

Commercial Bank of Ceylon PLC – PQ 116
Circular to Shareholders on Proposed Employee Share Option Plan – 2019
(ESOP-2019)

Dear Shareholder/s,

1. Business Case

(a) Background and Proposal

Commercial Bank of Ceylon PLC (the 'Company') has, with the approval of the Shareholders successfully implemented the three Employee Share Option Plans ('ESOPs') which were introduced during the years 2002 ['ESOP-2002'], 2008 ['ESOP-2008'] and 2015 ['ESOP-2015'] respectively. The said ESOPs, which had also received the approval of regulatory bodies were operated in accordance with the Guidelines set out by the Securities and Exchange Commission of Sri Lanka (the 'SEC') and the Colombo Stock Exchange (the 'CSE') and the said ESOP 2002 and ESOP 2008 were successfully concluded in 2006 and 2012 respectively and ESOP 2015 is still operative.

Given the success of the above ESOP schemes, which have been of mutual benefit to both employees and Shareholders of the Company, and, in keeping in line with modern international practices, the Company's Board of Directors propose to introduce an ESOP for the year 2019 ['ESOP-2019'], subject to regulatory and Shareholder approval being obtained therefor. It is to be noted that in comparison to the 2002 and 2008 ESOP schemes, the eligible employee coverage has been improved significantly, in this scheme.

Furthermore, ESOP-2019 has been structured with the professional assistance of NDB Investment Bank ['NDBIB']. The terms and conditions governing the ESOP-2019 are, as set out herein, subject however to the provisions of applicable Statutes, the Listing Rules of the CSE and other applicable rules and regulations of regulatory bodies and provided that any matter not expressly dealt with herein or which lacks clarity will, for purposes of administrative efficacy and clarity of this scheme, be determined at the discretion of the Company's Board of Directors [subject to such Board being constituted for this purpose only of the Non-Executive Directors] within the framework of the Report provided by NDBIB to establish ESOP-2019.

ESOP-2019 will come into effect from January 30, 2020 [subject to all necessary approvals being obtained therefor] and will lapse on September 30, 2024.

(b) Global Trends

ESOPs are increasingly used in the corporate world as an effective tool to align employee interests with Shareholder expectations by enabling employees to take part in the share ownership of the Company.

(c) Benefits to Shareholders and to the Company

As you are aware your Company has been performing consistently well, recording profits viz. Rs.14.51Bn, Rs.16.58Bn and Rs.17.54Bn in the years 2016, 2017 and 2018 respectively. These successes of the Company are largely due to the efforts and contributions made by the employees, in particular the Executive Officers in Grade 1A and above, whose efforts have been highly appreciated by the Shareholders at General Meetings of the Company.

The ESOP-2019 is proposed by the Board of Directors in aiming at further motivating the employees, so that they would continue to maintain the growth momentum of the Company and push the Company into new heights in the future with consequential direct and indirect benefits to Shareholders. The Board of Directors is confident that the employees motivation generated through the proposed ESOP-2019 will contribute substantially towards the success of your Company in out-performing the local market, in terms of business growth, profitability and market capitalisation of its shares.

2. Quantum of Share Options to be Issued

Under the proposed ESOP-2019, the Company will allocate up to 2% of the total issued and fully-paid ordinary [voting] shares of the Company amounting to 19,225,046 (subject to exercise of existing ESOPs and due to any further issues the company may decide to opt.). This equity allocation would be issued to employees in the form of share options in a maximum of three (03) tranches, each spread over a period of three (03) years, commencing from 2020. The ESOP-2019 will lapse in 2024.

The first two tranches would amount to a maximum of 0.5% each, whilst the third tranche would amount to a maximum of 1%, of the ordinary (voting) shares in issue as at the respective grant date [i.e. the date on which the share options are offered/granted to the employees]. The Company's Board of Directors will, however,

have the discretion to decide on the exact size of an annual tranche up to the said limits to be granted in a financial year, depending on the extent of achievement of the qualifying criteria by the Company in the previous year, as detailed in Section 3 below (subject however to the 2nd paragraph of Section 4 below). If the quantum of share options offered in a given year is less than the abovementioned maximum amounts of 0.5% or 1%, the remainder which has not been offered in a given year will remain unissued.

