

# Sri Lanka

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RISK & COMPLIANCE REPORT

DATE: October 2018

## Executive Summary - Sri Lanka

<b>Sanctions:</b>	None
<b>FAFT list of AML Deficient Countries</b>	Yes
<b>Higher Risk Areas:</b>	<p>Compliance with FATF 40 + 9 Recommendations</p> <p>Not on EU White list equivalent jurisdictions</p> <p>Corruption Index (Transparency International &amp; W.G.I.)</p> <p>Failed States Index (Political Issues) (Average Score)</p>
<b>Medium Risk Areas:</b>	World Governance Indicators (Average Score)
<p><b>Major Investment Areas:</b></p> <p><b>Agriculture - products:</b></p> <p>rice, sugarcane, grains, pulses, oilseed, spices, vegetables, fruit, tea, rubber, coconuts; milk, eggs, hides, beef; fish</p> <p><b>Industries:</b></p> <p>processing of rubber, tea, coconuts, tobacco and other agricultural commodities; telecommunications, insurance, banking; tourism, shipping; clothing, textiles; cement, petroleum refining, information technology services, construction</p> <p><b>Exports - commodities:</b></p> <p>textiles and apparel, tea and spices; rubber manufactures; precious stones; coconut products, fish</p> <p><b>Exports - partners:</b></p> <p>US 22.6%, UK 9.8%, India 6.4%, Belgium 5.2%, Germany 4.8%, Italy 4.3% (2012)</p> <p><b>Imports - commodities:</b></p> <p>petroleum, textiles, machinery and transportation equipment, building materials, mineral products, foodstuffs</p> <p><b>Imports - partners:</b></p> <p>India 21.3%, China 16.5%, Singapore 8.6%, Iran 7.7%, UAE 4.4%, Malaysia 4.3% (2012)</p>	

**Investment Restrictions:**

The government allows 100% foreign investment in any commercial, trading, or industrial activity other than a few specified sectors, which are regulated and subject to approval by various government agencies or the BOI: air transportation; coastal shipping; large scale mechanized mining of gems; lotteries; and manufacture of military hardware, military vehicles, and aircraft; dangerous drugs; alcohol; toxic, hazardous, or carcinogenic materials; currency; and security documents.

Foreign investments in the areas listed below are limited to 40% of foreign equity. Foreign ownership in excess of 40% must be approved on a case-by-case basis by the BOI: the production for export of goods subject to international quotas; growing and primary processing of tea, rubber, coconut; timber-based industries using local timber; deep-sea fishing; mass communications; education; freight forwarding; travel agency; and shipping agency business. The government is considering opening higher education to foreign investment. Foreign investment is not permitted in the following businesses: non-bank money lending; pawn-brokering; retail trade with a capital investment of less than US\$1 million; and coastal fishing.

Private entities are free to establish, acquire, and dispose of interests in business enterprises. Private enterprises enjoy benefits similar to those granted to public enterprises, and there are no known limitations to access to markets, credit, or licenses. Foreign ownership is allowed in most sectors, although the new land ownership law prohibits foreigners from owning land according, with some exceptions.

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## Section 1 - Background

The first Sinhalese arrived in Sri Lanka late in the 6th century B.C., probably from northern India. Buddhism was introduced in about the mid-third century B.C., and a great civilization developed at the cities of Anuradhapura (kingdom from circa 200 B.C. to circa A.D. 1000) and Polonnaruwa (from about 1070 to 1200). In the 14th century, a south Indian dynasty established a Tamil kingdom in northern Sri Lanka. The coastal areas of the island were controlled by the Portuguese in the 16th century and by the Dutch in the 17th century. The island was ceded to the British in 1796, became a crown colony in 1802, and was formally united under British rule by 1815. As Ceylon, it became independent in 1948; its name was changed to Sri Lanka in 1972. Tensions between the Sinhalese majority and Tamil separatists erupted into war in 1983. After two decades of fighting, the government and Liberation Tigers of Tamil Eelam (LTTE) formalized a cease-fire in February 2002 with Norway brokering peace negotiations. Violence between the LTTE and government forces intensified in 2006, but the government regained control of the Eastern Province in 2007. By May 2009, the government announced that its military had defeated the remnants of the LTTE. Since the end of the conflict, the government has enacted an ambitious program of economic development projects, many of which are financed by loans from the Government of China. In addition to efforts to reconstruct its economy, the government has resettled more than 95% of those civilians who were displaced during the final phase of the conflict and released the vast majority of former LTTE combatants captured by Government Security Forces. At the same time, there has been little progress on more contentious and politically difficult issues such as reaching a political settlement with Tamil elected representatives and holding accountable those alleged to have been involved in human rights violations at the end of the war.



## Section 2 - Anti – Money Laundering / Terrorist Financing

### FATF status

Sri Lanka is on the FATF List of Countries that have been identified as having strategic AML deficiencies

### Latest FATF Statement - 19 October 2018

Since November 2017, when Sri Lanka made a high-level political commitment to work with the FATF and APG to strengthen the effectiveness of its AML/CFT regime and address any related technical deficiencies, Sri Lanka has taken steps towards improving its AML/CFT regime, including by providing case studies and statistics to demonstrate that competent authorities can obtain beneficial ownership information in relation to legal persons in a timely manner; issuing amendments to the directive in relation to CDD obligations; and establishing a targeted financial sanctions regime to implement relevant UNSCRs related to Iran and issuing a related directive. Sri Lanka should continue to work on implementing its action plan to address its strategic deficiencies, including by enhancing risk-based supervision high-risk DNFBPs, including through prompt and dissuasive enforcement actions and sanctions, as appropriate; and demonstrating effective implementation of its targeted financial sanctions obligations related to proliferation financing.

### Compliance with FATF Recommendations

The last Mutual Evaluation Report relating to the implementation of anti-money laundering and counter-terrorist financing standards in Sri Lanka was a follow-up to the APG evaluation that took place in September 2015. According to the Evaluation, Sri Lanka was deemed Compliant for 5 and Largely Compliant for 16 of the FATF 40 Recommendations. It was deemed Highly effective for 0 and Substantially Effective for 1 of the Effectiveness & Technical Compliance ratings.

### Key Findings

Sri Lanka has an acute understanding of terrorist financing (TF) risks, shaped by years of war between the Sri Lankan Government and the Liberation Tigers of Tamil Eelam (LTTE) that ended in 2009. Sri Lanka's National Security Strategy focuses on security threats and risks, including LTTE financing from abroad. The Chief of National Intelligence, reporting to the Secretary of Defence, comprehensively coordinates activities and information sharing among all relevant agencies to address TF risks including disrupting possible re-emergence of the LTTE through financing from abroad.

Sri Lanka has a reasonable understanding of its money laundering (ML) risks. This understanding has not manifested in a national AML strategy, nor have there been coordinated activities to address key ML risks such as corruption or drug trafficking.

Sri Lanka has not implemented a risk-based approach to AML/CFT activities informed by the results of its first national risk assessment (NRA), completed in October 2014. Recommendations made in the NRA are still awaiting approval as at the end of the onsite.

Sri Lanka's use of financial intelligence and other information for ML/TF and associated predicate offence investigation does not extend to the full range of potentially relevant information. The FIU uses limited available and obtainable police information in its operational analysis of STRs, which has had a negative consequential impact on the quality of intelligence products disseminated to the police.

The financial intelligence unit (FIU) is not using financial intelligence or other available information to undertake strategic analysis, including in identifying emerging ML/TF trends and threats.

Sri Lanka possesses the foundation for an effective AML system, but to date there has been limited demonstration of effectiveness with only one ML conviction. The low prosecution and conviction rates for ML are mostly explained by the jurisdiction's lack of capacity and policy imprimatur to investigate and prosecute the ML offence. Sri Lankan authorities find it easier to prosecute the predicate offence, as it is a quicker process and less challenging given existing skills and resources.

Sri Lanka's counter-terrorism and TF regime's success is a result of high-level governmental commitment, multi-pronged and well-coordinated efforts amongst agencies, and the focus and dedication of terrorism investigative units such as the Terrorist Investigation Division (TID) and Criminal Investigation Division (CID).

Sri Lanka's has clear and high national-level policy focus on deterring terrorist activities especially through confiscating the assets of terrorists. This has been effective in countering the LTTE's operations in Sri Lanka. It is evident from the statistics that this avenue has been broadly and effectively used, including successfully disrupting recent attempts at LTTE resurgence since 2012.

The Prevention of Terrorism Act No. 48 of 1979 as amended (PTA), with its non-conviction based, administrative mechanisms, has been the preferred legislative tool to successfully deprive the LTTE of funds and property. It is particularly useful in instances where access to evidence is challenging, such as where the evidence or the offender lies abroad and there are challenges in obtaining international cooperation to obtain the evidence or the offender.

However, Sri Lanka has been less effective in prosecuting TF cases especially with foreign elements given the challenges with international cooperation to obtain evidence to prosecute terrorist financiers. Moreover, there have been only three TF convictions under the PTA as well as three indictments for the TF offence under the Convention on the Suppression of Terrorist Financing Act (CSTFA) with no convictions yet.

Sri Lanka has not yet dealt with proliferation financing.

Sri Lanka has not fully assessed the ML/TF risk in respect to the use of legal persons and arrangements and there are significant technical and implementation deficiencies in respect to obtaining and making available beneficial ownership information on a timely basis.

Sri Lanka's dependence on using existing information, including reliance on using existing information held by financial institutions and designated non-financial businesses and professions (DNFBPs) to mitigate the abuse of legal persons and arrangements, is not an effective mechanism as there are gaps in this information, including on beneficial ownership

Since the last MER, Sri Lanka has made progress in promulgating enforceable rules under the Financial Transactions Reporting Act (FTRA). However, significant gaps still exist in prescribed requirements in a number of key areas such as customer due diligence (CDD), politically exposed persons (PEPs), high-risk countries, internal controls, correspondent banking, wire transfer and money value transfer service (MVTS) providers, among others. These gaps inhibit the effective implementation of preventive measures across all financial sectors.

Financial institutions' (FIs) level of understanding of ML/TF risks and obligations is variable across sectors and, within a sector, across institutions. There is a need for a stronger application of the risk-based approach (RBA) across sectors to more effectively implement the full range of preventive measures.

Apart from banks, the relevant supervisory authorities lack clear powers to prevent criminals from participating as beneficial owners in FIs and DNFBPs, while the directors and senior officers of FIs and DNFBPs in sectors identified as higher risk are not subject to any fit-and-proper requirements. The infrastructure for regulation and AML/CFT supervision of the gaming industry remains unclear.

The recent completion of the NRA has not translated into risk-based supervision of FIs by the FIU and prudential supervisory authorities, with the FIU being significantly under-resourced in its role as the primary AML/CFT supervisor. Sanctions for AML/CFT non-compliance have been focused mainly on the banking sector, and do not appear to be sufficiently dissuasive.

There are significant legal and structural limitations to Sri Lanka's effective ability in relation to its formal international cooperation mechanisms, in particular the fact that their legislation requires a mutual legal assistance arrangement between Sri Lanka and the State requesting assistance; it is not clear whether coercive assistance can be provided in absence of such arrangement. This limits Sri Lanka's ability to provide assistance where a court order is required, namely assistance for freezing of funds and confiscation of assets.

The central authority does not adequately maintain and monitor the status and timeliness of requests made and obtained. In combination with varying levels of inter-agency coordination, this leads to a cumbersome system where the progress of requests is not always apparent. However, there appears to be more effective international cooperation amongst the law enforcement agencies and their respective foreign counterparts, where assistance is initiated and monitored at an informal level.

### **Risks and General Situation**

Sri Lanka's ML/TF risks involve cross-border illicit flows because of Sri Lanka's geographic location. As a major transshipment port, Sri Lanka receives 70% of all vessels sailing to and from South Asia, exposing Sri Lanka to associated drug and human trafficking. Authorities

consider that the proceeds of drug trafficking are mostly laundered back to their source jurisdictions, and for human smuggling, to end destinations or transit points, and not just within Sri Lanka. Overall, Sri Lanka is not considered an end destination for foreign proceeds of crime. Conversely, Sri Lanka is an end destination for terrorist funds raised abroad in support of the LTTE.

Corruption and drug-related proceeds pose the highest ML risk. Drug trafficking proceeds originate primarily from the trafficking of heroin from India and Pakistan for consumption in Sri Lanka, and as a transit point for heroin heading to other destinations. Corruption-related ML risk originates from domestically generated proceeds and is compounded by a lack of corruption-related ML investigations, prosecutions, and convictions.

Sri Lanka's terrorist threat has greatly diminished since the end of the civil war in 2009, but TF risk remains with LTTE-related incidents occurring since then, most recently in April 2014. Sri Lanka is cognizant of other TF risk associated with the Islamic State of Iraq and the Levant (ISIL).

### **Money Laundering / Terrorism Financing Risks**

The assessment team considers the following two as the main risk areas for ML because they pose greater systemic challenges and broader, negative societal impact than other ML risks:

**Drug trafficking:** According to the NRA, drug-related offences and proceeds are the highest among all predicate crimes for ML. The drug trafficking threat originates primarily from the trafficking of heroin from India and Pakistan for consumption in Sri Lanka, and as a transit point for heroin heading to other destinations. The measures undertaken have been limited by capacity constraints and existing sectoral and national vulnerabilities.

**Corruption:** Corruption is also identified in the NRA's top-tier category of predicate crimes for ML. Corruption-related proceeds are a significant risk given the systemic negative impact on society. Compounding this risk is the lack of corruption-related ML investigations, prosecutions, and convictions. Based on statistics provided by Sri Lanka, there were 7706 reported cases of bribery and corruption between 2008 and 2013. Of those, 336 were prosecuted, with only one leading to an ML investigation.

