compared against last financial years.

RISK ANALYSIS AND MEASUREMENT

How we analyse and measure risks

As per LBF's Risk Management Process, risk assessment begins with the rigorous quantification of all key risks under normal and stressed conditions in order to establish the Company's ability to absorb the impact of these events, if they materialised. Moreover, as part of our regular analysis, key products and portfolio risks are reviewed with risk assessment scorecards prepared to capture risk drivers that may have an impact on branches as well as those relevant only to specific portfolios.

In the year under review, a new Risk Assessment Scorecard was implemented as an effort to create a standardized mechanism to quantify the risk of branches and Gold Loan Centers (GLCs). As per the scorecard, each branch/GLC is assessed on a series of KPIs under 6 major categories: Credit, FD, Gold Loans, Profitability, Operations and Other Internal Controls and assigned scores depending on the risk level of each KPI.

Following table depicts the types of risks and the KPIs used in arriving at the branch risk grading.

Concentration Risk	Size of the portfolio
	Customer Concentration
Default Risk	NPA ratio
	Collection ratio
	Activity ratio
Liquidity Risk	FD renewal ratio
Operational Risk	Physical security measures
	Controls on fire risk
	CCTV surveillance
Market Risk	Safety margin
Reputational Risk	No. of customer complaints
Strategic Risk	Target achievement
	Interest spread
	Cost to income ratio
	Profitability

The new Risk Assessment Scorecard also helps LBF to comply with the Finance Business Act Direction No.6 of 2020 requirements on Business Expansion and Operations. Accordingly, the Integrated Risk Management Committee reviews the results of this Branch Risk Assessment Scorecard on a quarterly basis.

RISK MANAGEMENT DECISION

How risk outcomes are incorporated into the decision-making process

LBF's risk strategy, including the risk appetite limits for each major risk category are reviewed and approved by the Board annually in line with the Company's short, medium and long term plans. Risk appetite limits are set for all key risk categories to provide the foundation for risk taking activities, while risk tolerance levels are set within the context of the risk appetite limits. These along with a framework of policies and procedures serve as operational controls to facilitate responsible risk taking in the course of the day-to-day business.

RISK MONITORING AND REPORTING

How risk is monitored and reported

Risk monitoring and reporting is an integral part of LBF's overall risk management approach. The main aim of our risk reporting mechanism is to provide the management with consistent, accurate, clear and useful risk data to enable them to understand material qualitative and quantitative risks that have a bearing on LBF's overall risk profile.

The Risk Appetite Statement (RAS) is reviewed and approved by LBF's Board of Directors on an annual basis to reflect the current and expected developments in the operating environment.

The Company's Risk Management Department is tasked with proactively monitoring all key risks using appropriate modeling tools and monitoring metrics. Accordingly, the Risk Management Department monitors risks taken by the business units against the board-approved risk appetite along with risk-reward considerations.

Risk Appetite Statement

Risk Appetite Criteria	Appetite	Regulatory Limit	Actual as at 31st March 2021	Actual as at 31st March 2020
Credit Risk				
Loans and Advances				
Non-performing loans ratio – Gross	5%-7%		5.36%	3.93%
Non-performing loans ratio – Net	< 1.0%		0.10%	-0.12%
Exposure to secured loans and advances	>95%		97.00%	97.26%
Maximum exposure to single borrower – secured - Individual	<=5%	15% of capital funds	1.67%	1.78%
Maximum exposure to single borrower – secured - Group	<=10%	20% of capital funds	1.67%	1.78%
Maximum exposure to single borrower – unsecured – Individual	<=0.5%	1% of Core capital	0.07%	0.07%
Maximum exposure to aggregate unsecured financing	<=4%	5% of capital funds	0.58%	1.12%
Liquidity Risk				
Liquid assets ratio	12.00%	Fixed Deposits - 6% Savings -10% Unsecured Borrowings -5%	17.89%	15.65%
Deposits renewal ratio	>=75%		83.52%	87.87%
Maximum single depositor/group exposure	<=5% of total deposits		2.10%	2.68%
Maximum exposure to large deposits (Over Rs.50 mn)	<=20% of total deposits		18.06%	20.23%
Capital Adequacy				
Core capital ratio	9.00%	7.00%	23.87%	19.04%
Total risk weighted capital ratio	15.00%	11.00%	25.32%	20.75%
Capital funds to deposits ratio	12.00%	10.00%	32.83%	25.77%
Market Risk (Increase in market interest rates on rate sensitive liabilities)				
% Impact on Net Interest Income from 100 bps shock	5.00%		3.35%	3.50%
% Impact on Net Interest Income from 200 bps shock	10.00%		6.70%	7.00%
% Impact on Net Interest Income from 300 bps shock	15.00%		10.05%	10.50%
% Impact on Net Interest Income from 400 bps shock	20.00%		13.40%	14.00%

Our risk monitoring and reporting infrastructure is designed to capture the regulatory reporting parameters and other disclosures to support internal management decision making processes. As part of our Risk Management and Reporting (RMR) Procedure, a series of "Key Risk Reports" are prepared by the Risk Management Department, in varying frequencies to enable the relevant governing bodies to monitor, steer and control the Company's risk taking activities effectively.

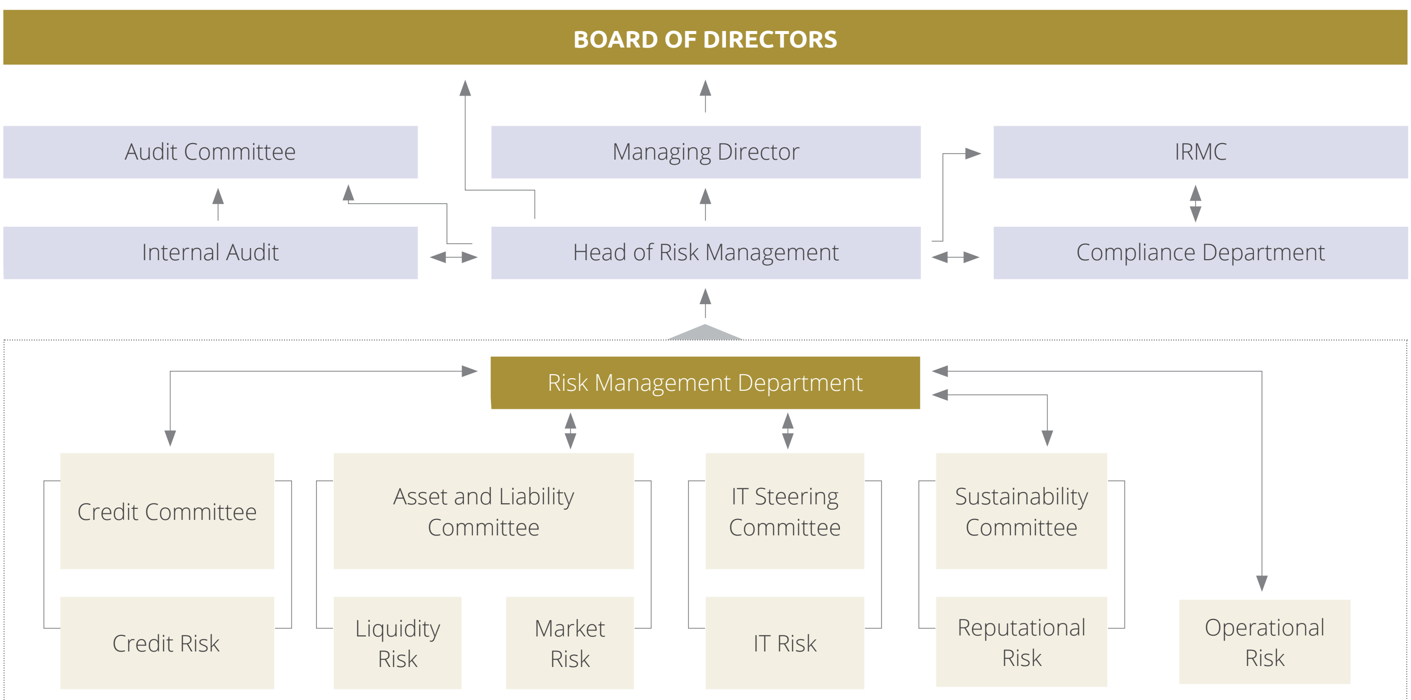
KEY RISK REPORTS INCLUDED IN THE RMR PROCEDURE

Report	Frequency	Prepared by	Submitted to (Relevant governing Body)
Key Risk Indicators (KRIs)	Monthly	RMD	IRMC
	Quarterly		BoD
Risk Database	Quarterly	RMD	IRMC
Top Risks	Quarterly	RMD	IRMC and BoD
Qualitative Risk Report	Quarterly	RMD	IRMC
Branch Risk Assessment	Quarterly	RMD	IRMC

RISK GOVERNANCE

As the apex body responsible for the stewardship of the Company, the Board of Directors is the ultimate authority in charge of risk governance at LBF.

