



**OVERVIEW OF CAPITAL AND  
CURRENT TRANSACTIONS  
REGULATIONS UNDER THE  
FOREIGN EXCHANGE ACT**

**MR. KAPILA WEERAKOON**

[Limited Sharing]

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# Overview of Foreign Exchange Regulations Related to Current & Capital Transactions

**Kapila G Weerakoon**

Deputy Director

Department of Foreign Exchange

Central Bank of Sri Lanka

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# Brief History/Evolution

- **History of Exchange Controls**
  - Exchange control function regulates cross border foreign exchange flows
  - Exchange control regulations emerged as a widely accepted mechanism to preserve foreign exchange reserves by controlling outflows during World War II
  - Conservation of foreign reserves, stabilisation of exchange rates, avoiding capital flight, correcting disequilibrium in balance of payments were among the cited justifications
  - In Sri Lanka, the exchange control function formally established in terms of the Exchange Control Act., No. 24 of 1953
  - During the period that Sri Lanka adopted a fixed exchange rate regime, exchange control was a necessity as it helps to forgo 'free capital mobility'

## Brief History/Evolution ... cont.

- Exchange Control function performed by CBSL as an agent of the Government. Therefore, it was closely follow the policy of the prevailing Govt
- Following the broader economic liberalization policies introduced in 1977, exchange control regulations on current transactions were gradually liberalized and the process completed in ealy 1994 with the Sri Lanka's acceptance of the obligations under Article VIII of IMF
- Liberalization of capital transactions beings in 1990 and continued in a gradual and sequential manner. The process was expedited after 2010
- Foreign Exchange Act (FEA) as enacted in 2017
- The instability emerged during the 2020 – 2023 period lead to temporary suspend/limit some of the permissions

# Capital Account Liberalization process

## What is “Sequencing”?

- Inflows Vs Outflows (relax restrictions on inflows before the outflows)
- Long-term Vs Short-term (allow short-term capital flows at a later stage)
- Institutions Vs Individuals (priority be given to the institutional sector)

## Capital Account Liberalization process ...cont.

### Important milestones of Liberalization in Capital Transactions in Sri Lanka\*

- 1990 - Issue/transfer shares in a listed public company up to 40% of its issued capital to a NR (introduction of SIERA)
- 1992/1993 - Issue/transfer shares in a listed or non-listed company up to 100% of its issued capital to a NR, subject to exclusions/limitations
- 2002 - Further relaxed the exclusions and limitations relating to issue/transfer shares
- 2006 - Opening of T/Bond market for foreigners (5% cap., min. holding period of 2 yrs for maturity/1 yrs for sale)
- 2008 - Authorized investments in deposits at DBU from NRs (under SFIDA)
- 2010 - Opened listed debentures for foreign investors
- 2011 - Limited overseas investments by resident companies and individuals in Sri Lanka
- 2013 - Authorized investments in unit trusts by NRs
- 2013 - Permitted foreign borrowings under External Commercial Borrowing Scheme (ECBS)
- 2014 - Opened non-listed debentures for foreign investors

\*General permissions and subject to conditions.

## Foreign Exchange Act., No. 12 of 2017 & Role of CBSL/DFE

- Replaced with Exchange Control Act and Exchange Control Dept
- Different emphasis

*“AN ACT TO MAKE PROVISION CONFERRING POWERS, AND **IMPOSING DUTIES AND RESTRICTIONS**, IN RELATION TO GOLD, CURRENCY, PAYMENTS, SECURITIES, DEBTS, AND THE IMPORT, EXPORT TRANSFER AND SETTLEMENT OF PROPERTY .....” ~~~~Primable of ECA*

*“AN ACT TO PROVIDE FOR THE PROMOTION AND REGULATION OF FOREIGN EXCHANGE; TO VEST THE RESPONSIBILITY FOR **PROMOTING AND REGULATING FOREIGN EXCHANGE** IN THE CENTRAL BANK AS THE AGENT OF THE GOVERNMENT;.....” ~~~~Primable of FEA*