The assessment team considers other predicate offences identified in the NRA as important ML risks, but not in the same categories as illicit proceeds from corruption and drug trafficking. These other risks include fraud (cheating, criminal breach of trust, criminal misappropriation), robbery, credit and debit card fraud, human smuggling/trafficking, extortion and counterfeiting of currency. Fraud and human trafficking are recurrent risks. According to Sri Lanka's crime statistics there were 39 068 and 11 344 cases of fraud investigations and prosecutions respectively between 2008 and 2012. On human trafficking, Sri Lanka is primarily a source country. There are about 1.1 million unskilled Sri Lankans working abroad, some in conditions of forced labour. The risk posed by human smuggling has declined in recent years with successful cooperation between Sri Lanka and Australia in deterring people smuggling. Credit card and debit card fraud is increasing as the economy grows and card usage increases, although it is more limited to hotels and higher end retail outlets.

Terrorist financing associated with the Liberation Tigers of Tamil Eelam (LTTE) remains, despite its military defeat in 2009. The LTTE international network is still actively pursuing the objectives

of the LTTE and certain elements of the Tamil diaspora are providing support for possible LTTE resurgence. However, according to Sri Lankan authorities the funding base has declined by 80% post 2009. Nevertheless, there have been three LTTE incidents over the last two years, the most recent in April 2014, which involved an attempted resurgence of the LTTE in the Jaffna Peninsula. The National Security Strategy covers comprehensively the issue of the ongoing threat and risk associated with the LTTE and other emerging threats. The non-sanitised version of the NRA also goes into further detail than the summary provided in the sanitised version. Universally, competent authorities demonstrate a high level of understanding of the ongoing terrorist threats and TF risks, and remain vigilant against any possible LTTE resurgence, or other activities that may cause internal conflict. The NRA, National Security Strategy and officials met during the onsite indicate that the banking sector had been used to facilitate financing of terrorist activities. NGOs and MVTs hawalas have also been used to channel funding for terrorism.

There is a nexus between LTTE TF and ML. The LTTE was known to engage in criminal activities, including human trafficking, people smuggling and arms trafficking to support its activities. There are also publicly available reports of LTTE affiliates based overseas being investigated and prosecuted for ML. Likewise, as noted in the National Security Strategy, as a result of the rise of terrorism and the civil war Sri Lanka experienced previously, and the response required from the state, a considerable amount of arms and ammunition inadvertently fell into the hands of criminals.

The cross-border connection is not limited to the financing of LTTE, as Sri Lanka's ML/TF risks also involve transnational illicit flows because of Sri Lanka's geographic location. Sri Lanka is a major transshipment port and accounts for 70% of all ships sailing to and from South Asia. Many of the world's most important sea-lanes are located in close proximity to Sri Lanka. This structural feature has exposed Sri Lanka to drug trafficking, human trafficking and people smuggling. Authorities consider that the proceeds of drug trafficking are mostly laundered back to their source jurisdictions and for human smuggling, to end destinations or transit points and not just within Sri Lanka.

Overall, Sri Lanka is not considered an end destination for proceeds of crime. Sri Lanka is not an important regional financial centre and the civil war years have deterred private sector flows into the country, although that is changing in the hotel sector because of increased tourism.

It is more likely that proceeds of crime are exported to foreign jurisdictions from Sri Lanka, a reverse of the situation with TF, where funds are imported into Sri Lanka. There have been reported cases of proceeds of corruption being laundered into overseas bank deposits or property offshore, and law enforcement investigations have indicated that drug money is laundered offshore.

The NRA reasonably considers the non-bank financial sector and certain designated non-financial businesses and professions (DNFBPs) as higher risks. In addition to the usual higher risks associated with the banking and securities sector based on international typologies, casinos, real estate agents and dealers in precious stones pose higher risks in Sri Lanka because of the absence of any meaningful prudential and AML supervision, although there is some basic prudential supervision for precious stones. While the casino sector is currently limited to five small operations, and no junket tours, there is potential for further expansion. The commercial real estate sector is experiencing significant growth because of the booming economy, and Sri Lanka is one of the world's major producers of precious stones.

Informal money or value transfer service (MVTs) providers pose significant vulnerabilities and TF risks. The NRA appears correct in identifying the informal MVTs sector as the highest risk sector. Based on the NRA the alternative remittance sector accounts for 15% to 43% of all private remittances. Most remittances, either formal or informal, come from Sri Lankans living or working in the Middle East region. Informal remittances are commonplace in Sri Lanka, particularly to facilitate Sri Lankans working overseas in sending money home. Although the LTTE has exploited this channel for TF, most funds remitted from abroad are for legitimate purposes, such as overseas workers remitting funds to their relatives in Sri Lanka.

#### **Extract from 2013 Asia Pacific Group on Money Laundering Yearly Typologies Report:**

#### **Money Laundering Trends:**

##### **Emerging and Continuing Trends**

- Remitting money out of Sri Lanka purported to be payment for imports, where no actual imports had taken place
- Use of accounts to collect funds from human smuggling and trafficking.
- Use of accounts to collect proceeds of the drug trade
- Frauds relating to internet and e-banking
- Use of accounts for third party deposits where depositors were requested to deposit money into an account as job application registration fees, investment schemes or lottery contributions. Such deposits were then immediately withdrawn through ATMs

##### **Declining Trends**

- Use of bank accounts to collect ransom
- Use of individual accounts to finance terrorist activities
- Use of non-profit organizations for terrorist financing activities

#### **US Department of State Money Laundering assessment (INCSR)**

Sri Lanka was deemed a "Monitored" Jurisdiction of by the US Department of State 2016 International Narcotics Control Strategy Report (INCSR).

Key Findings from the report are as follows: -

#### **Perceived Risks:**

Sri Lanka is neither an important regional financial center nor a preferred center for money laundering. Nevertheless, the lack of transparent tender mechanisms in government projects, past experience with terrorism, tax evasion, and a large informal economy make the country vulnerable to money laundering and terrorism financing. Corruption and drug-related proceeds pose the highest money laundering risks. Local authorities report that drug trafficking, primarily of heroin, is becoming an increasing problem. Terrorism financing activity, by all accounts, has diminished significantly since the end of Sri Lanka's civil war in 2009.

As a major transshipment port, Sri Lanka receives 70 percent of all vessels sailing to and from South Asia, exposing Sri Lanka to associated drug and human trafficking. Authorities believe the proceeds of drug trafficking are mostly laundered back to their source jurisdictions, and those for human smuggling, to end destinations or transit points. Overall, Sri Lanka is not considered an end destination for foreign proceeds of crime. There does not appear to be a significant black market for smuggled goods in the country.

Legal remittance flows through the formal banking system have increased sharply in recent years, reaching \$7 billion in 2014. Remittances originate primarily from Sri Lanka's substantial overseas workforce. According to local authorities, these funds are processed largely through the banking system, and therefore, do not present serious money laundering concerns. The Sri Lankan government's Board of Investment regulates the 12 free trade zones (FTZs) in Sri Lanka. FTZs employ strict access and customs controls with no reported incidences of suspicious transactions.

DO FINANCIAL INSTITUTIONS ENGAGE IN CURRENCY TRANSACTIONS RELATED TO INTERNATIONAL NARCOTICS TRAFFICKING THAT INCLUDE SIGNIFICANT AMOUNTS OF US CURRENCY; CURRENCY DERIVED FROM ILLEGAL SALES IN THE U.S.; OR ILLEGAL DRUG SALES THAT OTHERWISE SIGNIFICANTLY AFFECT THE U.S.: NO

CRIMINALIZATION OF MONEY LAUNDERING:

"All serious crimes" approach or "list" approach to predicate crimes: List approach

Are legal persons covered: criminally: YES civilly: YES

KNOW-YOUR-CUSTOMER (KYC) RULES:

Enhanced due diligence procedures for PEPs: Foreign: YES Domestic: YES

KYC covered entities: Banks, registered finance companies, insurance companies, securities companies and brokers, money changers, casinos, real estate agents, dealers in precious metals and stones, lawyers, and trust or company service providers

REPORTING REQUIREMENTS:

Number of STRs received and time frame: 718 in 2014

Number of CTRs received and time frame: 5.5 million in 2014

STR covered entities: Banks, registered finance companies, insurance companies, securities companies and brokers, money changers, casinos, real estate agents, dealers in precious metals and stones, lawyers, accountants, and trust or company service providers

MONEY LAUNDERING CRIMINAL PROSECUTIONS/CONVICTIONS:

Prosecutions: 7 in 2014  
Convictions: Not available

RECORDS EXCHANGE MECHANISM:

With U.S.: MLAT: NO Other mechanism: YES  
With other governments/jurisdictions: YES

Sri Lanka is a member of the Asia/Pacific Group on Money Laundering (APG), a FATF-style regional body.

**ENFORCEMENT AND IMPLEMENTATION ISSUES AND COMMENTS:**

The primary barriers to stronger enforcement of Sri Lanka's AML/CFT laws appear to be inadequate judicial resources and a lack of financial crime investigative experience. While about 10 money laundering and terrorist financing-related cases have been filed by Sri Lanka's Attorney General in the past few years, all cases are still pending. Reportedly, there has been only one money laundering conviction. The financial intelligence unit (FIU) is not using financial intelligence or other available information to undertake strategic analysis or to identify emerging ML/TF trends and threats.

There have been no criminal indictments which relate to money laundering facilitated by public corruption. Investigation of public corruption-related money laundering is hindered by the fact corruption cases are investigated and prosecuted by the Bribery Commission under bribery law, while money laundering charges are prosecuted by the Attorney General. The Advisory Board to the FIU coordinates AML/CFT activities in general, and the Office of the Chief of National Intelligence coordinates matters specifically relating to terrorism and terrorist financing.

The Government of Sri Lanka is concerned the Liberation Tigers of Tamil Eelam's (LTTE) international network of financial support is still functioning. In March 2014, the government issued a notification listing 16 groups and over 400 individuals, based in several countries, as terrorists connected to the LTTE. The notification states that all funds, assets, and resources belonging to these entities should be frozen. The order also prohibits Sri Lankan nationals from maintaining links or contacts with members of the proscribed organizations and prevents them from obtaining funds from them for activities in Sri Lanka.

The magnitude of alternative remittance systems is not known, but the Colombo Fraud Bureau has examined illegal money transfer agencies popularly known as undiyals in localities in and around Colombo. Many of these money transfer agencies have been involved in the transfer of illicit funds. Undiyal, meaning bills of exchange, is the Sri Lankan equivalent of hawala and uses an international network of agents.

Although AML/CFT laws cover designated non-financial businesses and professions (DNFBPs), such as casinos and gem dealers, no regulator has issued KYC or currency reporting policies covering these entities. These entities are not required to maintain customer information or report suspicious activity.

In 2015, the Sri Lankan government provided an amnesty to overseas bank account holders as a result of the implementation of Swiss bank laws that would result in the closure of

unnamed bank accounts. The Sri Lankan minister of finance stated that, as of November 2015, Sri Lankan banks received \$450 million dollars from overseas accountholders. The Sri Lankan amnesty program means that depositors will not be asked questions as to the source of the funds or how the funds were earned.

Sri Lanka should develop a mechanism for its enforcement agencies to work more closely, given that corruption generates illicit funds that are laundered. The FIU should enhance its operational analysis procedures to ensure that essential and critical information, beyond what is provided in financial intelligence, is included in its initial analysis. The government should provide the necessary resources and capacity to ensure all DNFBPs are adequately supervised and adhere to KYC and reporting requirements.

### **Current Weaknesses in Government Legislation (INCRS Comparative Tables):**

According to the US State Department, Sri Lanka does not conform with regard to the following government legislation: -

**Arrangements for Asset Sharing** - By law, regulation or bilateral agreement, the jurisdiction permits sharing of seized assets with third party jurisdictions that assisted in the conduct of the underlying investigation.

### **EU White list of Equivalent Jurisdictions**

Sri Lanka is not currently on the EU White list of Equivalent Jurisdictions

### **World Governance indicators**

[To view historic Governance Indicators Ctrl + Click here and then select country](#)

### **Failed States Index**

[To view Failed States Index Ctrl + Click here](#)

### **Offshore Financial Centre**

Sri Lanka is not considered to be an Offshore Financial Centre

### US State Dept Narcotics Report 2012:

Sri Lanka plays only a minor role in the international narcotics traffic as a transshipment route for heroin transiting from India and Pakistan. Government of Sri Lanka (GSL) officials work to raise awareness of and vigilance against drugs and illicit drug smuggling. The lead agency for counternarcotics efforts is the Police Narcotics Bureau (PNB). The GSL does not, as a matter of policy, encourage or facilitate the illicit production or distribution of any controlled substances or the laundering of proceeds from illegal drug transactions.

Sri Lanka is a party to the 1988 UN Drug Convention. There is a bilateral extradition treaty between the United States and Sri Lanka, but no bilateral mutual legal assistance treaty.

The primary drugs available and abused in Sri Lanka are Southwest Asian (SWA) and Indian produced 'brown sugar' heroin, and cannabis in the form of marijuana and hashish. Brown sugar heroin is widely available throughout the country, particularly in the capital Colombo. The GSL considers heroin a growing threat and remains committed to targeting drug traffickers. The majority of locally consumed heroin originates from India. The remaining percentage is either produced in Pakistan/Afghanistan or of unknown origin.

Maritime drug smuggling from India is the greatest threat to Sri Lanka. According to police officials, drugs are transported across the Palk Strait from India and then overland to the south. Police officials report that the Bandaranaike International Airport is the second major entry point for drugs. According to the PNB, Pakistani drug couriers have changed their patterns of travel to avoid detection because direct flights from Pakistan are screened more thoroughly than other flights. Many Pakistani couriers are traveling to Dubai then onward to Sri Lanka in an attempt to avoid detection.