Risk Governance Structure



Risk Governance Framework

In its capacity as the main governance body, the LBF Board has established the 'three lines of defence' mechanism to provide the foundation for the cohesive governance of risk at all levels of the business.

BOARD OF DIRECTORS

1st Line of Defence	2nd Line of Defence	3rd Line of Defence
HODs Management Committees	IRMC Audit Committee RMD	Internal Audit External Audit Compliance Function

Day-to-Day Management of Risks

- First and direct responsibility for the assessment and control of the Company's risks
- Embeds Risk Management Framework and sound risk management practices into standard operating procedures
- Monitors risk management performance in operation
- Accountable for effectiveness of risk management in operation

Oversight of Risk Policies and Framework

- Develops and implements the framework, policies, systems, procedures and tools
- Providing support to the business units, review and report key risks to the IRMC

Independent Review and Assurance

- Reviews effectiveness of risk management practices
- Confirms level of compliance
- Recommends improvements and enforces corrective actions where necessary

1ST LINE OF DEFENCE

The first line of defence comprises of business units, departments and specific Management Committees. The primary responsibility for risk management in the day-to-day operations of the business is borne by the business units. They operate under the supervision of a network of Management Committees appointed for specific purposes.

The Asset and Liability Committee (ALCO) provides oversight for liquidity risk at an operational level. The ALCO's responsibilities include monitoring and managing the assets and liabilities of the Company and also maintaining the Company's overall liquidity position to ensure LBF's liquidity levels are in line with regulatory requirements. Market risk management also comes under the purview of the ALCO. In this regard, the ALCO is responsible for monitoring market risk, reporting and analyzing, making proposals, setting limits and guidelines, and formulating and implementing plans relating to market risk management.

The Credit Committee is held accountable for the day-to-day management of credit risk. As part of their duties, the Credit Committee monitors LBF's lending portfolio and oversees the management of asset quality and recovery actions. The Committee also periodically reviews the credit policy and lending guidelines issued to business segments, vis-a-vis changing market conditions and industry dynamics.

IT Steering Committee (ITSC) is charged with managing operational risk and more specifically IT risk. In doing so, the ITSC provides leadership for the planning and management of IT investment and the execution of LBF's IT strategy to support the achievement of the Company's growth objectives. The ITSC is further responsible for safeguarding the Company's information security infrastructure.

The Sustainability Committee is tasked with safeguarding the Company against reputational risks that could arise as a result of sustainability issues. Accordingly, the Sustainability Committee is responsible for the formulation and the review of LBF's CSR policy and to ensure that CSR and sustainability initiatives undertaken by the Company have the capacity to augment LBF's reputation as a sustainable entity. Stemming from this, the Sustainability Committee is further charged with the responsibility of implementing social and environmental initiatives that demonstrates how sustainability is integrated into our business strategy.

2ND LINE OF DEFENCE

Two Board appointed Sub Committees (Integrated Risk Management Committee and the Board Audit Committee) along with the Risk Management Department form the second line of defence.

The Integrated Risk Management Committee (IRMC) - Please refer to page 236 of this report for a detailed account of the IRMC's composition, key functions and activities for the current financial year.

The Board Audit Committee - Please refer to page 233 of this report for a detailed account of the Audit Committee's composition, key functions and activities for the current financial year.

Risk Management Department of the Company, plays a vital role in the holistic management of risk across the business. It is the responsibility of the Risk Management Department to develop and implement the necessary procedures and instructions for managing risks at all levels of the business operations. In addition, the Risk Management Department is required to monitor on an ongoing basis, all risk metrics to ensure they remain within approved tolerance limits.

The Risk Management Department is headed by the Senior Manager – Risk Management who directly reports to the Managing Director and has a functional reporting line to the Board of Directors and the IRMC.

3RD LINE OF DEFENCE

The third line of defence which comprises the **Internal Audit Department, Compliance Function and the External Auditors,** periodically review the adequacy of the Company's risk management infrastructure, the level of compliance with policies and standards and the completeness and reliability of the risk assessment and reporting process. They are also collectively responsible for providing an assurance regarding the efficacy of LBF's overall risk control and management process.

RISK CULTURE

We promote a strong risk culture where employees at all levels are responsible for the proper management of risks in line with the Company's established risk control mechanisms. With the LBF Board setting the tone from the top, a sound risk culture permeates across all levels of the business. In addition, our Risk Management Department regularly engages in awareness building activities aimed at reinforcing a strong risk culture among employees.

MANAGING OUR KEY RISKS

Summary of Key Risks

Risk Type	Risk Level	Objective	Trend
Credit Risk	M	To safeguard the asset quality and reduce exposures to high risk segments	▲
Liquidity Risk	L	To safeguard against funding constraints that prevent growth and meet demands of depositors/investors	—
Capital Management	L	To maintain adequate capital buffer to withstand unexpected losses	—
Market Risk	M	To safeguard against adverse movement of market factors arising out of price sensitivities of funding sources, investments, commodity prices	—
Operational Risk	L	To improve the reliability and effectiveness of business operations and enhance organisational capability in ensuring safety of staff.	▲
Strategic Risk	L	To minimize risks associated with Company's business strategy, strategic objectives and strategy execution	—
IT and Information Security Risk	M	To safeguard information asset and ensure business continuity	▲
Legal/Regulatory Risk	L	To minimize the cost of non-compliance and litigation	—
Human Resource Risk	L	To ensure the availability of skilled and competent human resources to successfully conduct business operations	—
Reputational Risk	L	To safeguard the Company's brand value / goodwill against adverse internal and external events	—

H High M Moderate L Low ▲ Increasing ▼ Decreasing — Stable

CREDIT RISK

Credit risk is the potential loss LBF would have to bear should its borrowers fail to meet their obligations towards the Company. In our business, credit risk is inherently associated with our core lending model and hence constitutes the Company's largest risk exposure. This can be broadly categorised into three types; default, concentration and settlement risk. When it comes to financing business, settlement risk also falls under the category of credit default risk.

Key Policies and Procedures for Managing Credit Risk

Credit Risk Management Framework and Policy

In the year under review LBF took the initiative to develop a comprehensive Credit Risk Management Framework and Policy.

The new Credit Risk Management Framework and Policy sets the overall direction for managing credit risk at the enterprise level based on a clearly articulated Risk Appetite Statement of the Company (RAS). The RAS had been articulated putting more emphasis on credit risk since it's the largest risk the Company is exposed to. The indicators of RAS pertaining to credit risk promotes responsible risk taking by providing greater clarity on the credit risk tolerance limits for key segments of LBF's loan book including maximum exposure limits for secured and unsecured loan portfolios along with single borrower limits to mitigate concentration risk.

The following policy manuals are in place to underpin the Credit Risk Management Framework and Policy of the Company.

