

Bank of Ceylon (UK) Limited - 09th -20th of December 2024

An audit inspection on the affairs of the Bank of Ceylon (UK) Ltd, a fully owned Subsidiary of the Bank of Ceylon was carried out under my direct supervision in pursuance of provision in Article 154 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka during the period of 9 – 20th of December 2024. Matters which I consider should be brought to Parliament attention are given in this report.

1.1 Introduction to the Bank of Ceylon (UK) Limited

1.1.1 Incorporation

Bank of Ceylon UK Ltd is a fully-fledged banking organization registered under UK Law in the year 2010 and 100 per cent owned subsidiary of Bank of Ceylon - Sri Lanka. This bank had been operating as a branch of Bank of Ceylon from 1949 until 2010. Due to the pressure from UK regulators, it has incorporated as a subsidiary of Bank of Ceylon and hence brought under the supervision of the UK regulator, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCU) requiring the creation of governance and local operating structures. The Bank holds strategic importance as Sri Lanka's financial representative in the United Kingdom and Europe.

1.1.2 Business Environment

Currently, UK banking industry is highly competitive and dominated by a few very large banks, including the Lloyds Group, Barclays, the Royal Bank of Scotland, HSBC Holdings, NatWest, Standard Chartered, Santander UK7, Nationwide Building Society, Virgin Money UK and Metro Bank. In terms of market shares for all categories of business, the market is clearly oligopolistic.

During the early phased after converting into a subsidiary, it took time and effort to meet the PRA requirements rather than focusing on running the business, which resulted in sustained losses. As a new Bank with no track records, it had to rely on funding from the parent to meet the liquidity requirement for lending.

The Company performs Treasury operations, depositing overnight GBP money market products with the Bank of England, Lending to UK BTL customers, and Correspondent Banking with Sri Lankan Banks, Business Loans, Overdrafts, Bills Discounting and Investments in Sri Lankan Sovereign Bonds, US Treasury Bills and European Corporate Bonds. The bank has a small retail banking presence specializing in terms of deposits and facilitating loans.

1.1.3 The Governance Structure of the Bank

BOC (UK) Limited is a company incorporated in England which operates as a commercial bank and has been authorized by the Prudential Regulation Authority (PRA) and is regulated by the PRA and Financial Conduct Authority (FCA). The BOC (UK) Limited is governed by the Board of Directors comprising six (6) directors as follows.

- i) Two Non-Executive Non-Independent Directors
- ii) Chief Executive Officers (CEO) and Chief Operating Officer (COO) of the Bank
- iii) Two Independent Non-Executive Directors

According to the Appointment, appraisal, professional development and removal procedure of directors, approved at the meeting of the Board of Directors (Board) of the Bank held on 5 February 2020, the Board of the Bank is structured as follows.

Nature of the Director	Type of the Director	Nominated by
Chairman of the Bank of Ceylon, Colombo (BOC Colombo)	Non-Independent Non-Executive Director	Nominated by the BOC Colombo. Nominees will usually be directors or members of corporate management of BOC Colombo.
General Manager of the Bank of Ceylon (BOC Colombo)	Non-Independent Non-Executive Director	
Chief Executive Officer (CEO) of the Bank of Ceylon (UK) Limited	Executive Director	CEO is appointed by the BOC Colombo as per its HR policy for three years period.
Chief Operating Officer (COO) of the Bank of Ceylon (UK) Limited	Executive Director	COO is appointed by the BOC Colombo as per its HR policy for three years period.
Other two (2) Directors	Independent Non-Executive Directors (INEDs)	Appointed with the support of the BOC Colombo.

All directors' appointments and re-appointments required the support of the Bank's shareholder by way of a copy of a Board resolution from BOC Colombo agreeing to the appointment. Board members may challenge or seek clarification in respect of the applicant. Subject to satisfactory responses, the candidate will be appointed by majority of votes. The appointment of all directors is made by the Board of the BOC (UK) Limited.

The CEO and COO are generally appointed for three-year period on secondment basis from BOC Colombo. They are usually senior officers of Bank of Ceylon and are nominated by the BOC Colombo after a duly approved selection process to serve as directors of the UK subsidiary. CEO and COO are selected by the BOC Colombo and the Board of BOC (UK) Limited approves the selection and recommends the application for Senior Management Function (SMF) approval as required by the UK regulator, PRA.

Two Non-Independent Non-Executive Directors are nominated by the BOC; one of the Non-Independent Non-Executive Directors will usually stand for appointment as Chairman of the Board of the Bank. According to the past practice, the Chairman and General Manager of the BOC Colombo had been nominated by the Board of Directors of the BOC Colombo as two Non-Independent Non-Executive Directors. As they are not employed by the BOC (UK) Ltd, they receive no remuneration for their roles as directors of the Bank.

There should be two Independent Non-Executive Directors, one of which is the chairman of the Audit and Risk Committee. Applicants will be sought through either known contracts or established recruitment agencies. The Board should determine whether the applicant is independent in character and judgment and whether there are relationships or circumstances which could affect the director's judgment.

1.2 Accounts Receivables and Payables

1.2.1 Advances

Audit Issue	Management Comment	Recommendation
<p>Dependency on limited numbers of borrowers for Loans and Advances</p> <p>The total loans and advance balance of the Bank as at 31 December 2023 was GBP 34,032,241 and out of that GBP 24,694,307 or 73 per cent are spread among top 25 borrowers of the Bank. As well loans granted under Buy to Let Mortgage and Mixed Commercial Loan categories represents 87 per cent of the total loans and advance portfolio of the Bank.</p> <p>The total loans and advance balance of the Bank as at 30 September 2024 was GBP 53,301,965 and out of that GBP 32,524,101 or 61 per cent are spread among top 25 borrowers of the Bank. As well loans granted under Buy to Let Mortgage and Mixed Commercial Loan categories represents 75 per cent of the total loans and advance portfolio of the Bank.</p> <p>This indicates that the Bank is more depend on limited numbers of borrowers with high loan value which may expose to high concentration and high default risk. As well the major portion of the loan portfolio of the Bank has disbursed to the customers of a particular industry and falling down of such industry may badly affect to the loan book of the Bank.</p>	<p>BOC (UK) Ltd employs two key risk mitigation measures when lending to customers. First, lending is capped at 25% of Tier 1 capital, ensuring compliance with PRA regulations. Second, all loans must be fully secured, either against property or a deposit. For property-backed loans, the loan-to-value (LTV) ratio is limited to a maximum of 70% of the property's value. This prudent approach minimizes exposure to customer default risk and strengthens financial stability.</p>	<p>It is recommended that the Bank continues to monitor the concentration risk of its loan portfolio and explore opportunities to further diversify its lending across different borrowers, sectors, and products to minimize dependency on a limited number of borrowers and specific industries.</p>

