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Siva and His Vision in the New Normal Economic Turnaround: The Challenge of Bankers

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It is an honour as well as a privilege for me to deliver the 19th Late Mr K Sivagananathan Memorial Oration 2021. The late Mr Sivagananathan, known to his friends as Siva, was my friend, colleague, and mentor. We became friends in late 1980s after a chance meeting at the Central Bank. At that time, I was a Deputy Director of Economic Research at the Central Bank and Siva was a Deputy General Manager at the Bank of Ceylon. He saw me with another colleague of his, Mr K Kathiravelupillai, DGM, BOC, to provide some clarifications on a new unit trust being promoted by his bank. Unit trusts were a novel idea at that time and the Central Bank was a little hesitant in approving them without proper investigations. Siva made a lucid presentation, assisted by Kathiravelupillai, about the economic value of unit trusts convincing the Central Bank Team that there was a case for approving the proposal by BOC. That was the birth of the Ceybank Unit Trust and it was the beginning of a long friendship between Siva and me.

PART I – SIVA'S CONTRIBUTION TO BANKING EDUCATION AND TECHNOLOGY IMPROVEMENT IN BANKS

Then, he became a colleague of mine when he joined the Central Bank as an advisor on banking and finance in late 1990s. Because of his wide experience in banking and finance and his enviable professional network among bankers, he had been handpicked by the Late Mr A S Jayawardena, Governor, to advise the Monetary Board on issues relating to the sector. Both of us worked together in several projects relating to the modernisation of the Central Bank. Two such important projects were the upgrading of the Institute of Bankers of Sri Lanka or IBSL to international standards and the creation of LankaClear by converting the Central Bank's Automated Clearing House or ACH to a public-private-partnership with commercial banks. In these two ventures and in many more such projects, he was my mentor.

International recognition of IBSL's qualifications

The IBSL project was started in 1998 after Siva was appointed as its Vice Chairman by Governor Jayawardena. At that time, I was its Director of Studies, a position that I held concurrently with my normal work at the Bank. But the whole project came under me in 2000 after I was appointed Deputy Governor and Chairman of the Institute. Governor Jayawardena's instructions to us were that IBSL should seek accreditation from an international professional institute of repute. There were many options but the most suitable one was to approach the Chartered Institute of Bankers, London, which had been renamed at that time the Institute of Financial Services or IFS. Siva was a Fellow of IFS and had developed a strong network with it, while he was serving as the Manager of the London Branch of BOC, and later, as an active member of its Colombo Chapter. Siva had to shuttle between London and Colombo many times to negotiate with IFS and he did so at his personal expense because he used his regular visits to his family in London for this purpose. It was a tough negotiation because IBSL at that time was not up to the global professional standards. Several audit teams that visited Colombo from IFS had identified areas needing improvements. To address them, IFS supported training programmes were conducted to upgrade the internal administration and quality of lecturers, paper setters and examiners. Siva coordinated all this work from London and finally was successful in accomplishing the impossible. Accordingly, we signed the necessary agreements with IFS in a simple ceremony in London in 2000 to get its accreditation for the qualifications offered by IBSL. With that international recognition, those who pass out from IBSL managed to get employment outside Sri Lanka. This joint accreditation continued even after Siva's sudden demise in 2002 till IFS decided to withdraw from it after it had gained university status by the UK's Privy Council in 2010. However, students who passed out from IBSL between 2000 and 2010 are eternally grateful to Siva for the upgraded professional qualification they had got from IBSL.

Creation of LankaClear

The creation of LankaClear as a public-private-partnership to handle the country's cheque clearing and later the payment system was done as a part of the Central Bank's modernisation project implemented from 2000 to 2004. I have written about the creation of LankaClear elsewhere but for the present purpose, the presentation of a detailed account is in order[1]. I chaired the Steering Committee on Modernisation of the Central Bank under the guidance of the Late Mr A S Jayawardena, Governor. The objective of the project was to introduce new technology to Central Bank, make it a lean and efficient organisation, improve the skills base and competencies of its staff, and help Bank to concentrate on its co-objectives, namely, the economic and price stability and financial system stability. Under this model, the Central Bank could not run many ancillary operations which were not directly connected to the two co-objectives. Accordingly, the Automated Clearing House or ACH which had been established in 1985 could be safely handed to its main clients, the licensed commercial banks. To implement this, a sub-committee was setup under my chairmanship.

