



First Capital
A Janashakthi Group Company



CBSL Debt Restructuring Proposal to Cabinet

29th June 2023

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DEBT SUSTAINABILITY ANALYSIS TARGETS

Public Debt to GDP: Below 95% of GDP by 2032




Gross Financing Needs (GFN): Below 13% of GDP during 2027-32

Foreign Debt Servicing: Below 4.5% of GDP during 2027-32

External Financing Gap: Debt service reduction during 2022-27 should close external financing gaps of USD 16.9Bn

WHY IS DOMESTIC DEBT OPTIMIZATION ESSENTIAL?

- Fiscal adjustment and external debt restructuring alone are inadequate to meet Debt Sustainability Analysis (DSA) targets
 - Restructuring foreign debt only is insufficient to bring down the GFN to 13%
 - Implementing significant fiscal adjustments to achieve substantial surpluses in the primary balance would place an additional burden on individuals and businesses
- Although the DDO positively impacts the Public Debt Stock, it is mostly aimed at bringing GFNs down (as GFNs incorporate both local and external components)

	GFNs avg. between 2027-32	Is the GFNs target met? avg. 13% between 2027-32
Absence of debt treatment	16.8%	
External debt restructuring (no DDO)	14.2%	
External debt restructuring and DDO	12.7%	
DDO Impact on GFN	1.5 percentage points	N/A

Source: CBSL

INDICATIVE TERMS OF SRI LANKA'S DDO

CBSL T-BILLS & GOVT. ADVANCES

- To be converted into T-bonds (10 instruments maturing from 2029 to 2038)
 - Out of 10 instruments, 4 instruments maturing between 2029-2032, each equal to 4% of tendered amount
 - Balance 6 instruments maturing between 2033-2038, each equal to 14% of tendered amount
- Bullet Repayment
- To be implemented in Phase 2 of the DDO through a step-down coupon structure:
 - 12.4% up until 2024 (incl.)
 - 7.5% up until 2026 (incl.)
 - 5.0% until maturity



SUPERANNUATION FUNDS' T-BONDS

- To be exchanged against longer term maturity T-Bonds (voluntary)
 - 12 instruments maturing from 2027-2038
- No principal haircut
- Bullet Repayment
- Step-down coupon structure:
 - 12.0% up until 2025 (incl.)
 - 9.0% until maturity



OPTIONS PRESENT FOR SLDBs & FCBUs

• Every holder would be entitled to choose between one of the three options listed below:

1) USD Option 1 - Exchange against new USD-instruments

- 30% principal haircut
- 6-year maturity until 2029 at 4.0% fixed interest rate

2) USD Option 2 - Exchange against new USD-instruments

- No principal haircut
- 15-year maturity until 2038, 9-year grace-period (first amortization: 2033)
- 1.5% fixed interest rate

3) LKR Option - Exchange against new LKR-instruments

- No principal haircut
- 10-year maturity until 2033
- SLFR +1.0% floating interest rate

**Note - Past due interest and interest accrued up to the settlement date will be settled in LKR (cash) across all 3 options above*