The Company shall make provisions in the scheme for the adjustment of the exercise price/ the number of shares underlying the options that have not been exercised in the event of an increase in the total number of shares of the Company (e.g. right issues, issue of shares credited as fully paid-up by way of capitalization of reserves and sub division of shares); or decrease in the total number of shares of the Company (e.g. consolidation of shares and repurchase of shares) which occur during the vesting period and the exercise period.

3. Qualifying Criteria that the Company should satisfy to proceed with ESOP-2019

(a) Profitability

- i. The Bank should achieve the annual budgeted profit after tax for the respective financial years commencing from 2018 for eligible employees to be entitled for share options.
- ii. The Company's percentage growth of Profit After Tax (PAT) in a financial year should exceed the average of percentage growth of PAT disclosed by the competitor banks in their Annual Reports during the same period. However, PAT of the Company and competitor banks will be adjusted on account of the foreign currency transaction gains/losses, if any, arising from their overseas banking operations, and which are currently recognised in the Statement of Changes in Equity, as per the Accounting Standards.

These competitor banks for 2019 will be Hatton National Bank PLC, The Hongkong and Shanghai Banking Corporation Ltd - Sri Lanka Branch, Sampath Bank PLC, National Development Bank PLC and Seylan Bank PLC. The Board of Directors has the authority to amend the list of comparator banks, depending on the market conditions and other relevant issues.

(b) Return on Equity (ROE)

There are two sub-criteria to be fulfilled in this connection-

- (i) The Company's ROE for a financial year measured as per the following formula should exceed the required ROE of the Company, to be decided by the Board of Directors of the Company.

$$\text{ROE} = \frac{\text{Profit After Tax}}{\text{Average of quarterly book value of Equity (Shareholders' funds)}} \times 100$$

Required ROE = Simple average of the weekly published weighted average rates of interest (after tax) on one (01) year Treasury bills during the applicable financial year (risk free rate) + an equity risk premium to be determined by the Board of Directors between 5% to 7% which will be communicated to the eligible employees annually in advance.

- (ii) ROE of the Company, measured as per the formula in 3(b)(i) above for a financial year should exceed the average (pooled) ROE of comparator banks during the same period, to be calculated using the same formula referred to in 3(b)(i) above.

(c) Compliance

The Company should fulfill all the following compliance requirements:

- i. To obtain an unqualified audit opinion from the external Auditors;
- ii. To fulfill the Regulatory Requirements on Capital Adequacy, Liquid Assets and Statutory Reserve Requirements of the Central Bank of Sri Lanka (the 'CBSL'), without any material breach;
- iii. To classify the Non Performing Loans properly;
- iv. To make provisions on Non Performing Loans accurately;
- v. To adhere to the rules of the CSE and the SEC; and
- vi. To adhere to the applicable provisions of the Mandatory Corporate Governance Code of the CBSL.

Fulfillment of the above compliance criteria should be established from the disclosures made in the Directors' and Auditors' Reports contained in the Company's Annual Report.

4. How to be Eligible for ESOP-2019

From 2019 onwards the Company will be required to fulfill any two of the four criteria referred to in 3(a), 3(b)(i) and 3(b)(ii) above in the financial year applicable, in addition to the compulsory fulfillments of the criterion on Compliance, referred to in 3(c)above.

An employee of the Company shall not be entitled to acquire through ESOPs more than one per centum (1%) of the total number of shares issued by the Company at any given time.

Hence, share options under the annual tranches up to a maximum of three (03) will be granted during the period from 2020 to 2021. Any share options not allocated during this period, due to the Company not achieving the above qualifying criteria will be cancelled.

5. Share Option Grant Dates

Share options under the First (1st) tranche of the ESOP-2019, shall, in respect of the year 2018, be offered on January 30, 2020. Thereafter, options under the remaining tranches will be offered on April 01 each year until the conclusion of the maximum of three (03) tranches of the ESOP-2019, the last being on April 01, 2021.

6. Share Option Allocations to Individual Employees – Eligibility Criteria

For an employee to be eligible for share options under a particular tranche of the ESOP -2019, he/she should be an Executive Officer in Grade 1A and above and the Corporate Management including the Chief Executive Officer (CEO) of the Company and having a performance grading of 'Very Good' or above in the annual performance assessment system of the Company for the applicable year.