Two issues faced by the Steering Committee

Siva with his maturity, knowledge and professional network was the livewire in this committee. The other members were Mr P D J Fernando, Director of Information Technology of the Bank at that time but later retired as its Deputy Governor, and the late Mr Justin Wickramasinghe, Manager of ACH assisted by his deputy, the late Mr Ariyawansa. We had two issues to resolve in addition to the legal problems. One was to get the licensed commercial banks on board on terms and conditions acceptable to both the Central Bank and the banking community. The other was the handling of the staff that had been recruited to the Central Bank specifically for ACH operations. Sri Lanka Banks Association or SLBA which negotiated with us on behalf of the banking community was not willing to take that staff to the outfit being newly created. It wanted to have the freedom to recruit its own staff to handle the operations. The problem was that this staff, recruited to the Bank on qualifications lower than those required for entry to the Bank's non-staff grade, could not be absorbed to the Bank because of the objections by the Bank's non-staff unions. There were a dozen of such unions and they were so diverse in membership and objectives that it was nearly impossible to have a productive negotiation with them. Both issues created an explosive situation and had to be handled carefully.

Getting banks on board

Siva was to handle the first issue, while I took it upon myself to resolving the second one. From day one, Siva started negotiating with SLBA coming up with draft after draft for a suitable structure for the new outfit. He had to satisfy both the Monetary Board and SLBA. The problem was further complicated because Sri Lanka did not have previous experience in structuring a suitable and acceptable public-private-partnership. When one proposal was made, it was not acceptable to the Monetary Board. When it was amended to meet the Board's requirements, it was not acceptable to SLBA. But Siva was skilled in this type of back-and-forth negotiations and finally managed to zero on a proposal acceptable to both. Under this proposal, the Monetary Board agreed to divest a part of its ownership in favour of a private limited liability company to be floated to handle the country's cheque clearing function and payment system. An MOU was signed among the three parties, the Central Bank, SLBA, and LankaClear to provide clearing and payment services in Sri Lanka under Central Bank's overall supervision. Thus, the Central Bank which was earlier both the owner and regulator of clearing and payments services was now to function only as the regulator cum supervisor. That was Siva's achievement.

Handling the labour issue

About the labour dispute, the best solution was to take the staff attached to ACH back to the Central Bank despite their lower entry qualifications. For that, we had to win both the Monetary Board and trade unions to our side. I recall visiting ACH practically every day to negotiate with the staff for a harmonious solution. Finally, we succeeded in winning their consent to join the mainstream Central Bank by offering them better career prospects there, including opportunities for foreign training. This was successfully sold to both the Monetary Board and the trade unions. In that way, we were able to

[1] Accessible at http://www.ft.lk/columns/Channa-de-Silva-Technology-should-be-for-people-s-convenience/4-655988 (Accessed on 8.3.2021)

avert the dreaded labour dispute and allow LankaClear to mark out its destiny with its own business strategy[2].

Siva was a trailblazer

In both these projects, Siva was a behind me like a strong tower. His advice, proposals, strategies, and counter strategies helped me as a person and the Central Bank as an institution. Through his friendly approach, he had become an important member of the Central Bank family. Hence, it was with much heart pain that we learned in 2002 of his sudden demise in London, while still serving as the Vice Chairman of IBSL and advisor to the Monetary Board. But he is still among us with his long-lasting contribution to banking education and initiating the move to introduce technology to the banking system.