Cannabis is cultivated locally, primarily in smaller operations in the former conflict areas of the North and East. All indications are that locally grown cannabis is strictly for domestic consumption and there are no indications that it is being exported. The police regularly work to locate and eradicate cannabis crops. Police note that the "party drugs" found in Colombo social venues are believed to be imported from Thailand.

Efforts began in late 2010 to increase the size, reach and responsibility of the PNB as well as to foster better cooperation between the PNB and other GSL institutions including the Customs Service, the Department of Excise and the Navy. From January to October 2011, the GSL made 11,787 arrests for using, dealing or trafficking heroin, 7 for Hashish, 4 for Cocaine and 22,691 for Cannabis. Though arrests increased from last year, seizures of heroin decreased significantly. This drop has been attributed by senior officials within the PNB to better cooperation and information sharing between the agencies involved in the counter-narcotics effort thus reducing trafficking. The GSL seized 23kg of heroin (down from 137 kg in 2010), 18 kg of hashish (down from 23kg), 10 kg of cocaine and 50,000 kg of cannabis (up from 20,270 kg) thus far in 2011. The cocaine seizure was the single largest seizure of cocaine in Sri Lanka's history.

The National Dangerous Drugs Control Board (NDDCB) runs a total of 5 treatment and rehabilitation centres island wide capable of treating approximately 1000 patients a year. The most recently opened centre, inaugurated on October 3, 2011 is the only one in the country specifically for women. Women comprise just 1 percent of heroin addicts.

The GSL welcomes U.S.-sponsored training for criminal investigative techniques and management practices. Sri Lanka also works with regional and international partners on narcotics issues, particularly the Colombo Plan, a regional organization with special expertise in drug prevention and treatment. The SAARC- the South Asian Association for Regional Cooperation Drug Offense Monitoring Desk (SDOMD), located within the PNB, serves as a clearing house for SAARC countries to input, share, and review regional narcotics statistics. GSL officials maintain steady contact with counterparts in India and Pakistan, origin countries for the majority of drugs in Sri Lanka.

The U.S. government will continue to aid the Sri Lankan police in its transition to community-focused policing techniques. The U.S. government provided no narcotics specific training to Sri Lanka in 2011. The U.S. also expects to continue its support of regional and country-specific training programs, particularly through the Colombo Plan. The U.S. Drug Enforcement Administration attaché based in New Delhi visits Colombo regularly and has plans to provide the PNB and other agencies with training opportunities in 2012.

#### **US State Dept Trafficking In Persons Report 2016 (Introduction):**

Sri Lanka is classified a Tier 2 (watch list) country - A country whose government does not fully comply with the Trafficking Victims Protection Act's minimum standards, but is making significant efforts to bring themselves into compliance with those standards.

Sri Lanka is primarily a source and, to a lesser extent, a destination country, for men, women, and children subjected to forced labor and sex trafficking. Some of the Sri Lankan men, women, and children who migrate to the Middle East, Southeast Asia, and Afghanistan to work in the construction, garment, and domestic service sectors are subjected to forced labor. Before leaving Sri Lanka, many migrant workers go into debt to pay high recruitment fees imposed by unscrupulous labor recruitment agencies—most of them members of Sri Lanka's Association of Licensed Foreign Employment Agencies—and their unlicensed sub-agents. Migrant laborers receive a monetary advance as an incentive to move abroad, only to be trapped in debt bondage upon arrival at their destination. Some recruitment agencies commit fraud by changing the agreed upon job, employer, conditions, or salary after the migrant's arrival. Some Sri Lankan women are subjected to forced prostitution in Jordan, Maldives, Malaysia, Singapore, and elsewhere.

Within the country, women and children are subjected to sex trafficking in brothels. Boys are more likely than girls to be forced into prostitution in coastal areas for child sex tourism. Children, individuals with physical deformities, and those from socially vulnerable groups are forced to beg or engage in criminal activity in Sri Lanka's largest cities. Some child domestic workers in Colombo, generally from the Tamil tea estate sector, are subjected to physical, sexual, and mental abuse, non-payment of wages, and restrictions of movement—indicators of labor trafficking. A small number of women from Asia, Central Asia, Europe, and the Middle East have been subjected to forced prostitution in Sri Lanka in recent years. Police

accept bribes to permit brothels to operate, some of which exploit trafficking victims. Sub-agents collude with officials to procure fake or falsified travel documents to facilitate travel of Sri Lankans abroad.

The Government of Sri Lanka does not fully meet the minimum standards for the elimination of trafficking; however, it is making significant efforts to do so. During the reporting period, the government ratified the 2000 UN TIP Protocol and the Cabinet approved the government's national action plan to combat human trafficking. Despite these measures, the government did not demonstrate overall increasing anti-trafficking efforts compared to the previous reporting period; therefore Sri Lanka is placed on Tier 2 Watch List for the fourth consecutive year. Per the Trafficking Victims Protection Act, Sri Lanka was granted a waiver from an otherwise required downgrade to Tier 3 because its government has devoted sufficient resources to a written plan that, if implemented, would constitute significant efforts to meet the minimum standards. Authorities slightly increased investigations and prosecutions of trafficking cases; however, convictions stagnated at one trafficker convicted—the same number as in 2014—and the sentence of two years' imprisonment was not sufficiently stringent to deter future trafficking crimes. Provisions for victim protection were inadequate, as the government arrested sex trafficking victims and charged them with crimes committed as a direct result of being subjected to trafficking, provided no specialized services to male victims, and mixed child victims with criminals in state institutions.

### **US State Dept Terrorism Report 2016**

**Overview:** The 2009 military defeat of the terrorist Liberation Tigers of Tamil Eelam (LTTE) marked the beginning of a new era for the country. The Sri Lankan government maintained a strong military presence in post-conflict areas and continued to voice concern about the possible reemergence of pro-LTTE sympathizers, but the democratically-elected government of President Maithripala Sirisena and Prime Minister Ranil Wickremesinghe emphasized its commitment to seek political reconciliation with the Tamil community, including through talks with the Tamil diaspora.

In January, Defense Secretary Karunasena Hettiarachchi noted reports of approximately 36 Sri Lankans who traveled to Syria, with some joining ISIS, but he asserted ISIS and other terrorist groups were not physically present in Sri Lanka. The Ministry of Defense stated the security forces and intelligence agencies were on full alert against the possibility of ISIS or its affiliates emerging in the country.

The security services' focus on a possible LTTE resurgence and the government's new focus on emerging threats, such as reports of Sri Lankan foreign terrorist fighters joining ISIS and other terrorist groups, led the government to maintain a flexible counterterrorism policy. In 2016, the police recovered two separate stocks of explosives and a suicide kit, leading to the arrest of approximately 25 people, including five former LTTE leaders. In November, Minister of Justice Wijedaya Rajapakse announced to parliament that approximately 32 well-educated Sri Lankan Muslims of four families had joined ISIS in Syria. His statement sparked controversy within the Muslim community in Sri Lanka.

Counterterrorism cooperation and training with the United States in 2016 was limited, but the bilateral security and defense relationship continued to grow. An advanced U.S. P-8 maritime patrol aircraft with long-range maritime patrol capabilities conducted an exercise in

December with the Sri Lanka Air Force and Navy on safe-guarding the international shipping lanes. This training also enhanced the government's capacity to interdict potential foreign terrorist fighters attempting to transit through the country.

**Legislation, Law Enforcement, and Border Security:** Counterterrorism legislation in Sri Lanka was historically focused on eliminating the LTTE, although concerns about foreign terrorist fighters increased in 2016. The Government of Sri Lanka continued to use the Prevention of Terrorism Act (PTA), enacted in 1982 as a wartime measure, which gives security forces broad powers to search, arrest, and detain individuals. The government pledged to end the broad application of the PTA and is in the process of drafting a new counterterrorism act (CTA) to replace the PTA. As part of the drafting process, the government consulted civil society groups and international partners, who criticized early drafts of the CTA as not fully conforming to international standards. At the end of 2016, the government had not yet released a final draft for public comment or presented it as a bill for cabinet approval.

In June, President Sirisena publicly issued a presidential directive to police and security forces setting out appropriate procedures for arrests and detentions under the PTA. The Department of Prisons detained at least 50 prisoners under the PTA without charges, with at least 15 still in custody for over a year.

Sri Lanka's law enforcement capacity was robust and continually improving, and its political leadership has launched a broad modernization effort. Interagency cooperation and information sharing is strong, with specific plans to respond to attacks on some soft targets. Law enforcement leadership recognized the need for improvement and actively sought assistance to raise capacity up to western standards, particularly in modernization of police computer systems and new technology. Leadership eagerly seeks out any opportunity to send officers to specialized training courses. The Special Task Force is an elite special forces unit of the Sri Lanka Police Service specializing in counterterrorism and counter-insurgency operations and a major security arm of the state involved in the security of top government and foreign government officials, protecting sensitive terrorist targets, and suppressing activities that pose a threat to national security.

Border security remained a significant issue for the Sri Lankan government. The Sri Lankan government expanded its partnership with the U.S. Departments of State, Homeland Security, Defense, and Energy on securing its maritime border. The U.S. Coast Guard, under the Department of State's Export Control and Related Border Security program, continued to train Sri Lankan Coast Guard and Navy personnel on border and export control matters, and the Government of Sri Lanka continued to cooperate with U.S. Customs and Border Protection through the container security initiative, megaports, and related initiatives.

Sri Lanka hosted the Eleventh Regional workshop for Judges, Prosecutors, and Police Officers on Effectively Countering Terrorism in South Asia in October. Sri Lankan law enforcement, border security, and customs officials participated in the event, and judicial personnel attended a special session on counterterrorism legislation.

The Government of Sri Lanka continued to collaborate with the European Union Immigration Department on an advanced passenger information system, which transmits passenger information to Sri Lankan immigration officials upon arrival. The data generated from these collection systems will be significant assets to the Sri Lankan government in its efforts to control and counter illegal migration. The Department of Immigration and Emigration, with technical support of the International Organization for Migration, and funding from the

Australian Department of Immigration and Border Protection, completed implementation of a 2015 initiative to capture biometric data from all new passport applicants.

In November, Sri Lanka removed the ban on an additional 69 individuals previously on the terrorism watch list that had been established by the Rajapaksa-led government and criticized by civil society for being excessively broad in scope. Eight organizations and 86 individuals remained on the list at the end of 2016.

**Countering the Financing of Terrorism:** Sri Lanka belongs to the Asia Pacific Group on Money Laundering (APG), a Financial Action Task Force-style regional body. Sri Lanka's Financial Intelligence Unit (FIU) is a member of the Egmont Group of Financial Intelligence Units. Although it is neither an important regional financial center nor a preferred center for money laundering, Sri Lanka remains vulnerable to money laundering and terrorist financing. Key contributing factors included a lack of transparent tender mechanisms in government projects, history of terrorist activity, tax evasion, and a large informal economy. Sri Lanka's risks also involve cross-border illicit flows because of its geographic location.

Sri Lanka has criminalized terrorist financing in accordance with international standards. The Central Bank amended customer due diligence (CDD) regulations in 2016 to address gaps identified by a recent APG evaluation.

A substantial overseas workforce, primarily in the Middle East, sends remittances back to Sri Lanka, and the CDD regulations passed in 2016 began regulating money transfer services. Although anti-money laundering/countering the financing of terrorism laws cover non-financial entities such as real estate agents, jewelers, and dealers in precious metal, no regulator has issued "know your customer" policies covering these institutions. Sri Lanka has not yet issued regulations to cover non-profit organizations.

In 2016, the FIU signed agreements with Sri Lanka customs, the Department of Inland Revenue, and the Department of Immigration and Emigration to facilitate investigations and prosecutions on money laundering and terrorist financing.

## International Sanctions

None applicable

## Bribery & Corruption

Index	Rating (100-Good / 0-Bad)
Transparency International Corruption Index	38
World Governance Indicator – Control of Corruption	48

There is a moderately high risk of corruption for businesses in Sri Lanka. The most common forms of corruption include facilitation payments paid to avoid bureaucratic red tape, bribe solicitation by government officials, nepotism and cronyism. There is a high-level of corruption in the public procurement sector. The main anti-corruption laws are the Penal Code and Bribery Act, which criminalize corruption and attempted corruption in the form of extortion, and active and passive bribery. No clear distinction between bribery and facilitation payments is made, but gifts given with a corrupt intent are prohibited under the Prevention of Corruption Act. While Sri Lanka's government has started to enforce the anti-corruption laws, enforcement remains constrained by a lack of resources and technical expertise, and powerful political elites often go unpunished for committing corruption crimes. **Information provided by GAN Integrity.**

### US State Department

While the country has generally adequate laws and regulations to combat corruption, enforcement is considered weak and inconsistent. U.S. firms identify corruption as a constraint on foreign investment, but, by and large, it is not a major threat to operating in Sri Lanka – at least once a contract has been won. The business community claims that corruption has the greatest effect on investors in large projects and on those pursuing government procurement contracts. Some claim that the level of corruption makes it difficult to compete with bidders not subject to the U.S. Foreign Corrupt Practices Act. Projects geared toward exports face fewer problems. Local investors say internal controls do exist, although they are weak. Sri Lanka ratified the UN Anti-Corruption Convention in 2004. Sri Lanka has signed but not ratified the UN Convention against Transnational Organized Crime. Sri Lanka is a signatory to the OECD-ADB Anti-Corruption Regional Plan. Attempts to introduce a Freedom of Information Act to increase transparency have been unsuccessful.

### Bribery Commission

The Bribery Commission is the main body responsible for investigating allegations brought to its attention and instituting proceedings against responsible individuals in the appropriate court. The law states that a public official's offer or acceptance of a bribe constitutes a criminal offense and carries a maximum sentence of seven years imprisonment and a fine at the discretion of the courts. A bribe by a local company to a foreign official is not covered by the Bribery Act.

