

{ PREFACE }

A STORY WORTH SHARING

Seylan Bank's return to financial stability warrants a unique case study - with lessons for the entire financial services industry.

In December 2008, Seylan Bank was confronted by a sudden, unexpected crisis of public confidence. The situation facing Sri Lanka's fifth largest bank, while, no doubt linked to widespread uncertainty in the wake of the global economic downturn, was triggered by a highly publicised financial collapse much closer to home. As a result, many concerned customers rushed to withdraw their deposits, creating a run on the Bank. The ensuing period of instability threatened the very future of a 20-year old, systemically important institution.

The reasons behind the crisis are complex, and we will examine them in detail over the following pages. But the central point of the Seylan Bank story is very simple: A run that could have been catastrophic was halted, and the support of both customers and investors quickly restored without the need for a bail out from the Sri Lankan Government or the nation's Central Bank. This is unprecedented in banking history.

Our goal in *The Case Study* is to tell this unique story - clearly and candidly, heartened by the knowledge that the crisis is behind us and we can already point to measurable signs of progress. At the same time, some of the problems that sparked this dramatic event, both inside our Bank and in the wider market-place, have yet to be fully resolved. We will examine those challenges as well, and the strategic plan we've put in place to address them.

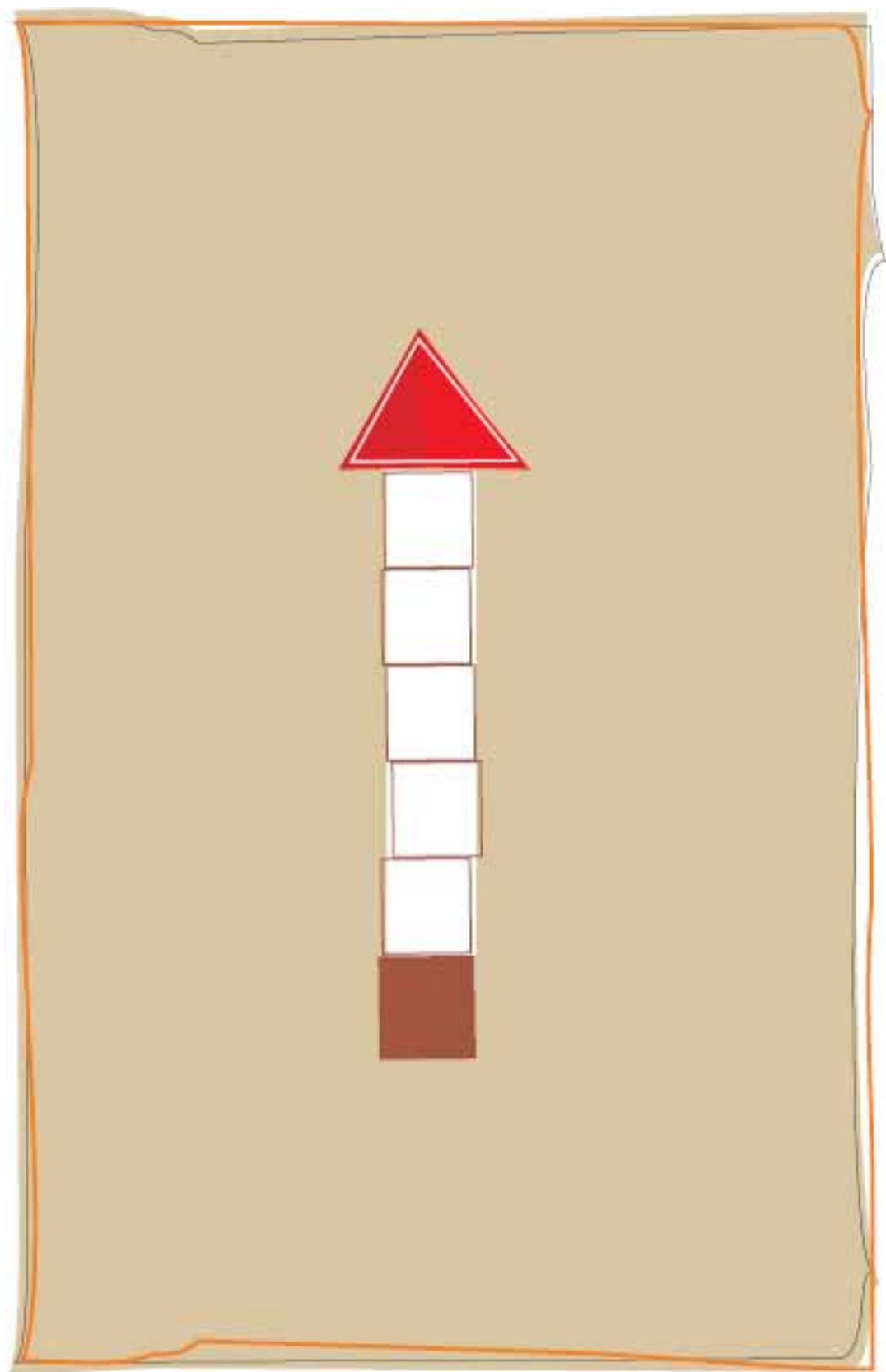
Above all, our purpose here is to share the lessons learned and remedies applied as we've worked to make Seylan Bank more responsive and accountable to the needs of all stakeholders. Our sincere hope is that, others will benefit from seeing what has been accomplished in a remarkably short time, through the collective efforts of many dedicated individuals and institutions. We welcome this opportunity to set our corporate vision within a solid factual framework - to make the case for Seylan Bank as we build a healthy, sustainable business for the future.



Eastman Narangoda

Executive Chairman

17th February 2010



{ CHAPTER 1 }

GROWTH AND ITS CHALLENGES

From its founding in 1987, 'The Bank with a Heart' grew rapidly, and managing that success became increasingly difficult.

Seylan Bank PLC was founded in 1987 and opened its doors for business on 24th March 1988, in Colombo Fort, the traditional banking district of Sri Lanka's largest city. Originally named Seylan Trust Bank Limited, it was designated a Licensed Commercial Bank and incorporated as a public company with a broad base of shareholders. From its founding, the new institution was part of the Ceylinco Group of Companies, a major Sri Lankan conglomerate operating in a wide range of industries.

The goal of the Bank's Founder Chairman, Dr. Lalith Kotelawala, was to offer retail customers a more welcoming, service-oriented alternative in a banking culture that was generally perceived to be formal and regimented, even a bit austere. From the outset, Seylan Bank presented itself as a flexible, customer-friendly choice, summing-up its promise in a service motto that soon caught the attention of prospective customers: 'The Bank with a Heart'.

A CUSTOMER SERVICE LEADER

Seylan Bank quickly differentiated itself in the Sri Lankan market-place with a range of innovative services, including:

- Extended weekday banking hours, as well as Saturday service
- 1% bonus interest on minimum average balances for savings accounts
- Special high-interest savings accounts with contracted monthly deposits
- 5% 'thank-you' bonuses on interest reinvested in fixed deposits
- Personal Assistance Loans for customers with limited credit opportunities
- Cash-card access to non-resident foreign currency accounts (often used by Sri Lankan expatriates to transfer funds to their dependents)

In 1992, the Bank introduced Sri Lanka's first homegrown credit card - Seylan Card - in association with Golden Key Credit Card Co. Ltd. Three years later, Seylan Bank joined the Visa International network and over the next decade became the largest issuer of Visa cards in Sri Lanka. A network of Automated Teller Machines was implemented beginning in 1995.

The same period saw the Bank extend its retail network across the country, opening new branches and acquiring those of other institutions, including the Sri Lankan branches of the failed Bank of Credit and Commerce International (BCCI). In addition, through the mid-1990s Seylan Bank extended its retail services internationally, becoming a regional agency of the Western Union global money transfer system and establishing presence in Dubai and Oman to serve expatriate Sri Lankans working in the Middle East.

Entering the new millennium, Seylan Bank continued its course of steady growth, adding branches in previously under-served areas of Sri Lanka. The Bank also maintained its reputation as an industry innovator, leading the market with a mobile palmtop banking solution in 2007 and, in the following year, launching the country's first corporate website in all three official languages - Sinhala, Tamil and English.

At the same time, the Bank sought ways to further strengthen customer relationships. For example, the Rewards Plus programme, featuring a prize draw that benefited a few fortunate depositors, was replaced by a more sophisticated loyalty programme called Merit Rewards, which recognised customers' academic and professional excellence, sporting achievements and medical or bereavement needs. Seylan Bank also affirmed its leadership in the realm of social responsibility - notably by taking an active role in national rebuilding initiatives following the devastating tsunami of December 2004 (the victims of which included many Bank customers as well as employees).

RAPID, PROFITABLE GROWTH

Seylan Bank enjoyed immediate success, reporting after tax profit of Rs. 11.3 Mn. for its first partial year (i.e., from 24th March) ending 31st December 1988. Over the next 17 years, the Bank grew at an unprecedented pace, with assets totalling Rs. 113.6 Bn. by the end of 2005. Profits in the same period fluctuated to some degree but followed the same overall rapid trajectory, reaching Rs. 687 Mn. (after taxes) in the 2005 financial year.

Other key measures showed a similar pattern of dramatic growth. The Bank's workforce increased steadily from an original staff of 72 to a companywide total of 3,733 employees. A single head office location grew into a network of 117 outlets - based, from 1997 onward, in a new headquarters, Ceylinco Seylan Towers. By 2005, Seylan Bank was Sri Lanka's fifth-largest Bank and ranked third among privately owned financial institutions.