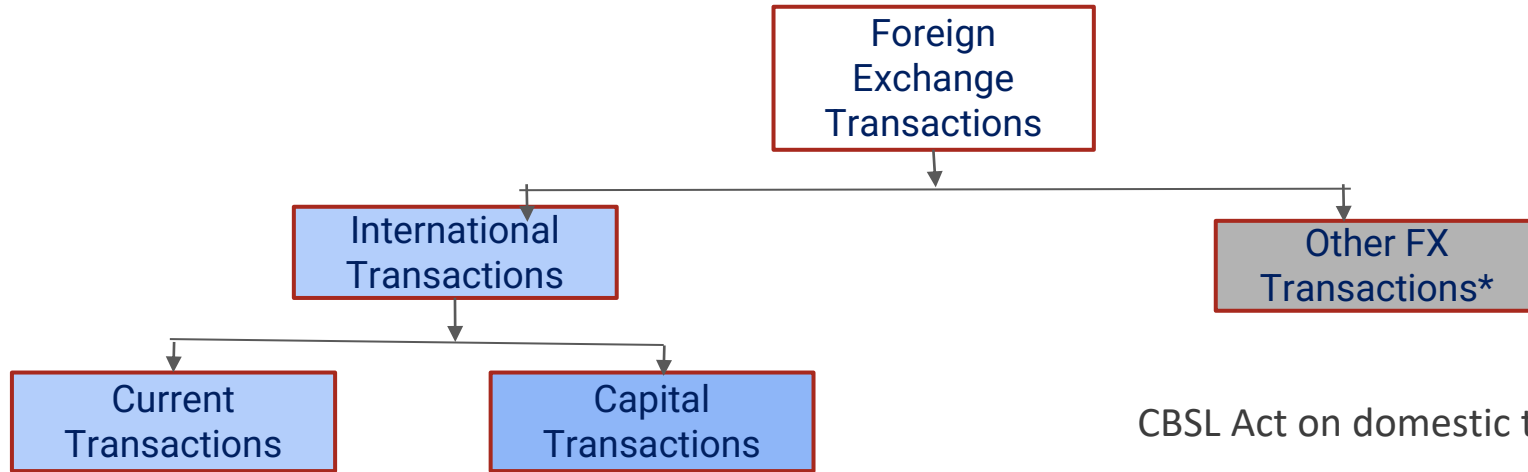
## Foreign Exchange Act., No. 12 of 2017 & Role of CBSL/DFE ...cont

### Role of CBSL and DFE

*The Central Bank shall as the agent of the Government, be responsible for implementing the provisions of this Act in order to ensure proper promotion and regulation of foreign exchange in Sri Lanka.....*

*..... such power, duty or function may be exercised, **performed or discharged by the officer designated as the head of the Department of Foreign Exchange** or on his behalf any other officer designated as an assistant to him, .....*

# Foreign Exchange Transactions



CBSL Act on domestic transactions

*47(2) Any transaction executed or liquidated **between or among residents in Sri Lanka** shall, unless otherwise authorized by the Central Bank for the purposes of the Foreign Exchange Act, No. 12 of 2017, be in Sri Lanka rupees.*

## Key provisions of FEA on Current Transactions

- “Payment for current transactions means **payment which are not for the purpose of transferring capital assets**”
- Schedule 1 of the **Direction No. 2 of 2021** specifies an indicative list. Most common examples;
  - Import/export of goods and services
  - Travel expenses and Educational/Medical expenses
  - Interest and income from investments
  - Moderate amounts for upkeep of dependents abroad
  - Moderate amounts for amortization of loans
- Payments shall be subject to *Trade Policy of the Govt* as may be conveyed by other laws and regulations pertaining to current transactions. E.g. regulations published under Import & Export Control Act No. 01 of 1969 - Special Import License and Payment Regulation of No 01 of 2011 (as amended).

## Key provisions of FEA on Current Transactions ... cont.

### Section 6 of FEA:

- 6(1) *A person shall be entitled to deal in foreign exchange for a current transaction of such person, through an authorized dealer .....*
- 6(3) *Prior to dealing in foreign currency for a current transaction, an authorized dealer shall request the person requiring foreign exchange for such transaction to provide such information/documents/declaration as is reasonably necessary.....*
- 6(4) *An authorized dealer or a restricted dealer shall refuse to deal... 6(5) shall communicate such decision in writing together with the reasons therefor.*
- 6(6) *..... appeal against such refusal to the Central Bank, within fourteen days after such decision*

## Key provisions of FEA on Capital Transactions

“Payment for capital (non-current) transactions means **payment made for the purpose of transferring capital assets**”

Most common examples are ....

- Investments in Sri Lanka by residents outside Sri Lanka (ref. Regulation 2 of 2021)
- Borrowings by residents in Sri Lanka. (ref. Regulation 2 of 2021)
- Expansion of Business abroad by residents in Sri Lanka (ref. Regulation 1 of 2021 + Orders published under Section 22 of FEA)
- Setting up a business place (office) abroad (ref. Regulation 1 of 2021 + Orders published under Section 22 of FEA)
- Transactions relating to immigrants (ref. Regulation 3 of 2021 + Orders published under Section 22 of FEA)
- Miscellaneous Capital Transactions including Guarantees (ref. Regulation 4 of 2021)

## Key provisions of FEA on Capital Transactions ... cont.

### Section 7 of FEA:

- 7(1) *The Minister shall in consultation with the Monetary Board and with the approval of the Cabinet of Ministers, **authorize by regulations, the class or classes of capital transactions** .....*
- 7(3) *The regulations published under subsection (1) may specify the limits... and the terms and conditions....*
- 7(4) *..., a person shall be entitled to deal in foreign exchange in respect of a capital transaction of such person, through an authorized dealer ....., being capital transactions of a class or classes, **which is or are authorized by regulations made under subsection 7(1).***
- 7(6) *Prior to dealing ..... in respect of a capital transaction under this section, the authorized dealer ..... shall request the person requiring foreign exchange for such transaction, to provide such information/documents/declaration as is reasonably necessary.....*
- 7(7) *An authorized dealer .....shall refuse to deal... 7(8) shall communicate such decision in writing together with the reasons therefor.*
- 7(9) *..... appeal against such refusal to the Central Bank, within fourteen (14) days after such decision*
- 7(10) *.....Monetary Board taking into consideration the **existence of any exceptional circumstances** has granted approval for such capital transactions in accordance with such directions as may be issued by the Minister*  
.....