## Corruption and Government Transparency - Report by Global Security

### Political Climate

In 2010, President Rajapaksa's United Peoples Freedom Alliance (UPFA) won a landslide victory. According to Freedom House 2013, President Mahinda Rajapaksa has introduced a more centralised rule, which has raised concerns over the lack of transparency in policy formulation and decision-making.

According to Freedom House 2013, official corruption continues to be a problem, and this is closely linked to the current inadequate legal and administrative framework. The enforcement of existing safeguards on corruption problems remains weak, such as wealth-declaration requirements. The Sri Lankan political system is marked by three significant types of corruption: bribes paid to avoid bureaucratic red tape, bribe solicitation by government officials, and nepotism or cronyism. In an attempt to combat these practices all appointments, transfers, promotions as well as disciplinary action within the public service sector have been assigned to the Public Service Commission (PSC). However, the President and his advisors appoint PSC members, meaning that the formally independent commission is composed of members that owe their position directly to the President. The December 2008 appointment of a new Attorney General with close relations to the present administration is yet another example of the politicisation of state institutions. Moreover, there are no stipulations to secure asset declarations for public officials, nor are there any rules on conflict of interest, as reported by the Bertelsmann Foundation 2012. Corruption is carried out with a sense of impunity, and it is worth noting that no high-ranking official or politician has been prosecuted for corruption or abuse of power while serving in office. According to the US Department of State 2013, Sri Lanka has lost 2 percentage points from its annual GDP growth due to corruption.

Sri Lanka has been a war-based economy since 1983, producing an environment conducive to corruption. Hence, military expenses are not only high, but are also protected from the Auditor General's scrutiny through the enactment of the Official Secrets Act and other legislative enactments. Several sources, most recently Transparency International's Global Corruption Report 2009, concluded that military procurement is rigged through commissions and often involves low quality goods. The report, for example, describes that the purchase of old but overpriced military aircraft was exposed by newspapers in 2007 and 2008. While media attention prompted the government to investigate the case, the investigation was soon discontinued before it could yield any result. Transparency International Sri Lanka's Annual Report 2011 shows that Sri Lankan households often encounter petty corruption in their interaction with government agencies. According to the report, and supported by the cases posted on the website of the Commission to Investigate Allegations of Bribery or Corruption, bribes are commonly extorted by middle and lower-ranking officials in education, health, land administration, police and the judiciary. According to Transparency International's Global Corruption Barometer 2013, 35% of surveyed Sri Lankan households perceive that corruption has increased a lot over the past 3 years, and 19% reported to have paid a bribe within the last year. Furthermore, 36% believe that the government's actions to fight corruption are ineffective.

## **Business and Corruption**

Sri Lanka has managed to maintain a relatively stable level of economic development. The country has developed a strong market economy and a liberal free trade and investment regime. Nevertheless, the US Department of State 2013 notes that the business environment also poses challenges for investors. For instance, the unpredictable economic policy framework imposes high costs on investors. This is further supported by the World Economic Forum's Global Competitiveness Report 2012-2013, which cites policy instability and corruption amongst the most important obstacles to doing business in Sri Lanka. Sri Lanka was formerly committed to a policy and process of privatisation of public companies and made some progress in privatisation, including part of the national airline and various hotels. However, according to the US Department of State 2013, the current government has increased state control over both the public and the private sectors, and has halted or even reversed several privatisations. According to the US Department of State 2010, privatisation was conducted in a corrupt manner, which is estimated to have cost Sri Lanka USD 1.3 billion. For example, Lanka Marine Services and Sri Lanka Insurance Company were privatised in 2002. Over the course of 2008 and 2009, the Supreme Court of Sri Lanka reversed the decision to privatise these two companies. In its 2009 report, the Supreme Court denounced the corruption associated with the privatisations in the strongest terms. Both companies were undervalued by complicit auditors and sold off to private interests well-connected to high-level government officials.

According to the former chief justice, as cited in a 2011 news article by Reuters, corruption has become systemic in Sri Lanka, which will discourage foreign investors from investing in the country. Likewise, the US Department of State 2013 also reports that foreign companies identify corruption as a constraint to foreign investment, but that in the big picture it does not pose a major threat after the contracts have been won. Corruption seems to have the greatest influence on investors in large projects and on those seeking government procurement contracts. Companies seeking to contract agents to facilitate business transactions on their behalf, whether planning to invest in or already doing business in Sri Lanka, are strongly recommended to conduct extensive due diligence to avoid contracting potentially corrupt agents. Nonetheless, the World Bank & IFC's World Bank & IFC's Enterprise Surveys 2011 does indicate that petty corruption is prevalent and constitutes a constraint to business dealings. For example, 15.6% of the surveyed companies identify corruption as a major constraint to their current operations and almost 14% claim that they expect to bribe public officials to 'get things done'. Moreover, a considerable percentage of companies expect to make unofficial payments to get licences and permits, and to access various public utilities, such as electrical connections.

The level of corruption is markedly high in public procurement. Business executives in the Global Competitiveness Report 2012-2013 report that the diversion of public funds to companies, individuals or groups due to corruption is fairly common. One of the reasons for this is insufficient legislation. For instance, the law on declaration of assets does not require political parties and parliamentary candidates to declare the sources of their funding, thus obscuring potential biases politicians may hold towards bidders. Political bribery has reportedly reached considerable proportions, and it is reported that in order to obtain large contracts, commissions and bribes are often paid overseas and in hard currency. This is backed by the Enterprise Surveys 2011, where more than 18% of the surveyed companies expect to pay unofficial payments to secure government contracts. Therefore, companies

are recommended to develop, implement and strengthen integrity systems, and conduct extensive due diligence during the procurement process when planning to invest in or when already doing business in Sri Lanka.

## **Regulatory Environment**

According to the World Economic Forum's Global Competitiveness Report 2012-2013, Sri Lanka's inefficient government regulations and political instability are significant problematic factors for doing business. The country's political instability and frequent policy shifts create uncertainties among companies, impeding their ability to make a proper business risk assessment. According to the US Department of State 2013, both foreign and domestic investors still complain that the regulatory environment is characterised by unpredictability due to outdated or inaccessible regulation and rigid administrative procedures. While many foreign companies have had positive experiences in Sri Lanka, some have also had problems with government practises and unexplained delays. According to the US Department of State 2013, state-owned companies are crowding out private investments. The Board of Investment (BOI), a government agency that is responsible for foreign investments, functions as a one-stop shop for investors. The BOI is effective in helping investors who intend to set up business in the BOI-established industrial processing zones, which also offers better infrastructure and reliable public supplies and utilities. However, the US Department of State 2013 maintains that the BOI is less effective in assisting investors seeking to operate outside these zones. Some of the operating difficulties cited by companies pertain to difficulties in clearing supplies and equipment through customs, finding a factory location and obtaining approvals for operations.

The Sri Lankan tax regime is characterised by a cumbersome bureaucracy. According to the Global Competitiveness Report 2012-2013, tax rates and regulations are identified by the surveyed business executives as major business constraints. Nevertheless, according to the World Bank & IFC Doing Business 2013, the total tax rate paid by companies has been reduced from being twice the average of the OECD to almost the same level. The same report further notes that Sri Lanka has eased the process of starting a business by computerising and expediting the process of obtaining registration numbers of employees. Thus, starting a business in Sri Lanka has become simpler and quicker, now requiring 5 procedures and taking an average of 7 days with no requirements for minimum capital. Attempts have been made to reduce red tape by introducing standard tariff rates and in order to minimise corruption and attract more foreign investment to Sri Lanka, uniform administrative procedures have been introduced.

Companies should be aware that resolving disputes in the courts may be a lengthy process, because the procedures allow for one party in the dispute to prolong the case indefinitely. The court system is considered unreliable and cannot be depended upon for upholding the sanctity of contracts; therefore, companies often prefer to resolve matters out of court, for example, through arbitration, as reported by the US Department of State 2013. The Arbitration Act of 1995 recognises foreign arbitration awards. Arbitral awards made outside Sri Lanka can be enforced in Sri Lanka, and similarly, awards made in Sri Lanka are recognised and enforceable abroad. The Institute for the Development of Commercial Law and Practice (ICLP) arbitration centre has been established to facilitate settlement of commercial disputes. If the Sri Lankan government is party to the dispute, often the case when foreign companies are involved, the ICLP is unlikely to become involved in the dispute.

However, Sri Lanka is a member of the International Centre for the Settlement of Investment Disputes (ICSID) and has ratified the New York Convention 1958. Access the Lexadin World Law Guide for a collection of legislation in Sri Lanka.

### Section 3 - Economy

Sri Lanka continues to experience strong economic growth following the end of the government's 26-year conflict with the Liberation Tigers of Tamil Eelam. The government has been pursuing large-scale reconstruction and development projects in its efforts to spur growth in war-torn and disadvantaged areas, develop small and medium enterprises, and increase agricultural productivity.

The government's high debt payments and bloated civil service have contributed to historically high budget deficits and low tax revenues remain a concern. Government debt of about 72% of GDP remains among the highest in emerging markets.

The new government in 2015 drastically increased wages for public sector employees, which boosted demand for consumer goods but hurt the overall balance of payments and reduced foreign exchange reserves.

#### **Agriculture - products:**

rice, sugarcane, grains, pulses, oilseed, spices, vegetables, fruit, tea, rubber, coconuts; milk, eggs, hides, beef; fish

#### **Industries:**

processing of rubber, tea, coconuts, tobacco and other agricultural commodities; telecommunications, insurance, banking; tourism, shipping; clothing, textiles; cement, petroleum refining, information technology services, construction

#### **Exports - commodities:**

textiles and apparel, tea and spices; rubber manufactures; precious stones; coconut products, fish

#### **Exports - partners:**

US 26%, UK 9%, India 7.2%, Germany 4.3% (2015)

#### **Imports - commodities:**

petroleum, textiles, machinery and transportation equipment, building materials, mineral products, foodstuffs

#### **Imports - partners:**

India 24.6%, China 20.6%, UAE 7.2%, Singapore 5.9%, Japan 5.7% (2015)

### Banking

Sri Lanka has a fairly well diversified banking system, which includes the Central Bank of Sri Lanka (CBSL), two large state-owned commercial banks, nine private domestic commercial banks, eleven foreign banks, a national savings bank, six regional development banks, two long-term lending institutions, two housing banks, two private savings banks, and 12

merchant banks. The domestic commercial banks operate branches throughout the island. All commercial banks operate foreign currency banking units (FCBU) and conduct off-shore business and finance projects approved by the BOI.

The Central Bank is responsible for regulation and supervision of Sri Lanka's banking system. The legal framework consists of the Monetary Law Act and the Banking Act. The Central Bank is empowered to issue detailed directives to the commercial banks. In January 2008, Sri Lanka adopted International Convergence of Capital Measurement and Capital Standards widely known as the Basel II Framework for computation of the capital adequacy ratio. Commercial banks are also required to comply with Sri Lanka Auditing and Accounting Standards and Central Bank guidelines on loan loss provisioning.

## **Stock Exchange**

The Colombo Stock Exchange has been the second highest performing stock market in both 2009 and 2010. Foreign direct investment (FDI) finances about 4% of overall investment. Foreign investors are allowed to access credit on the local market. They are also free to raise foreign currency loans.

The Colombo Stock Exchange (CSE) is a company limited by guarantee, and established under the Companies Act No. 17 of 1982. The CSE took over the Stock Market in 1985 from the Colombo Share Brokers Association.

### Executive Summary

Sri Lanka is located in South Asia off the southern coast of India, on the main East-West Indian Ocean shipping lanes. In January 2015, President Maithripala Sirisena was elected to a six-year term. He campaigned on a platform of good governance and anti-corruption as well as ethnic reconciliation. Candidates running on a similar platform gained a majority of seats in parliamentary elections held in August 2015. Sirisena leads a national unity government comprising the pro-business United National Party (UNP), the reformist wing of the Sri Lanka Freedom Party (SLFP) and several smaller political parties. The coalition has embarked on a major political and economic reform process including constitutional reforms aimed at reducing the powers of the executive president. The government is working to improve its relations with other countries and to develop its economy to compete more effectively in the global marketplace. Specifically, Sri Lanka is working to position itself as a financial and trading hub in South Asia.

The Sirisena government's initial attempts to introduce economic reforms received mixed reactions. The government's 2016 budget contained extensive reforms that were commendable but which special interest groups were not prepared to accept. As a result, the government has reversed several reforms, creating uncertainty among investors. In March 2016, the government introduced new taxes to meet increasing debt obligations and to cover previously unannounced financial commitments made by the former administration. The government has identified the following key economic priorities: 1) integration of the economy into the global marketplace; 2) attracting increased foreign direct investment (FDI); 3) job creation; and 4) increased digitalization. The government is eager to enter into trade pacts with the United States, China, and Singapore to boost trade and investment and wants to expand the current Free Trade Agreement (FTA) with India to a broader Economic and Technology Agreement (ECTA). It is also trying to regain the European Union's (EU) Generalized Scheme of Preferences (GSP+) privileges for Sri Lankan exports. The EU withdrew GSP+ status from Sri Lanka in 2010 due to alleged human rights abuses committed by the military and security forces during the 26 year long civil war that ended in 2009. Additionally, several government agencies are investigating suspected corruption by the previous administration. Several officials and politicians connected to the former regime have been arrested for corruption or are on bail.

The Sri Lankan economy grew 4.8 percent in 2015, a year in which the new government began reversing years of statist economic policies. Gross domestic product (GDP) reached USD82 billion in 2015, and the per capita GDP was USD3,925. Growth is expected to be approximately 5.3 percent in 2016. The new government's efforts to boost the economy are hampered by a large fiscal deficit and the slowing global economy. The government tax revenue to GDP ratio is one of the lowest in the world. Sri Lanka also suffers from a large foreign debt burden and a persistent current account deficit. Foreign debt is comprised of concessional debt and commercial debt, including debt owed to China for recent infrastructure investment. Exports and foreign remittances from Sri Lankan workers overseas declined, and the rupee depreciated approximately nine percent in 2015. In March 2016, rating agencies downgraded Sri Lanka's credit ratings and revised its rating outlook from 'Stable' to 'Negative,' citing increased refinancing risks, weak public finance, decline in foreign exchange reserves, and higher foreign debt. The government has requested

assistance from the International Monetary Fund (IMF). Financing from the IMF could lead to substantial fiscal consolidation and increased taxation.