1.2.2 Deposits

Audit Issue	Management Comment	Recommendation
<p>Dependency on limited numbers of customers for Deposits</p> <p>The total deposit base of the Bank as at 31 December 2023 was GBP 19,228,900 and out</p>	<p>The Raising deposit is recorded in our books as an aggregate amount based on daily collections. However, each</p>	<p>It is recommended that the Bank continues to monitor its deposit concentration levels, particularly in</p>

of that GBP 16,296,046 or 85 per cent are spread among top 25 depositors of the Bank. As well the deposit collected through Raisin Flat form amounted to GBP 13,873,103 and it represents 72 per cent of the total deposit base of the Bank.

The total deposit base of the Bank as at 30 September 2024 was GBP 37,613,000 and out of that GBP 34,766,771 or 92 per cent are spread among top 25 depositors of the Bank. As well the deposit collected through Raisin Flat form amounted to GBP 28,748,000 and it represents 76 per cent of the total deposit base of the Bank.

This indicates that the Bank is more depend on limited numbers of customers with high deposit value which may expose to high liquidity risk. As well the Bank has relatively large elements of its funding from a single depositor, the Raisin aggregator. Competition from deposit aggregators remains strong. The Bank should recognize the need to stay responsive to market changes and customer behavior, ensuring it remains competitive in attracting funds promptly to support the growth of its asset portfolio.

daily collection consists of multiple individual deposits, each capped at a maximum of GBP 85,000 in accordance with the FCA guarantee. As a result, all deposits are either GBP 85,000 or below, effectively reducing concentration risk.

relation to its reliance on the Raisin platform and top individual depositors. The Bank should evaluate the potential risks associated with sudden withdrawals or changes in aggregator agreements and implement strategies to diversify its deposit base by attracting a broader customer base through its own channels.

1.2.3 Payables

Audit Issue	Management Comment	Recommendation
<p>Long Outstanding Balances in GL Accounts</p> <p>The Suspense Account Creditors account recorded a balance of GBP 8,144.62 as at 30 September 2024 and out of that GBP 7,242.90 is lying in the same account for more than 3 years period. Satisfactory actions have not been taken by the Bank to clear the long outstanding balances.</p>	<p>The balances recorded in the suspense account prior to 2024 pertain to customer deposits received through HSBC (our clearing account) that lacked proper references. Despite multiple efforts, we have been unable to trace the depositors, as these transactions may have been one-off deposits by non-bank customers. However, where the deposits were made by bank customers, we have successfully identified and resolved the cases.</p>	<p>It is recommended that the Bank continues its efforts to identify the owners of the long outstanding balances in the Suspense Account Creditors account and clear the long outstanding balances.</p>

Following the introduction of new regulations by the BOE, depositors are now required to provide a minimum level of information to prevent such issues in the future. In compliance with regulatory requirements, we must hold these unclaimed deposits for at least 15 years before transferring them to a charity designated by the Bank of England.

1.3 Non-Compliance with Laws, Rules, Regulations and Management Decisions, etc...

The Key points highlighted by the Prudential Regulatory Authority in its Periodic Summary Meeting (PSM) feedback reports and compliance to those key issues are summarized below.

Date of Report and Key Risk or Risk Area	Views of PRA	Progress achieved by BOCUK	Management Comment	Recommendation
Date of Report 12.02.2022- Business Model Sustainability	BOC UK has provided an updated business plan that sets out strategies it is implementing to diversify its business lines and become less reliant on the Sri Lankan home state economy and its parent bank. This includes conducting trade finance business in Eastern and South Eastern Asia and developing existing UK-based lines of business.	As per PSM report dated 09 August 2024, key risks such of External context and developments in the Sri Lankan economy' and 'Business model sustainability' have both been downgraded from Key Risks to be Areas of Focus.	<p>There are several action points recommended by the PRA in their PSM letter.</p> <p>Most of the actions required by the PRA have been completed by 31.01.2025.</p> <p>Following reports/documents were to be submitted to PRA.</p> <p>a) Succession Plan</p> <p>b) Business Plan 2025/27</p>	<p>It is recommended that the Bank continues to closely monitor the implementation of its updated business plan to ensure effective diversification of business lines and maintain proactive communication with the PRA, providing timely updates on the progress of strategic initiatives and compliance with regulatory expectations.</p>

c) Reasons for the Strategic Shift for business model of the Bank

These were presented to the Board meeting held on 21.02.2025 and since approved.

The documents were submitted to PRA on 28.02.2025.

Date of Report	Our expectations around the independence of UK subsidiaries from Group are significant and materially different to the expectations we have of overseas branches. The PRA also wishes to emphasize that the ultimate decision-maker in respect of executive appointments at BOC UK is the BOC UK Board.	As per this PSM Report, Number of activities/reports are required to be submitted to the PRA which are in the process of preparing/submitting as at 20 December 2024. Some of the reports are as follows.	BOC (UK) Ltd. is in the process of on boarding a Credit Risk Manager with adequate exposure to UK market and credit experience to improve the asset quality of the loan book. This process is expected to be finalized prior to 31.03.2025.	It is recommended that the Bank ensures timely completion and submission of all reports and activities required by the PRA to maintain compliance with regulatory expectations.
09.08.2024				
Management and Governance	<p>If it were to become clear that material decisions such as the appointment of senior UK executives were being taken outside of or in spite of the view of the UK Board, and hence outside of the PRA's jurisdiction, the PRA would need to consider whether the BOC UK was continuing to meet the Threshold Condition of Effective Supervision.</p> <p>We view the UK Board's inability to effectively engage</p>	<ul style="list-style-type: none"> • Lessons Learnt Report • Updated Board Succession Plan 		

with group and resolve concerns, without intervention from the PRA, as a sign of weakness. We would like BOC UK to undertake a 'lessons learnt' exercise to consider the events earlier this year and share the outcome with the PRA.