Credit and Operations Manual

The purpose of the Credit and Operations Manual is to streamline the loan origination process. It serves as a guide for Marketing Officers by detailing the credit facilities / products offered by the Company along with the credit granting criteria under each lending category. It also captions the respective due diligence protocols that need to be carried out as part of the initial customer on-boarding process for new lending activities.

Credit Approval Manual

The Credit Approval Manual sets out credit approval limits and approval criteria for each loan / product category. The Credit Approval Manual also specifies structural controls along with the relevant protocols for the delegation of authority for credit approvals in order to promote proper accountability.

Recovery Manual

The Recovery Manual is designed as a guide for Recovery Officers to ensure post-disbursement credit risk mitigation activities are carried out effectively. Accordingly, the Recovery Manual details the procedure that needs to be followed for the recovery of delinquent loans and advances starting from initial follow-up to repossession of assets. It also contains the responsibilities of Recovery Officers and the documentation process to be followed at each stage of the recovery process.

Default Risk

The potential financial loss to the Company if borrowers do not honour their repayment obligations to the Company as and when they fall due.

How does the risk translate to the business:

Borrowers' failure to meet their debt commitments towards the Company, diminishes LBF's earning capacity in turn causing margin pressure due to increase in loan loss provisioning. It also causes a disruption in the planned cash flow cycle and raises concerns regarding a liquidity mismatch.

Key Risk Indicators:

- Gross NPL Ratio
- Provision Coverage Ratio
- Stage analysis of impairment provisions
- Types of collateral

Management Approach

LBF's fundamental approach to credit risk management is based on secured lending activities coupled with selective lending strategy for unsecured loans.

Monitoring and Governance

- Follow up actions by the Recoveries Department.
- The Credit Committee periodically reviews and updates the credit policy and lending guidelines issued to business segments, vis-a-vis changing market conditions and industry dynamics.

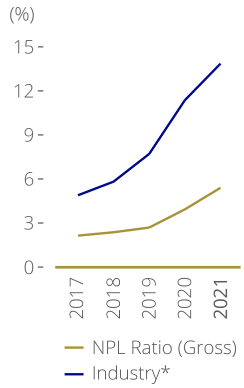
Situational Analysis for FY 2020/21

The practical difficulties due to the island-wide lockdown from March - May 2020, meant customers were unable to service their loans during this time, leading to a deterioration in LBF's Gross NPL Ratio in the first quarter of the current financial year. However, with the resumption of economic activity after lockdown restrictions were lifted in mid-May 2020, a gradual improvement in the NPL Ratio was observed towards the latter part of the financial year.

Industry (LFCs and SLCs) NPL Ratio stood at 11.37% in March 2020 and 13.86% by Dec 2021 - Source CBSL.

TRENDS

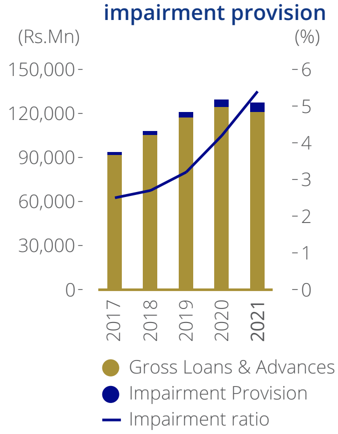
NPL ratio



**Industry is comprised of LFCs and SLCs which represents data as at 31/12/2020 (Source - CBSL)*

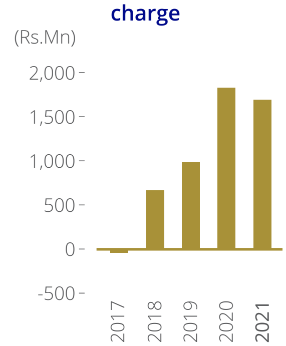
Due to the pandemic related economic downturn, the asset quality of the industry as a whole deteriorated during the year under review. Company was able to maintain its outperformance against the industry by maintaining a much stronger overall asset quality.

Gross loans and impairment provision



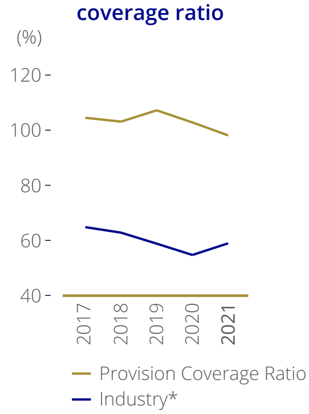
The provision for impairment as a percentage of gross loans and receivables has increased as a result of the increase in the NPL ratio.

Impairment charge



During the year under review the impairment charge dropped mainly due to the drop in the leasing portfolio and the improvements in collecton.

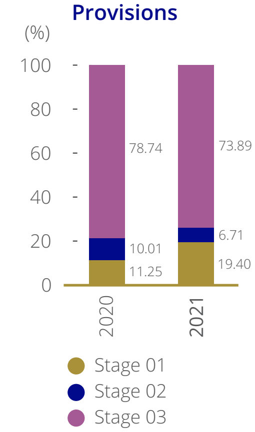
Provision coverage ratio



**Industry is comprised of LFCs and SLCs which represents data as at 31/12/2020 (Source - CBSL)*

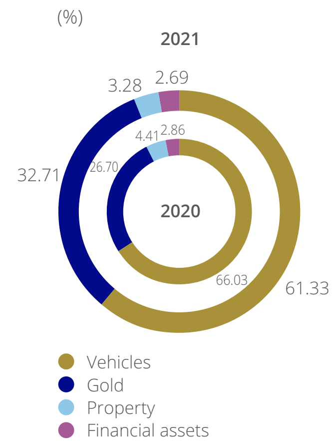
As a result of Company's prudent provisioning policy, almost all the delinquent loans have been fully provided for. Thus, the Company's provision coverage ratio is significantly above the industry.

Stage Analysis of Impairment Provisions



During the current year, stage 3 composition has come down as a result of settlements.

Main types of collaterals



From total loans and advances 97.3% is secured by either physical or financial collaterals as at 31st March 2021.

Impairment stress test

Stressed scenario- Impairment charge increasing by stressed amounts impacting the Company's capital adequacy ratio.

Total Risk Weighted Capital Ratio 25.32%			
Scenario	**1**	**2**	**3**
Magnitude of Shock	10.00%	25.00%	50.00%
Capital Adequacy Ratio	24.90%	24.26%	23.17%

Top 20 customer stress test

Stressed Scenario - Top 20 customers falling into NPL category and if provided fully impacting the capital adequacy ratio

Total Risk Weighted Capital Ratio 25.32%			
Scenario	**1**	**2**	**3**
Magnitude of Shock	Top 5	Top 10	Top 20
Capital Adequacy Ratio	25.03%	24.88%	24.67%

Actions Taken by the Company to Manage the Default Risk

LBF's credit risk appetite limits were reviewed and revised by the Board in mid-2020.

Expedited the planned digitalization of recovery operation by extending the online lease/loans settlement flexibility to customers via LB CIM App.

MIS was strengthened, with a series of dashboards introduced on the daily progress of collections.

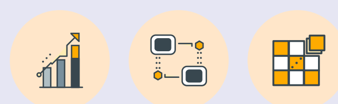
Additional provisioning was made in tandem with the increase in the Gross NPL Ratio for the year.

The Risk Management Department prepared few specialized reports to demonstrate the province/district wise default risk status.

In line with debt moratorium announcements by CBSL, LBF offered relief for the customers who would be eligible to receive moratorium benefits.

Meanwhile, the company gained a better understanding on the impact on the default risk and provisioning requirements.

A Credit Risk Scoring Model was developed with collaboration of a team of international data scientists.



Focus for the Future

Expedite the testing and model validation aspects to enable the implementation of the Customer Rating Scorecard for all core products.

Concentration Risk

The potential financial loss to the Company due to the lack of portfolio diversification.

How does the risk translate to the business:

The overdependence on a specific product may stifle LBF's ability to generate consistent returns in a low credit growth market. Over exposure to a specific customer, sector, geography and etc. will threaten the continuity of the business in the event of unforeseen challenges affecting customer/sector/geography prospects.