7. Vesting Period

Once the share options are granted for 2020 and 2021 the eligible employee should remain in the employment from January 30, 2020 to June 30, 2020, from April 01, 2020 to September 30, 2020 and April 01, 2021 to September 30, 2021 respectively for them to be able to exercise each option of ESOP-2019. Hence, every tranche will have the following vesting schedule:

Tranche	% of Voting Shares Issued (maximum)	Period of Performance Evaluation	Option Grant Date (Assumed)	Date of Vesting	Exercise Period
1	0.5%	FY 2018	30/01/2020	30/06/2020	01/07/2020 to 30/06/2023
2	0.5%	FY 2019	01/04/2020	30/09/2020	01/10/2020 to 30/09/2023
3	1.0%	FY 2020	01/04/2021	30/09/2021	01/10/2021 to 30/09/2024

7.1. Early Vesting

In the event of retirement or death of an eligible employee, there will be an immediate vesting of all the options granted to the respective eligible employee.

8. Exercise Period

This is the period which follows the vesting period, during which an eligible employee could exercise the share options to purchase the ordinary [voting] shares of the Company at the pre-determined exercise price, as detailed in Section 9 below.

The exercise period applicable after each of the vesting periods referred to in Section 7 above would be three (03) years. Accordingly, the exercise period schedule of the ESOP-2019 would be as follows, assuming that options under each of the annual tranches will be issued up to the full 0.5% in the first two tranches and the full 1% in the third tranche, in the consecutive years 2020 and 2021.

Tranche	% of Voting Shares Issued (maximum)	Period of Performance Evaluation	Option Grant Date (Assumed)	Date of Vesting	Exercise Period
1	0.5%	FY 2018	30/01/2020	30/06/2020	01/07/2020 to 30/06/2023
2	0.5%	FY 2019	01/04/2020	30/09/2020	01/10/2020 to 30/09/2023
3	1.0%	FY 2020	01/04/2021	30/09/2021	01/10/2021 to 30/09/2024

Any options not exercised during the applicable period will be cancelled, subject to the vesting arrangements applicable for eligible employees on retirement and/or death [such vesting arrangements and applicable Exercise Periods shall be

determined at the discretion of the Company's Board of Directors (subject to such Board being constituted for this purpose only of the Non-Executive Directors)].

However, in the event of resignation of an employee prior to vesting (as detailed in Section 7 above), any options offered to him, but not vested will be cancelled, allowing him to exercise only the vested but unexercised options, if any. On the other hand, in the event of dismissal or serious disciplinary action being taken against a particular employee, all vested but unexercised options, if any, as at the date of dismissal/date on which disciplinary action is taken [including where the employee voluntary resigns due to such factors] would be cancelled.

9. Share Option Exercise Price

All share options will be offered at a predetermined price. However, in order to ensure that the Company would receive a fair value, the share options will be priced at a volume-weighted average market price considering all share transactions of the Company's ordinary (voting) shares, during the period of thirty (30) market days, immediately prior to each option grant date.

However, in the event of a Bonus Issues [Capitalisation of Reserves], Stock Dividends, Rights Issues and/or Sub-division/Consolidation of shares by the Company during the applicable vesting periods of the ESOP-2019, the share option exercise price of the affected tranches will be adjusted as per the applicable rules of the ESOP-2019 which have been drafted in accordance with the accepted market practices and in accordance with Rule 5.6.6 (a)(iv) of the CSE Listing Rules.

10. Financial Support to Purchase Shares Under the ESOP-2019

Board of Directors confirms that neither the Company nor its subsidiaries will provide any direct or indirect financial support to the Company's employees to purchase shares under the proposed ESOP-2019.

The employees holding shares issued under any previous ESOPs which were funded by the Company or any of its subsidiaries and an employee share trust, shall not participate in voting at the Extraordinary General Meeting to be held on January 30, 2020.

11. Accounting and Financial Reporting Implications to the Company Under the ESOP-2019

The Company is mindful of the “Sri Lanka Accounting Standard - SLFRS 2 Share-based Payments” which sets out the financial reporting implications to an entity when it undertakes a share-based payment transaction. In particular, it requires an entity to reflect in its profit and loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. This has been modelled after IFRS 2 - Share Based Payments.

At the grant date of the options, the Company is required to recognise the value of the share options granted to employees through the ESOP-2019. The value of the share options should be calculated using an option valuation model. SLFRS 2 recommends using either Black-Scholes-Merton Model or Binomial Option Valuation Models for this purpose. NDBIB has estimated the value of the options using the Binomial Model of option valuation.