Unfortunately, that same year brought a dramatic heightening of public concern - following several years of increased scrutiny from regulators, banking analysts and other industry watchers - that Seylan Bank's remarkable record of growth masked some significant underlying management problems. In retrospect we can see that these unresolved issues, while not the direct cause of the Bank run three years later, undoubtedly set the stage for the crisis to come.

OVEREXPANSION CARRIES A PRICE

In the view of some stakeholders, the staggering growth achieved by Seylan Bank had led to a classic case of overtrading. Banking is by definition a capital-intensive business. However, in the case of Seylan Bank, aggressive expansion, both in terms of business volumes as well as physical infrastructure - opening branches, expanding the ATM network, building new premises, etc. - had exerted tremendous pressure on the limited amount of capital available. Within five years of the Bank's founding, its gearing ratio (the degree of leverage required to finance operations, calculated as total assets divided by total shareholders' funds) shot up past 29 times. This pointed to serious problems ahead.

The ratio in fact remained extraordinarily high through the rest of the 1990s and beyond. Where other industry players typically hold the gearing ratio below a threshold of 15 times, Seylan Bank rarely managed to keep this key performance indicator below 20 times, and in many years it rose significantly higher. In retrospect, one need only glance at the Bank's financial performance highlights from the early 1990s onward to confirm a long-standing gap between business needs and available resources.

Another, complementary measure of the Bank's financial health was its capital adequacy ratio, which had been consistently forced downward as growth in capital failed to keep pace with growth in the volume of business. Beginning in 1993, the year it was first reported, this vital ratio was frequently below - and never more than marginally above - the statutory minimum of 8% to 10% at the Tier I and II levels.

In retrospect, one need only glance at the Bank's financial performance highlights to confirm a long-standing gap between business needs and available resources.

With concern growing over these and other key indicators, in 2005, the Central Bank of Sri Lanka moved to impose limitations on Seylan Bank's expansion plans. These included restrictions on the number of new branches the Bank was permitted to open, as well as its planned expansion of student-service centres and even its ATM network. Summing-up several years of such restrictions in the 2005 Annual Report, the Chairman expressed frustration over measures that, in his view, prevented the Bank from fulfilling its mandate as a leader in the 'bottom-up' development of an emerging economy:

“Despite (our) contribution towards the economy and the employment we have generated, I feel sad that we are not given a voice when it comes to development plans or even in our own growth... I feel this is wrong because it is entrepreneurs like us who help grow the economy...”

OTHER WARNING SIGNS

In addition to the obvious indicators of overly ambitious expansion, industry observers noted a growing number of signs that management at Seylan Bank was not aligned with current professional standards for the industry. Among members of the public as well, there was a growing perception that the Bank was not being run properly.

The indicators that aroused concern covered various aspects of management:

- Seylan Bank’s cost-to-income ratio was the highest in the industry.
- Its ratio of non-performing loans, ranging from just over 11% to more than 18% since reporting began in 1998, was similarly among the highest in the industry.
- In addition to the shortfall in capital adequacy, there were other areas where the Bank failed to comply with minimum statutory requirements.
- Seylan Bank was half the size of the country’s largest private bank in terms of assets, yet it employed virtually the same number of staff.
- Operating expenses were as high, in absolute terms, as those of the nation’s largest private bank.
- Productivity, gauged by assets per staff member and earnings per staff member, was below industry norms.
- Profitability, measured both by return on assets and return on shareholders’ funds, fell significantly below industry norms - and below the returns posted by competing banks.

In pointing out these warning signs, industry experts drew some general conclusions about management effectiveness at Seylan Bank. Clearly, there was reason to question the quality of credit appraisals in the Bank's lending and other financing activities. Risk management practices likewise fell short of reasonable standards. And the Bank was significantly overstaffed, demonstrating a lack of adequate human resource policies and procedures.

Equally apparent to outside analysts were more specific problems in one crucial aspect of the Bank's business conduct - its relationship to the Ceylinco Group, whose principal shareholder and Chairman was also Seylan Bank's chair, Dr. Lalith Kotelawala.

THE CEYLINCO CONNECTION

Founded in 1939 as the Ceylon Insurance Co., the company now known as Ceylinco had just three small subsidiaries and a total of 100 employees when Mr. Kotelawala took on the Chief Executive role in the early 1960s. Under his leadership, it grew into one of Sri Lanka's major corporations, employing over 30,000 people and encompassing more than 250 affiliated companies. Some of those companies were publicly held and listed on the Colombo Stock Exchange; most, however, were owned by other companies within the Group, or by the Chairman and various Ceylinco directors.

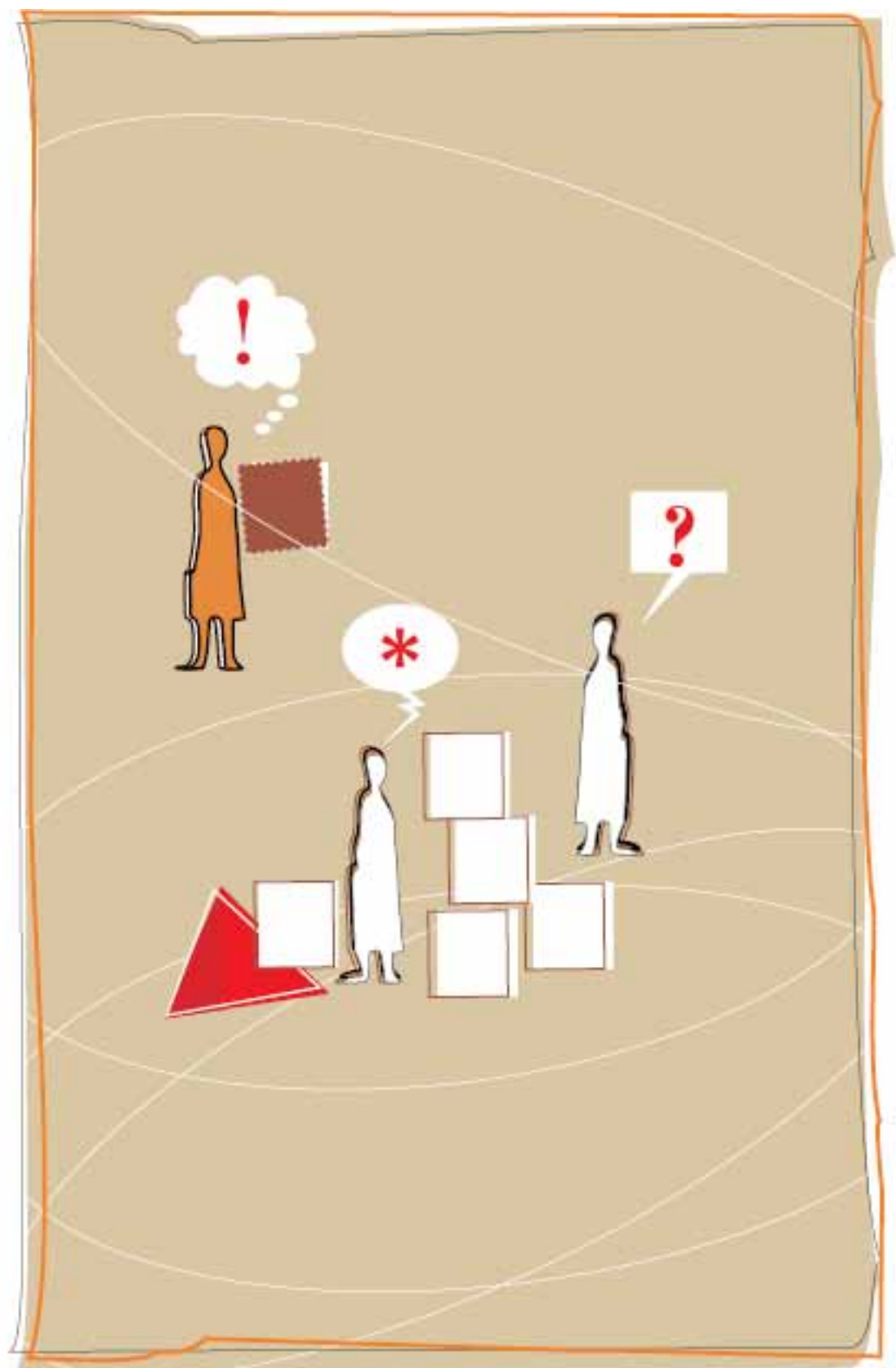
The complex interrelationships between Seylan Bank and many of the companies associated with Ceylinco were a further source of unease for analysts examining the Bank's financial performance, management practices and corporate governance.

Ceylinco was a major shareholder in Seylan Bank from its founding, with an ownership stake averaging approximately 24% through the end of 2008. In addition, the two entities entered into a diverse range of business relationships over the years. For instance, in 1992, the Bank established a subsidiary, Ceylinco-Seylan Development Company Limited, which involved a partnership between the two businesses. And, as stated earlier, the Bank's original credit cards were issued under a franchise agreement with Golden Key Credit Card Co. Ltd., a company in the Ceylinco Group.

The complex interrelationships between Seylan Bank and many of the companies associated with Ceylinco are beyond the scope of this case study. What is salient is that those close connections were a further source of unease for analysts examining the Bank's financial performance, management practices and corporate governance.

In short, it was widely agreed that Seylan Bank (a) had taken on excessive and unjustified lending exposures with regard to many companies within the Ceylinco Group, and (b) had signed contracts deemed unfavourable to the Bank's own interests in order to obtain services from, or deliver services to, a large number of Ceylinco companies.

Again, these specific inferences about Seylan Bank's connection to Ceylinco, and even broader public conclusions about the competence of senior management, did not directly cause the Bank run of December 2008. But there is no question that they contributed to an overall climate of uncertainty around Seylan Bank, such that the actual triggering event, when it did come, had consequences that expanded far beyond the immediate crisis.