The achievements of LankaClear since its formation

As Siva had expected, LankaClear has risen from height to height since its formation in 2002. Immediately after it was setup, LankaClear started US Dollar Cheque Clearing System or DCCS to facilitate the clearing of cheques drawn on Sri Lankans and cut the realisation time from about 3 weeks to about 4 days. In a similar development done to local cheque clearing, realisation time was cut from previous T+4 to T+0 in Colombo and T+1 in outstations by introducing Cheque Imaging and Truncation System or CITC in 2006. The Sri Lanka Interbank Payments System or SLIPs which had been started by ACH as an offline fund transfer system in 1993 was upgraded to a full online system by LankaClear in 2010. This was extended to online US Dollar payments in 2015. Another novelty introduced was the Common Electronic Fund Transfer Switch or CEFTS enabling bank customers to make payments via Automated Teller Machines or ATMs, mobile phones, or internet at any time of the day. In 2013, a Common ATM Switch or CAS and a Shared ATM Switch or SAS were introduced to economise on the use of ATMs and provide a more convenient service to bank customers. The flagship product of LankaClear was introduced in 2021 in the form of a national payment platform[3]. Accordingly, LankaPay introduced by LankaClear enables bank customers to make retail and large payments to government departments and other parties[4]. As of February 2021, four financial institutions, 3 commercial banks and one savings bank, had joined LankaPay facilitating bank customers to pay income taxes, custom duties and excise payments. The other banks, once they have modified their internal systems suitably to meet LankaPay's requirements, are expected to follow suit soon. Had Siva been alive today, he would have been the happiest man to witness the healthy growth of the baby who came into being by his active contribution.

Eighth K Sivagananathan Memorial Oration

It was in this background that I was invited to deliver the Eighth K Sivagananathan Memorial Oration in 2010[5]. The theme of this oration was that banks in the future will be technology-driven and it posed a serious challenge to bankers unless they train themselves to meet them. I, therefore, emphasised the following in the oration.

Bank of the Future

"The competition, the need for making a wider outreach at low costs and thinning of interest margins will compel banks to find ways of reducing costs and still offering quality services to customers. To accomplish this feat, there is no other way than using modern technology generously. As the current state of technology stands, it is not a substitute for human beings. Technology, being the servant, must be under the command of a master. Therefore, though banks have embraced technology ardently, they have not displaced the human masters completely. That is why when banks grow, they must hire new workers in increasing numbers to take care of the growing business, on the one hand, and to succeed the retiring workers, on the other. Hence, both the technology application and the human capital engagement go hand in hand in current banking. But this may not be the trend in the future. The current research in ICT field is expected to lead the world to ground-breaking discoveries. At present, we live in a world in which machines cannot replicate human brains. Intelligence is still the

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[2] Central Bank of Sri Lanka, Annual Report for 2002, Part II, p XXXII

[3] https://www.lankaclear.com/ (Accessed on 10.3.2021)

[4] https://www.cbsl.gov.lk/en/financial-system/financial-infrastructure/payments-and-settlements-systems (Accessed on 10.3.2021)

[5] The excerpts of this oration can be accessed at: https://www.nation.lk/2010/03/14/busi4.htm (Accessed on 8.3.2021)

monopoly of humans and all that machines can do is to work according to the commands made by their human masters. It is still a world where machines do not have intelligence of their own[6]"

Bankers need continuous learning

But I cautioned that distributed artificial intelligence was within sight and intelligent machines will surely take over most of the routine jobs in banks. I said that the biggest challenge faced by a banker in the future was to accept an intelligent machine as a co-worker. That was because intelligent machines which has the capacity for self-learning, are faster and more efficient than bankers made-up of flesh and blood. Certainly, it is a fertile ground for discontent and frustration. I also predicted that with internet and mobile phone banking, the bank branch would be a shrunk outfit in the future. Bank branches which would be called Banking Kiosks will be manned not by men and women but by intelligent machines. It is therefore inevitable that bankers in flesh and blood would be irrelevant in the future. To prevent this, I suggested that bankers should put themselves on a continuous learning and professional development programme.

The new normal will be permanent normal

The last decade has seen the fast conversion of traditional banks to what had been predicted as the 'bank of the future' by me. The introduction of cryptocurrencies and technologies like the blockchain technology have expedited this process. However, banks began to feel the need for this strongly after they were hit by the prolonged economic lockdowns by the government to prevent the spread of COVID-19 pandemic. A new concept called 'the new normal' was developed to address this issue. Since the world must live with the virus for another two to three years, the new normal has become the permanent normal today. It is therefore useful to examine how the bankers should cope with this new permanent normal. This constitutes the theme of my oration today.