The PRA remains concerned about the potential for excessive turnover in senior roles at BOC UK. Succession around key Board roles including CEO, Chair, and INEDs will need to be skillfully handled by BOC UK. A smooth succession process, including sufficient period of handover of executive responsibilities, is crucial for the stability of the bank.

A smooth handover is especially important for the role of CEO, so we have welcomed the appropriate use of extension(s) to the secondment tenure of the incumbent CEO.

The PRA acknowledges that it may be necessary for Group to recall a seconded member of staff from a UK bank, and we would expect this process to be handled with due sensitivity and regard to the UK bank and the decision-making role of its UK Board. We would like to encourage the UK bank to continue to do everything it reasonably can to engage with Group around succession at the UK bank and specifically for seconded staff. Once BOC UK has had the opportunity to do this, we will

Credit Risk	<p>require to see an updated Board succession plan.</p> <p>Overall, we assessed BOC UK's credit analysis to be of a poor quality. The firm displayed a lack of understanding of the nature of the exposures e.g., what constitutes a closed and open bridge, weaknesses in the bank's stress-testing methodology e.g., a lack of interest rate stress-testing and incorrect application of risk weights to construction / development and open bridging financing facilities, among other credit specific issues.</p> <p>Our review also highlighted that BOC UK has struggled to grow its depositor base to cover the increasing loan portfolio. This was reflected in BOC UK's Asset Liability Committee (ALCO) memorandum where the liquidity position of the firm was described as "critically low" and required "strategic actions to ensure the stability and sustainability of the organization".</p> <p>We expect firms to have adequate levels of liquidity resource and a prudent funding profile, and that they comprehensively manage and control liquidity and funding risks. Specifically, we expect BOCUK to have necessary liquidity to fund a deal pipeline ahead of securing new loans/deals.</p> <p>A review of the Credit Roles & Responsibilities for BOC UK indicated that senior</p>	-Do-	<p>At present BOC (UK) doesn't have NPA facilities.</p>	<p>Strengthen its credit analysis framework by ensuring a comprehensive understanding of all exposure types.</p> <p>The Bank should continue to develop and implement a long-term funding strategy to broaden its depositor base and reduce reliance on limited funding sources.</p> <p>The Bank should assess and address any capability gaps within its senior credit decision-making team to ensure sufficient expertise is in place to manage the complexities of the UK lending market effectively.</p>
	<p>BOC (UK) liquidity ratio at present is well above the regulatory requirements.</p>		<p>BOC (UK) has adequate liquidity to meet the lending pipeline to secure new loans/deals at present.</p>	
	<p>BOC (UK) is in the process of arranging</p>			

management demonstrated insufficient expertise in UK property finance and certain responses to PRA queries on the loan book were deemed unsatisfactory, further calling into question the expertise of senior management.

training for the Senior management in the UK property market and other related credit management practices during 1st quarter 2025.

2. Financial Review

2.1 Financial Result

The financial result for the year under review amounted to a profit of GBP 327,000 and the corresponding profit in the preceding year amounted to GBP 889,000. Therefore, a deterioration amounting to GBP 562,000 of the financial result was observed. The reasons for the deterioration are the decrease of net gain from Forex transactions by GBP 324,000 and the increase of personal and operational expenses by GBP 157,000 and GBP 193,000 respectively during the year under review when compare with the preceding year.

2.2 Profitability analysis during the past 10 year's period

Out of past 10 years period, the Bank has reported losses for the years of 2014, 2015, 2016, 2020 and 2022 while reporting marginal profit for the years of 2017, 2018, 2019 and 2021. It was also observed that the Bank has reported continuous accumulated losses during the past 10 years period and due to that it was unable to pay dividend to its parent since its inception in 2010.

Amount in GBP'

Year	Profit before Tax	Profit after Tax	Accumulated Losses
2024	412,000	327,000	-966,000
2023	1,068,000	889,000	-1,293,000
2022	-147,000	-146,000	-1,989,000
2021	114,000	112,000	-1,843,000
2020	-26,000	-23,000	-1,955,000
2019	108,000	105,000	-1,932,000
2018	85,000	85,000	-2,037,000
2017	18,000	18,000	-2,087,000
2016	-123,000	-123,000	-2,105,000
2015	-312,000	-312,000	-1,982,000
2014	-596,000	-596,000	-1,669,000

2.3 Trend Analysis of Major Income, Expenditure, Asset and Liability items of the Bank

Trend analysis of major income, expenditure, assets and liabilities as at 30 September 2024 and preceding years with the percentage of increase and decrease are given below.

Major Income & Expenditure Items

Description	For the year ended			Amounts in GBP	
	30/09/2024	31/12/2023	31/12/2022	31/12/2021	31/12/2020
Interest Income from Loans and Advances	2,133,706.62	1,414,292.80	1,073,580.58	929,227.70	878,532.16
% Change when compare to the previous year	51%	32%	16%	6%	-
Interest Income - Bills Discounted	222,000.81	187,563.57	323,195.60	78,559.29	45,368.16
% Change when compare to the previous year	18%	-42%	311%	73%	-
Net Interest on Money Market Operations	290,092.09	804,335.66	404,772.71	285,551.78	138,119.20
% Change when compare to the previous year	-64%	99%	42%	107%	-
Interest Income Investments	54,249.63	6,651.71	20,472.62	197,148.41	306,017.57
% Change when compare to the previous year	716%	-68%	-90%	-36%	-
Net Gain from Forex Transaction	74,490.49	421,289.28	193,318.12	50,287.62	119,255.60
% Change when compare to the previous year	-82%	118%	284%	-58%	-
Commission Income	426,654.58	530,188.13	474,037.97	360,935.77	634,488.48
% Change when compare to the previous year	-20%	12%	31%	-43%	-
Interest Expenses	1,041,076.26	218,776.50	112,951.18	10,129.28	9,084.66
% Change when compare to the previous year	376%	94%	1015%	11%	-
Impairment Provision	-	290,483.00	404,863.00	59,235.00	196,339.00
% Change when compare to the previous year	-100%	-28%	583%	-70%	-
Personal Expenses	1,024,945.88	1,300,696.43	1,125,647.65	1,084,742.46	1,112,297.31
% Change when compare to the previous year	-21%	16%	4%	-2%	-
Operational Expenses	806,718.57	940,000.00	878,145.56	722,745.04	766,000.00
% Change when compare to the previous year	-14%	7%	22%	-6%	-
Profit Before Tax	236,382.05	1,067,940.44	-147,000.00	114,000.00	-26,000.00
% Change when compare to the previous year	-78%	826%	-229%	538%	-