{ CHAPTER 2 }

A CRISIS OF CONFIDENCE

In a general climate of uncertainty, misunderstandings around the collapse of Golden Key Company triggered a run on Seylan Bank.

The immediate chain of events that led to the historic run on Seylan Bank occurred within - and was accelerated by - a broader context of public unease arising from two recent institutional failures in Sri Lanka's financial services sector.

Several years earlier, Pramuka Savings & Development Bank Limited had failed, jeopardising the savings of more than 14,000 depositors. The Central Bank of Sri Lanka had subsequently stepped in and liquidated the failed bank, transferring its assets to a new entity. The complex process had taken sometime to complete, however, and in 2008, the Pramuka Bank saga was still fresh in the minds of Sri Lankan consumers as an example of the potential personal risk of entrusting deposits to a mismanaged institution.

Then, in late September 2008, Sri Lankan media headlines were dominated by revelations that an unlicensed finance company had defrauded several thousand depositors of an estimated Rs. 900 million after luring them with promises of exceptionally high rates of return. In what came to be called the Sakvithi Scam (named after the individual reportedly responsible for the collapsed investment scheme - who subsequently fled the country), attention quickly shifted from the plight of individual investors to the overall hazards of dealing with finance companies that operated outside regulatory controls.

In an effort to raise public awareness, the Central Bank of Sri Lanka published - not for the first time - a list of all officially registered finance companies. Among the significant omissions that immediately drew notice were several companies within the Ceylinco Group, including Golden Key Credit Card Co. Limited. In subsequent media reports, it emerged that Golden Key, while not licensed to do so, had been accepting deposits from credit card holders in the manner of a bank. Moreover, the Company had been offering rates of return significantly higher even than those of the more aggressive finance companies - reportedly in the range of 24% to 30% annually.

THE PROBLEM OF GOLDEN KEY

The question of how such extraordinary interest rates could be offered by any institution, licensed or otherwise, took on a new urgency in light of the Sakvithi scandal. And the doubts only intensified as a series of unprecedented crises in the global banking industry through the final months of 2008 sent the world's economy spiralling into a severe recession. Rumours of financial difficulties at Golden Key appeared to be confirmed by reports of depositors whose interest payment cheques had bounced and others who had been unable to withdraw their funds.

At the beginning of December 2008, Dr. Lalith Kotelawala - in his role as Chairman of Ceylinco, Golden Key's corporate parent - wrote to depositors assuring them that all outstanding interest payments would be settled within two months. This did little to calm growing apprehension over the financial health of Golden Key, which at that point (according to later Court testimony) held about Rs. 26 Bn. on behalf of some 10,000 depositors. As new deposits dried up, and with no other means of covering the premature withdrawal requests, the Company could do little more than offer further assurances. At one point, a large group of angry depositors demonstrated outside the Golden Key offices, demanding their funds back.

Alarm over what appeared to be the imminent collapse of Golden Key spread to customers of other Ceylinco companies that mobilised deposits - which soon faced similar problems in fulfilling the demand for withdrawals. Meanwhile, unsubstantiated stories circulated about behind-the-scenes transactions among other Ceylinco subsidiaries designed to help Golden Key meet its obligations. In this climate of rising anxiety, it was not surprising that the cloud of rumours soon enfolded one of the most prominent enterprises in which Ceylinco had a major shareholding: Seylan Bank. Tainted by association, the Bank tried in vain to dispel suggestions that its own depositors had cause for concern.

THE FINAL STRAWS

With public fears at their peak, the last few cards were played that brought Seylan Bank to the brink. On 19th December 2008, having admitted to mismanaging Golden Key (according to later statements by Ceylinco Chairman, Dr. Lalith Kotelawala), the Company's Chief Executive Officer tendered his resignation to Dr. Kotelawala. Police authorities were called and the CEO handed over his passport. In a subsequent statement, Dr. Kotelawala confirmed that Golden Key had been enmeshed in a major credit card fraud.

On the afternoon of 23rd December, Dr. Kotelawala addressed thousands of concerned Golden Key depositors at a convention centre in Colombo. After listening to a series of first-person accounts of the hardships caused by Golden Key's liquidity crisis, the Chairman pleaded with the crowd to be

patient and give the Company time to make good on its obligations. Then, on 27th December the Executive issued a further statement, which proved to be the inadvertent triggering event for what happened next to Seylan Bank.

In retrospect it's generally agreed that what Dr. Kotelawala meant to communicate, as he tried once again to allay concerns over Golden Key, was that equity in other companies within the Ceylinco Group would be redeployed to help the failed credit card company pay off its depositors and creditors. However, when the Chairman specifically referenced selling his conglomerate's stake in Seylan Bank, it was misinterpreted - through an unfortunate combination of unclear reporting and public misunderstanding - as meaning that Ceylinco would directly allocate bank assets in order to refund Golden Key deposits. Panicked Seylan Bank customers, convinced that their savings were about to be diverted toward a Ceylinco bail out, rushed to their home branches to make withdrawals. In a matter of hours, a classic bank run was rapidly gaining momentum.

A RUN ON THE BANK

Over the next few days, long queues formed outside Seylan Bank locations across Sri Lanka. Branch staff faced some tense moments, between fielding questions from upset customers and securing additional funds from head office to meet the extraordinary demand for withdrawals. Contrary to some media rumours, the Bank never attempted to stop withdrawals. Indeed, in some branches, money was conspicuously displayed to reassure anxious depositors waiting in line that there were sufficient funds to cover their requests. Meanwhile, the corporate management team, faced with a shrinking number of funding lines from other banks, worked closely with those institutions that maintained support - Bank of Ceylon, Wachovia Bank, Standard Chartered Bank, Pan Asia Bank, Nations Trust Bank, People's Bank, HSBC and State Bank of India - to ensure a steady supply of cash.

Seylan Bank staff worked with remarkable diligence and professional composure in handling a crisis situation none of them had ever confronted before. They managed for the most part to keep customers calm and in some cases even managed to convince depositors to leave their accounts intact. But, it was clear that this impressive grassroots effort could only go so far. History held plenty of examples of Bank runs that had quickly spiralled out of control, not only bringing down the original institutions but also threatening entire national economies. With the worldwide economic downturn already prompting comparisons to the Great Depression of the 1930s, who could say how far the tremors from one national bank failure might reach?

Clearly something had to be done - and at the highest level of Sri Lanka's banking system, a remarkable recovery effort was already in motion.



News items extracted from The Sunday Times relating to the developments in Seylan Bank

28th December 2008

Seylan Bank crisis was more about overall financial market management

By **Natasha Gunaratne**

Some economists feel the situation at Seylan Bank, precipitated by the unfolding drama with the Golden Key Credit Card Company has nothing to do with the global financial crisis. Instead, it is about the mismanagement of the financial market in Sri Lanka in which the Central Bank (CB) should take responsibility for, according to senior lecturer and head of the Economics Department at the University of Colombo Dr. Anura Kumara. He said the CB is the only authority that can handle situations such as this. At the same time, given the global changes that have taken place in financial markets over the years and the demands of new instruments and innovations entering the market, the present Monetary Act is not sufficient and does not give enough authority to the CB to regulate the industry. Dr. Kumara says the Act must be amended. Dr. Kumara's lecture in Lanka will take an outline from the global economic crisis because it has not fully opened its financial markets. At the moment, it is through trade that Sri Lanka is being the impact of the global financial crisis. "It has normally opened for all the baskets of our products especially garments and tea which are our main exports. They have virtually collapsed because of one or two big countries. We are without a market for our goods," he said. Dr. Kumara explained that when any kind of shock takes place in the rest of the world, they will be affected in the domestic economy. There are two ways in which this can happen, either through Sri Lanka's capital exports or trade account. As the capital markets are not fully developed in Sri Lanka, there are restrictions and so Lanka is protected in that. But as a result, most of the economies of Sri Lanka's buyers have collapsed. Dr. Kumara said Sri Lanka will continue to have a trade problem if the financial crisis drags on for the next several months. He said there is a lot of living policies in the country and addressing the problem is to have a stable and healthy financial system in the country with regulatory and legal bodies. With the trend that is taking place in the financial markets today, people will be cautious investors. "That is more important in the markets and the government and the CB have to make sure activities in their Managing Director of Lanka Kumara's Bank. Although it is the global recession which may become a depression will severely impact Sri Lanka because it is a trading country and exports a substantial amount of commodities. Deflating commodity prices will impact both industries and businesses which will lead to devaluation and then the services industry, the rubber industry. He said Sri Lanka is somewhat insulated because it has top reserve generators to foreign remittances. Despite plunging of prices, migrant workers have a huge presence in the Middle East and the companies overseas will be able to afford to continue paying the workers. However, Dr. Kumara said a major development in the new financial crisis in Sri Lanka which was triggered by the Golden Key Credit Card Company situation. The latter has led to a slowdown in the insurance lending industry which supports all the while being some companies that are selling services on the Golden Key. 28 to 29% increase in returns would be a difficulty as Golden Key would

28th December 2008

Ceylinco to sell Seylan shares to pay Golden Key depositors

By **Bandula Srinivasa**

As the Golden Key Credit Card crisis grew, Ceylinco Consolidated Chairman Lalith Kotelawala - in an unexpected move - yesterday announced he was divesting the stake of his Ceylinco Group in Seylan Bank, saying he needed the money to settle depositors at the crisis-hit credit card company. The move came amidst concerns from the Central Bank where officials were worried about the impact on deposits at the Seylan Bank, founded two decades ago by Mr. Kotelawala, a powerful and politically influential businessman. Seylan Bank CEO Ajitha Pasqual confirmed the Ceylinco Group was exiting and selling off all its interests in Seylan. "It may be 23-24 percent or even more," Mr. Kotelawala wants to raise funds to settle Golden Key depositors," he said, adding that there were two interested parties in buying this stock, one from abroad. Mr.