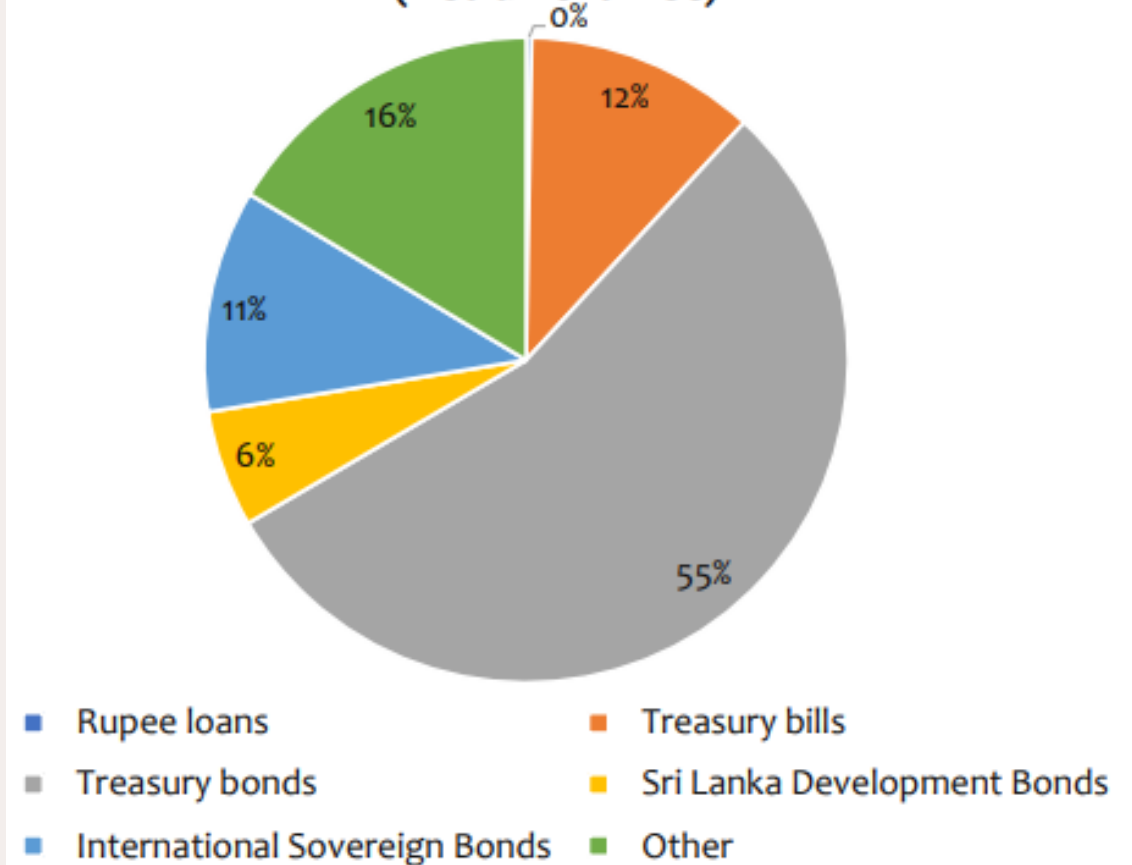
**SLDBs - Sri Lanka Development Bonds, FCBUs - Foreign Currency Banking Units*



BANKING SECTOR'S T-BILL & T-BOND HOLDINGS

- Exempted from the DDO as it has already borne a significant burden of the fiscal adjustment and the economic crisis in several ways such as the provision of debt moratoria (loans under concession as at 31st Mar 2023 was 15.7% of total loans of the banking sector)
- Some domestic banks are expected to contribute to debt restructuring through the ad hoc bondholder committee comparable with the ISB holders
- Restructuring of foreign currency debt is anticipated to create a considerable loss for the banking sector. Therefore, a further burden on the domestic banking system could potentially jeopardize the financial system stability.
- Burden on the banking sector is also borne by depositors through lower returns on savings (no.of depositors of the banking system is 57.2Mn)
 - Total tax burden to the banking sector increased from 39% to 48% (Corporate tax increased to 30% c.f. 24% and VAT on financial services increased to 18% c.f. 15%)
 - Total impairment on existing loan portfolio is LKR 916.0Bn
 - Non-Performing Loans ratio in Q1 2023 increased to 12.7% c.f. 8.4% YoY

Commercial Banks' Holdings of Government Securities
(Instrument wise)



Source: CBSL

INCENTIVES FOR PARTICIPATION OF SUPERANNUATION FUNDS

- To encourage the participation of Superannuation Funds in the proposed DDO plan, higher income tax would be applied to non-participating funds
- Authorities may consider increasing income tax to 30% from the current special treatment at 14% for Superannuation Funds that do not meet the minimum participation requirement, set at 50% for outstanding bonds maturing in 2023 and 100% of bonds maturing between 2024 and 2032 (incl.)
- Options available for Superannuation Funds:
 - Option 1: Participation to the DDO as per the DDO terms
 - Option 2: No participation to the DDO, application of higher annual income tax rate of 30%

Participation of Superannuation Funds	Avg. return (after tax) on T-bonds portfolio of Superannuation Funds over 2023-2038 (proj.)
Option 1	9.1%
Option 2	7.7%

Source: CBSL

Note: current status quo (no DDO and annual income tax at current rate of 14%) provides 9.4% in avg. returns over 2023-38

TIMELINE FOR DDO APPROVAL

2023



28th JUNE - Sri Lanka's Cabinet approves domestic debt restructuring plan



29th JUNE - Session 1 includes feasibility discussion with Govt of SL, CBSL and COPF officials. Session 2 includes feedback on DDO strategy from all creditors including banks, insurance and superannuation funds



30th JUNE - Discussions with all the stakeholders to take place. Following that, COPF approval to be granted



01st & 02nd JULY - Approval of the DDO plan through parliamentary debate and voting

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Thank you!

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MANAGING RISKS”*

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