Sri Lanka's annual exports are approximately USD10.5 billion, mostly tea and garments. Imports are approximately USD19 billion, leaving an annual trade deficit of nearly USD8.5 billion. The United States is the largest single market for Sri Lankan exports, capturing over USD2 billion of the total. Remittances from migrant workers, approximately USD7 billion per year, are Sri Lanka's largest source of foreign exchange and help to offset the external deficits. Tourism is a USD2.9 billion industry with 1.8 million tourist arrivals in 2015.

Future growth will require structural changes to the economy, including a shift away from agriculture, as well as greater diversification of exports, improvements in productivity levels across all sectors, and the establishment of a more transparent regulatory and procurement framework. Sri Lanka needs to modernize education and improve government administration in order to build the foundation for long-term economic growth. The bloated civil service and losses at state-owned enterprises (SOEs) are significant challenges for the government.

Table 1

Measure	Year	Index or Rank	Website Address
TI Corruption Perceptions index	2015	83 of 175	<a href="http://transparency.org/cpi2014/results">transparency.org/cpi2014/results</a>
World Bank's Doing Business Report "Ease of Doing Business"	2015	107 of 189	<a href="http://doingbusiness.org/rankings">doingbusiness.org/rankings</a>
Global Innovation Index	2015	85 of 143	<a href="http://globalinnovationindex.org/content/page/data-analysis">globalinnovationindex.org/content/page/data-analysis</a>
U.S. FDI in partner country (\$M USD, stock positions)	2015	USD 111	BEA
World Bank GNI per capita	2014	USD 3,460	<a href="http://data.worldbank.org/indicator/NY.GNP.PCAP.CD">data.worldbank.org/indicator/NY.GNP.PCAP.CD</a>

### Millennium Challenge Corporation Country Scorecard

The Millennium Challenge Corporation, a U.S. Government entity charged with delivering development grants to countries that have demonstrated a commitment to reform, produced scorecards for countries with a per capita gross national income (GNI) of \$4,125 or less. The most recent score card for Sri Lanka is available here: <http://www.mcc.gov/pages/selection/scorecards>. Details on each of the MCC's indicators and a guide to reading the scorecards are available here: <http://www.mcc.gov/pages/docs/doc/report-guide-to-the-indicators-and-the-selection-process-fy-2015>.

## 1. Openness To, and Restrictions Upon, Foreign Investment

Attitude toward Foreign Direct Investment

Sri Lanka is a constitutional multiparty republic. In 1978 it shifted away from a socialist orientation and opened up to foreign investment, although changes in government have often been accompanied by reversals in economic policy. The current coalition government led by President Sirisena and Prime Minister Wickremesinghe has vowed to follow a pro-business stance with an emphasis on expanding exports, upgrading industry and boosting private investment and public-private partnerships. Prime Minister Ranil Wickremesinghe represents the pro-business United National Party.

Former President Rajapaksa (2005-2015) followed a statist economic policy, advocating government control of strategic enterprises and expanding the role of the state. The Rajapaksa administration also introduced a substantial government infrastructure development program, largely financed with Chinese loans. President Sirisena's administration has suspended work on many of these projects pending review of possible corruption and some contracts are being renegotiated.

Sri Lanka will require high levels of foreign direct investment (FDI) to meet its growth targets. Most of the current economic potential is concentrated in the tourism sector, with 1.8 million tourists per year and growing. Several major international hotel franchises plan to build new hotels over the next few years. Investors are capitalizing on Sri Lanka's environment, culture, religious history, and wildlife to attract high-end tourists, and to tap into the growing markets of India and China. Ports could be another important driver of growth, with the Colombo Port being one of the most active in the region, situated on a major global shipping lane.

Ample scope exists for an expansion in the information technology/business processing operations (IT/BPO) sector. With a growing middle class, investors see opportunities in franchising, retail, and services, as well as light manufacturing. However, importers to Sri Lanka face high taxes. According to a recent World Bank study, Sri Lanka's present import regime is one of the most complex and protectionist in the world. The new government is keen to improve education and skills development. Sri Lanka's free trade agreements (FTAs) with India and Pakistan offer preferential access to those markets, and Sri Lanka is currently negotiating an Economic and Technology Agreement (ETCA) with India and an FTA with China. The capital city of Colombo offers expatriate managers a good quality of life relative to the region.

Sri Lanka can still be a challenging place to do business, with high transaction costs caused by an unpredictable economic policy environment. While some government departments and ministries boast competent staff, the government's overall provision of services is impeded by inefficiency. While the new administration has started to implement more transparent procurement practices, economic growth is stymied by lingering opaque government procurement practices.

Foreigners are prohibited from purchasing land and real estate except for apartments above the 4th floor. Currently, the Cabinet can approve a land purchase for an investment in the national interest, provided there is a substantial foreign remittance for the purchase of the land. A land transfer tax of 100 percent may still apply. The 2016 budget promised to consider further relaxing restrictions on land ownership on identified investments. Other policies of concern include the November 2011 Underutilized Assets Act, which resulted in the seizure of 37 companies. The current government imposed a one-time 25 percent tax on companies making profits over LKR 2 billion (USD 15 million) in the 2013/14 financial year. Foreign investors

enjoying tax holidays are exempted from the tax. The government has said that they would refrain from introducing such retroactive policies and taxes in the future.

Local investors cite the risks of contract repudiation, cronyism, damage to reputation, and de facto or de jure expropriation as concerns, although the new government has started to address these issues. From an investor viewpoint, the power and petroleum sectors are particularly challenging, as decision-making authority is highly fragmented, and the capital investments required are substantial. Trade union opposition at both the Ceylon Petroleum Corporation and the Ceylon Electricity Board (CEB) make reform of these loss-generating state-owned enterprises (SOEs) very difficult.

Sri Lankan financial institutions may have trouble complying with the U.S. Foreign Accounts Tax Compliance Act (FATCA). The government has directed banks to register with the Internal Revenue Service (IRS). Almost all commercial banks have registered with the IRS.

Investors report that starting a business in Sri Lanka is relatively simple and quick – especially when compared to other frontier markets – and 20 percent cheaper than in neighboring countries. Scalability is a problem, however, as the lack of skilled labor and a smaller talent pool means companies can take years to double in size. Investors claim employee retention is good in Sri Lanka, but numerous public holidays, reluctance of workers to work at night (which is especially problematic in the IT/BPO sector), lack of labor mobility, and a difficulty in recruiting women can reduce efficiency and increase start-up times. The garment industry has had more difficulty with employee retention, especially in the North and East, due to quality of life issues in these regions. On the other hand, many service sector companies can rely on Sri Lankan engineers, researchers, technicians, and analysts to deliver high-quality, high-precision products. Foreign and local companies report a strong worker commitment to excellence in Sri Lanka, with rapid adaptation to quality standards.

#### Other Investment Policy Reviews

Sri Lanka has been a member of the World Trade Organization (WTO) since 1995. The most recent WTO Trade Policy Review for Sri Lanka was conducted in 2010. This is Sri Lanka's third Trade Policy Review. Additional information including both the full report and a summary may be found at: [https://www.wto.org/english/tratop\\_e/tpr\\_e/tp337\\_e.htm](https://www.wto.org/english/tratop_e/tpr_e/tp337_e.htm)

The government of Sri Lanka has not conducted any other investment policy reviews through the Organization for Economic Cooperation and Development (OECD) or the U.N Conference on Trade and Development (UNCTAD).

#### Laws/Regulations on Foreign Direct Investment

The Board of Investment (BOI, [www.investsri Lanka.com](http://www.investsri Lanka.com)), an autonomous statutory agency, is the primary government authority responsible for investment, with a focus on foreign investment. BOI promotes the following sectors as priority sectors for FDI: tourism and leisure; infrastructure; knowledge services; utilities; apparel; export manufacturing; export services; agriculture; and education. BOI also promotes transshipment trading, international logistics services, operations of headquarters, off shore business and research and development.

The BOI manages a number of export processing zones that feature business-friendly regulations and improved infrastructure for foreign investors. The BOI is intended to provide "one-stop" service for foreign investors, with duties including the approval of projects, granting incentives, and arranging utility services. It also assists in obtaining resident visas for expatriate personnel and facilitates import and export clearances. The BOI is not yet a one-stop shop. Although the BOI is relatively effective in assisting investors who want to establish operations within its export processing zones, it is less effective in facilitating and servicing large investments outside these zones. Sri Lanka's bureaucracy often works at cross-purposes with BOI authorities. For example, registration of foreign company branch offices in Sri Lanka can be expensive.

The government is working to establish an apex body named the Agency for Development to facilitate policy regarding investments, tourism and exports and supervise state institutions - such as the BOI - in these sectors. The government has also promised to introduce a new investment law and an incentive regime.

Currently, the principal law governing foreign investment is Law No. 4, created in 1978 (known as the BOI Act), as amended in 1980, 1983, and 1992, along with implementing regulations established under the Act. The BOI Act provides for two types of investment approvals. Under Section 17 of the Act, the BOI is empowered to recommend concessions to companies satisfying certain eligibility criteria on minimum investment. Such companies are eligible for generous investment concessions. Investment approval under Section 16 of the BOI Act permits companies to operate under the "normal" laws of the country and applies to investments that do not satisfy eligibility criteria for BOI incentives. From 2008 to 2015, the Strategic Development Project Act of 2008 (SDPA) provided generous tax incentives for large projects that the Cabinet identifies as Strategic Development Projects. Such investments are expected to be covered by the new Investment Law in the future. Other laws affecting foreign investment are the Securities and Exchange Commission Act of 1987 as amended in 1991 and 2003, the Takeovers and Mergers Code of 1995 (revised in 2003), and the Companies Act of 2007. Various labor laws and regulations also affect investors. For more details, please visit: <http://www.lawnet.lk/>.

Foreign investments, particularly if not keyed toward export, are often more successful when guided by a local partner who can navigate the cultural and political landscape. Some sectors, however, such as IT/BPO, report relatively little need to rely on local agents or the government to start operations. Most investors agree that any export-based investment faces fewer problems, especially if the company is registered with the BOI. The greatest challenges lie in infrastructure contracts or competing for any government tender offer, where foreign investors find it difficult to navigate the opaque procurement process.

### *Business Registration*

The Department of Registrar of Companies ([www.drc.gov.lk](http://www.drc.gov.lk)) has the responsibility for business registration. There is no online registration system except for submitting the name approval application for a business registration. Registration at the Companies Registry takes, on average, 7 to 10 days. The business registration regime does not require a notary to sign the documents. In addition to the Registrar of Companies, businesses must register with the Inland Revenue Department to obtain a taxpayer identification number for payment of taxes, and the Department of Labor for payment of social security payments.

The Board of Investment facilitates foreign investment. BOI services are available to all investors. However, tax incentives are available only to investors meeting certain criteria such as minimum capital levels and a minimum number of employees.

According to the World Bank (<http://iab.worldbank.org/>) it takes six procedures and 65 days to establish a foreign-owned limited liability company (LLC) in Sri Lanka.

#### Industrial Promotion

The government aspires to promote goods and services exports, tourism, ICT industries, agriculture, education and research & development. The government has proposed to create an international finance center in the capital (Colombo) which will be a specific zone similar to the Dubai International Financial Centre. The proposed financial center will have its own commercial court for resolution of commercial disputes. The government is proposing to invite domestic and international banks to operate in the proposed center. The government also hopes the current Free Trade Agreement with India, a proposed ECTA with India, and the proposed FTA with China will help Sri Lanka to become a gateway to those significant markets.

#### Limits on Foreign Control and Right to Private Ownership and Establishment

The government allows 100 percent foreign investment in any commercial, trading, or industrial activity other than a few specified sectors: air transportation; coastal shipping; large scale mechanized mining of gems; lotteries; manufacture of military hardware, military vehicles, and aircraft; dangerous drugs; alcohol; toxic, hazardous, or carcinogenic materials; currency; and security documents. (These sectors are regulated and subject to approval by various government agencies or the BOI.)

Foreign investments in the following areas are restricted to 40 percent ownership: the production for export of goods subject to international quotas; growing and primary processing of tea, rubber, coconut; timber-based industries using local timber; deep-sea fishing; mass communications; education; freight forwarding; travel services; and businesses providing shipping services. Foreign ownership in excess of 40 percent must be preapproved on a case-by-case basis by the BOI. The government is considering opening higher education to foreign investment. Foreign investment is not permitted in the following businesses: non-bank money lending; pawn-brokering; retail trade with a capital investment of less than USD 1 million; and coastal fishing.

In areas where foreign investment is permitted, foreign investors are treated equally with domestic investors and may benefit from the wide range of incentives provided by the BOI or from the Treasury.

Private entities are free to establish, acquire and dispose of interests in business enterprises. Private enterprises enjoy benefits similar to those granted to public enterprises, and there are no known limitations in accessing markets, credit, or licenses. Foreign ownership is allowed in most sectors, although the land ownership law prohibits foreigners from owning land, with some exceptions. Most investors say acquiring land is often the biggest challenge for any new business in Sri Lanka. Private land ownership is limited to fifty acres per person. The government owns approximately 80 percent of the land in Sri Lanka, including land housing

most tea, rubber, and coconut plantations, which are leased to the private sector on 50-year terms. Although state land for industrial use is usually allotted on a 50-year lease, the government may approve 99-year leases on a case-by-case basis, depending on the nature of the project. Many land title records were lost during the war, and significant disputes remain over property ownership in the North and East. The new government has started a program to hand back property taken by the government during the war to people in the North and East.