Key Risk Indicators:

- Exposure by Customer size
- Product Concentration
- Industry Concentration
- Geographical Concentration

Management Approach

Ensure the lending portfolio remains well diversified which prevents accumulation of risky exposures to a specific product/ customers/sector/geographical location.

Monitoring and Governance

The Risk Management Department closely monitors the lending portfolio to determine movements in the product, industry and geographical concentration.

Situational Analysis for FY 2020/21

With many customers reluctant to borrow amidst widespread economic uncertainty, the demand for large scale facilities declined significantly in FY 2020/21. The Company also followed a cautious approach in lending large scale facilities.

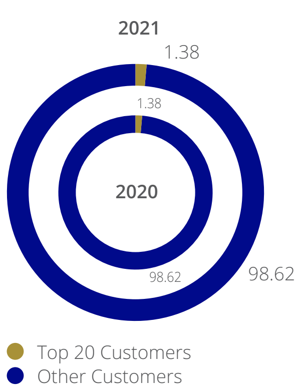
Meanwhile on the back of the vehicle import ban, the demand for leasing of unregistered vehicles also slumped during the financial year. However, the market appeared to correct itself in the latter part of the financial year leading to a surge in demand for registered vehicle leases, a trend that was seen for the remainder of the financial year.

A strong demand for the Gold Loans was seen in FY 2020/21 as the product continues to gain traction as a mainstream financial solution for the SME sector. The upward movement in world gold prices helped to further bolster the demand for Gold Loans throughout the current financial year.

TRENDS

Credit exposure to top 20 customers

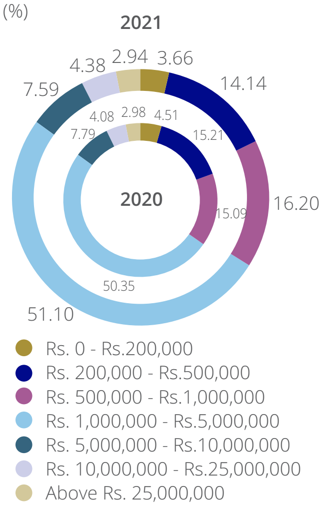
(%)



Due to the uncertainty of the country's economy, the Company did not encourage the disbursement of large credit facilities. As a result, the concentration of top 20 customers remained unchanged during the year.

Exposure by customer size

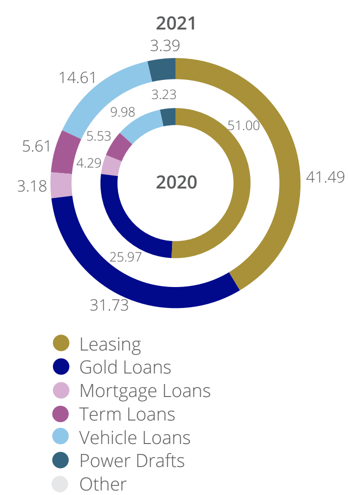
(%)



The graph depicts an analysis of exposure by customer size (consolidated exposure) based on net outstanding before impairment. This excludes gold loans customers; represents 69.6% of the total portfolio. Exposure to large customers (over Rs.25Mn) stood at 2.9%, proving the low customer concentration of the Company.

Product concentration

(%)

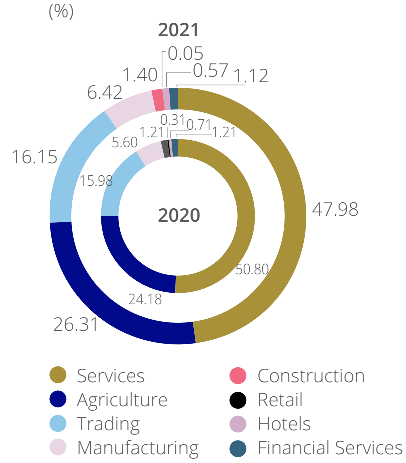


Due to the ban on vehicle imports that prevailed during the year, the concentration on vehicle backed loans (Leasing, Vehicle Loans, power Drafts and HP) declined from 64.2% to 59.5%.

TRENDS

Industry concentration

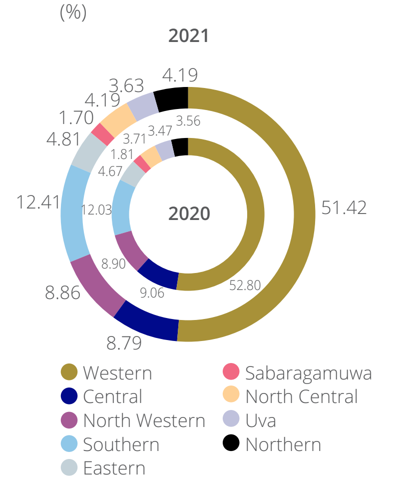
(%)



Concentration on services sector has declined due to the pandemic related adverse impact on the sectors such as tourism and transportation.

Geographical concentration

(%)



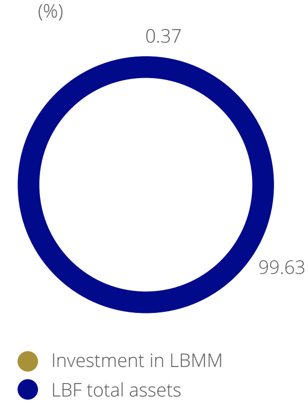
Western province remains to be on the top in term of geographical concentration whilst the contribution declined due to disturbed economic activity prevailed during the year.

Cross-border risk

The risk that the Company will be unable to obtain payments from its customers or third parties on their contractual obligations as a result of certain actions taken by foreign governments, mainly relating to convertibility and transferability of foreign currency is referred to as the cross-border risk. The Company's cross-border assets comprise investment in L B Microfinance Myanmar Company Limited (LBMM).

Exposure to cross-border assets

(%)



LBF has only 0.4% from its assets on Myanmar subsidiary.

Actions Taken by the Company to Manage the Concentration Risk

Realigning with the market by promoting leasing and auto finance as a solution for registered vehicles.

Improving portfolio diversity by increasing the skew towards Gold Loans.

Continuous and ongoing monitoring of all portfolios, sectors / geographical thresholds to detect the likelihood of higher concentration or overexposure.

Stress testing at the total portfolio and sub-portfolio level, to assess the impact of changing economic conditions on LBF's asset quality, earnings performance, capital adequacy and liquidity.

Focus for the future

- Be vigilant to market developments following the third wave of the pandemic in order to minimize accumulation of risky exposures.
- Continuing to follow a cautious approach in lending for large scale facilities.
- Strengthening the stress testing framework of the Company emphasizing more on concentration risk.

LIQUIDITY RISK

The Company's primary objective in liquidity risk management is to ensure adequate funding for its businesses throughout market cycles, including periods of financial stress. To achieve this objective the Company regularly monitors liquidity position and maintains an adequate buffer of liquid assets. The Company also maintains access to diverse funding sources to meet unforeseen liquidity requirements. All statutory and prudent liquidity ratios are monitored against tolerance limits and stress testing is carried out regularly to assess the effectiveness of liquidity management.

Liquidity Risk

Liquidity risk for a financial institution can take two forms; market liquidity risk and funding liquidity risk.

- **Market liquidity risk** is the inability to exit a position easily or asset liquidity.
- **Funding liquidity risk** means the Company's inability to finance assets continuously at an acceptable borrowing rate.

How does the risk translate to the business:

Typically, a Company's market liquidity risk is considered to be low if its assets can be liquidated without a significant shift in price.

Funding liquidity risk generally arises when creditors either withdraw credit or change the terms on which funds are granted in such a way they are no longer profitable. Funding liquidity risk would increase if the Company's credit quality is perceived to be deteriorating and also when the financial conditions as a whole are deteriorating.