Pasqual said there was no cause for alarm as Seylan had met all the statutory requirements, and was "ash and sound". The CB in a statement said certain depositors of some of the regulated companies in the Ceylinco Group had shown "signs of stress" over the recent events at Golden Key. "This emerging situation naturally causes concerns within the financial system, since there are two licensed banks and several registered financial institutions popularly associated with the Ceylinco Group of Companies," the regulator said adding that the CB had enough regulations to protect depositors in regulated institutions. Thus, it said the public should continue with normal financial transactions with licensed and registered financial institutions and were assured that the Monetary Board would act in case there was any imminent risk to such institutions.

Mr. Kotelawala, under pressure

11th January 2009

Seylan Bank will curtail lending to Ceylinco Group



By **Natasha Gunaratne**

Seylan Bank, banking arm of the Ceylinco Group will curtail its lending to other Ceylinco subsidiaries from now on, according to a Seylan official. The official told The Sunday Times PT, on the sidelines of a press conference on Thursday to give the media "the full story", "the new strategic plan the new board will be implementing in the short term will be to reduce lending to Ceylinco subsidiaries." He also said this was the main reason for the Central Bank to appoint a new board on December 29 last year. The Central Bank removed the former board of directors of Seylan Bank and directed the Bank of Ceylon to appoint a new board in order to ensure continued financial stability. Since the Golden Key Credit Card Company crisis and subsequent events had created concern among the depositors of Seylan Bank that

led to heavy withdrawals, the Monetary Board had decided on this course of action under Section 30 (1) of the Monetary Law Act No. 56 of 1949. Asked to what extent companies in the Ceylinco Group including Golden Key owe money to Seylan Bank, the officials declined to comment.

Eastman Narangoda, new Chairman, Seylan Bank, told reporters that the urgent and critical issues to be handled in the short term are the credit quality, expenses, investments and off-balance sheet items. He advocated moving towards a slightly 'conservative banking paradigm' in order to improve the credit quality. He said the board will focus on medium term issues, which will include an organizational transformation and continuous improvement processes.

The process will include preparing the team to the new environment, identifying critical issues, establishing new vision/mission/goals in line with

from depositors to return their money, said in a newspaper advertisement yesterday that he was divesting the investment of Seylan Bank, which triggered speculation that Seylan was being sold. This prompted the bank to issue a clarification later in the day admitting it had received inquiries from the public, and saying that it was the Ceylinco Group's stake in Seylan Bank that was being sold to settle depositors at Golden Key.

There are an estimated 10,000 depositors at the credit card company. They include doctors, engineers, business professionals, housewives, parliamentarians, past and present test cricketers, pensioners, retired bank executives and heads of state bodies - depositors drawn by the high interest rates. The crash of the company came when an increasing number of anxious

11th January 2009

Seylan to reduce lending to Ceylinco

Seylan Bank, recently taken over by the Central Bank, plans to cut lending to the Ceylinco Group. Officials said the whole purpose of the management take-over was essentially for this purpose. One official said the "new strategic plan the new board will be implementing in the short term will be to reduce lending to Ceylinco subsidiaries."

Management of the bank, owned by Ceylinco, has been handed over to the Bank of Ceylon which in turn has appointed a new board of directors chaired by Eastman Narangoda. The official declined to comment when asked to what extent companies in the Ceylinco Group including Golden Key owe money to Seylan Bank.

The official, who declined to be named, said "this in other words means the inter-group exposure will be reduced. Seylan has lent to group companies and it will be reduced largely hereafter." Mr. Pasqual said that whatever Seylan

lent in the crisis hit Golden Key had been fully secured. The official confirmed this saying that the security is mostly in terms of land. Mr. Narangoda said there were about Rs. 700 million withdrawals during the past two weeks and this run was mostly by retailers. He said the Bank will meet any request to withdraw money.

He said there are no plans to retrench staff. "When compared to other (peers) banks, Seylan may be overstaffed, but we are utilizing them," he added. Mr. Pasqual said that there are certain parties interested in buying the 23% equity in Ceylinco and commented parties at Seylan. Mr. Narangoda said Seylan has returned to normal and customers are now bringing in new deposits including senior who bring the deposits that had withdrawn. "The new partnership with the Bank of Ceylon is a source of strength and will provide a solid support for Seylan Bank as the Bank resumes to its original status."

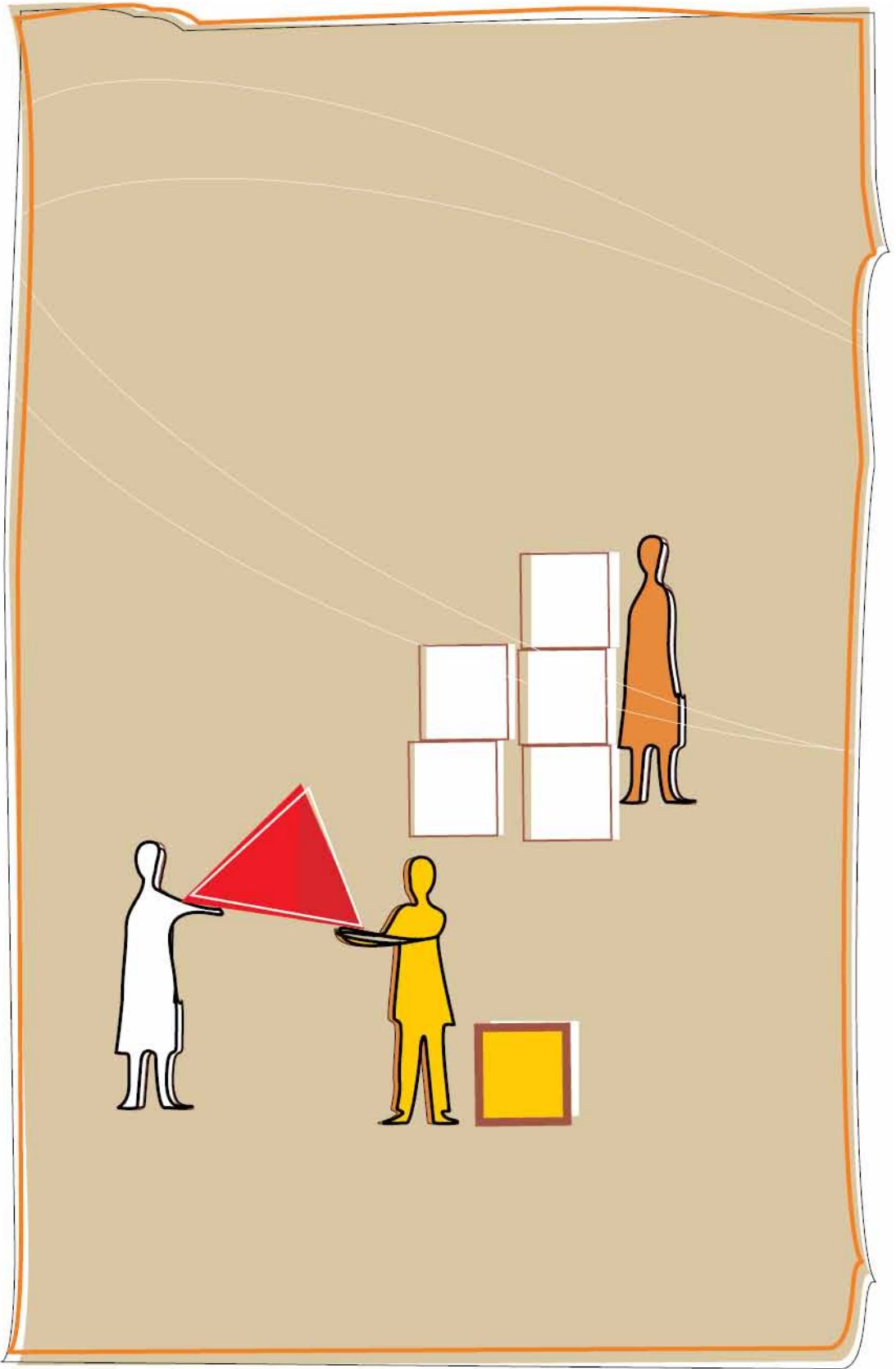
28th December 2008

CB didn't want to manage Seylan-official

By **Darshini Edirisinghe Chandrasekera**

The Central Bank didn't want to manage Seylan and instead asked the Bank of Ceylon (BoC) to nominate a new board of directors to oversee its management, a Central Bank official told The Sunday Times PT. When asked why the regulator itself had not stepped in to manage Seylan in this crisis situation, he said, "We would have had to assume it had we wanted to manage it. We clearly did not want to do this because we had a bad experience in the early 90's with

Messaline Credit. We are not people who can run banks. So this was the best option." In response to a question as to why the regulator chose BoC, he said, "It is the biggest bank, it has the blessings of the state and so far there has not been any controversies with BoC." He argued that BoC will be privy to all Seylan sensitive information, but that could not be helped. "This was the best option."



{ CHAPTER 3 }

SWIFT AND DECISIVE ACTION

The Central Bank stepped in quickly, installing a new board of directors to stabilise the business and apply corrective measures.