Major Asset and Liability Items

Description			As at	Amount in GBP		
	30/09/2024	31/12/2023	31/12/2022	31/12/2021	31/12/2020	31/12/2019
Assets						
Cash in Hand	30,000	33,000	39,000	49,000	57,000	52,000
% Change when compared to the previous year	-9%	-15%	-20%	-14%	10%	-
Bank Balance Nostro	3,276,000	6,896,000	3,105,000	2,817,000	1,882,000	718,000
% Change when compared to the previous year	-52%	122%	10%	50%	162%	-
Bank of Englands Reserve Account	104,600,000	108,173,000	83,615,000	17,850,000	106,220,000	131,800,000
% Change when compared to the previous year	-4%	30%	368%	-83%	-19%	-
Loans and Advances						
NRFC loans	445,000	253,000	600,000	480,000	196,000	1,451,000
% Change when compared to the previous year	76%	-58%	25%	145%	-86%	-
Staff Loans	69,000	47,000	31,000	12,000	9,000	-
% Change when compared to the previous year	47%	52%	158%	33%	100%	-
Business Loans	7,046,000	3,289,000	3,490,000	3,397,000	3,600,000	4,462,000
% Change when compared to the previous year	114%	-6%	3%	-6%	-19%	-
Buy to Let Mortgage Loans	29,203,000	22,340,000	10,454,000	12,129,000	12,452,000	10,997,000
% Change when compared to the previous year	31%	114%	-14%	-3%	13%	-
Bridge Finance	4,339,000	-	-	-	-	-
% Change when compared to the previous year	100%					
Mixed Commercial Loans	10,934,000	7,388,000	2,971,000	2,179,000	2,023,000	-
% Change when compared to the previous year	48%	149%	36%	8%	100%	-
Overdraft	1,265,000	715,000	550,000	1,162,000	2,084,000	667,000

% Change when compared to the previous year	77%	30%	-53%	-44%	212%	-
	53,301,000	34,032,000	18,096,000	19,359,000	20,364,000	17,577,000
% Change when compared to the previous year	57%	88%	-7%	-5%	16%	-
Investments	2,147,000	435,000	453,000	1,499,000	3,139,000	4,798,000
% Change when compared to the previous year	394%	-4%	-70%	-52%	-35%	-
Fixed Assets	3,814,000	3,834,000	3,461,000	3,585,000	3,713,000	2,999,000
% Change when compared to the previous year	-1%	11%	-3%	-3%	24%	-
Liabilities						
Deposits						
Current Accounts	3,609,000	2,300,000	2,716,000	2,460,000	2,391,000	4,474,000
% Change when compared to the previous year	57%	-15%	10%	3%	-47%	
Fixed Deposits	3,060,000	1,096,000	510,000	485,000	489,000	402,000
% Change when compared to the previous year	179%	115%	5%	-1%	22%	
Raisin FD	28,748,000	13,873,000	5,956,000	-	-	-
% Change when compared to the previous year	107%	133%	100%	-	-	-
Call Deposit	11,000	23,000	59,000	35,000	60,000	62,000
% Change when compared to the previous year	-52%	-61%	69%	-42%	-3%	-
Savings Accounts	2,185,000	1,937,000	2,186,000	2,831,000	1,792,000	1,607,000
% Change when compared to the previous year	13%	-11%	-23%	58%	12%	-
	37,613,000	19,229,000	11,427,000	5,811,000	4,732,000	6,545,000
% Change when compared to the previous year	96%	68%	97%	23%	-28%	-
Vostro Account	7,749,000	5,066,000	15,167,000	3,415,000	3,550,000	3,872,000
% Change when compared to the previous year	53%	-67%	344%	-4%	-8%	-

Money	Market						
Deposit (Short Term)		107,864,000	98,429,000	52,013,000	6,874,000	103,000,000	128,071,000
% Change when compared to the previous year		10%	89%	657%	-93%	-20%	-
Money	Market						
Deposit (Term)		15,337,000	15,794,000	17,488,000	17,834,000	17,283,000	17,448,000
% Change when compared to the previous year		-3%	-10%	-2%	3%	-1%	-

- (i) The Bank has reported losses before tax during the period of 2020 and 2022 which resulted to increase the accumulated losses of the Bank. However, the Bank was able to generate a Profit before Tax amounting to GBP 1,067,940 during the financial year 2023 which was mainly due to increase of interest income from loans and advances, interest income on money market operations, net gain from Forex Transactions and the commission income.

Management Comment

The bank has faced under capitalization for many years, relying primarily on trade finance activities and limited UK lending, funded through its equity and long-term deposits from the parent. The constrained funding availability, restricted lending capacity, while the interest rates charged by the parent on long-term deposits were not competitive for lending. As a result, the income generated was insufficient to cover the minimum fixed costs, leading to sustained losses.

It was not until 2020 that the bank partnered with Raisin, a deposit platform aggregator, to raise UK deposits from domestic customers. These funds have provided much-needed liquidity at competitive rates, enabling increased lending in the UK market. This, in turn, has supported higher lending volumes and contributed to a more sustainable level of profitability.

- (ii) The interest income from loans and advances has increased by 32 per cent during the year 2023 when compared to the previous year which was mainly due to increase of loans and advances during the year 2023 by 88 per cent when compared to the previous year.