#### Privatization Program

The new government is seeking to improve the efficiency of state-owned enterprises (SOEs), through private sector-style management practices. It also proposes to list some SOEs on the Colombo Stock Exchange and fully or partially privatize non-strategic SOEs.

The previous government halted privatizations, preferring to maintain SOEs, and even reversed several privatizations it had granted in the past. SOE labor unions often oppose privatization and seem particularly averse to foreign ownership. In the past, this made the privatization of government entities problematic for new foreign owners.

#### Screening of FDI

The BOI ([www.investsrilanka.com](http://www.investsrilanka.com)), an autonomous statutory agency, is the primary government authority responsible for investment, with a focus on foreign investment. Foreign investors applying for incentives offered under the Board of Investment law are screened by the BOI. Some investments, especially in utilities, are screened by respective statutory agencies or line ministries.

#### Competition Law

Sri Lanka does not have a specific competition law. Instead, BOI or the respective regulatory authority may review transactions for competition-related concerns.

## **2. Conversion and Transfer Policies**

#### Foreign Exchange

Sri Lanka generally has investor-friendly conversion and transfer policies. Companies note they can repatriate funds relatively easily. In accordance with its Article VIII obligations as a member of the IMF (<http://www.imf.org/external/pubs/ft/qa/qa08.htm>), Sri Lanka liberalized exchange controls on current account transactions in 1994, and in 2010-2012, the government relaxed exchange controls on several categories of capital account transactions. When the government experiences balance of payments difficulties, the government tends to impose controls on foreign exchange transactions. In November 2015, the government imposed a 100 percent deposit requirement on motor vehicle imports, requiring importers to pay up front the full value of motor vehicles when opening letters of credit with commercial banks. The government lifted the 100 percent deposit requirement on December 1, 2015. At the same time, however, the government imposed a policy capping vehicle financing to no more than 70 percent of the value of the vehicle. This policy was intended to limit motor vehicle imports in an effort to counteract the increase of vehicle

imports over the previous year, which adversely affected Sri Lanka's trade deficit and caused traffic congestion in the capital.

Sri Lanka follows a flexible exchange rate regime with the Central Bank intervening to smoothen volatility. The rupee depreciated by over nine percent in 2015. Capital outflows intensified in 2015, and foreign exchange reserves declined. Foreigners are permitted to invest in Sri Lankan debt instruments, both government and corporate debt. The Central Bank's rupee-denominated T-bill and T-bond issues in the local market are also open to foreign investors. Both foreign and local companies are permitted to borrow from foreign sources.

### *Remittance Policies*

No barriers exist, legal or otherwise, to the expeditious remittance of corporate profits and dividends for foreign enterprises doing business in Sri Lanka, provided required documents are in place. The average delay for remitting investment returns, interest, and principal on private foreign debt, lease payments, royalties, and management fees through normal legal channels is one to four weeks. All stock market investments can be remitted without prior approval of the Central Bank through a special bank account. Investment returns can be remitted in any convertible currency at the legal market rate. Sales proceeds and gains from real estate can be transferred provided there is sufficient evidence to prove the funds used to originally purchase the property were remitted into the country to acquire the property. Exporters must repatriate export proceeds within 120 days to settle export credit facilities. Other export proceeds can be retained abroad, provided such funds are not used for acquisition of property or other capital assets outside Sri Lanka. An informal money transfer/exchange system is available to facilitate Sri Lankans working overseas and sending money home, although with higher rates. In June 2013, the Financial Action Task Force (FATF) removed Sri Lanka from the list of countries that are subject to FATF's monitoring process. A Financial Intelligence Unit (FIU) was created in 2006 and operates under the Central Bank.

### **3. Expropriation and Compensation**

Since economic liberalization policies began in 1978, the government has not expropriated a foreign investment. The last expropriation dispute was resolved in 1998. However, in 2011, the previous government approved the Revival of Underperforming Enterprises and Underutilized Assets Act, allowing for the expropriation of assets belonging to 37 companies the government considered as underperforming. These companies had leased land from the government, but the government claimed the companies were not meeting the conditions of the agreement. Although many of the companies were defunct, several others were viable businesses. The Central Bank stated that the Act was to be considered a one-off measure. The law increases investor uncertainty regarding property rights in Sri Lanka and is often cited as having a chilling effect on foreign direct investment.

Apart from the Underutilized Assets Act, the land acquisition law empowers the government to take over private land for public purposes. Compensation is paid based on government valuation, which some local investors consider relatively fair. There are cases, however, of the military taking over businesses in the North and East - on claims they are on government land - with little or no compensation. Many land records were lost or destroyed during the war, which complicates land tenure issues and delays resolution. Under the previous regime, there

were reports of government taking over private lands throughout the country purportedly for public purposes. The new government has pledged to refrain from the takeover of private assets.

In January 2015, the new government presented an interim budget. The budget included a one-time 25 percent tax entitled the "super gain tax" on companies or individuals who reported more than LKR 2 billion (USD 15 million) in profits (before income tax) in the tax year ending March 2014. Foreign investors enjoying tax holidays were exempted.

#### **4. Dispute Settlement**

##### Legal System, Specialized Courts, Judicial Independence, Judgments of Foreign Courts

Sri Lanka's legal system reflects diverse cultural influences. Criminal law is fundamentally British. Basic civil law is Roman-Dutch. Laws pertaining to marriage, divorce, and inheritance are ethnic. Sri Lankan commercial law is almost entirely statutory. The law reflects colonial British law, but amendments have largely kept pace with subsequent legal changes in the United Kingdom. Several important legislative enactments regulate commercial matters: the Board of Investment Law; the Intellectual Property Act; the Companies Act; the Securities and Exchange Commission Act; the Banking Act; the Industrial Promotion Act; and the Consumer Affairs Authority Act (<http://www.lawnet.lk/>).

Sri Lanka's court system consists of the Supreme Court, the Court of Appeal, provincial high courts and the Courts of First Instance, i.e., district courts (with general civil jurisdiction) and magistrate courts (with criminal jurisdiction). The provincial high courts have original, appellate, and reversionary criminal jurisdiction. The Court of Appeal is the intermediate appellate court with a limited right of appeal to the Supreme Court. The Supreme Court exercises final appellate jurisdiction for all criminal and civil cases. Citizens may apply directly to the Supreme Court for protection if they believe any government or administrative action has violated their fundamental human rights.

All commercial matters, including intellectual property claims, exceeding the value of LKR 3 million (approximately USD 20,700) fall within the jurisdiction of the Commercial High Court of Colombo. A number of tribunals also exercise judicial functions, such as the Labor Tribunals that hear cases brought by workers against their employers. Litigation can be slow. Monetary judgments are usually made in local currency, but procedures exist for enforcing foreign judgments. Overall, Sri Lanka's record in handling investment disputes is problematic. Disputes have become politicized, and the stability of contracts in general could be improved.

##### Bankruptcy

The Companies Act and the Insolvency Ordinance provide for dissolution of insolvent companies, but there is no mechanism to facilitate the reorganization of financially-troubled companies. Other laws make it difficult to keep a struggling company solvent. The Termination of Employment of Workmen Special Provisions Act (TEWA), for example, makes it difficult to fire or lay off workers who have been employed for more than six months for any reason other than serious, well-documented disciplinary problems, unless the employee agrees to such termination.

In the absence of proper bankruptcy laws, extra-judicial powers granted by law to financial institutions protect the rights of creditors. A creditor may petition the court to dissolve the company if it cannot meet a creditor's demands for payment of money in excess of LKR 50,000 (USD 380.00). Lenders are also empowered to foreclose on loan collateral without court intervention. However, loans below LKR 5 million (USD 38,000) are exempt, and lenders cannot foreclose on collateral provided by guarantors to a loan. Financial institutions also face other legal challenges as defaulters obtain restraining orders on frivolous grounds due to technical defects in the recovery laws.

The Companies Act of 2007 introduced a solvency test to determine the financial stability of a company. The solvency test is intended to prevent companies without sufficient assets from obtaining loans and to protect rights of creditors. The law sets forth the responsibilities of a company's directors in cases of serious loss of capital. While the Companies Act does not provide for the revival of struggling companies, the courts generally take a liberal attitude towards any restructuring plans that would benefit a company.

#### Investment Disputes

Sri Lanka's courts have a mixed record with regard to upholding the sanctity of contracts. The courts are not practical for resolving disputes or obtaining remediation, because their procedures allow one party to prolong cases indefinitely. Aggrieved investors (especially those dealing with government projects) have frequently pursued out-of-court settlements in hopes of speedier resolution. In late 2008, the Supreme Court, in an interim order, halted payments to five international and local banks involved in oil hedge contracts with the government. One of the involved banks was American. The banks filed for international arbitration.

Some U.S. companies have experienced problems with payment of valid contracts, and implementation of agreements with the government, despite demonstrated superior performance, high value, and competitive bids. In practice, it may be advisable to seek to include provisions for international arbitration in legal documents.

Soon after coming to power the current government halted several major infrastructure projects negotiated between the Rajapaksa administration and China, most notably the USD 1.4 billion Colombo Port City project. The government cited irregularities, environmental issues and allegations of corruption for the suspension of the projects. After a review, most of the projects have been authorized to continue.

Civil society groups and environmentalists have been active in disputes involving foreign investors. In the case of the Colombo Port City project, at least two civil society groups sought court intervention to stop the project. The Center for Environmental Justice sought an order from the Court of Appeal to suspend what it described as illegal agreements without following the proper legal procedures. A fisheries organization also filed a Fundamental Rights petition before the Supreme Court complaining that sand mining for this project may adversely affect fisheries. Other civil society groups have protested saying the project is likely to harm the environment.

#### International Arbitration

Most investors tend to prefer arbitration over litigation. Arbitral awards made abroad are now enforceable in Sri Lanka. Similarly, awards made in Sri Lanka are enforceable abroad. There is a considerable delay in enforcing arbitral awards and the respondents are often seen making objections based on technicalities or on public policy considerations.

The Institute for the Development of Commercial Law and Practice (ICLP) ([www.iclparbitrationcentre.com](http://www.iclparbitrationcentre.com)) and Sri Lanka National Arbitration Centre ([www.slnarbcentre.com](http://www.slnarbcentre.com)) engage in private settlement of commercial disputes through arbitration.

#### *ICSID Convention and New York Convention*

Sri Lanka is a member state to the International Centre for the Settlement of Investment Disputes (ICSID convention). It is also a signatory to the convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958 New York Convention) without reservations.

Sri Lanka's Arbitration Act of 1995 recognizes within its legal framework the terms of the New York Convention.

#### *Duration of Dispute Resolution – Local Courts*

It takes between two to three years to resolve a commercial dispute valued at less than LKR 5 million (USD 34,500) in a district court. Commercial disputes over LKR 5 million come under the jurisdiction of the Commercial High Court and take a year or two for a final judgment. These timeframes exclude any time taken to resolve subsequent appeals filed in higher courts.

District courts have a backlog of cases, driving the majority of delays. The time between court hearings is, therefore, long, delaying resolution. The Commercial High Court consists of three court houses and judges are specialized in hearing commercial disputes. The delays in the high court are generally related to the long backlog of cases fixed for a particular date or other urgent matters taking precedence.

Enforcement of a court decision in the event the losing party does not comply is implemented by means of execution of the writ with the assistance of the court.

## **5. Performance Requirements and Investment Incentives**

### **WTO/TRIMS**

To qualify for investment incentives, the BOI specifies certain minimum investment amounts for both local and foreign investors. A member of the World Trade Organization (WTO), Sri Lanka complies with WTO Trade Related Investment Measures (TRIMS) obligations.

### **Investment Incentives**

Sri Lanka offers various investment incentives. The government plans to introduce a new investment regime and an incentive structure in mid-2016. Currently, the BOI is following BOI regulation No.2 of 2006 when granting approvals and incentives until a new investment law

and incentives are formulated. Some of the current incentives are listed below. Potential investors are encouraged to contact the BOI directly for information as the incentive structure is undergoing changes.

#### Incentive Program I

Qualifying industries: Non-traditional manufacturing exports and companies supplying to exporting companies, export oriented services, manufacture of industrial machinery, small-scale infrastructure, research and development, agriculture and agro-processing industries, and export trading houses in the rural sector.

Incentives: A five-year tax holiday and preferential tax rates thereafter. Some of these industries qualify for duty-free imports. Exporting companies and export-oriented services will be exempted from exchange control regulations. They will also qualify for free repatriation of profits and dividends and free transferability of shares. Minimum investment levels apply.

#### Incentive Program II

Qualifying Industries: Information technology, information technology training institutes, business process outsourcing, and regional operating headquarters. Minimum investment and employment levels apply.

Incentives: IT services, IT training institutes, and BPO firms qualify for tax holidays of five to 12 years provided they meet minimum employment levels. Otherwise, a preferential tax of 10 percent applies for two years. Regional operating headquarters qualify for a three-year tax holiday. Preferential tax rates apply after the tax holiday. Capital goods for these projects will be exempted from import duty.

Five to 15 year tax holidays are available for large infrastructure projects.

For further information on investment incentives and other investment-related issues, potential investors should contact the BOI directly ([www.investsrilanka.com](http://www.investsrilanka.com) or [info@boi.lk](mailto:info@boi.lk).)

#### *Research and Development (R&D)*

Government funding of research is limited and currently restricted to state research institutions and universities. Private sector companies engaged

#### Performance Requirements

There are no performance requirements. In most cases, firms enjoying preferential incentives in the manufacturing sector must export 80 percent of production, while those in the service sector must earn at least 70 percent of their income in foreign exchange. Foreign investors are generally not expected to reduce their equity over time, nor are they expected to transfer technology within a specified period of time, except for build-own-transfer or other such projects in which the terms are specified within pertinent contracts.