# Other important provisions for Business Transactions

## Business Foreign Currency Accounts (BFCA)

- Facilitated wide variety of transactions involve foreign currency earners (Merchandise exporters as well as Service exporters)
- Ref. Direction 5 of 2021 as amended (Amended by Directions #24 of 2021, #27 of 2021, #02 of 2022, #09 of 2022 and #02 of 2023)

## Recovery of FX Loans granted by ADs

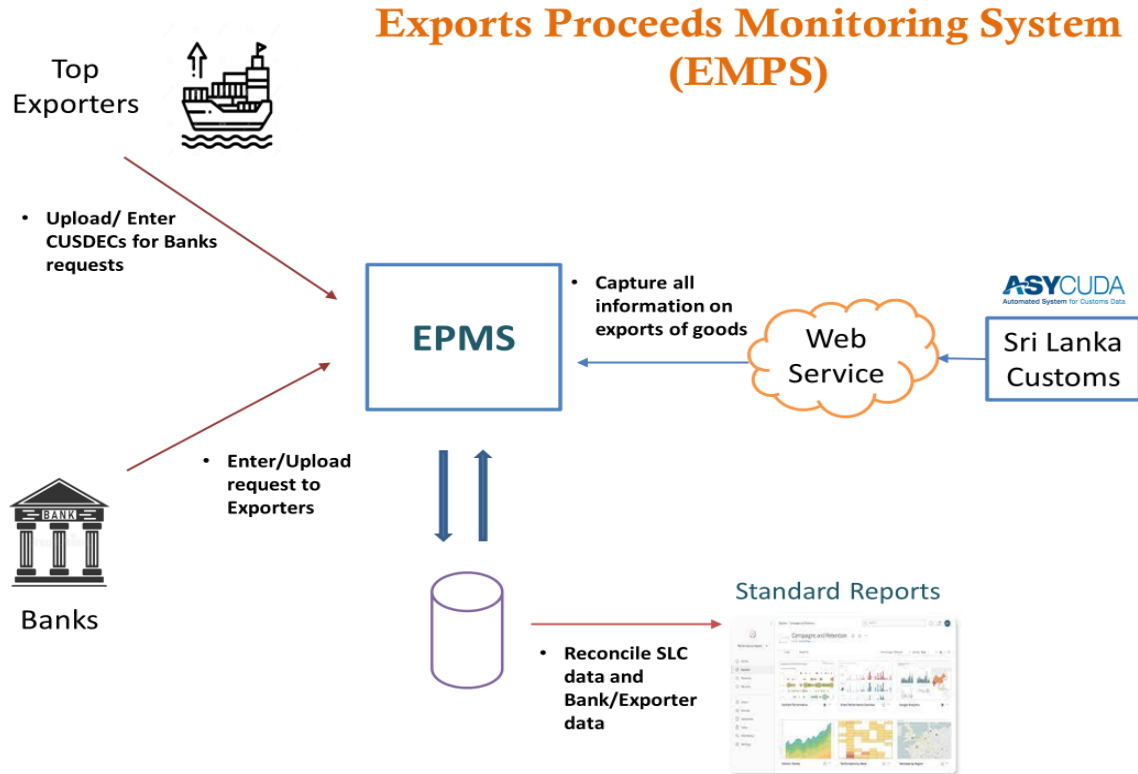
- Recoveries of loans/accommodations shall be using foreign exchange earnings of the borrower.
- ADs shall carry out recovery of accommodations in Sri Lanka Rupees, as a last resort where necessary, when recovery of such accommodations in foreign currency is remote.

## Common Mistakes

- Failure to grasp (big picture) the request/transaction (and the payment obligation)
- Failing to establish underlying transaction/payment by customer
- Inadequate refusal communication, lacking reasons. (ADs to explain the rationale)
- Forwarding requests to CBSL to please customers, bypassing compliance divisions
- Encouraging DFE approval requests without recommendation of the AD
- Extending FX loans/accommodations without properly assessing ability to repay **in FX**
- Reporting inaccuracies in Form 1&2, ITRS (incorrect purpose codes)
- Issues related to EPMS (Export Proceeds Monitoring System)



# Key priorities & Recent initiatives



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Visit **Department of Foreign Exchange** website

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*Thank You*