Management Comment

Agreed with the observation.

- (iii) The increase of loans and advance balance during the year 2023 was mainly supported by the increase of loan categories of Buy to Let Mortgage and Mixed Commercial Loans which reported an increase of 114 per cent and 149 per cent respectively when compared to the previous year.

Management Comment

Agreed with the observation.

- (iv) During the year 2024, the Bank has introduced a new loan product named "Bridge Finance" and recorded a loan balance of GBP 4,339,000 as at 30 September 2024.

Management Comment

Agreed with the observation.

- (v) Out of total interest related income of the Bank, more than 60 per cent is received from interest income from loans and advances of the Bank. A gradual increase of interest income from loans and advances was observed since the financial year 2021.

Management Comment

Agreed with the observation.

- (vi) The Bank of England Reserve Account shows the investment on overnight GBP money market products with the Bank of England. The majority of the investment has been made from the money received from the parent Bank and minor portion is from the BOC (UK) Limited. The net interest income received for the GBP investment of the BOC (UK) Limited has increased by 99 per cent during the year 2023 when compared with the previous year.

Management Comment

Agree with observation.

The increase in interest income in 2023 compared to 2022 was primarily driven by base rate hikes during 2022 and 2023. The base rate rose from 3.50% at the beginning of 2023 to 5.25% by year-end, contributing to higher interest earnings.

- (vii) The interest expense of the Bank has also increased by 94 per cent during the year 2023 which was mainly due to the increase of deposit base of the bank by 68 per cent when compared to the previous year.

Management Comment

Agree with observation.

The main reasons for the significant increase in interest expenses during 2023 over the 2022 base year are:

In 2022, Bank of England (BOE) base rate rose from 0.25 per cent at the beginning of the year to 3.5 per cent by year-end. These increases were implemented gradually, with rate hikes of 25 basis points (bps) each month. As a result, the average interest rate for 2022 was approximately 2.00 per cent.

In 2023, BOE base rate started at 3.5 per cent and climbed to 5.25 per cent by August. The average interest rate for 2023 was around 4.25 per cent.

The combination of this higher average interest rate and increased borrowing to support balance sheet growth were the primary drivers of the rise in interest expenses.

- (viii) The increase of deposit base of the Bank during the year 2023 was mainly supported by the increase of Raisin FD and Fixed Deposit products of the Bank which reported an increase of 133 per cent and 115 per cent respectively when compared to the previous year.

Management Comment

Agree with observation.

- (ix) The Bank was able to collect deposits through “Raisin Flatform” since the end of year 2021, and the deposits collected through that represented more than 70 per cent from the total deposit portfolio of the Bank during the years of 2023 and 2024.

Management Comment

Agree with observation.

- (x) The personal expense of the Bank has also increased by 16 per cent during the year 2023 when compared to the previous year mainly due to the salary increments granted and the bonus payment made to the staff.

Management Comment

Agree with observation.

The increase is driven by several factors, including the UK government's hourly rate adjustment, the recruitment of skilled staff at managerial levels, an increase in the London weighting allowance, and the payment of a bonus.

3. Operational Review**3.1 Transaction of Contentious Nature**

	Audit Issue	Management Comment	Recommendation
(i)	<p>Significant Involvement of INEDs over extension the term of Former CEO</p> <p>During the audit, it was observed that two Independent Non-Executive Directors (INEDs) had significantly made efforts to extend the term of the incumbent CEO for further period of time.</p> <p>According to the succession planning document prepared by two INEDs dated 04 May 2023, and emailed to Chairman of BOC Colombo, stated that they had a view as Board of UK to seek of extending the term of the incumbent CEO for further two years till May 2026 along with their term extensions.</p>	Noted the concern.	<p>It is recommended that the Bank ensures the governance process for CEO appointments and extensions remains independent, objective, and free from potential conflicts of interest. The Board should consider implementing clear policies outlining the appropriate roles and boundaries of INEDs in executive succession planning decisions.</p>

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| (ii) | <p>Further, the letter dated 14 February 2024 of the INEDs addressed to the Chairman and members of the Board of Directors of BOC Colombo, on the theme of Interviews for the position of CEO, BOC (UK), strongly recommended the extension of the tenor of incumbent CEO for further two years period and also stated that they are not supporting for the appointment of any of the five interviewees as CEO of BOC UK.</p> | <p>It was noted that INEDs had strongly requested BOC Board for an extension of incumbent CEO for further 2 years. Based on the same it was also noted that the INEDs had not supported the appointment of any of the five interviewees as CEO of BOC (UK) Ltd.</p> | |
| (iii) | <p>Further, the Board Paper dated 07 March 2024 and 11 March 2024 submitted by INEDs to the BOC UK Board, continuously emphasized the requirement of extending the tenor of incumbent CEO in order to fully handover the duties to a successor.</p> | <p>Observation noted.</p> <p>INEDs continuously emphasized on the extension of the incumbent CEO for a serious handover.</p> <p>INEDs had strongly requested BOC Board for an extension of incumbent CEO for further 2 years. Based on the same it was also noted that the INEDs had not supported the appointment of any of the five interviewees as CEO of BOC (UK) Ltd.</p> | |
| (iv) | <p>Special Involvement of INEDs for making a Special Bonus Payment to former CEO</p> <p>A memorandum dated 05 December 2023 to the Board of Directors of BOC (UK) had been submitted for the payment of a one-month gross salary as an incentive /bonus to all staff of BOC UK , in line with the exceptional financial performance achieved amidst challenging business environment during the year 2023, subject to the terms and conditions stipulated in the memorandum. One of the said conditions was that the proposed one-month gross salary equivalent bonus payment is eligible for all permanent staff and seconded staff.</p> | <p>As per the 05 December 2023 memorandum, all permanent and seconded staff were eligible for a one-month gross salary bonus. Mr. Aruna Kumara, as seconded staff, was entitled to this bonus. Additionally, following another memorandum created by the INEDs to the Board, a special bonus was granted to Mr. Aruna Kumara, approved by the Board of Directors of BOC (UK).</p> | <p>The Bank should establish clear policies requiring that any special payments to executive management are subject to robust justification, review by independent remuneration committee and secure the full transparency.</p> <p>As well the Bank need to review its governance framework</p> |

Accordingly, then CEO of the Bank also falls in to the seconded staff category and entitled the one-month gross salary as bonus in terms of the above memorandum.