Foreign investors who remit at least USD 250,000 can qualify for a one-year resident visa, which can be renewed. Employment of foreign personnel is permitted when there is a

demonstrated shortage of qualified local labor. Technical and managerial personnel are in short supply, and this shortage is likely to continue in the near future. Foreign employees in the commercial sector do not experience significant problems in obtaining work or residence permits. Sri Lanka offers dual citizenship status to Sri Lankans who have obtained foreign citizenship in seven designated countries. Tourist and business visas are granted for one month, with possible extensions.

#### Data Storage

Sri Lanka has no specific requirements for foreign IT providers to turn over source code or provide access to surveillance. Provisions relating to interception of communications for cybercrime issues are subject to court supervision under the Computer Crimes Act of 2007. Sri Lanka became a party to the Budapest Cybercrime Convention in 2015. As a result, safeguards based on this convention are in force. Although, there is no comprehensive legislative protection of electronic data, the Computer Crimes Act has a provision to protect data and information. Steps are being taken by the Government to formulate data protection legislation. There is no ban on the sale of electronic data for marketing purposes.

Sri Lanka ratified the UN Electronic Commerce Convention in July 2015 and began implementing it on February 1, 2016 by taking steps to amend the Sri Lanka Electronic Transactions law to comply with the convention.

### **6. Protection of Property Rights**

#### Real Property

Secured interests in property in Sri Lanka are generally recognized and enforced, but many investors claim protection can be flimsy. A fairly reliable registration system exists for recording private property including land, buildings, and mortgages, although problems exist due to fraud and forged documents. In the World Bank's 2016 "Doing Business Index" Sri Lanka ranked 153 out of 189 countries in the category of registering a property. Property registration required, on average, completion of nine procedures lasting 51 days. Foreigners are prohibited from the purchase of lands. A regulation imposing a 15 percent tax on leases to foreigners was removed in January 2016.

#### Intellectual Property Rights

IPR enforcement is improving in Sri Lanka, although counterfeit goods continue to be widely available, making it difficult for the legitimate industries to protect their markets. Local agents of well-known U.S. and other international companies representing recording, software, movie, clothing, and consumer product industries continue to complain that lack of IPR protection damages their businesses. Sri Lanka has a comprehensive IPR law and several offenders have been charged or convicted. Overall, progress on IPR protection is improving in the country. For instance, the government's information technology (IT) policy requires government agencies to use licensed or open source software. Software companies have reported an increased interest by large companies in improving IPR regimes. Sri Lanka does not track and report on seizures of counterfeit goods.

Sri Lanka is a party to major intellectual property agreements. Sri Lanka adopted an intellectual property law in 2003 that was intended to meet both U.S.-Sri Lanka bilateral IPR agreements and, to a great extent, trade-related aspects of intellectual property rights (TRIPS) obligations. The law governs copyrights and related rights; industrial designs; patents, trademarks and service marks; trade names; layout designs of integrated circuits; geographical indications; unfair competition; databases; computer programs; and undisclosed information (e.g., trade secrets). All trademarks, designs, industrial designs, and patents must be registered with the Director General of Intellectual Property. No legal provisions exist for registration of copyrights and trade secrets.

The National Intellectual Property Office has stepped up efforts to improve the trademarks and patents administration regime. Infringement of intellectual property rights is a punishable offense under the IP law with criminal and civil penalties. Recourse available to owners includes injunctive relief; seizure and destruction of infringing goods and plates or implements used for the making of infringing copies; and prohibition of imports and exports. Penalties for the first offense include up to six months imprisonment or a fine of up to LKR 500,000 (USD 34,500), but smaller penalties are the norm. Aggrieved parties can seek redress for any IPR violations through the courts, though this can be a frustrating and time-consuming process. In recent times warning letters have proved to be an effective alternative to litigation in cases of minor copyright and trademark infringements. Sri Lanka Customs' regulatory code provides *ex officio* authority to seize suspected counterfeit shipments at the borders. However, police and customs authorities generally do not proactively initiate action against IPR violators unless the victims bring it to the authorities' attention and work with them on enforcement actions. Judicial cooperation continues to improve. The government has established a special antipiracy and counterfeit unit in the Criminal Investigation Division (CID) of the police to specifically address IPR concerns. There is also an IPR unit in the Social Protection Unit of Sri Lankan Customs, and a trademark database to advance IPR protection. The government has yet to make full use of this database.

The U.S. Embassy, the United States Patent and Trademarks Office (USPTO), and the American Chamber of Commerce of Sri Lanka are working to pursue more aggressive enforcement and enhance public awareness. Sri Lanka is not listed in USTR's Special 301 report.

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at <http://www.wipo.int/directory/en/>.

#### *Resources for Rights Holders*

Contact at U.S. Embassy Colombo:

- William Humnicky, Economic Officer
- 94-11-2498500
- Email: [commercialcolombo@state.gov](mailto:commercialcolombo@state.gov)
- Local lawyers list: <http://srilanka.usembassy.gov/service/legal-resources-in-sri-lanka.html>

Country/Economy Resources:

- American Chamber of Commerce in Sri Lanka: [www.amcham.lk](http://www.amcham.lk)
- National Intellectual Property Office of Sri Lanka: [www.nipo.gov.lk](http://www.nipo.gov.lk)

## 7. Transparency of the Regulatory System

The BOI strives to inform potential investors about laws and regulations affecting operations in Sri Lanka, and the new government has stated a commitment to reform and reorganize relevant government agencies to improve services. However, existing laws remain hard to find, and proposed laws and regulations, while generally made available for public comment, are occasionally published without public discussion. Foreign and domestic investors complain the regulatory system is unpredictable due to outdated regulations, rigid administrative procedures, and excessive leeway for bureaucratic discretion. Effective enforcement mechanisms are sometimes lacking, and investors cite coordination problems between the BOI and relevant line agencies. Lethargy and indifference on the part of mid- and lower-level public servants compound transparency problems. Lack of sufficient technical capacity within the government to review financial proposals for private infrastructure projects also creates problems during tendering. Under the former government, the Sri Lankan Cabinet had to approve strategic projects in order for private investors to receive incentives. It is unclear what the new government's approval process will be.

Although many foreign investors, including U.S. firms, have had positive experiences in Sri Lanka, some encountered significant problems with the former government's practices and regulations. Under the previous regime, some claimed that the level of corruption made it difficult to compete against bidders not subject to the U.S. Foreign Corrupt Practices Act. While the new government has started to implement its platform of good governance and transparency, the administration has yet to eliminate all elements of corruption in the bidding process. Some multinational firms continue to experience delays in reaching agreement on investment projects, largely due to the new government's desire to review all existing projects.

The Institute of Chartered Accountants of Sri Lanka (ICASL) is responsible for setting and updating accounting standards to comply with current accounting and audit standards adopted by the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB) respectively. Sri Lanka follows International Financial Reporting Standards (IFRS) for financial reporting purposes set by the IASB.

Sri Lankan accounting standards are applicable for all banks, companies listed on the stock exchange, and all other large and medium-sized companies in Sri Lanka. Accounts of such enterprises are required to be audited by professionally qualified auditors holding ICASL membership. ICASL has published accounting standards for small companies as well. The

Accounting Standards Monitoring Board (ASMB) is responsible for monitoring compliance with Sri Lankan accounting and auditing standards. British professional accounting bodies are quite active in Sri Lanka. The Chartered Institute of Management Accountants (CIMA), a leading professional accounting body based in the United Kingdom and spread over the Commonwealth, has its largest overseas presence in Sri Lanka.

At pre-enactment stage, bills are drafted by respective ministries. Public consultation at this stage is limited in most instances. Every bill must be published in the government gazette at

least seven days before it is placed on the Order Paper of the Parliament. This is the first occasion the public is officially informed of proposed laws. Until this time the draft is treated as a confidential document. Any member of the public can challenge the bill in the Supreme Court if they do so within one week of its placement on the Order Paper of the Parliament. If the Supreme Court orders amendments to the bill, these have to be incorporated before can be debated and passed.

## **8. Efficient Capital Markets and Portfolio Investment**

The Securities and Exchange Commission (SEC) covers the Colombo Stock Exchange (CSE), unit trusts, stock brokers, listed public companies, margin traders, underwriters, investment managers, credit rating agencies, and securities depositories. Portfolio investment is encouraged. Foreign investors can purchase up to 100 percent of equity in Sri Lankan companies in numerous permitted sectors. In order to facilitate portfolio investments, country and regional funds may obtain SEC approval to invest in Sri Lanka's stock market. These funds make transactions through share investments in external rupee accounts maintained in commercial banks.

The new government has vowed to improve stock market regulation, and has appointed a new SEC management. The SEC has recently expanded the investigation and enforcement divisions and reopened several stock market manipulation cases.

Previous attempts to investigate insider trading and fraud at the CSE during 2011-2012 had to be abandoned as the SEC came under pressure from powerful market players. Four senior SEC officials resigned over regulatory issues during this period, citing pressures from high net-worth local investors.

In accordance with its IMF Article VIII obligations, the government and the Central Bank generally refrain from restrictions on current international transfers. When the government experiences balance of payments difficulties, it does tend to impose controls on foreign exchange transactions, but it in recent years has exercised restraint in resorting to such measures.

The state consumes over 50 percent of the country's domestic financial resources and has a virtual monopoly on the management and use of long-term savings in the country. This inhibits the free flow of financial resources to product and factor markets. In the past, high budget deficits have caused interest rates to rise and resulted in higher inflation. Average inflation in December 2015 was 0.9 percent compared to 3.3 percent in December 2014. The Average Prime Lending rate was 11 percent in December 2015. Both inflation and interest rates are on an upward trend in 2016. The Central Bank increased policy interest rates by 50 basis points in February and has not ruled out a further increase in 2016. Retained profits finance a significant portion of private investment in Sri Lanka. Commercial banks are the principal source of bank finance. Bank loans are the most widely used credit instrument for the private sector. Large companies raise funds through corporate debentures as well. Credit ratings are now mandatory for all deposit-taking institutions and for all varieties of debt instruments. Local companies are allowed to borrow from foreign sources. Foreign direct investment finances about six percent of overall investment. Foreign investors are allowed to access credit on the local market and are free to raise foreign currency loans.

Sri Lanka has a fairly well-diversified banking system. There are 25 commercial banks – 13 local and 12 foreign. In addition, there are seven local specialized banks. Citibank NA is the only U.S. bank operating in Sri Lanka. Several domestic private commercial banks have substantial government equity acquired through investment agencies controlled by the government. In 2014, the Central Bank actively promoted consolidation in the banking and financial sector. The new government is reviewing consolidation plans.

The Central Bank is responsible for supervision of all banking institutions and has driven improvements in banking regulations, provisioning, and public disclosure of banking sector performance. Credit ratings are mandatory for all banks operating in Sri Lanka. The Central Bank has accepted the Basel II standardized approach framework, and has introduced accounting standards corresponding to International Financial Reporting Standards for banks.

Total assets of commercial banks stood at LKR 5,884 billion (USD 45 billion) as of December 31, 2014. The two fully state-owned commercial banks – Bank of Ceylon and People's Bank – are still important players, accounting for about 40 percent of all banking assets. The two state banks have a large portfolio of non-performing loans. Both these banks have significant exposure to state-owned companies, which are treated as performing loans. However, as these banks are implicitly guaranteed by the state, their problems have not harmed the credibility of the rest of the banking system.

Private commercial banks and foreign banks operating in Sri Lanka generally follow more prudent credit policies and, as a group, are in better financial shape. Foreign banks tend to follow international best practices, as most foreign bank branches are subject to supervision in their own country in addition to that of the Sri Lankan Central Bank. Fitch maintains a stable sector outlook for the Sri Lankan banking sector for 2016, forecasting little or no deterioration in this sector's credit profile, even though operating conditions could worsen. Capital adequacy ratio (CAR) for the banking industry declined in 2014 but remained above the regulatory minimums of five percent and 10 percent set by the Central Bank of Sri Lanka for core CAR and total capital, respectively. The capital quality of Sri Lankan banks is generally high, consisting mostly of core capital. However, Sri Lankan bank CARs are overstated due to the absence of a capital charge on certain asset exposures including gold-backed loans and foreign currency-denominated exposures.

### **9. Competition from State-Owned Enterprises**

State Owned Enterprises (SOEs) are active in transport (bus and railways, ports and airport management, airline operations); utilities such as electricity; petroleum imports and refining; water supply; retail; banking; telecommunications; television and radio broadcasting; newspaper publishing; and insurance. Since the end of the war, Sri Lankan armed forces have begun operating air services, tourist resorts, and farms for civilian purposes, crowding out some private investment. In total, there are 245 SOEs of which 55 have been identified by the Sri Lanka Treasury as strategically important SOEs. SOEs employ over 221,000 people. There is widespread recognition that SOEs are poorly managed and in urgent need of reforms. SOEs make purchases from private companies and foreign firms and have easy access to credit from state-owned-banks and to government-owned land. SOEs do not

engage in research and development (R&D). The current government is keen to improve SOE management.

#### OECD Guidelines on Corporate Governance of SOEs

Sri Lanka has not taken a position on the OECD guidelines on corporate governance of SOEs.

The government has not specified an ownership policy for SOEs. Directors of SOEs are appointed by the Cabinet or a line ministry. The government allocates board seats to both senior government officials and politically-affiliated individuals. In the past, government-owned banks were required to take on debt from inefficient SOEs, forcing them to carry a greater share of non-performing loans. In addition, there are several large private banks in which multiple government entities own interest. On aggregate, therefore, these companies are majority government owned. By virtue of its shareholding, the government exerts control over the appointment of boards of directors and management of these banks. SOE governance structures are not strong. SOE senior managers usually report to politically-affiliated boards of directors and SOEs are often charged with operating based upon political agendas.