Key Risk Indicators:

- Net Liquidity Gap Based on Contractual Maturities
- Net Loans to Total Assets ratio
- Loans to Deposit Ratio
- Deposit Renewal Ratio
- Statutory Liquid Asset Ratio
- Funding Mix
- Interest Bearing Liabilities Mix

Management Approach

LBF's Liquidity management approach aims to build a solid funding base that will provide a consistent source of funds to ensure that sufficient liquidity is maintained to support the Company's growth strategy, business plans and honour its financial obligations, under normal as well as adverse circumstances. Therefore, the Company aims to maintain an adequate buffer of liquid assets at all times. As part of its overall liquidity management strategy, LBF strives to maintain access to diverse funding sources both locally and internationally. All statutory and prudent liquidity ratios are also monitored against tolerance limits while stress testing is carried out regularly to assess the effectiveness of the Company's liquidity management strategy.

Monitoring and Governance

- The ALCO is responsible for monitoring liquidity risk, reporting and analyzing, making proposals, setting limits and guidelines, and formulating and implementing plans relating to liquidity risk management. The Treasury Department prepares forecasted cash flow statement and presents at the ALCO to evaluate the future funding requirements of the Company.
- The Risk Management Department uses stressed behaviour modeling techniques to determine the Company's cash flow requirements, covering stress points during the month.
- Daily funding requirements are closely monitored by the Treasury Department taking into consideration routine cash flows as well as one-off outflows that relate to large single obligations.

Situational Analysis for FY 2020/21

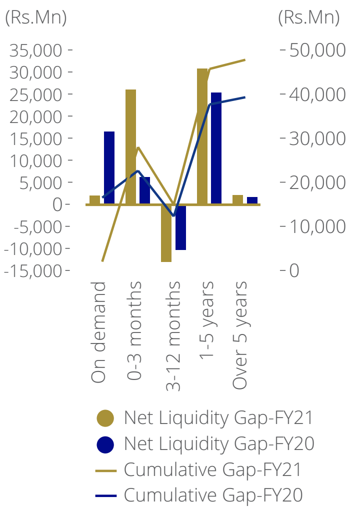
The Company continued to maintain adequate liquidity throughout the year, ensuring that sufficient funds were available to meet sudden/unforeseen funding requirements such as Fixed Deposit withdrawals. However, withdrawals were not high as the expected levels which exhibited the trust placed on the Company's stability. Company has maintained high liquidity buffer than the average levels throughout the year.

This was mainly due to the following reasons;

- The Company further strengthened its funding pipeline to withstand liquidity related shocks which would have arisen due to debt moratoriums announce by CBSL.
- The credit slump created by the pandemic induced economic downturn leading to the lack of viable lending opportunities compared to previous years.
- The high renewal rate for existing deposits and the steady inflow of new deposits in spite of the low interest rate environment.
- The CBSL's decision to lower the Statutory Liquid Asset ratio applicable to NBFIs from April 2020.
- The CBSL's decision to reduce the statutory minimum threshold for investments held in government securities by NBFIs.

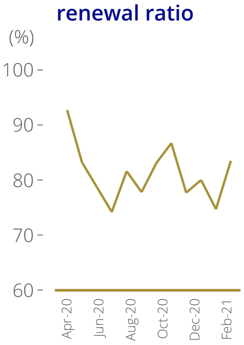
TRENDS

Net liquidity gap based on contractual maturities



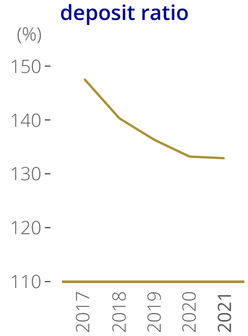
The new liquidity position in 0-3 months bracket increased due to the excess liquidity position of the Company. Even though the 3-12 age bracket shows a negative liquidity gap, the FD renewal ratio above 75% makes the gap positive in the actual position.

Deposit renewal ratio



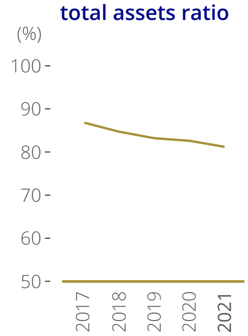
The renewal ratio was maintained above the threshold limit of 75% through out the year despite the economic shocks generated by the pandemic.

Loans to deposit ratio



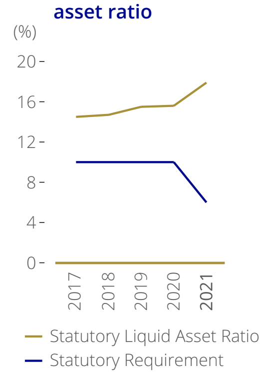
The Company's loan book is predominantly financed by deposits from customers. Loans to deposit ratio over 100% indicates that the Company is making the optimum use of deposit financing by transforming them into interest earning assets.

Net loans to total assets ratio



The consistency in the net loans to total assets ratio of the Company reflects that the Company has maintained the share of loans and advances in total asset base reflecting its focus on growing core business, i.e. loans and advances.

Statutory liquid asset ratio



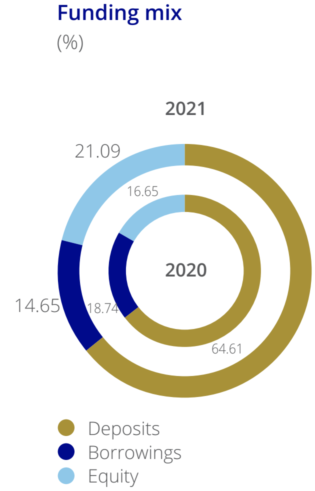
The Company's statutory liquid asset ratio soared during the year due to the Company's decision of maintaining higher liquidity buffers.

Stress Test on Liquid Asset Ratio

Stressed Scenario - Sudden fall in deposit base impacting liquid asset ratio.

Statutory Liquid assets ratio as a 31st March 2021 - 17.89%			
Scenario	1	2	3
Magnitude of Shock	2.50%	5.00%	10.00%
Stressed Statutory Liquid Asset Ratio	15.67%	13.82%	9.83%

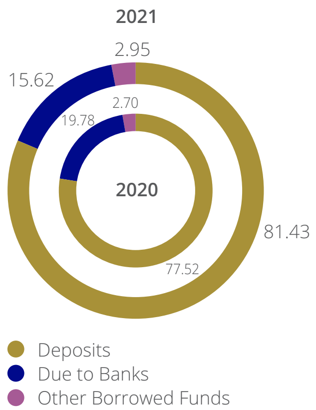
Funding mix



As at 31st March 2021, 78.9% of Company's total assets are funded by either borrowings or public deposits as opposed to 83.4% as at 31st March 2020.

TRENDS

Interest bearing liabilities mix
(%)



The Company settled few bank loans during the year, hence the dependence on bank borrowings declined.

Actions Taken by the Company to Manage the Liquidity Risk

The Risk Management Department prepared a comprehensive cash flow analysis to assess the impact on cash flows under stressed conditions, in particular by taking into consideration the lower cash inflows from customers during the moratorium period. The findings were presented to the ALCO and to the relevant Board Sub-Committees.

Based on the findings of the cash flow analysis, a series of early warning signals were implemented to ensure the LBF's liquidity position continues to be consistently well managed under both normal and stressed conditions.

Realigned the funding mix by systematically replacing large deposits with higher number of more sustainable smaller-ticket deposits (More details on page 103 - Deposits).

Focus for the Future

Company is in the process of obtaining a foreign loan which can be a measure of exhibiting our stability even during a stress environment.

CAPITAL MANAGEMENT

LBF's approach to capital management aims to support the Company's business strategy and ensure an adequate level of capital is available under all market conditions, including to withstand severe macroeconomic downturns without breaching regulatory requirements.