However, at the BOC UK Board meeting held on 18 December 2023, two INEDs recommended a special bonus for the CEO and instructed the UK Board that a paper to be circulated for approval and forwarded to the BOC Board in Colombo for information.

Further one of INED had prepared a letter dated 28 December 2023 on the topic of “Special Bonus for CEO” and recommend to pay a special bonus to former CEO in addition to the staff-wide bonus agreed, as a recognition of his successful achievements.

This proposal had been supported by all the directors of the BOC UK while one of the INEDs, approved this proposal by stating as “Strongly supported”.

According to the Board Paper dated 02 December 2024 to implement salary revision of the staff of BOCUK, the annual gross salary of the CEO was £93,722 and accordingly CEO bonus was more than three times higher than the monthly gross salary, which was paid to the all other staff as bonus. Accordingly, initiation and involvement for such a decision by INEDs would create a doubts about their independence.

regarding remuneration decisions to ensure that the roles and actions of INEDs remain within appropriate boundaries and do not compromise their independence.

3.2 Proposed representation from BOC Colombo to the BOC UK Board

Audit Issue	Management Comment	Recommendation
(i) According to the Section 5 of the Supervisory Statement SS5/2016 issued in March 2016 by the PRA, stated that “in the case of listed firms, established best practice is that at least half of the board, excluding the chairman, is comprised of independent non-executives, but even	BOC (UK) Ltd. is only obliged to have a minimum of two INEDs. The appointment of further Directors as INEDs will be undertaken in such a way not to	It is recommended to ensure that any future appointments to the BOC UK Board are made with careful consideration of Supervisory requirements, by maintaining the

smaller firms should ensure that they have at least two independent non-executives”. Further Section 12.5 of the SS5/2016 states that the PRA also considers it generally undesirable for some key positions on the board of such a subsidiary, such as chairman, chair of the key board sub-committees, chief executive or finance director, to be occupied by executive members of the group or parent board. This does not prevent group executive and non-executive board members from sitting on the subsidiary board as non-executive directors, so long as the overall independent balance of the board is satisfactory”.

Accordingly, in the case where new Board members are going to be appointed, it leads to increase the composition of independent non-executive directors as well in order to maintain the overall independence balance of the Board.

It was observed that BOC Colombo had made an effort to appoint two directors to the BOC UK Board. At the meeting of the Board of BOC(UK) held on 16 September 2024, the then Chairman of the BOC Colombo (Notified Director of BOC UK) proposed to add two additional Board members from Colombo to the BOC UK Board. However, BOC UK Board was not having its consent for this to be implemented due to its impact on the Board imbalance and potential for undue pressure to be applied by the directors from Sri Lanka, rather than the directors acting on behalf of UK. However, the BOC UK Board proposed to appoint directors from Sri Lanka as observers without having voting rights.

disturb the overall appropriate balance of independence of the independent non-executive BOC (UK) Ltd. Board. directors to uphold

Appointment of further Directors has not yet been finalised. This will be included as a discussion point in the Board meeting scheduled for 1st quarter 2025.

effective governance and mitigate potential conflicts of interest.

3.3 Non-Implementation of the Board Decision

Audit Issue	Management Comment	Recommendation
<p>(i) As per the minute of the meeting held on 20 April 2023, then CEO of the Bank presented a proposal to recruit an IT expert. He stated that “the bank has created a JD for the post and will consider only suitable profiles from the parent bank to take up the role. With the new IT position, the Assistant dealer position will not be continued in the future”. The Board unanimously agreed that an IT expert was needed to support the bank in its digital transformation plans and that the cost of this post can partially be covered, rather than an assistant dealer who is only looking after the payments and settlement in the back office.</p> <p>Accordingly, an IT Manager had been appointed to the BOCUK from BOC Colombo on secondment basis. However, it was observed that Assistant Dealer position is continuing as at the audit closing date of 20 December 2024.</p>	<p>A decision was made to prioritize the on boarding of an IT System Analyst for BOC UK, given the critical need for IT resources. Accordingly, the IT System Analyst was on boarded.</p> <p>Assistant Dealer was already in the Bank by April 2023 and his tenure was to end in April 2025. Since we understand the importance of the above position, a memorandum will be submitted to the Board of Directors of Bank of Ceylon UK to assess the necessity of continuing this position.</p>	<p>It is recommended that the Bank promptly reviews and finalizes its staffing structure to avoid role duplication and to ensure optimize resource allocation.</p>

3.4 Delays in Projects or Capital Works

Audit Issue	Management Comment	Recommendation
<p>(i) Renovation of the Bank Building</p> <p>As per the Minutes of the Board meeting held on 18 December 2023, the internal renovations had been started and it was anticipated that the fourth floor would be completed in mid-January and that the builders would subsequently move on to the works on the ground floor. Further, external works are scheduled to be completed when</p>	<p>Renovation work on the ground, third, and fourth floors, as well as the exterior, has been completed as of today 17.02.2025. The bank is currently drafting a procurement policy for</p>	<p>It is recommended that the Bank expedites the approval and implementation of a comprehensive procurement policy to govern all future purchasing and</p>

the weather improves in the spring, and it is anticipated to be finalized in April.

In order to do the renovation works, the Bank had invited quotation from prospective contractors and evaluated their bids. However, it was observed the unavailability of a Board approved procurement policy for the BOC UK.

BOC UK, which will be finalized by 30.06.2025.

contracting activities, ensuring transparency, fairness, and compliance with good governance standards.