The new government has vowed to improve SOE governance and management. The government plans to bring all SOEs under a government-owned holding company. This holding company would be operated based on sound financial principles and market economics. A new Public Enterprise Act is to be enacted to provide the necessary legal framework to this effect.

#### Sovereign Wealth Funds

Sri Lanka does not have a sovereign wealth fund. Instead the government manages and controls large pension funds from private sector employees and uses these funds for budgetary purposes and stock market investments. In the past, the government and the Central Bank have been accused of misusing the Employees' Provident Fund (EPF), a large retirement fund of private sector workers managed by the Central Bank, for unwise stock market investments and to help supporters of the governing party. When funds are invested in stock market listed companies, government representatives have played an active role in the management of such companies. Experts argue the fund must be segregated from politics and professionalized. The new government has vowed to improve the management of the pension funds. SOEs and government-managed pension funds must meet Sri Lankan accounting standards.

### **10. Responsible Business Conduct**

The concept of Corporate Social Responsibility (CSR) is more widely recognized among Sri Lankan companies than the Responsible Business Conduct (RBC) initiative. Leading companies in Sri Lanka are actively promoting CSR, and some small and medium enterprises have also started to promote CSR. The Ceylon Chamber of Commerce, the largest business chamber in Sri Lanka, promotes CSR among its membership. Several organizations promote good business practices through programs and awards to recognize sustainability policies, good corporate governance, and sound management practices. Internationally, some of Sri Lanka's leading companies have joined the UN Global Compact initiative.

The apparel industry, Sri Lanka's largest export industry, has a specially designated CSR program for the industry under the title "Garments without Guilt" ([www.garmentswithoutguilt.com](http://www.garmentswithoutguilt.com)). The ethical sourcing and sustainable development practices under the program aim to empower women and their communities. In addition, the program endeavors to promote sustainable eco-friendly manufacturing practices.

The majority of private sector CSR programs in Sri Lanka are professional and competent, but the government does not regulate the programs. The SEC together with the ICASL published the "Code of Best Practices on Corporate Governance" in 2008 in order to establish good corporate governance practices in the Sri Lankan capital markets.

The government has not launched an initiative to promote RBC principles such as the OECD Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights endorsed by the UN Human Rights Council.

## **11. Political Violence**

The Sri Lankan government's military campaign against the Liberation Tigers of Tamil Eelam (LTTE) ended in May 2009 with the defeat of the LTTE. During the war, the LTTE had a history of attacks against civilians, although none of the attacks were directed against U.S. citizens. There have been no terrorist attacks since the end of the conflict. The government has authority throughout the island. Demonstrations take place in Sri Lanka from time to time in response to world events or local developments. Demonstrations near Western embassies are not uncommon. Protests aimed at Western embassies have been well-contained, with support from the Sri Lankan police and military.

### **Business-related Violence**

Business-related violence has not been notable over the last two years but there has been business-related violence in the past. In August 2013, a large rubber glove manufacturing factory was forced to move to a new location due to protests. Residents near the factory protested, alleging it had polluted water in the area. An army crackdown on protesters resulted in three deaths. In March 2014, residents near another rubber factory protested against water pollution. In mid-2013, a leading international food company temporarily suspended operations in Sri Lanka, citing precautionary measures to ensure the safety of its employees after it faced product bans, court cases, and angry demonstrators over the sale of contaminated milk powder. In 2013, a group of local politicians were charged with killing a Sri Lankan tea estate manager.

In May 2011, workers at the Katunayake Export Processing Zone (EPZ), the country's largest EPZ, held a large protest demanding the withdrawal of a proposed new pension plan covering all private sector employees. The protest led to a violent clash between workers and police. The clashes resulted in the death of one EPZ worker, injuries to a number of protestors and police officers, and damage to several factories. The government closed the EPZ for two days as a precautionary measure. Following the clash, the government withdrew the pension bill.

## **12. Corruption**

While Sri Lanka has generally adequate laws and regulations to combat corruption, enforcement is considered weak and inconsistent. U.S. firms identify corruption as a constraint on foreign investment but generally not a major threat to operating in Sri Lanka once contracts have been established. The business community claims that corruption has the greatest effect on investors in large projects and on those pursuing government procurement contracts. Some claim that the level of corruption makes it difficult to compete with bidders not subject to the U.S. Foreign Corrupt Practices Act. Projects geared toward exports face fewer problems. Local investors say internal controls do exist, although they are weak. The new government created new departments and agencies to investigate corruption allegations, mostly from the previous regime, and granted new resources to existing anticorruption departments. It also appointed the local head of Transparency International as a senior advisor on anticorruption matters. The government has introduced a Right to Information Act in Parliament to increase transparency.

The Commission to Investigate Allegations of Bribery or Corruption (CIABOC or Bribery Commission) is the main body responsible for investigating bribery allegations. The Bribery Commission institutes proceedings against responsible individuals in the appropriate court. The law states a public official's offer or acceptance of a bribe constitutes a criminal offense and carries a maximum sentence of seven years imprisonment and a fine at the discretion of the courts. A bribe by a local company to a foreign official is not covered by the Bribery Act.

In response to allegations of corruption during the previous Rajapaksa administration, the government has appointed a multitude of agencies and commissions to probe allegations.

Some of the newly created agencies are:

- Anti-Corruption Secretariat under the Prime Minister's Office
- A Presidential Commission of Inquiry to probe allegations of corruption and abuse of power
- Police Financial Crimes Investigation Division (FCID)
- State Asset Recovery Task Force (START)
- National Executive Council's Subcommittee on Corruption

*UN Anticorruption Convention, OECD Convention on Combatting Bribery*

Sri Lanka signed and ratified the UN Convention against Corruption in March 2004. Sri Lanka has signed but not ratified the UN Convention against Transnational Organized Crime. Sri Lanka is a signatory to the OECD-ADB Anti-Corruption Regional Plan, but has not joined the OECD Anti-Bribery Convention.

*Resources to Report Corruption*

Contact at Government Agency responsible for combating corruption:

- Dilrukshi Wickremasinghe, Director General
- Commission to Investigate Allegations of Bribery or Corruption
- No 36, Malalasekara Mawatha, Colombo 7
- Phone: 94-11- 2595039
- Email: dg bribery@gmail.com

Contact at watchdog organization:

- Chairman
- Transparency International, Sri Lanka
- 183/5 High Level Road, Colombo 6
- Phone: 94-11- 4369783???
- Email: tisl@tisrilanka.org

### 13. Bilateral Investment Agreements

The government of Sri Lanka has signed investment protection agreements with the United States (which came into force in May 1993) and with the following other countries: Australia, Belgium-Luxembourg, China, Denmark, Egypt, Finland, France, Germany, Indonesia, India, Iran, Italy, Japan, Korea, Kuwait, Malaysia, the Netherlands, Norway, Pakistan, Romania, Singapore, Sweden, Switzerland, Thailand, the United Kingdom, and Vietnam. Under Article 157 of the Sri Lankan Constitution, investment protection agreements enjoy the force of law, and no legislative, executive, or administrative action can contravene them

#### Bilateral Taxation Treaties

Sri Lanka signed a bilateral taxation treaty with the United States in 1985, which was amended in 2002. Information about the treaty can be found at:

<http://www.irs.gov/Businesses/International-Businesses/Sri-Lanka---Tax-Treaty-Documents>

The Embassy encourages prospective U.S. investors to contact an international auditing firm operating in Sri Lanka to assess their tax liability.

### 14. Foreign Trade Zones/Free Ports/Trade Facilitation

Sri Lanka has 12 free trade zones, also called export processing zones, administered by the BOI. In addition, a large private apparel company runs a fabric park. The company invites local and foreign companies to set up fabric and apparel factories in this eco-friendly park.

In the past, firms preferred to locate their factories near the Colombo harbor or airport to reduce transport time and cost. However, excessive concentration of industries around Colombo has caused heavy traffic, higher real estate prices, environmental pollution, and scarcity of labor. The BOI and the government now encourage export-oriented factories to set up in industrial zones farther from Colombo, although Sri Lanka's poor roads make these outlying zones more challenging.

### 15. Foreign Direct Investment and Foreign Portfolio Investment Statistics

Table 2: Key Macroeconomic Data, U.S. FDI in Host Country/Economy

	Host Country Statistical source		USG or international statistical source		USG or International Source of Data: BEA; IMF; Eurostat; UNCTAD, Other
	Year	Amount	Year	Amount	
Economic Data	2015	\$82,000	2014	\$78,820	<a href="http://www.worldbank.org/en/country">www.worldbank.org/en/country</a>
Host Country Gross Domestic					

Product (GDP) (\$M USD)					
Foreign Direct Investment	Host Country Statistical source		USG or international statistical source		USG or international Source of data: BEA; IMF; Eurostat; UNCTAD, Other
U.S. FDI in partner country (\$M USD, stock positions)	2014	NA	2014	\$111	BEA data available at <a href="http://bea.gov/international/direct_investment_multinational_companies_comprehensive_data.htm">http://bea.gov/international/direct_investment_multinational_companies_comprehensive_data.htm</a>
Host country's FDI in the United States (\$M USD, stock positions)	2014	NA	2014	NA	BEA data available at <a href="http://bea.gov/international/direct_investment_multinational_companies_comprehensive_data.htm">http://bea.gov/international/direct_investment_multinational_companies_comprehensive_data.htm</a>
Total inbound stock of FDI as % host GDP	2014	NA	2014	NA	.NA

Table 3: Sources and Destination of FDI

Direct Investment from/in Counterpart Economy Data						
From Top Five Sources/To Top Five Destinations (US Dollars, Millions), 2014						
Inward Direct Investment			Outward Direct Investment			
Total Inward	Amount	100%	Total Outward	Amount	100%	
Netherlands	1,861	18%	Singapore	295	49%	
U.K.	1,381	13%	Malaysia	175	29%	
India	996	9.5%	Maldives	30	5%	
Switzerland	851	8%	India	24	4%	
Mauritius	838	8%	Jordan	16	3%	

"0" reflects amounts rounded to +/- USD 500,000.

Table 4: Sources of Portfolio Investment

Portfolio investment data are unavailable for Sri Lanka.

## Section 5 - Government

### Chiefs of State and Cabinet Members:

For the current list of Chief of State and Cabinet Members, please access the following - [Central Intelligence Agency online directory of Chiefs of State and Cabinet Members of Foreign Governments](#)

### Legal system:

mixed legal system of Roman-Dutch civil law, English common law, and Jaffna Tamil customary law

### International organization participation:

ABEDA, ADB, ARF, BIMSTEC, C, CD, CP, FAO, G-11, G-15, G-24, G-77, IAEA, IBRD, ICAO, ICC (national committees), ICRM, IDA, IFAD, IFC, IFRCS, IHO, ILO, IMF, IMO, IMSO, Interpol, IOC, IOM, IPU, ISO, ITSO, ITU, ITUC (NGOs), MIGA, MINURSO, MINUSTAH, MONUSCO, NAM, OAS (observer), OPCW, PCA, SAARC, SACEP, SCO (dialogue member), UN, UNCTAD, UNESCO, UNIDO, UNIFIL, UNISFA, UNMISS, UNWTO, UPU, WCO, WFTU (NGOs), WHO, WIPO, WMO, WTO

## Section 6 - Tax

### Exchange control

For further information - <http://www.gov.lk/web/index.php?lang=en>

### Treaty and non-treaty withholding tax rates

For further information - <http://www.gov.lk/web/index.php?lang=en>

## Methodology and Sources

### Section 1 - General Background Report and Map

(Source: [CIA World Factbook](#))

### Section 2 - Anti – Money Laundering / Terrorist Financing

	Lower Risk	Medium Risk	Higher Risk
<a href="#">FATF List of Countries identified with strategic AML deficiencies</a>	Not Listed	AML Deficient but Committed	High Risk
<a href="#">Compliance with FATF 40 + 9 recommendations</a>	>69% Compliant or Fully Compliant	35 – 69% Compliant or Fully Compliant	<35% Compliant or Fully Compliant
<a href="#">US Dept of State Money Laundering assessment (INCSR)</a>	Monitored	Concern	Primary Concern
<a href="#">INCSR - Weakness in Government Legislation</a>	<2	2-4	5-20
<a href="#">US Sec of State supporter of / Safe Haven for International Terrorism</a>	No	Safe Haven for Terrorism	State Supporter of Terrorism
<a href="#">EU White list equivalent jurisdictions</a>	Yes		No
<a href="#">International Sanctions</a> <a href="#">UN Sanctions</a> / <a href="#">US Sanctions</a> / <a href="#">EU Sanctions</a>	None	Arab League / Other	UN , EU or US
<a href="#">Corruption Index (Transparency International)</a> <a href="#">Control of corruption (WGI)</a> <a href="#">Global Advice Network</a>	>69%	35 – 69%	<35%
<a href="#">World government Indicators (Average)</a>	>69%	35 – 69%	<35%
<a href="#">Failed States Index (Average)</a>	>69%	35 – 69%	<35%
<a href="#">Offshore Finance Centre</a>	No		Yes

### **Section 3 - Economy**

General Information on the current economic climate in the country and information on imports, exports, main industries and trading partners.

(Source: [CIA World Factbook](#))

### **Section 4 - Foreign Investment**

Information on the openness of foreign investment into the country and the foreign investment markets.

(Source: [US State Department](#))

### **Section 5 - Government**

Names of Government Ministers and general information on political matters.

(Source: [CIA World Factbook](#) / <https://www.cia.gov/library/publications/world-leaders-1/index.html>)

### **Section 6 - Tax**

Information on Tax Information Exchange Agreements entered into, Double Tax Agreements and Exchange Controls.

(Sources: [OECD Global Forum on Transparency and Exchange of Information for Tax Purposes](#) [PKF International](#))

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