In the year under review, LBF's Capital Adequacy levels further strengthened owing to early action taken by the Company to comply with the capital adequacy directive for NBFI's issued by the CBSL in June 2018. As per the original directive, NBFI's with an asset base over 100 billion were required to ensure Tier I capital of 8% and total capital adequacy of 12% by end June 2020. Although the requirement was suspended for another year due to COVID-19, LBF with 23.9% (Tier I) and 25.3% (Total capital adequacy) as at 31st March 2021, continued to remain fully compliant with the new requirements as early as the end of the current financial year.

Components of Capital	01/07/2018	01/07/2019	01/07/2020	01/07/2021	01/07/2022
Tier I Capital (%)	6.00	7.00	7.00	8.00	10.00
Total Capital (%)	10.00	11.00	11.00	12.00	14.00
Capital Surcharge on D-SILFC *(%)	-	0.50	1.00	1.00	1.50

*D-SILFC - LFCs with total assets equal or more than Rs. 100bn.

As of 31st March 2021, the Company reported a Tier I ratio of 23.9% and a total of Tier I and II of 25.3% which remain comfortably above the CBSL's minimum capital requirements.

Item	FY 2020/21	FY 2019/20
Tier I Capital	27,889,835	22,725,746
Total Capital	29,575,195	24,769,809
Total Risk Weighted Amount	116,826,438	119,382 ,457
Risk Weighted Amount for Credit Risk	92,703,346	97,294,303
Risk Weighted Amount for Operational Risk	24,123,092	22,088,154
Regulatory Minimum Tier I Ratio	7.00%	7.00%
Company's Tier I Capital Ratio	23.87%	19.40%
Regulatory Minimum Total Capital Ratio	11.00%	11.00%
Company's Total Capital Ratio	25.32%	20.75%

Computation of Total Capital

Tier I Capital	28,276,871	23,105,780
Stated Capital	838,282	838,282
Non-cumulative, Non-redeemable Preference Shares		
Reserve Fund	7,683,689	6,323,170
Audited retained earnings	19,754,900	15,944,328
(Less) Revaluation gains/surplus of investment property		-
General and other disclosed reserves		-
Adjustments to Tier I capital	387,036	380,034
Goodwill (net)		
Other intangible assets (net)	26,021	
Other Comprehensive Income losses	87,583	106,231
Deferred tax assets (net)		
Shortfall of the cumulative impairment to total provisions and interest in suspense		
50% of investment in banking and financial subsidiary companies	260,581	260,581
50% of investment in other banking and financial institutions	12,851	13,222
Shortfall of capital in financial subsidiaries		
Tier I Capital (after adjustments)	27,889,835	22,725,746
Tier II Capital	1,958,792	2,317,866
Instruments qualified as Tier II capital	800,000	1,200,000
Revaluation gains		
General provisions /collective impairment allowances	1,158,792	1,117,866
Eligible Tier II Capital	1,958,792	2,317,866
Total Adjustments to eligible Tier II Capital	273,432	273,803
50% of investment in banking and financial subsidiary companies	260,581	260,581
50% of investment in other banking and financial institutions	12,851	13,222
Eligible Tier II Capital after adjustments	1,685,360	2,044,063
Total Capital	29,575,195	24,769,809

MARKET RISK

Market risk refers to the possible loss to the Company that could arise from changes in market variables such as interest rates, exchange rates, equity prices and commodity prices. Among them, interest rate risk and commodity price risk have been identified as the most critical for LBF.

Interest Rate Risk

The potential loss LBF would have to bear owing to unexpected movements in interest rates. The Company's exposure to interest rate risk is primarily associated with factors such as;

- **Re-pricing risk** arising from a fixed rate borrowing portfolio where re-pricing frequency is different to that of the lending portfolio.
- **Yield curve risk** arising from unanticipated shifts of the market yield curve.

How does the risk translate to the business:

Interest rate volatility has a direct impact on LBF's Net Interest Income (NII) and ultimately Net Interest Margins (NIMs). The fluctuations in market interest rates will result in either weakening or strengthening of NIMs depending on the rate structure (fixed/variable) of rate sensitive assets and rate sensitive liabilities.

Key Risk Indicators:

- Rate structure of interest bearing borrowings

Management Approach

Increase the correlation between interest rate sensitive assets and liabilities and in doing so ensure that the margin spreads are not unduly affected by movements in interest rates.

As part of the broader approach, the Company also seeks to;

- Promote lending products with shorter re-pricing cycle to reduce interest rate sensitive gaps
- Explore hedging options such as interest swaps
- Negotiate interest rate caps on new borrowings

Monitoring and Governance

- The ALCO closely monitors the interest rate movements and issues directions to lending and borrowing units on interest rate strategies.
- The Risk Management Department conducts regular stress testing to assess interest rate sensitivity on LBF's asset and liability portfolios and gauge the likely financial impact under adverse scenarios.

Situational Analysis for FY 2020/21

The CBSL cut down the policy interest rates on two consecutive occasions in 2020, in order to stimulate credit growth of pandemic affected economy of the country. Thus, the Company too brought down its lending rates in tandem with the market. Further, the interest rates of bank borrowings with variable rates structure declined in FY 2020/21. On the other hand, the treasury bill rate pegged ceiling rate on deposits also came down and repriced the deposit base at a lower interest rate. Hence, the Company had a blended impact on its NII during the financial year.

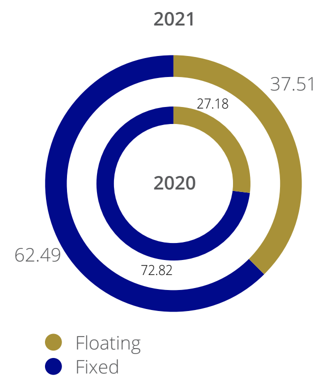
TRENDS

Impact on the Company's Net Interest Income due to fluctuations in market interest rates is closely monitored on an on-going basis. The Company uses the interest rate sensitivity of its assets and liabilities for modelling the financial impact. The table below illustrates the impact on Net Interest Income from different interest rate scenarios.

Stress Test on NII from Parallel Interest Rate Shocks

Annual Impact on NII	2021		2020	
	Parallel Increase	Parallel Decrease	Parallel Increase	Parallel Decrease
1%	135,282	(135,282)	107,361	(107,361)
2%	270,564	(270,564)	214,722	(214,722)
3%	405,846	(405,846)	322,084	(322,084)

Borrowings - fixed to floating mix
(%)



The majority of the borrowings (bank borrowings and debentures) are fixed rated which is favorable in an interest rate increasing environment.

Actions Taken by the Company to Manage the Interest Rate Risk

Strategic repricing of assets to reflect the current market interest rates environment.

Reduce the rate sensitivity of the funding base by shedding high cost deposits and increasing the share of savings deposits which by nature are less rate sensitive.

Promote lending products with shorter re-pricing cycle to reduce interest rate sensitive gaps.

Focus for the Future

The Company will explore the possible options to hedge the interest rate risk associated with its future foreign funding.

Commodity Price Risk

The potential loss to LBF owing to the volatility in world gold prices.

How does the risk translate to the business:

Movements in world gold prices have a direct bearing on the prospects of the LBF's Gold Loans business. Frequent fluctuations in gold prices will be reflected in earnings volatility in the Gold Loan operation.

Key Risk Indicators:

- Gold Market Price Vs. Maximum Advances Value
- Loan-to-value (LTV) ratio of new Gold Loans disbursements

Management Approach

While promoting Gold Loans as part of its secured lending strategy, strict control is exercised to ensure the board approved safety margin is maintained at all times. Accordingly, the advance offered per gold sovereign is subject to regular change in direct correlation to world gold price movements.

Furthermore, LBF's Gold Loan offering is designed as a short term lending proposition (typically 1 or 3 months), which provides the flexibility to make necessary adjustments in line with world market prices.