3.5 Capital Constrain of BOC UK Limited

Audit Issue	Management Comment	Recommendation
(i) The UK lending and bill discounting volumes are close to full utilization of the available regulatory capital, pushing the Bank to optimum levels where further activity could risk breaching regulatory limits. In the trade finance sector, capital constraints have forced the Bank to exit newly entered markets, including Vietnam and Bangladesh. Therefore, the parent Bank is invited to support to BOC UK Limited by converting the present long-term loan of GBP 10.7 Mn into Tier 1 Capital in January 2025. The parent decision regarding the above request is still pending.	Agreed. If BOC (UK) Ltd. is to sustain its growth momentum and generate profits on a sustained basis, we agree that the parent long term deposit should be converted to Tier 1 long term equity. The conversion will provide the much-needed capital headroom to be able to expand current lending volumes in the UK and expand trade finance business which will provide sustained volumes. BOCUK has already submitted a business development plan inviting Parent Bank to convert the long term deposit into tier 1 capital of the bank and is awaiting parent decision.	It is recommended that BOC UK continues to actively engage with the parent Bank to expedite the conversion of the long-term loan into Tier 1 Capital to strengthen regulatory capital adequacy. In parallel, BOC UK should develop contingency plans to manage regulatory capital constraints, including reviewing lending growth strategies and optimizing capital deployment.

4. Accountability and Good Governance

4.1 Governance related observations

Audit Issue	Management Comment	Recommendation
(i) According to the approved procedure of appointment, appraisal, professional development and removal procedure of Board of Directors as mentioned under section 1.2.3, in particular the Board should be able to state its reasons for considering a director as independent, if the director has served on the Board for more than nine years. However, it was observed that the same procedure had not been applied for the two Independent Non-Executive Directors (INEDs) who had been served in the BOC UK Board for more than nine years.	<p>Agreed. The term of the existing INEDs has been extended from time to time with Board approval till last year. The bank has now taken the necessary actions. Two INEDs were appointed as of 17.01.2025 subject to PRA approval to replace Mr. Roy England (RE), whose term ended on 30.11.2024, and Mr. David Swanney (DS), whose term will conclude on 28.02.2025. The letters of engagement for the newly appointed INEDs have been signed, specifying their tenure as follows:</p> <p><i>"Non-Executive Directors are typically expected to serve two to three-year terms. However, the Board may invite them to serve an additional term, provided that the total tenure does not exceed a maximum of five years if extended."</i></p>	The Bank should consider implementing periodic reviews of director independence, which are aligned with documented procedures, best practices and regulatory guidance to ensure ongoing Board effectiveness and governance transparency.
(ii) According to the succession planning document prepared by two INEDs dated 04 May 2023, existing two INEDs had been appointed when BOC (UK) Limited was incorporated in 2009. Accordingly, they have completed almost 14 years as INEDs. In the above documents, INEDs themselves had mentioned that <i>"the position of the INEDs is in many ways more complex. Replacements need to be found from the market, which could take time, but over the next few years there has to be a change as both individuals are very long serving"</i> .	<p>Considering the smooth handover process from existing INEDs to new INEDs the tenure of DS has been extended till 31.12.2025. Board has taken the decision based on smooth handover process and continuity. However, Mr. David Swanney submitted his resignation on 27th November 2024, with effect from 28th February 2025. Accordingly, the bank has recruited two INEDs to ensure Board continuity.</p>	
One INED's term had to be over on 30 June 2024 and another on 31 December 2024.		

However, further extension of time has been granted to the existing INEDs by the Board.

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| <p>(iii) According to the succession planning document prepared by two INEDs dated 04 May 2023 and e-mailed to Chairman of BOC Colombo, they themselves have made a proposal to extend their tenure of work as follows.</p> | <p>As per the succession plan it was observed that INEDs themselves had proposed to extend their tenure to the Board.</p> |
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i) Roy England- Retired Banker until 31 December 2025

ii) David Swanney- Three-year term to June 2027

After working as INEDs for nearly 14 years, they themselves making such a request to extend their term of office as INEDs appears inappropriate.

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| <p>(iv) Further, as mentioned in the U.K. Corporate Governance Code (which of course does not formally apply to wholly owned subsidiaries), INEDs are expected to serve a maximum of nine years (generally three terms of three years) after which they are usually no longer regarded as independent. Further, the Letter of the General Manager/CEO of the Bank of Ceylon who is also one of the Non-Executive Directors of BOC UK Limited, has written on behalf of the Board of Directors of BOC, stated that Directors who serve for over nine years are no longer considered as independent and leave themselves open to accusations of losing their independence and becoming too close to company management.</p> | <p>This is the case for large firms and is considered best practice and the term of the existing INEDs has been extended from time to time with Board approval till last year. The bank has now taken necessary actions to appoint two new INEDs subject to PRA approval.</p> | <p>The Bank should implement a formal policy by limiting INED tenure, with any exceptions and need to clearly justified, documented, and approved by the Board.</p> |
| <p>(v) According to the succession planning document prepared by two INEDs dated 04 May 2023, the principal regulator (PRA), has a focus on banks governance arrangements as a key matter in their assessment of the viability of the Bank. They have raised this issue with BOC (UK) in the past, however, generally in relation to the position of chairman, where there has been a more than usual series of changes since its incorporation.</p> | <p>The position of Chairman changed more frequently during 2024 due to political changes and the situation prevalent in Sri Lanka.</p> <p>The Board approved TOR provides that in the absence of Chairman, a Non-Executive Director or the chairman appointed at the meeting could chair the Board meeting. It has</p> | <p>It is recommended that the Bank strengthens its succession planning processes to ensure timely appointment and obtaining PRA approval for the Chairman to avoid prolonged interim arrangements that may impact effective governance and</p> |

When a new chairman is appointed, until such time the approval from PRA is taken, the new chairman has to work as “Notified Director” and cannot exercise his voting rights (Normal vote and casting vote) at the decision of the Board.

been the practice of to appoint a strategic decision-making process. INED as the interim Chairman pending approval of PRA when a new Chairman is appointed. This is a short-term arrangement until the approval for Chairman is received from PRA.

Though Mr. Kavan Rathnayake was appointed as the Chairman of the BOC on 03 March 2024 and his position had not been approved by the PRA (Senior Management Function- SMF- 9) until 25 September 2024. However, his notice of withdrawn (Form B) had been submitted to PRA on 25 September 2024 as new chairman had been appointed to the BOC Colombo.