On 29th December 2008, Seylan Bank issued a statement clarifying the Chairman's press release of two days earlier:

“What has been stated in the press release is that our Founder/Chairman and Ceylinco Group have decided to divest Seylan Bank shares owned by Ceylinco Group so as to raise funds to honour the dues to Golden Key credit card holders. We emphasise that the intended sale is of the shares owned by Ceylinco Group to a potential reputed investor subject to the permission of the relevant regulatory authorities... It is further clarified that what is intended for sale are not the assets of the Seylan Bank, investments made by the Bank or any shares owned by Seylan Bank. Furthermore, we wish to inform that Seylan Bank will not use the depositors' funds to meet the obligations to Golden Key credit card holders.”

The clarification may have helped ease concerns in some quarters but, as we've seen, did not succeed in neutralising the run on the Bank. What had far greater impact, immediately and over the longer term, was a succinct statement issued the same day by the Central Bank of Sri Lanka: The board of directors of Seylan Bank had been dissolved. State-owned Bank of Ceylon had been asked to appoint a new board and, in the meantime, would be providing management support to Seylan Bank.

It was a swift, decisive move following a few days of intensive behind-the-scenes consultations and reflecting the crucial support of the President and the Government of Sri Lanka. The general consensus was that a high-profile bank failure would have disastrous consequences for the financial sector and, indeed, for the overall Sri Lankan economy, which was already shaken by the ongoing global crisis. Faced with such circumstances, the Central Bank was empowered to take action. Under the provisions of Section 31 of the Monetary Law Act, the regulator could suspend the activities of a distressed Bank, remove its board and order the immediate resumption of business under new management.

As the Central Bank made clear in its statement, the intervention of its Monetary Board was sparked not simply by the plight of depositors, but by the broader threat to economic equilibrium:

“The difficulties of Seylan Bank PLC presented a potential danger to the stability of the financial system. Therefore, the Monetary Board is of the view that immediate measures require to be taken to stabilise the financial system.”

With management support from Bank of Ceylon, the largest commercial bank owned by the Sri Lankan Government, Seylan Bank would carry on operating under its incumbent General Manager with no interruption in service, and all current employees would retain their jobs. The Monetary Board assured Seylan Bank customers that their deposits were safe and they could conduct all transactions as usual. At the same time, the Central Bank reinforced the message to the general public that the banking system was not in jeopardy.

This well-orchestrated intervention on behalf of Seylan Bank required a remarkable level of cooperation and support among all key players, including the Governor of the Central Bank of Sri Lanka, Mr. Ajith Nivard Cabraal, as well as the Monetary Board, its Bank Supervision Department and staff at many levels.

UNDER NEW MANAGEMENT

On 30th December, the Central Bank Governor, Mr. Cabraal, met with the newly appointed board of directors of Seylan Bank. The new Executive Chairman was Mr. Eastman Narangoda, a veteran of the banking industry who had previously held the position of General Manager/CEO of National Savings Bank, a state-owned, AAA-rated institution. A former President of the Association of Professional Bankers of Sri Lanka, he had also served as Vice-Chairman of Financial Ombudsman Sri Lanka (Guarantee) Limited and participated as a Commissioner in a Presidential Commission investigating failed financial institutions.

Mr. Narangoda was joined by fellow directors Mr. Lalith Withana, a Chartered Accountant; Mr. Naomal Goonewardena, a Chartered Accountant and Attorney-at-Law; and Mr. Nihal Jayamanne, President’s Counsel and a former President of the Bar Association of Sri Lanka. Also at the meeting was Seylan Bank’s senior management team, led by the General Manager, Mr. Ajitha Pasqual.

The significance of this landmark, first meeting was summed up by the Central Bank Governor: “We have brought in the Bank of Ceylon together with leading professional personalities in the country to head the new Seylan board, and they are expected to perform their duties until that Bank becomes stable.”

That same day, trading in Seylan Bank shares, which had been halted by securities authorities during the crisis, resumed on the Colombo Stock Exchange and immediately showed a slight rise in value - an encouraging sign of restored confidence. (Significantly, a day earlier the Bank had announced the extension of a five-year debenture issue, after the full subscription of the first tranche of Rs. 400 Mn. - further evidence of longer-term support from institutional investors.)

Mr. Pasqual, Seylan Bank’s General Manager, stressed to the media that the Bank was functioning normally with the backing of the Bank of Ceylon and the Central Bank. Now the challenge was to win back those customers who had withdrawn their savings. He also asserted that the Bank would have no involvement with Golden Key, other than to assist with Ceylinco’s anticipated partial divestiture of its shareholding in Seylan Bank in order to reimburse depositors in the credit card company.

Highlighting the Bank’s successful track record as a retail services innovator, Mr. Pasqual emphasised that the recent crisis had originated from one segment of its customer base. Local and overseas funding partners, while initially concerned, had for the most part been reassured that Seylan retained a solid foundation on which to move ahead and rebuild any lost business.

The spirit of a new beginning was symbolically reinforced when the board of directors joined Seylan Bank employees at a head office gathering to welcome in the New Year. After the traditional lighting of an oil lamp, the new Executive Chairman expressed his confidence that the Bank would soon return to strength. With the immediate crisis already showing signs of abating, it was time to address some of the deeper management challenges and help Seylan Bank reach even greater heights as a leader in the financial services industry.



“WE HAVE HONOURED EACH AND EVERY CUSTOMER WHO CAME TO WITHDRAW MONEY AND NEVER TURNED THEM BACK AT ANY SINGLE POINT... I MUST ALSO TELL YOU THAT WHEN THE CENTRAL BANK INTERVENED AND APPOINTED A NEW BOARD OF DIRECTORS, PUBLIC PERCEPTION CHANGED AND MANY CUSTOMERS WHO EARLIER WITHDREW MONEY IN FACT RETURNED TO THIS BANK TO DO THEIR FINANCIAL TRANSACTIONS.”

Eastman Narangoda

Executive Chairman

At a media briefing held on 8th January 2009

THE BOARD OF DIRECTORS



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1. **Mr. Eastman Narangoda** *Executive Chairman*
2. **Mr. R. Nadarajah** *Executive Director*
3. **Mr. Nihal Jayamanne** - *President's Counsel, Director*
4. **Mr. Latith Withana** *Director*

The profiles of the directors are given on pages 228 and 229



5. Rear Admiral (Rtd.) B.A.J.G. Peiris *Director*

6. Mr. Pradeep G.S. Kariyawasam *Director*

7. Dr. Nalaka H. Godahewa *Director*

8. Mr. Ajith L. Devasurendra *Director*

9. Mr. Ishara C. Nanayakkara *Director*

10. Mr. Samantha P.S. Ranatunga *Director*

THE NEW BOARD'S PRIORITIES

At the beginning of January 2009, two additional members joined the new Seylan Bank board of directors: Rear Admiral (Retired) Ananda Peiris and Mr. R. Nadarajah, former DGM of Bank of Ceylon and Managing Director/CEO of Pan Asia Banking Corporation. The expanded board set to work, and in short order the Executive Chairman outlined a set of immediate priorities:

- Re-establish financial stability
- Remedy any continuing stresses on operations as a result of the Bank run
- Introduce more effective risk management policies and practices
- Restore the full confidence of customers and win back those who had made pre-emptive withdrawals
- Improve the quality of credit appraisal, monitoring and recovery
- Implement new measures for containing and managing operational costs

At the same time, the board identified a number of key objectives for the longer term, including:

- Continuous improvement of business processes across the enterprise
- Transformation of the organisational structure and resources required to implement those processes
- Preparation of employees to embrace and support the planned changes
- Identification of critical issues facing the business going forward
- Establishing a new vision, mission, values statement and set of defined corporate goals
- Creation of a comprehensive strategic plan with clear guideposts for management success

The new board of directors understood that the reinvention of Seylan Bank must begin at the highest level.

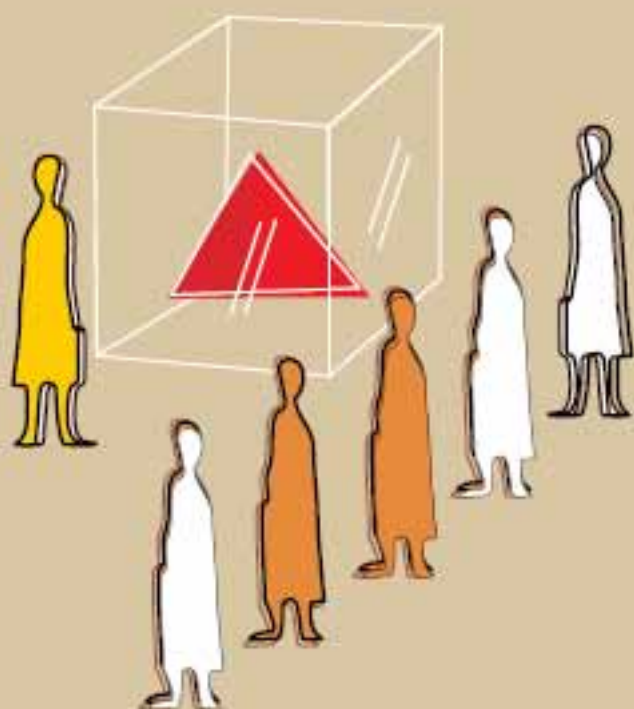
Mr. Narangoda outlined these objectives in a highly publicised media briefing on 8th January 2009. The Executive Chairman also used this occasion to share the new board's perspective on the recent crisis, revealing that a total of Rs. 7 Bn. had been withdrawn in the preceding weeks:

“We have honoured each and every customer who came to withdraw money and never turned them back at any single point... I must also tell you that when the Central Bank intervened and appointed a new board of directors, public perception changed and many customers who earlier withdrew money in fact returned to this Bank to do their financial transactions.”