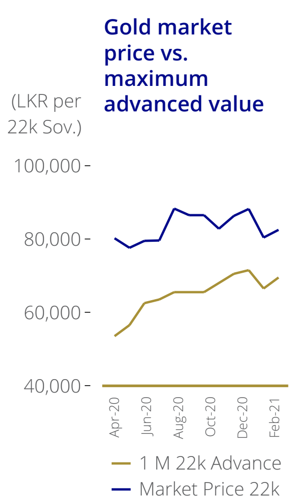
Monitoring and Governance

- The Risk Management Department uses the Value-at-Risk (VaR) method to compute (on a monthly basis) the potential losses the Company may have to incur in the event of a shift in world gold prices. The VaR calculation is based on the Exponential Weighted Moving Average (EWMA) where a greater weightage is assigned to recent price changes while a progressively lower weightage is allocated to price movements over the preceding 12 month period.

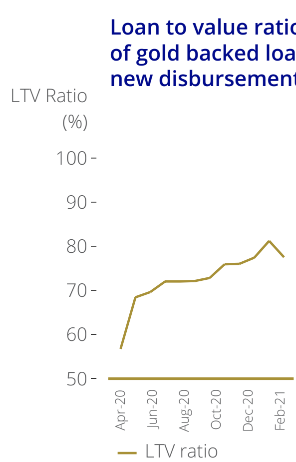
Situational Analysis for FY 2020/21

The global price for gold faced many fluctuations during the year under review owing to factors such as world economic downturn due to COVID-19, the US presidential elections, success rate of COVID-19 vaccines, trade war between the US and China, changes in the US treasury yields etc. In August 2020, gold price spiked to USD 2070 and thereafter showed a slight declining trend towards the end of the year. The local price for gold remained stable despite the slight moderation of global prices due to elevated demand for recycled gold caused by import restrictions. Therefore, with the price being stable in local market, a surge in demand for gold backed lending was seen throughout the year.

TRENDS



The Company has adopted a dynamic lending strategy to determine the Loan to Value ratio based on the global gold prices. Advance offered per gold sovereign is constantly adjusted in line with the gold market prices.



During the year under review, the Company managed to maintain a prudent Loan to Value ratio on new disbursements by dynamically adjusting the advanced value.

Actions Taken by the Company to Manage the Commodity Price Risk

Strategically realigning the gold loan product to take advantage of the upward movement in world gold prices.

VaR calculation methodology was further strengthened based on new assumptions. This was done with the intention of introducing a dynamic provisioning based on more accurate predictive analysis.

Focus for the Future

Continuing to be watchful on the factors affecting the global gold prices and related developments in the local market.

Assessing the adequacy of safety margin time to time in light of gold price fluctuations.

Exchange Rate Risk

The potential loss to LBF owing to the sharp shifts in the local currency (LKR) movement.

The Company is exposed to two types of risks caused by currency volatility.

- **Transaction risk** arises whenever the Company has contractual cash flows (receivables and payables) whose values are subject to unanticipated changes in exchange rates due to contact being denominated in a foreign currency. This type of exposure is short-term to medium-term in nature.
- **Translation risk** arises from the effect of currency fluctuations on the Company's consolidated financial statements, particularly when it has foreign subsidiaries. This type of exposure is medium-term to long-term.

How does the risk translate to the business:

Unexpected currency volatility affects the following aspects of the business:

- Foreign currency received and paid for money exchanging
- Indirect impact on the local gold
- Consolidation of financial results of the Myanmar operation as part of the LBF Group results

Key Risk Indicators:

- System embedded alerting mechanism when the exchange rate fluctuations surpasses threshold limits.

Management Approach

The total LKR denominated portfolio of Foreign Currency Operations is controlled through the system which act as a cap on the maximum loss the Company can suffer in the event of LKR appreciation.

Monitoring and Governance

- The ALCO monitors forex loss/gain position of Foreign Currency Operations regularly.
- The changes to the total investment limit of the Foreign Currency Operations need to be approved at both the ALCO and Board levels.

Situational Analysis for FY 2020/21

The LKR depreciated sharply against the dollar in 2020 amidst a sizable decrease in exports stemming from COVID-19 related challenges.

Actions Taken by the Company to Manage the Exchange Rate Risk

System embedded controls to limit the exposure to soft currencies.

Managing the risk arising from the USD/LKR exchange rate volatility through maintaining an adequate safety margin on gold advances.

Focus for the Future

Formulating effective strategies to mitigate the exchange rate risk arising as a result of becoming a principal agent of Western Union.

Equity Price Risk

The risk of loss based on market changes in the value of equity investments.

Although the Company's exposure to equity price risk is negligible, mark-to-market calculations are conducted monthly on HFT and AFS portfolios. Company's exposure to equity price risk is very insignificant.

OPERATIONAL RISK

Operational risk is the potential loss LBF would have bear owing to inadequate human capital resources or breakdown in internal systems and processes.

In the year under review a new Operational Risk Management Policy and Framework was developed and implemented to ensure that all major operational risks are addressed systematically and managed proactively.

Taking into consideration the nature as well as the scope and scale of LBF's business, the following risks are covered under the new Operational Risk Management Policy and Framework;

- **Internal fraud -** The risk of misappropriation by employees .
- **External fraud -** The risk of misappropriation by third parties.
- **Employment practices and workplace safety -** The risk arising due to unsustainable human capital practices and poor working conditions.
- **Clients, products and business practices -** The risk associated with the launch of non-viable products or products that fail to comply with regulatory frameworks applicable to the NBFI sector.
- **Damage to physical assets -** The risk of damage to the Company's physical assets due to accidents, such as fire, natural disasters, destruction of property, riots, political uprisings, terrorism, etc.
- **Business disruption and system failures -** The risk of system failure or a breakdown in processes that could potentially lead to a business disruption.
- **Execution, delivery and process management -** The risk of being unable to meet stakeholder deliverables due to inadequate systems, processes and operational controls.

How we asses our Operational Risks

Operational process reviews are conducted regularly to identify loopholes in the operation.

- Collating internal and external fraud event report.
- Independent IT system audits on all core applications and system security.
- Analysing the number of system breakdowns, telecommunication failures, malfunctions and hacking events.

Actions Taken by the Company to Manage the Operational Risk

- Segregation of duties, well defined demarcated responsibilities for employees, use of procedural manuals, dual controls
- Periodic internal audits are conducted covering the entire branch network. The scope of the audit includes the review of adequacy and application of accounting, financial and operational controls
- Transferring insurable risk by obtaining insurance policies
- Installing access controls to identified high impact areas
- Staff training on technical aspects to comply with security regulations
- Assessing the adequacy and effectiveness of the insurance coverage periodically
- Conducting post completion audits after a successful implementation of system change/modification
- Disaster Recovery (DR) planning and Business Continuity Planning (BCP)
- Obtaining ISO 27001 certification to ensure information system security
- Use of exception reports and data analytics for detecting trends and unusual transactions

Business Continuity Management

LBF Business Continuity Management System (BCMS) is established to achieve operational resiliency for the Company. BCMS framework of the Company encompasses business continuity, disaster recovery, crisis management, incident management, emergency management and contingency planning activities. This will ensure the Company's ability to serve its stakeholders with minimum disruptions in the occurrence of an unforeseen event to the business activities arising through manmade, natural or technical disasters.

The BCM Steering Committee which is comprised of key staff members, plays an integral part of the BCM program. BCM Steering committee enables the companywide roll out of the BCM and ensure the alignment of business goals with the BCM goals.

The scope of the BCM includes programme initiation and management, risk evaluation and business impact analysis, developing business continuity strategies, emergency preparedness and response, developing and implementing business continuity plans, awareness building and training, business continuity plan exercise, audit and maintenance, crisis communications and coordination with external agencies.

A BCP exercise was successfully carried out in July 2020. Apart from that, the core and other critical systems were operated from the Disaster Recovery (DR) systems from mid December 2020 to end January 2021.

STRATEGIC RISK

Strategic risk can be seen as the impact on the Company's earnings or capital, due to poor business policy decisions, improper implementation of business strategies or lack of responsiveness to industry changes. Hence, strategic risk could arise due to internal or external factors.