PART II – BANKS' ROLE IN REVIVING THE POST COVID-19 PANDEMIC HIT ECONOMY

COVID-19 pandemic hit economy

By any standard, COVID-19 pandemic was an external shock delivered to the global economy disrupting all economic activities. The safe health measures introduced, and the prolonged lockdowns of economies have pushed the global economic growth to the negative region. In the case of Sri Lanka, 2020 has been a write-off year with respect to economic growth. The best estimates available indicate that the economy may have contracted by about 6% in 2020[7]. Though the authorities are hopeful that there would be a quick recovery in 2021, with the onset of a more disastrous second wave and possibly a third wave later, it would be a prolonged W-shaped recovery that Sri Lanka might at best be able to attain. What this indicates is that economic growth will be either negative or very low in the next few years. The best-case scenario is that the economy will revert to the normal growth path not earlier than 2025[8].

Banks being called to take the full burden of revival

A powerful section in society including the top policy leaders appears to be in the belief that it is the banking sector that should take the full brunt of the recovery of the economy in the post COVID-19 pandemic era. This was an erroneous suggestion since banks had only one nominal weapon, namely enhancing credit flows, whereas the recovery of the economy depended on stimulating the country's real economic flows. These real flows include the mobilisation of physical and human resources for enhanced economic activities supported by modern technology. I have discussed this in a previous

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[6] Ibid.

[7] ADB has projected a contraction of 5.5% (See: https://www.adb.org/countries/sri-lanka/economy), while the World Bank has put it at 6.7% (See: https://www.worldbank.org/en/region/sar/overview#:~:text=regional%20growth%20is%20expected%20to,to%204.5%20percent%20in%202021.)

[8] The normal growth path for Sri Lanka is 7% per annum; it has been estimated by World Bank that growth in 2021 and 2022 will be 3.3% and 2.0%, respectively (See: Ibid.); The Central Bank has projected that this rate will be attained only by 2025 (See: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/red/2020/Chapter_1_e.pdf)

article authored by me[9]. Banks have been accused of acting Shylocks, a demonised money lender in Shakespeare's Merchant in Venice, who asked for the pound of flesh from a borrower who had defaulted his dues. I have argued in this paper that politicians' asking banks to take the full responsibility for reviving the economy is like playing 'reverse Shylock' in the present circumstances. That is because banks being social institutions have their prime responsibility toward their depositors who have placed their trust in them. I specifically said that "Banks have a responsibility to society at large because they are social institutions that provide a host of services: functioning as a depository of savings, meeting the fund requirements of needy individuals, keeping the economy going and helping people to become prosperous. These obligations to society are beyond their profit goals. Hence, a bank must very carefully balance the obligations to owners, depositors, borrowers and society at large. Hence, any relief given to borrowers should not conflict their other obligations. The economic catastrophe that has been created by the unexpected COVID-19 pandemic has placed banks in this crucial choice-making position. A bank cannot abandon its borrowers and at the same time disregard its obligation to depositors. If one is done to the exclusion of the other, the bank loses and so does the society. Hence, politicians should be careful in not playing the reverse of the Shylock principle: demanding the pound of flesh from banks"[10].

Inundating the system with liquidity on false assumptions

Later when the credit flows did not move as expected by authorities, banks were faulted for impeding the economic recovery. Authorities had assumed that the credit flows had not moved due to lack of liquidity in the system. Hence, at the instance of the government, the Central Bank had inundated the system with a massive volume of liquidity by cutting the Statutory Reserve Requirement or SRR, creating a special refinance fund for on-lending to affected businesses and cutting down interest rates. The folly of this policy was discussed by me in another article published later[11]. I presented in this paper that the non-movement of credit flows was a structural problem, and that problem must be sorted first to facilitate banks to move out the excess funds they were having. I argued that "Thus, the blockage of credit flows is not a liquidity problem but a structural problem. Banks in the exercise of their prime responsibility to the depositors may not want to put the depositors' money at risk. Presently, the risk mitigation involves getting suitable collateral for loans, limiting loans to a single customer to a maximum, adopting a multi-tier loan approval process within banks and building capital within banks to provide a minimum protection to depositors. In an emergency in which both the government and the Monetary Board want to promote credit flows, these structural problems certainly stand in their way".