Seylan Bank subsequently announced that it would be reducing its lending to companies in the Ceylinco Group. It was the first in a series of signals that the Bank was distancing itself not only from Golden Key, but also from the larger conglomerate of which it was a part.

The failed credit card company continued to generate headlines in early January, both for the deepening legal difficulties of its principals and for Ceylinco's repeated assurances that it would soon begin paying back depositors. In the weeks and months that followed, there were further protests by angry Golden Key customers as well as employees - along with widening criminal investigations, high-profile arrests and revelations that other Ceylinco subsidiaries faced serious financial problems.

At Seylan Bank, meanwhile, that 8th January news conference was followed by a series of proactive steps aimed at getting key messages fully aired and understood by customers and the general public. It was clear that communications, even ahead of specific management changes, would play a vital role in getting the Bank back on a solid footing.



{ CHAPTER 4 }

REASSURING THE PUBLIC

The top priority of the Bank's new board was to restore confidence through forthright and transparent communications.

Seylan Bank not only survived the trying days that closed 2008, but did so in a way that was truly remarkable. Around the world, prominent banks dragged down by the global financial crisis had been rescued with Government bail outs, either in the form of massive infusions of capital or, in a few cases, outright nationalisation. By contrast, the express support of the Central Bank and a major state-owned commercial bank was sufficient for Seylan Bank to quickly regain its equilibrium and begin moving forward again, with no need for a full-fledged financial rescue.

THE FULL STORY

In mid-January Seylan Bank's new board oversaw publication of a communications vehicle entitled *The Full Story*, which was given wide national circulation. Through a series of executive interviews and partner testimonials, the document affirmed the Bank's status as an independently run entity that had prevailed in challenging circumstances by adhering to a core set of sound business practices. It also reinforced the Bank's continued commitment to the following "all regulations and compliance initiatives governing financial institutions instituted by the Central Bank, the Monetary Board and other regulatory bodies."

Highlighting Seylan Bank's strong fundamentals and traditionally high standards of service, Mr. Pasqual, the Bank's General Manager, delivered a strong message of pride, commitment and continuity: "Our customers have been our partners for 20 years, and we will be with you for the next 20 years and more." In a companion interview, the new Executive Chairman, Mr. Narangoda, underlined the professional credentials of the board and senior management team, as well as the expressions of solidarity from across the financial sector: "I have utmost confidence that the Bank can emerge from this situation."

Also contributing to *The Full Story* was the Chairman of Bank of Ceylon, Dr. Gamini Wickramasinghe, who spoke frankly about Seylan Bank's problems while affirming his Institution's unwavering support:

"We are the largest bank in the country. We are probably also the most stable due to our large asset base, reserves and risk management capabilities. Moreover, we carry the weight of the Government behind us, and this gives people immense confidence... Seylan Bank needed large infusions of local as well as foreign currency. The Central Bank has asked Bank of Ceylon to step in to fill the void of funding and to help Seylan Bank manage its affairs in this period of restoring confidence and consolidating its finances. I must, however, stress that we have no intention of being privy to privileged information, and our intention is purely to help a good and long-standing bank come through this difficult period."

As a testament to the fact that corporate clients had remained solidly behind Seylan Bank, *The Full Story* included endorsements from senior executives of several leading Sri Lankan corporations. They expressed their confidence in the new board's leadership and their continuing loyalty to the Bank, based on the successes of the past.

Lastly, the publication presented a selection of testimonials from Bank's employees, who recounted how they'd helped cope with the crisis at the retail level and shared their first-hand contributions to the Bank's success in getting back on track. As the centrepiece of a hurriedly launched media campaign, *The Full Story* was an effective vehicle for getting important messages across and garnering public attention. However, as the outflow of deposits continued - totalling Rs. 18 billion for January and February - there was no question that more work was needed to win back the hearts and minds of retail customers.

A MULTI-FRONT CAMPAIGN

Seylan Bank's public information campaign began in earnest within days of the new board assuming control and targeted a range of fronts simultaneously. Communications initiatives included:

Advertising and Public Relations

The Bank launched a coordinated campaign of press advertisements and PR efforts with major media outlets, all communicating the central message that the change in management marked not simply the end of the crisis but the beginning of a new era. The goal was to maintain constant visibility by issuing newsworthy releases and fostering journalistic contacts to suggest stories worthy of coverage. Head office initiatives were supported at the local level by branch managers, who were encouraged to act as PR representatives with the media and community groups. In addition, branch staff were briefed on new marketing plans at regular meetings.

Direct Mail Campaign

All customers who had remained with Seylan Bank throughout the crisis received a thank you letter expressing gratitude for their support during a difficult period. At the same time, letters were sent to those who had withdrawn their deposits, expressing understanding for their decision and asking that they now consider returning to the newly stabilised Bank.

Management Outreach

Management-level staff across the Bank launched a programme of regular meetings with customers as well as employees, getting the message out that the emergency had passed and smooth, reliable operations had resumed. The Executive Chairman and the General Manager visited Seylan Bank branches across the country, answering questions and offering personal assurances to members of the public as well as branch staff. Indeed, these visits were especially effective in raising morale, as many employees had never seen the Chairman of their Bank in person before. Through a steady programme of regional meetings and less formal gatherings, senior managers found new opportunities to connect with employees - seeking their input, keeping them informed, helping to shift attitudes and generally motivating everyone to work together in sustaining the Bank's return to health.

Enlisting Customer Support

In some locations, customers took the lead in showing support for the beleaguered Bank. Branches in Galle, Matara, Mirigama, Badulla and Bandarawela gratefully put up banners created by patrons who wanted others to know how Seylan Bank helped them through their own difficult times, so now they were pleased to reciprocate. A number of prominent customers took part in publicity campaigns that showed them depositing cash.

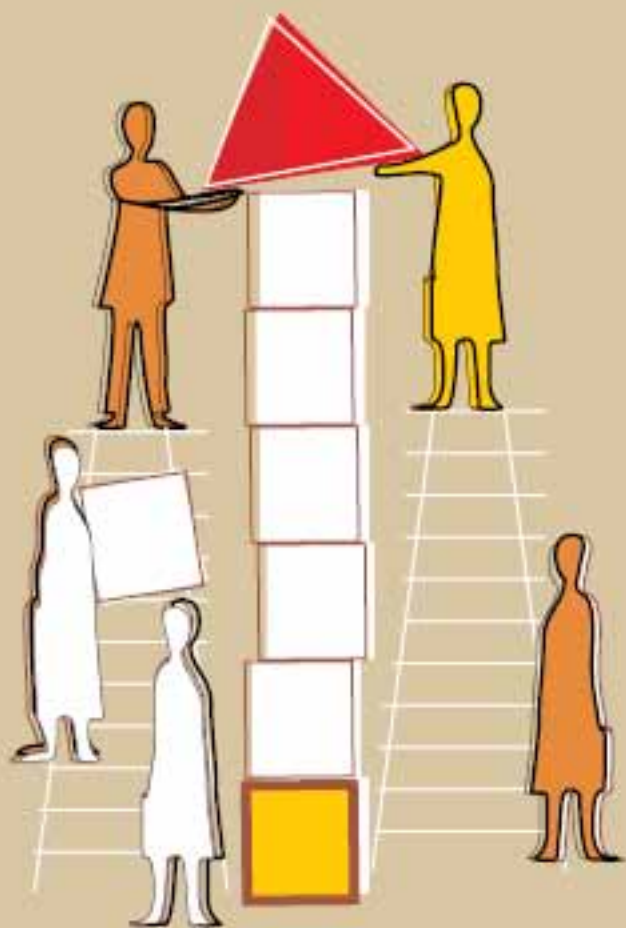
Door-to-Door Campaign

On the initiative of the Executive Chairman, Seylan Bank took its marketing efforts literally to the streets, introducing its first-ever house-to-house public awareness and promotional campaign. Launched across the country on 31st January 2009, the effort saw Bank's employees at every level - from branch staff to the Executive Chairman, the Executive Director and the General Manager - visiting homes and businesses and greeting people in public spaces, spreading

the word that 'The Bank with a Heart' was alive and well. Featuring prize draws, music and a festive street-party atmosphere, the campaign was hugely successful in sparking interactions with new and lapsed customers, and in generally rebuilding the Bank's positive public image - along with employees' team spirit.

Seylan Bank took its marketing efforts literally to the streets, introducing its first-ever house-to-house public awareness and promotional campaign.

Taken together, these various communications efforts spearheaded by the board of directors played a huge part in reaffirming Seylan Bank's place in the public consciousness as a solid, trusted, customer-focused market leader. Ensuring that the Bank once again met those expectations required a parallel effort behind the scenes, as the board and management worked to transform the new strategic plan into real business change with measurable results.



{ CHAPTER 5 }

REBUILDING THE BUSINESS

A series of practical steps, including a systematic rethinking of policy in every area, soon yielded measurable positive results.

The new board of directors understood that the reinvention of Seylan Bank must begin at the highest level, with new policies and practices around corporate governance. Board meetings, traditionally held once a month, now became weekly events, starting at 4:30 p.m. and often running as late as 2:00 the following morning. In addition to the Management Committee, the board established Credit, Audit, Nominations, Remuneration and Risk Management committees. With a better-defined corporate structure, a rigorous set of standards and a commitment to lead by example, the executive team could then begin implementing the myriad practical measures required to get the Bank moving forward on a secure and profitable path.

In a series of meetings in various forums, the Bank's leadership sought to restore employees' confidence in their institution and obtain their support for the collective effort to come. Employees gained a better understanding of their individual responsibilities in relation to the Bank's current position and future expectations. The response at all levels was overwhelmingly positive, as staff affirmed their commitment to returning Seylan Bank to full strength and beyond. Now the task was to implement specific tactical measures designed to re-engineer existing operations and processes.