(Refer "Delivering our Strategy and Resource Allocation" section on page 74 for more detailed information).

How we assess our Strategic Risk

Conducting reviews of pre and post implementation financial performance for every product, project and investment.

Actions Taken by the Company to Manage the Strategic Risk

- Quarterly budget reviews
- Monthly variance analysis on key income and expense items

IT AND INFORMATION SECURITY RISK

Company has identified information as a vital business resource and a key asset to the organization. Hence, any threat exploiting the vulnerabilities of this valuable and important asset can cause adverse impact to the business operation ranging from simple inconvenience to catastrophic in scale. This includes but not limited to events such as cyber-attacks, breakdowns, failures or interruptions which result in a system down time, frauds and malpractices through errors and manipulations, technological obsolescence and insufficient or ineffective infrastructure to support evolving business needs, falling behind the competitors in terms of the information technology.

Since every aspect of business relies heavily on Information Technology, it has emerged as the backbone of and the live wire of the organizations operations and innovations. As a result Information Security risk is recognized as a significant portion of the potential operational risk.

(Refer Intellectual Capital Report on page 166 for more detailed information).

In this context, Company has recognized information, information systems and technical infrastructure as assets of paramount importance and value to the organization. Therefore, with the objective of identifying and managing all IT-related risks effectively and efficiently in a consistent manner across the organization, Company has rolled out a comprehensive Information Technology Risk Management Framework.

IT risk mitigation methodology involves prioritizing, evaluating and implementing the appropriate risk treatment techniques such as technical, operational and management controls to prevent identified risks exploiting the vulnerabilities.
This process is strengthened by the implementation of the Company's Information Security Management System (ISMS), which was established according to the ISO/IEC 27001:2013 standard. With the implementation of ISMS, following information security objectives have been identified:

ISMS Objectives

- Establish safeguards to protect Company's information/information systems from theft, abuse, misuse and any form of damages.
- Assess and evaluate the established control mechanism and implement corrective and preventive actions.
- Maintain the confidentiality, integrity and availability of information.

Company first obtained the ISO/IEC 27001 Information Security Standard in 2014 and received recertification in 2020. Company has continued to demonstrate its commitment towards information security by maintaining certification throughout the years.

As part of IS Risk assessment and mitigation methodology, IS Audit & Compliance Division conducts independent IS risk reviews and audits of new IS developments/modifications whilst carrying out regular system and security audits for each system related functions.

Cyber Risk Management is key focus areas of IS Risk Management function in light of heightening threats of cyber-attacks which are continuously to escalating in scale and sophistication. The Company obtains the service from an independent service provider to conduct cyber security related vulnerability assessments and surveys periodically. In addition, as a proactive measure to combat growing external threats, the Company obtains Information

Security Operations Center service from an external service provider with Online Monitoring System capability.

At present the Company's Cyber Security Strategies include but not limited to evaluating vulnerabilities by conducting regular network vulnerability assessments covering external and internal security vulnerabilities, comprehensive web application security vulnerability assessment, comprehensive firewall security assessment and wireless network security assessment.

How we assess our IT and Information Security Risk

- Conducting information security review meeting with key functional heads.
- Monitoring of system audit trails to identify patterns and anomalies.
- Performing systems audit for every core system module before deploying into production environment.
- Thorough post implementation review following the changes to IT Systems or technical infrastructure, to ensure no unintended repercussions have occurred.
- Analysis of information security related incidents to identify the gaps and loopholes in the information system and infrastructure.

Actions Taken by the Company to Manage the IT and Information Security Risk

- Regular companywide awareness of Information Security risk management measures currently in pace
- Strict adherence to documented IT change management process
- Strengthening of NDA's with vendors by inclusion of information security clause
- Implementation of disciplinary action procedure for information security violations
- Promoting clear desk and clear screen policy

LEGAL/REGULATORY RISK

Legal/Regulatory risk is the risk of loss caused by non-compliance with existing or new legislation or supervisory regulations, disadvantageous changes to existing laws or supervisory regulations. Furthermore, legal risk includes losses due to ambiguity of laws or unfavourable contract clauses and loose contracts.

(Refer Corporate Governance Report on page 206 for more detailed information).

The Company conducts its business in accordance with the Company's code of conduct, laws and regulations imposed by the regulatory authorities with zero tolerance for failure or breach of such obligations.

How we assess our Legal/Regulatory Risk

- Internal audit reviews are carried out to assess the extent of compliance at branch and departmental level.
- Regular monitoring of compliance with the directions issued by the regulator.

Actions Taken by the Company to Manage the Legal/Regulatory Risk

Compliance function regularly reviews the Company's compliance with rules, directions and determinations of regulatory bodies

HUMAN RESOURCE RISK

Human Resource risks are events that prevent employees from fulfilling their responsibilities and thus keep the business from operating at full efficiency. Human resource risks include but are not limited to;

- High employee turnover
- Poor employee management practices
- Unexpected temporary leave
- Management error/incompetence
- Disability (temporary or permanent) death of employee/s

(Refer Human Capital Report on page 154 for more detailed information).

How we assess our Human Resource Risk

- Conducting employee engagement surveys to assess the level of motivation, engagement and loyalty
- Analysis of employee turnover ratios across different employee job categories
- Analysis of skill gaps among operational and front office staff
- Review of causes for resignations through exit interview data

Actions Taken by the Company to Manage the Human Resource Risk

- Training and development to help employees to improve their skills to be better at their current job and prepare for future challenges
- Strengthen the process for grievance handling and offer work place counselling

REPUTATIONAL RISK

Reputational risk arises from an event or behaviour that could adversely impact market 'perception' of the Company's goodwill. As reputation itself is a valuable business asset, the Company takes great care in managing its reputation risk. The exponential growth in channels of communication especially social media increases the risk of exposure to reputational risk given the extent of freedom allowed to a wider spectrum of stakeholders directly and indirectly associated with the Company's business. As all other types of risks impact reputation risk, efficient management of other risks also forms part of our management of reputational risk.

How we assess our Reputational Risk

- Evaluation of the effectiveness of CSR projects against the stated objectives
- Evaluation of the number of customer complaints and types of complaints

Actions Taken by the Company to Manage the Reputational Risk

- Sustainability Committee to play a key role in conceptualising and monitoring CSR initiatives (22 CSR events were carried out during the year incurring a cost of Rs. 37.20 Mn)
- Close monitoring of any events which could lead to reputational risk by adopting an early warning system including media reports, social media content, inputs from frontline staff and market survey results
- Training employees on work place professionalism, behaviour and educate them on business ethics
- Swift and efficient process of resolving customer complaints

Addressing all the risks, key risk management initiatives that the Company had covered during the year under review can be summarised as follows.

KEY RISK MANAGEMENT INITIATIVES IN FY 2020/21

Operational Risk Governance
Implemented the Operational Risk Management Framework and Policy

Credit Risk Governance
Implemented the Credit Risk Management Framework and Policy

Operational Risk Measurement
Conducted the annual risk assessment for existing outsourced activities and new outsourcing arrangements

Information Security Risk Governance
Revised and tightened internal data management process by clearly classifying all internal reports and defining who has access / sharing rights of sensitive data

Overall Risk Governance
Strengthened and updated the IRMC Charter, Risk Management Policy and Risk Appetite Statement

Operational Risk Monitoring
Strengthened the early detection of internal/external frauds with then use of exception reporting and data analytics

Operational Risk Measurement
Conducted the annual risk assessment of Money Laundering and Terrorist Financing (ML & TF) risks associated with customers, deposit products, lending products, processes and the overall Company

Credit Risk Measurement
Introduced a credit scoring / rating mechanism for all the borrowers

Overall Risk Identification
Implemented a comprehensive Branch Risk Scorecard

Operational Risk Measurement
Conducted the annual risk assessment of Money Laundering and Terrorist Financing (ML & TF) risks associated with customers, deposit products, lending products, processes and the overall Company

LB FINANCE