In the absence of an approved chairman, one of the INEDs had to work as the Chairman of the Board of BOC (UK). This may impair the exercising of the power of the Parent at the Board level decisions.

- (vi) Considerable time delays were observed between the dates of appointment of CEOs and receiving approvals from PRA for their appointments. Details are summarized below.
- Agreed
- It is recommended that the Bank reviews its CEO appointment and approval processes to identify and address causes of delays in obtaining PRA approval.

Name of the CEO	Appointment Date	PRA Approval Date	Effective	Time Period taken to get Approval
Mr. Aruna Kumara	May 2021 to May 2024. Extended until end of September 2024	06 December 2021		7 months
Mr. Madawa Dissanayake	March 2024	06 December 2024		9 months

- (vii) According to Section 10 (Succession Planning) of the Supervisory Statement 5/2016 (SS 5/2016), the PRA expects Boards to pay close attention to the skills, experience and effectiveness of its members. Boards should
- This observation is properly noted. BOC (UK) Ltd. has developed a succession plan for key Board roles which was presented for the
- It is recommended that the Bank ensures its succession planning framework proactively incorporates the typical

ensure they have robust succession plans that recognize current and future business needs and requirements. Boards should maintain succession plans that address the unexpected loss of key individuals, particularly those roles covered by the Senior Managers or Senior Insurance Managers Regimes including arrangements covering immediate and short-term situations as well as longer term replacements. Accordingly, as it appears significant delays in obtaining/giving approval from PRA as per its procedure, it is recommended to make the appointment of CEO having considered the time taken by the PRA for their clearance.

special Board meeting held on 21.02.2025 and has since been approved. The same was submitted to the PRA on 28.02.2025.

PRA approval timelines for CEO and other SMF appointments to avoid leadership gaps. Furthermore, the succession plan should be reviewed periodically to align with evolving business strategies and regulatory expectations, ensuring continuity in effective governance and executive management.

4.2 Implementation of the Digitalization project of the Bank

Audit Issue	Management Comment	Recommendation
<p>(i) While the most of institutions in UK are rapidly moving with technology by offering digital banking products to their customers for the purpose of customer convenience and reducing the cost for the customers as well as the institution, the BOC (UK) Limited is still lack behind the implementation of its digitalization process.</p> <p>As per the minute of the Board meeting held on 18 December 2023, a digital roadmap had been approved by the Board in earlier 2023, and during November an agreement was signed with the implementation partners and work had started to complete the remittance APP by March 2024. The CEO explained that the App will help to support the Sri Lankan community in the UK and help to facilitate the £10m annual remittances from the UK to Sri Lanka which BOCUK achieved in 2023. However, Remittance app (Cost incurred as at end December 2024 was £63,000) had not been in operation as at the end December 2024 and it was at the on-going testing and customizing stage to suit the Bank requirement. However, it was observed that some</p>	<p>Agreed with the comments.</p> <p>The bank is progressing according to its digitalization plan. The remittance application is scheduled to launch on or before 31.03.2025. In line with this, a customer felicitation ceremony is being planned, with hopes to hold it before the end of June 2025. The website revamp is also underway and is expected to be completed by 31.05.2025. The Confirmation of Payee project has been completed in compliance with regulatory requirements. Several other IT projects have been successfully</p>	<p>It is recommended to accelerate digital transformation, positioning BOC UK competitively in the market while improving operational efficiency and customer service standards.</p>

Information technology projects had been completed as of this date. completed to strengthen the bank's IT infrastructure,

Further, following projects/activities had not observed as completed as of the year end December 2024 although they were planned to complete in year 2024 as per the above Board minute. particularly in terms of IT security and business continuity.

- Plans were in hand to revamp the website and to include a mission statement for BOCUK and to improve the banks visibility.
- The bank plans to have a customer facilitation event to communicate directly with customers about the new service, to reach out to the Sri Lankan community, and support further marketing efforts.

In January 2024, the bank will also start work on the Confirmation of Payee project, to support the banks digital transformation and as a regulatory requirement for open banking.

4.3 Future Business Potentials of the Bank

Audit Issue	Management Comment	Recommendation
<p>(i) The lack of digital banking services spanning account opening facilities and mobile banking are the main draw backs in expanding the in-house deposit base of the Bank. The Bank was able to create a partnership with “Raisin”, a deposit aggregator at the end of year 2021 which no longer having to rely entirely on BOC for funding requirements.</p> <p>The Bank is expecting to improve its customer base through two natural communities. The first is the Sri Lankan community estimated to number around 700,000 and the second is the community of Small and Medium sized Enterprises (SMEs), which numbered 5.9 million businesses across the UK who are drawn</p>	<p>Agreed and noted.</p> <p>The complete Business plan 2025/27 which clearly indicates the future business potential had been submitted to BOC (UK) Ltd. Board meeting held on 21.02.2025 for approval. Upon Board approval the business plan has been forwarded to PRA.</p> <p>Further, a request inviting the Parent Bank to convert their long-term deposit with BOC (UK)</p>	<p>It is recommended that the Bank prioritises the development and implementation of comprehensive digital banking services, including online account opening and mobile banking, to enhance customer acquisition, deposit mobilisation, and competitive positioning.</p> <p>The Board should monitor the implementation of the approved Business Plan closely to ensure</p>

from a diversity of backgrounds, but are not the focus of the big high street banks who prefer to work with the very largest corporate clients. The linguistic and cultural ties to the Sri Lankan community greatly facilitate communication and understanding of these customer requirements.

The Bank plans to concentrate on the three geographies of London, Birmingham and Manchester where there are significant Sri Lankan communities and a well-established network of active and interacting communities.

By making partnership with global entities including London Forfaiting Agency and Credit Europe Bank, the bank was enabled to purchase LC bills from countries like Bangladesh and Vietnam. Hence the Bank is moving beyond traditional Letter of Credit transactions into secondary market trade finance. However, expansion in trade finance is limited by constraints of limited capital.

Ltd. into tier 1 capital (Development Plan) has been submitted to the Board in July 2024 and a decision of the Parent Bank is pending.

strategic initiatives are delivered effectively, supporting sustainable growth and regulatory compliance.