The range of business challenges fell into three main areas:

Banking Practices

- As long as a significant number of depositors continued to empty their accounts, management met on a daily basis to ensure branches had sufficient funds to pay out all withdrawals.
- The board provided senior management with new targets for reducing the Bank's ratio of non-performing loans (NPLs), which had risen above 30% during the crisis.

- Credit authority limits were reduced at every level, with all lending appraisals to be monitored by a Credit Committee that includes two members of the board.
- More aggressive measures were adopted for handling defaulters.
- Risk management moved to the top of the corporate agenda, beginning with workshops with an overseas professional on assessment and management practices for senior bank staff. The ultimate goal is to systematise risk management throughout the Bank's transactional operations.
- In the absence of proper procurement procedures, the Bank established a new, transparent process (based on the Bank of Ceylon model).

Cost Containment

The overall objective of the Bank's new cost-management approach was to curtail all expenditures that did not contribute to improved profitability.

- Employees were informed that the Bank was unable to pay incremental salary increases in the near term.
- The anticipated April 2009 bonus was cancelled, and the gratuity formula was reduced to half a month's salary from previously enhanced levels.
- Personal loans to staff were temporarily suspended.
- Overtime was severely limited.
- Foreign travel was eliminated unless absolutely necessary.
- Fuel benefits were curtailed, including for the senior management team (which also accepted fewer perks for entertainment and other expenses).
- All capital expenses were suspended unless they had the express approval of the Executive Chairman and/or the board.

Human Resources

- A study was initiated to examine the problem of Seylan Bank's high staffing ratio in relation to competing banks.
- Arrangements were discontinued for some individuals who worked for the Bank on a consulting basis.
- The age of retirement was lowered from 58 to 55.
- Some staff members who were considering resignation were offered encouragement.

- To support the Bank's new ethical standards, a revised Disciplinary Code was put in place.
- The Bank's organisational structure and depth of talent were improved with the addition of several new people in key positions, including:
 - a Chief Financial Officer (CFO)
 - an Executive responsible for corporate and retail banking
 - an Internal Auditor
 - an Assistant General Manager (AGM) in charge of premises and supplies
 - a head of private banking for high-net-worth customers
 - a Deputy General Manager (DGM) in a new role overseeing Recoveries
 - an external consultant in Information Technology.
- The Bank's two unions committed to cooperating with the new board. That positive relationship is strengthened through monthly meetings in which issues are discussed clearly and candidly, building an ongoing dialogue.
- The Human Resources department has been brought under the management of a DGM.

As these various pragmatic steps were being implemented, the board of directors made another key decision: For the first time in its history, Seylan Bank would begin developing a comprehensive three-year strategic plan (which will be detailed in the next chapter of *The Case Study*). At the same time, discussions were underway with the Central Bank regarding potential new sources of capital, as it was agreed that new shareholders bringing a fresh infusion of cash would help further stabilise the Bank, shore up investor confidence – and pave the way for the Central Bank's ultimate ceding of full management control back to the Seylan Bank board.

In March the Central Bank formally called for expressions of interest from potential strategic partners in the recapitalisation of Seylan Bank. The intended outcome was a new share issue that would result in an overall dilution of holdings (as opposed to a divestiture by any of the current shareholders).

A NEW WAY OF DOING BUSINESS

Another of the high-level commitments made by the new Seylan Bank board was to demonstrate strict compliance with all industry-specific regulations and other statutory provisions governing the financial services sector, including adherence to Sri Lanka Accounting Standards. In March the Bank published its draft accounts for the 2008 financial year. The board took this opportunity to formally state its intent with regard to financial reporting:

“Consequent to recent adverse market perception since December 2008, the Bank under its new directorate has decided to clean up and strengthen its Balance Sheet position by constantly evaluating its total investment portfolio, including loans and advances and other investments giving weightage to its realisability, market risk, interest rate risk and any other associated risks.”

The Bank’s statement went on to explain that during the current financial year, it had made provisions for falling value in its marketable investments and loan portfolio, in keeping with International Accounting Standards and in fact exceeding the guidelines stipulated by the Central Bank of Sri Lanka. Seylan Bank had established a significant new benchmark, dispelling past criticisms with a pledge to ensure clear, forthright and readily comparable reporting of results.

At the same time, there was renewed pressure to further differentiate Seylan Bank from the troubled Ceylinco conglomerate with which it was too closely - and now inappropriately - associated in the public mind. For the board and senior executives, the answer was to stay focused on building a compelling business case, showing how their Institution’s fundamental strengths, reshaped by a new Code of Conduct, would translate into positive results.

WELCOME SIGNS OF PROGRESS

Interim results for the six months ended 30th June 2009 showed an after-tax profit of Rs. 188 million for Seylan Bank and its subsidiaries (i.e., the Seylan Group) and earnings per share of Rs. 4.5 - a dramatic improvement over the first quarter. Moreover, a 20% reduction in expenditures compared to the same period in 2008 demonstrated that the new cost-cutting measures were having an impact. And while a provision of Rs. 296 Mn. for non-performing advances

definitely affected the bottom line, both liquidity and capital adequacy ratios had already been restored to accepted levels. In short, the immediate crisis was demonstrably past, and the steps toward longer-term recovery were already yielding measurable success - at a time when much of the financial sector was still mired in the global economic downturn.

Throughout the third quarter of 2009, there were many other signs of progress:

- By August the Bank had recovered about Rs. 300 Mn. from previously non-performing loans. The board's pledge to reduce NPLs and step up recovery efforts - including more aggressive pursuit of defaulters - was bearing fruit.
- Cost-cutting by the end of August had yielded Rs. 860 Mn. in savings, bringing the target of Rs. 1 Bn. for the year well within reach. (Indeed, cost savings reached Rs. 1.2 Bn. by the end of October.)
- In July and August the Bank launched a high-profile marketing campaign to win new customer deposits, showcasing its extensive history as a retail banking innovator with a range of attractive offers, including three-month and one-year fixed products with the highest interest rates of any Sri Lankan bank. The campaign exceeded all expectations, bringing in welcome revenue along with the reassurance that customer confidence was significantly restored.
- In a further strengthening of its national retail presence, Seylan Bank announced that it would soon be opening new branches in the East and North of the country, including areas newly amenable to development following the end of civil-war hostilities in May. The Bank has since opened a branch in Nelliaddy and two Convenient Banking Centres in Manipay and Chankanai. An additional new branch in Mannar is scheduled to open in March 2010.
- Foreign remittances also increased significantly for the first half of the year, totalling Rs. 12.7 Bn. Seylan Bank's extensive network of international money transfer agencies - recently augmented by new partnerships with MoneyGram International, XPRESS MONEY and EzRemit - made it easier than ever for expatriate workers and the Sri Lankan diaspora to send funds home from abroad. The growth in this area indicated that the Bank's reputation was secure overseas as well.

THE RECAPITALISATION EFFORT

As we've seen, the recovery of Seylan Bank stands out in the annals of banking because it was achieved without any external infusions of emergency cash. Through prudent management and implementation of the various measures discussed above, the Bank's declining liquid assets ratio was brought under control and ultimately raised, by the end of August, to 23% - comfortably above the minimum threshold of 20%. This was the single most significant sign of restored stability that stakeholders had been waiting to see.

By year-end, the Bank's liquid assets ratio had strengthened further to 29%. Meanwhile, its capital adequacy ratio, which had dropped as low as 8.0%, had reversed direction, reaching 11.74% against the required 10% minimum. To ensure the availability of capital for future growth, the Central Bank of Sri Lanka made its aforementioned call for expressions of interest from potential investors. On offer was a 33% stake in Seylan Bank for a specified minimum investment of Rs. 5.7 Bn. Six parties expressed serious interest; however, the bids they ultimately submitted were found to be not compliant with the terms and conditions established for the deal.

The Central Bank therefore decided to pursue an alternative method of recapitalising Seylan Bank - a new share issue that would combine a private placement with a public offering to raise slightly more than Rs. 3 Bn. In the private placement, two state-owned entities, Bank of Ceylon and Sri Lanka Insurance Corporation, agreed to make a combined investment of approximately Rs. 1.1 Bn. in new capital. The remaining Rs. 1.9 Bn. would be raised through a public offering of 54,290,000 ordinary (voting) shares at Rs. 35 per share. The issue, with a minimum subscription of 100 shares per application, was set for 22nd September 2009.

The public offering was an extraordinary success, so much so that 10 days later Seylan Bank announced it had been oversubscribed and all shares were sold. The Executive Chairman, Mr. Narangoda, summed up the gratitude of all bank employees:

“Given the crisis the Bank underwent towards the end of last year, this oversubscription is an unequivocal endorsement by the people of Sri Lanka demonstrating the confidence they have in the Bank. This has been a great team effort. On behalf of Seylan Bank, I thank everybody who contributed to this success story and reassure them that Seylan Bank will grow from strength to strength and live up to their expectations.”

With the public and private share issues complete, the total stake in Seylan Bank held by Government-owned institutions was now just over 28%, including 1.16% held by National Savings Bank. The highly successful initiative also marked another milestone in the Ceylinco saga, as the resulting share dilution further reduced the proportionate size of the conglomerate’s holding.

The Bank’s third-quarter results added further confirmation that Seylan Bank was back on track. An after-tax profit of Rs. 503 Mn. for the nine months ended 30th September compared favourably with a total of Rs. 155 Mn. for all of 2008. At the same time, the board reported that advances had dropped by Rs. 17 Bn for the year to date, and that recoveries had accelerated dramatically.

With these gratifying results and a large infusion of capital ensuring continued stability and growth, Seylan Bank could now turn its attention wholeheartedly to the future.