"Sri Lanka's bankers are not yet ready to assess the viability of a project and accommodate its credit requirements. Hence, it will take time to move from the present collateral based lending to project-viability based lending. Hence, to take the fear of lending out of the mindset of bankers, it is necessary to provide a comprehensive credit guarantee scheme to banks. That could be funded out of a seed capital to be given by the government initially and out of subscriptions of the banks that would get the benefits from the scheme. An automatic subscription flow can be generated by charging a premium of 1% annually from the loans granted out of the refinance funds of the Central Bank"[12].

Banks' new role in funding SMEs

If banks cannot take the full responsibility for the economic revival, then, what should be their role in the exercise? They could streamline the credit delivery practices and make it more customer friendly specifically to mesa, small and medium enterprises. This is because it is these entrepreneurs who play an important role in the supply chain which is a must for the economy to resume its development activities. One important casualty of COVID-19 pandemic and its prolonged economic shutdowns has been the supply chains involving agriculture and industry. These borrowers who have been badly affected by a cash shortage to resume economic activities need a quick support in the form of enhanced credit flows. They needed funds in time in adequate amounts to buy raw materials, produce goods and services and supply them to the chain which must connect them to the ongoing production

[9] Available at: http://www.ft.lk/columns/Post-COVID-19-reconstruction-Banks-alone-cannot-bail-out-the-economy/4-698849 (Accessed on 10.3.2021)
[10] Ibid.
[11] Available at http://www.ft.lk/columns/Accelerating-credit-flows-Address-structural-issues-first/4-701937 (Accessed on 10.3.2021)
[12] Ibid.

process and through it, the ultimate consumers. This has not been addressed adequately by the country's banking system which had been concentrating mainly on large scale borrowers.

The plight of small borrowers

SMEs have not been able to borrow from formal financial institutions due to several reasons. One is the strenuous loan procedures followed by them. Another is the overreliance on the reports submitted by the Credit Information Bureau or CRIB. A third is the inability of borrowers to submit the necessary security and collateral for loans. A fourth is the borrowers' own inability to present an acceptable loan proposal. All these factors have impeded credit flows to this sector. I have documented the problems faced by those in between the micro sector and the small sector, known as the mesa sector[13].

I have reported three case studies relating to such mesa borrowers in the paper under reference. One is a fishmonger; another is a tailor, and the third is a vegetable and fruit vendor. All these entrepreneurs operate from permanent places of businesses located along a major highway.

The woes of a fishmonger

The fishmonger tells me that he buys his fish from the Peliyagoda Wholesale Fish Market by paying ready cash. His daily purchase on average is about Rs 200,000. But his main customers are hospitals and restaurants which do not pay cash immediately. His normal credit sale cycle is about one month. Sometimes, they give him post-dated cheques which he sells to cheque buyers at a discount of 6%. Even then, his cash flow is in deficit and he must finance it by borrowing. He categorically tells me that formal commercial banks, both state and privately owned, do not entertain his requests for temporary overdrafts. He had approached one such private sector bank and the bank manager has been unresponsive to his demand. Then, one day he had been visited by a young man on a motor bicycle and told him of the possibility of getting an instant loan repayable within 100 days. He had been told that if he borrowed Rs 100,000, he should pay interest at Rs 10,000 per month which is worked out to be 10% per month or 120% per annum. Since he needed money very badly and the formal commercial banks were not of help, he had borrowed Rs 500,000 from the informal money lender. He had not signed any document or loan agreement but spoken to the informal money lender on the telephone and agreed to the terms and conditions.

The young man on the motorbike had immediately delivered cash to his fish stall. Thereafter, every day, he had visited him at the fish stall to collect the interest and loan repayment. For two months, he had paid interest with great difficulty. But it became a real problem after the infamous April 21 bomb explosions when the restaurants which had purchased fish from him started to cut the daily purchases and default the payments. Their explanation was that customers who had earlier frequented the restaurants in the night had dwindled due to curfews and unsettled situation in the country. He had to default the payments and then only he found the real taste of his borrowing at exorbitant interest rates.

The young man on the motorbike was insisting that he should pay or go for a new loan with stricter conditions now, namely, a loan for 75 days at 12% per month. He did not have a choice, says the fishmonger, but to accept the new conditions which is more stringent than the previous loan. Probably, if he defaults again, the period would further be reduced, and interest rate be increased. Like, the sovereign government of Sri Lanka, the fishmonger is deeply indebted and must service his loan by getting further indebted. Since he does not earn a return of 120% and above per annum, it is unlikely that he would be out of debt. He is already caught in the debt trap.