{ CHAPTER 6 }

A SOUND FUTURE STRATEGY

Guided by a comprehensive strategic plan, Seylan Bank is building a healthy, sustainable future for all stakeholders.

Faced with a uniquely challenging threat to its future as an institution, Seylan Bank has prevailed by building on - and believing in - its core strengths. The Bank welcomed the support of its partners, but at the same time took pride in never needing the financial rescue sought by so many other banks around the globe. In retrospect, it's clear that what helped Seylan Bank most in quickly recovering its stride was a collective grasp of the fundamentals:

- Commitment to ethical governance and accountability
- Respect for basic values such as integrity, commitment and trust
- Belief in the power of teamwork
- Leadership grounded in experience and sound judgment
- Dedication, among thousands of loyal employees, to doing whatever is needed to ensure success

As the current period of stabilisation and consolidation draws to a close, Seylan Bank expects to maintain its ranking as Sri Lanka's fifth largest bank, using its solid customer base as a springboard for future growth. It also remains 'The Bank with a Heart,' but at the same time is ready to make its strong brand even stronger, exploring new ways to provide the kind of responsive, flexible service that has always set Seylan Bank apart.

The Bank's strategic consultations have yielded a new vision:

"To be the leading financial solutions provider that delivers exceptional value to stakeholders."

And its collective aspirations have been captured in a new mission statement:

“To exceed customer expectations by providing competitively priced superior services through speedy and multiple delivery channels, whilst rewarding staff through recognition and empowerment; being a responsible corporate citizen; adopting environmental friendly practices and adding superior value to shareholders.”

Before Seylan Bank could fully articulate a new strategic plan, however, management first had to make a rigorous and objective evaluation of where the business stands today.

CURRENT STATE ASSESSMENT

Combining the specialised knowledge and skills of internal teams with the expertise of outside consultants, Seylan Bank has analysed systems and processes, policies and procedures in every area of its operations.

Financial Performance

The Bank has identified a broad range of indicators - including return on assets, operating profit, net income growth, cost-to-income ratio and growth in deposits - that can be used to gauge its comparative performance in the market-place. Seylan Bank's NPL ratio, for instance, was significantly higher than that of its competitors in 2008. And the fact that operating expenditure was as high as that of Sri Lanka's largest private bank - an institution twice the size of Seylan Bank, measured by assets and branches - underlines a pressing need, as discussed earlier, to look for greater efficiencies.

Products and Customer Segments

The enormously varied segmentation of the Bank's target market means that marketing strategies must be more focused than ever. By grounding campaigns in independent research and solid analysis of feasibility, and by refining the information tools used to measure success, Seylan Bank will further its reputation for highly innovative product development and delivery. A comprehensive strategic marketing plan is now being implemented.

Structure

Like most financial institutions, Seylan Bank has a complex organisational structure that undoubtedly could benefit from some economies of scale and efficiency. In future, the Bank aims to become more market-focused in its organisation, creating nimble business units that can move quickly to pursue opportunities without fragmentation or duplication of effort. The branches, in particular, will continue to evolve from self-contained “mini-banks” to delivery channels for a unified mix of products, services and relationship-building strategies.

Systems and Processes

Seylan Bank is conducting exhaustive reviews of systems at all levels, from cost allocation in the branches to enterprise-wide management information systems. The overriding goals are to maximise efficiency, increase integration and provide managers with the best possible reporting and analytical tools. Similarly, processes are being deconstructed and evaluated across the business, bringing together those, such as risk management, that benefit from central control and, in other cases, establishing more clean divisions between responsibilities - for example, relationship management and credit evaluation, or business and consumer lending. All of these measures will be facilitated by a new strategic plan for information technology, which is currently in development.

Human Resources

Internally, the Bank sees an opportunity to build on the momentum of the past year, developing new human resources practices that better reflect employees' demonstrated commitment to collaborative teamwork and tackling tough challenges. Some will benefit from being redeployed in areas where they can make more of a contribution. All will come to see the advantages of an HR environment in which performance reviews, promotions and rewards are more systematically and effectively managed, with clearly understood expectations from both management and staff. The sense of confidence and motivation that has accompanied the Bank's return to financial stability will help retain existing talent while strengthening recruitment efforts.

Image and Branding

As customer confidence continues to grow, Seylan Bank will balance its established identity as a caring, personally responsive institution with a more businesslike image – in effect using the residual positive impact of the crisis-recovery story to give its brand more depth and credibility. At the same time, efforts will continue to distance the Seylan Bank brand from the negative associations of the Ceylinco legacy.

THE STRATEGIC PLAN: 2009–2011

Out of the foregoing assessment process, Seylan Bank has identified the critical success factors for each area and mapped out a comprehensive three-year plan that will guide decision-making through the end of 2011. The specifics of the plan are proprietary in nature and therefore beyond the scope of this case study. However, its main elements can be summarised broadly as follows:

- *Goals* - defined and quantified in relation to seven specific performance indicators: return on equity, profit after tax, cost-to-income ratio, customer deposits, total assets, NPL ratio and market position in terms of total assets. These goals will be incorporated into the budgets developed for each financial year.
- *Strategic Initiatives* - including domestic and international expansion opportunities; capital requirements; governance structure and practices; liquidity management, including loans-to-deposits ratio and long-term asset maturity planning; risk management, especially with regard to NPL recoveries and credit evaluation; mergers and acquisitions; and image and branding.
- *Business-Level Strategies* - focusing on the core business areas of retail banking, corporate banking, customer segmentation and product market strategy, as well as a range of support areas, including organisational structure, centralisation of management systems and human resources management.

Guiding implementation of the strategic plan is a board whose success in stabilising Seylan Bank has won emphatic support from all stakeholders. Originally appointed for a period of six months, the directors, led by Mr. Narangoda as Executive Chairman, subsequently had their terms extended by a further three years. (The appointments were confirmed by a unanimous vote at the Annual General Meeting held in the month of June 2009.)

A NEW KIND OF BANK

Seylan Bank is a dramatically different institution from what it was just a year ago. There is continuity in the range of products and services on offer, and in the Bank's trademark attention to customer care. But for employees, retail customers, corporate and Government partners, industry analysts and regulators - for all stakeholders - Seylan Bank is an institution transformed.

By year-end, the Bank's capital adequacy ratio exceeded the statutory minimum requirement. The liquidity ratio, which at one point in the crisis fell to 13% - well below the statutory minimum of 20% - had increased to 29%. Indeed, the Bank is focused on compliance in all aspects of financial performance - as evidenced by the summary of performance highlights for 2009, and by the comprehensive and detailed report of financial and operational results for 2009 that follows.

Guiding implementation of the strategic plan is a board whose success in stabilising Seylan Bank has won emphatic support from all stakeholders.

There is still work to be done on many financial fronts. For example, at one stage in the past year Seylan Bank's NPL ratio, at 33%, was the highest in the Sri Lankan industry and significantly above the widely accepted benchmark of about 10%. The strategy for 2010 is to bring that ratio down to at least 15% - with a further reduction to 5% in 2011 - by practising more prudent lending. As for the recovery of outstanding loans, the Bank has set a tactical branch-level target of recovering at least 1% of bad and doubtful debts every month. At the regional level, the monthly goal is to reduce the NPL ratio by 2.5%.

Going forward, a new business team devoted exclusively to risk management will extend the board's vision deeper into the organisation, with the goal of creating a pervasive culture of risk-reward assessment and mitigation. Another team is working with an outside IT consultant to maximise the potential of the Bank's information systems and help employees take better advantage of the powerful tools on their desktops. Meanwhile, with recruitment strictly curtailed, the Bank's human resources specialists are looking at opportunities for retraining and redeploying current employees - including at new branches planned for cities in the North and the East. Area managers will also be moving to the regions for which they are responsible, giving them more visibility.

Changes, large and small, are evident everywhere at Seylan Bank. From the launch of a Titanium MasterCard, to the relocation of a branch to more attractive premises, to an ambitious new programme that will make all branches more customer-centric - in every respect the Bank is moving forward, propelled by a commitment to innovation and quality service that one twist in the road, however alarming, was not going to stop.

A CASE FOR THE FUTURE

What is the ultimate lesson to be drawn from the crisis at Seylan Bank? There are probably as many as there are pages in this case study. But if we had to boil it down to one, it would be this: The ultimate decision-maker in any business is, without question, the customer.

It was a sudden, plummeting loss of customer confidence that brought Seylan Bank to the edge of catastrophe. And it was a longer-term failure to uphold the core values of the customer relationship - trust, integrity, transparency, accountability, respect - that created the climate of uncertainty in which such a precipitous fall could happen so easily.

No other bank in the world has weathered such a run without a bail out. An investigative team from the International Monetary Fund, following a recent visit to Sri Lanka, commented that it was a miracle Seylan Bank had survived. The fact that the Bank did survive and, a year later, is poised to grow stronger than ever, comes down to the same powerful single factor that almost brought about its demise: customer confidence. That is the one investment, more fundamental than the deepest cash reserves, that no financial institution can take for granted.

Through the swift action and judicious planning of its new board, Seylan Bank was able to secure the savings of its depositors and protect the interests of its shareholders while also safeguarding thousands of jobs. These successes in turn helped ensure the economic stability of the entire country.

In the final analysis, though, every practical remedy and process step reviewed in these pages is ultimately directed at one basic goal - giving customers all that they need to believe in the value of a relationship. This is the fundamental business case that *The Case Study* has tried to illuminate. It is the grassroots truth at the heart of 'The Bank with a Heart.' And it is the lesson learned that Seylan Bank carries forward as it builds a healthy and sustainable business for the future.