A tailor cutting family welfare to service informal loans

The story of the tailor is like that of the fishmonger. He had purchased clothes on one month credit and tailored school uniforms for students. Typically, in previous years, he did not have difficulty in selling those school uniforms to students for cash before the school season starts in January. However, this year, he could not dispose of the stock because the demand had fallen. Apparently, the parents had their own financial problems that prevented them from supplying new school uniforms to their children. Faced with the problem of paying back to his creditors, he had approached a commercial bank for a bridging line of credit but to no avail. His application had been rejected by the bank on ground that his name had been on the CRIB register as a defaulter of a loan for which he had signed as a guarantor. The black mark attached to his name had been used by all banks to deny him a loan.

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[13] Available at http://www.ft.lk/columns/Fixing-lending-rates-and-waiving-farmer-loans-two-policies-that-do-not-augur-well-for-borrowers/4-687972 (Accessed on 10.3.2021)

Then, he had been helped only by the friendly-looking young man who came on a motorbike. Within hours, the tailor could raise of loan of Rs 400,000 at 10% per month repayable within 100 days. But, from the very first month onward, he ran into difficulty in paying interest because he did not have a sufficient surplus after meeting the rent, utility fees and family expenses. He cut the family expenses, but still could not have a sufficient surplus to pay as agreed interest payments. Finally, he had to go for another loan with stricter conditions as in the previous case and now he is deeply indebted.

A vegetable vendor getting into debt

The vendor of vegetables and fruits had a daily turnover of about Rs 100,000 but due to his wife delivering a baby, his monthly income was not sufficient to run the business. He had not tried a bank because of some frustrating experience he had had previously and straightaway had agreed to the conditions laid down by the informal money lender and borrowed Rs 200,000 for 100 days at 10% per month. Since his margins are very narrow, he cannot earn an enough surplus to pay interest on the loan. He fears that he must recycle the loan once he must return the principal amount after 100 days. Knowingly or unknowingly, he has been into debt now.

Eardrum and eyeball test of informal money lenders

All these cases are typical of how banks handle loan applications from prospective borrowers. To prevent the misuse of depositors' money, loan procedures have been designed in such a way that only a very fortunate loan applicant can borrow from a bank. The loan appraisal which is done laboriously takes time as well as goes against the borrower. Then, how could informal money lenders accommodate their requirements without formal loan applications, collateral, and loan appraisal? They also make an appraisal of the creditworthiness of borrowers but not as elaboratively as those done by banks. They are simply 'eardrum and eyeball tests' being done on prospective borrowers. In these tests, they listen to people around and watch carefully how he manages his business. Once a target borrower has passed both these tests, they approach him with a credit proposal. They are successful not only because of their unconventional loan appraisal systems, but also due to the unconventional loan recovery systems as well. The young man on the motorbike visits the borrower daily and does not leave any room for him to default the loan. Banks cannot relax their systems to such an easy and loose credit appraisal and recovery tactic. But it behoves them to emulate the informal money lenders and become worthy credit managers.

The abuse of CRIB reports

CRIB reports are another abused credit sanctioning criterion by banks. As the founding General Manager of CRIB, I am fully aware that CRIB was never intended to serve as a loan denier to customers. It was simply a pointer where the deciding bank must make a choice considering the degree of risk involved. These issues were discussed by me in a previous article on whether CRIB should be retained or scrapped[14].

Resolving the problem of asymmetrical information via CRIB

CRIB was never intended to be a stumbling block for borrowers. Instead, it sought to fill an information gap between lending institutions and borrowers. Borrowers knew everything about themselves, but the lending institutions knew only what the borrowers had disclosed to them. This is known as asymmetry in information. Taking advantage of this information asymmetry, borrowers would disclose only what is favourable to them. It is to their advantage to hide information that would go against them. Hence, information on their past borrowing records, especially those relating to default of loans, would not be disclosed to the lending bank when they apply for a loan. But, to assess the credit risk of the borrower, the lending bank should know this information. To get it from other banks is also not effective since banks normally do not disclose that information to their rival banks. In these circumstances, bad borrowers were used to shifting from bank to bank and defaulting all loans in the process. When this happens regularly, banks would end up with loans that are not paid back, a situation known as the existence of non-performing loans. When the non-performing loan portfolio is high in the entire banking industry, the stability of the industry is at high stakes. When banks fail, they must be rescued by governments to protect the dispositors and ensure the continuation of the financial system. Hence, it is in the interests of politicians to keep the financial system stable, and CRIB is one institution

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[14] Available at http://www.ft.lk/columns/Should-CRIB-be-killed-Not-until-Sri-Lanka-goes-for-open-banking/4-706659 (Accessed on 10.3.2021)

that helps them to achieve that objective. Therefore, all good-minded politicians should regard CRIB as a friend rather than an enemy.

Operation of CRIB

CRIB collects information on all borrowers – good as well as bad – from its member institutions. Borrowers here are defined to include those who have borrowed for themselves as well as those who have guaranteed loans for others to borrow. In the case of companies, in addition to the name of the company, the names of the directors of the company are also reported. These data are then collated and stored in its computers for release to member banks. When a member of public, say Punchi Singho, goes to a bank for a loan, it is now customary for the bank to check with CRIB on Punchi Singho's borrowing history from all banks. CRIB reports back whether Punchi Singho was a regular borrower (good borrower) or an irregular borrower (bad borrower). Regular borrowers are those who have been repaying their loans on time without running into arrears. Irregular borrowers are those who have not paid back their loan instalments for three months or more. Regular or good borrowers go through the loan processing speedily like those passengers with all the necessary documents could pass the immigration counters at an airport without a hurdle. In contrast, irregular or bad borrowers must wait before a decision on their loan applications is made known.

Defaults can happen due to many reasons

CRIB does not make this distinction, but a borrower could have become bad due to several reasons. In the first place, they could be wilful defaulters who have borrowed from banks with the sole objective of defaulting the loans. They are the ones on whom a lending bank should have a close watch. Then, there could be borrowers who have become bad not because of their intention but because of compelling circumstances beyond their control. This could happen due to global changes, loss of markets, natural calamities, and epidemics or pandemics of global proportions. For instance, the COVID-19 Pandemic which crippled the entire global economy has beaten Sri Lanka's businesses very badly. Some examples of very badly beaten industries are the travel, hospitality, and export industries. Without a regular cash inflow into the business, these firms have become unwitting defaulters. CRIB does not flag them on this count, and it is the duty of the lending banks to do so. Thirdly, there are those second or third-party defaulters. They are those who have guaranteed loans for others who have defaulted their loans, on the one side, and those who serve as non-executive directors in companies which have defaulted their loans, on the other. When a loan application is entertained from any one of them, it is necessary for lending banks to consider them with a different flag attached to them. Perhaps, a different colour code can be used from light red to mild red to hot red to denote the level of risk involved.

Of late, CRIB has introduced a credit score system

Since banks and other financial institutions have not been able to do it with consensus, CRIB has stepped into flagging the borrowers. But this it has done after 30 years of its existence. Beginning from 2020, CRIB has started to work out a credit score for each borrower in its data base[15]. When member banks ask for credit information, they are also supplied with a credit score that gives a rating grade flagged with colour codes. The colour code 'grey' has been used to denote non-scored borrowers. The others are categorised into five risk categories, very high, high, average, low and very low risk. The calculation of the credit score is a machine exercise that uses a built-in algorithm for the purpose. It uses for its calculation the past performance of a borrower under different permutations and combinations. This algorithmic calculation is accurate based on the data fed to the system. As a result, borrowers who are dissatisfied with the score assigned to them should take it up with his bank and see whether there have been errors in reporting. If there are, once they are corrected, the credit score too changes automatically.

High risk borrowers should be charged a high-risk premium

Does it mean that those who have got a credit score of C1 or less should be denied a loan facility. Not at all. The credit score reported to banks gives them some background information to put their loan applicants into different buckets and deal with them accordingly. If it is a good lending bank, the applicants who have got a score depicting average risk to high risks should be further investigated to ascertain whether they have been habitual defaulters or those who have just become defaulters due to factors beyond their control. Once this ascertainment is made, the lending bank should offer a higher

[15] https://cribscore.crib.lk/sign-in?ReturnUrl=%2f (Accessed on 3.10.2021)

lending rate to such borrowers to take care of the risks involved. For instance, the best customers of banks, categorised as prime customers, are given loans at relatively low interest rates. At present, in Sri Lanka's banking system, these customers are offered loans at average interest rates between 6 and 7%. A margin could be added to this depending on the colour code which a prospective borrower has been assigned by CRIB. Thus, credit risk is tackled not by denying a loan to a customer but by getting him to pay more for his loan. It gives him an incentive to improve his credit record as well.

CRIB in a high-tech era

CRIB was created at a time when the technology used in banks was not so advanced as it is today. At that time, internet or email was unknown and the first credit report was issued by CRIB in 1990 by using the latest communication technology available at that time, namely, the fax machine now in disuse[16]. At that time, banks had just been venturing into digital banking and their entry to the full digital world commenced as late as the end of the last century. According to the Australian futurist Bret King[17], banks have since then gone through four stages of digital banking: between 1998-2002, Digital Bank 1.0 involving E-banking, between 2003-8, Digital Bank 2.0 with multichannel integration, between 2009-15, Digital Bank 3.0 using omnichannel and since 2015, Digital Bank 4.0 taking advantage of Internet of Everything. His argument was that banks have been blessed with a massive data base about their customers and they should not just sit on them without using them for the benefit of the industry.

Open banking is the future of banking

These data bases, also known as big data, help an individual bank to profit from sharing them among different branches within a bank. For instance, the behaviour of the savings account customers, known only to those in the savings account department, will be helpful for the new product teams to design new products and marketing teams to promote the same. But it is a single entity use and it dissuades competition and innovation, a must for the sustained existence of the financial services industry. Thus, governments in many countries have forced banks to share such information among themselves in an initiative known as 'open banking'[18]. This is a more recent development that has started from around 2015 in the Digital Bank 4.0 era.

Third-party API developers

Open banking is a system that permits third party access to financial data through software applications known as Application Programming Interfaces or APIs. This interface is not between a machine to humans like in the case of a smart phone. When we use a smart phone, the applications within the phone are given directions by us and those applications simply obey our commands. That is how we can call or cancel a call to another party. In contrast, APIs used in open banking are from machine to machine. Once a third-party API developer is permitted to access our financial data, it could do so without our intervention or knowledge. Similar APIs are in our smart phones too. When the camera roll is permitted to download photos and videos sent to us through WhatsApp, and Google Photos or OneDrive Photos are permitted to download those photos or videos from the camera roll, it happens automatically using the limited data quota given to us by our internet service provider under different packages. That is why some smart phone users find that their data quota is consumed too quickly though they have not done it by themselves. The solution to this is simply to disable the access and through that action, we prove that we are the masters of smart phones.

Early entrants to open banking

Open banking has already been introduced to the European Union and the United Kingdom. Beyond these countries, the others which have already introduced open banking or in the process of introducing the same are as follows: Australia, Canada, Hong Kong, Japan, Israel, Mexico, New Zealand, and Singapore[19]. Recently, India too has shown interest in introducing open banking to its financial system. Once open banking is in full operation, banks can share information among themselves. However, decisions on sanctioning credit should be made not based on information, but on the best judgment of bankers regarding the creditworthiness of customers.

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[16] https://www.colombotelegraph.com/index.php/crib-at-25-brings-new-challenges/ (Accessed on 10.3.2021)

[17] King, Brett, 2018, Bank 4.0, Marshall Cavendish Business, New York.

[18] For details of open banking, see, https://www.openbanking.org.uk/customers/what-is-open-banking/ (Accessed on 10.3.2021)

[19] https://bbvaopen4u.com/en/actualidad/open-banking-beyond-europes-borders (Accessed on 10.3.2021)

What this means is that in the permanent normal, banks must be innovative lenders. They should establish a mechanism to accommodate the credit requirements of small and medium size borrowers to enable them to join the supply chains involved without obstructions. At the same time, they should avoid over relying on CRIB reports and make judgements about borrowers based on the credit score assigned to them by CRIB. The credit risk in the case of bad borrowers should be mitigated by having a flexible interest rate policy. These are issues in the new economy that commands the attention of the banking community.

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