The value of the options should be amortised over the vesting period. Assuming that the impact to the Statement of Comprehensive Income for the first year as per Auditor’s estimates is Rs.113.52Mn. which could however be amortised over the vesting period of three (03) years. Furthermore, there will be no outgoing from the Company in this connection, as the accounting entries to be passed for this purpose will be a debit to the Income Statement, whilst credit is placed in the equity account of the Company.

12. Tax Implications

The profit and loss impact mentioned above in each financial year will not be treated as tax deductible expenses for the Corporate Tax purposes and Financial Value-Added Tax (VAT) purposes since the expenses mentioned above will not be made in the form of cash/monetary means in the hands of employees. However, for Pay As You Earn (PAYE) tax purposes such expenses will be treated as employment benefits at the point of option exercise by the employees, hence, will warrant tax deduction according to each employee’s effective tax rate.

13. Appointment of Managers to the ESOP – 2019

The Company will arrange to appoint independent Managers with no conflict of interests, to manage and monitor the proposed ESOP-2019.

14. Consideration for the Issue of Shares

As required by Section 52 of the Companies Act No. 07 of 2007, the Board has resolved that in its opinion that the consideration, for which the Company's ordinary [voting] shares are proposed to be issued, is fair and reasonable to the Company and to all existing Shareholders.

Such consideration will be equivalent to the volume weighted average market price considering all share transactions of the Company's ordinary [voting] shares, during the period of thirty (30) market days, immediately prior to each option grant date.

15. Approvals

(i) Listing Rules of the CSE

The Board of Directors of your Company, having considered the above implications and overall benefits to the Company and its employees arising from the proposed ESOP-2019, is pleased to recommend ESOP-2019, which has been approved by them, to the Shareholders for their formal approval.

As per Listing Rule 5.6 of the Listing Rules of the CSE, the prior approval of the Shareholders, by way of a special resolution at a General Meeting must be obtained for the purpose of creating or establishing a scheme such as ESOP-2019. Accordingly, an Extraordinary General Meeting has been convened for January 30, 2020 for this purpose and the proposed resolutions to be passed thereat is set out in the attached Notice of Meeting, for the consideration and due adoption by the Company's Shareholders thereat. Subject to the above, your Directors have obtained 'in principle' approval of the CSE, for the listing of the ordinary [voting] shares to be allotted and issued under the ESOP-2019.

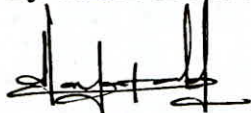
(ii) Requirements under the Companies Act No. 07 of 2007 and the Articles of Association of the Company

In terms of Article 9 A of the Company's Articles of Association, the Company's Shareholders have a pre-emptive right to new issues of shares, unless otherwise resolved to by way of an ordinary resolution. Since new ordinary [voting] shares will be issued under ESOP-2019, the requisite resolution to be passed by Shareholders waiving their pre-emptive rights thereto is set out in the attached Notice of

Meeting, for due consideration and adoption by the holders of the Company's ordinary (voting) shares.

Approval is also sought of the holders of the Company's ordinary [voting] shares by way of a special resolution, in relation to the allotment and issue of new ordinary [voting] shares under the ESOP-2019, in pursuance of Section 99 of the Companies Act No. 07 of 2007 and Article 10 of the Company's Articles of Association. The requisite resolution to be passed in this regard is set out in the attached Notice of Meeting, for due consideration and adoption by the holders of the Company's ordinary (voting) shares.

By Order of the Board of Commercial Bank of Ceylon PLC



R A P Rajapaksha
Company Secretary

January 06, 2020
Colombo

January 06, 2020

COMMERCIAL BANK OF CEYLON PLC – PQ 116**NOTICE OF MEETING****EXTRAORDINARY GENERAL MEETING****EMPLOYEE SHARE OPTION PLAN – 2019**

NOTICE IS HEREBY GIVEN that an Extraordinary General Meeting of Commercial Bank of Ceylon PLC will be held on January 30, 2020 at 10.30 a.m. at Sapphire Banquet Hall, Bandaranaike Memorial International Conference Hall (BMICH), Baudhaloka Mawatha, Colombo 07 for the following purposes:

1. ESTABLISHMENT OF THE EMPLOYEE SHARE OPTION PLAN - 2019 - Resolution No. 1

To consider and if thought fit to pass the following resolution by way of a Special Resolution:

“**THAT** the Employee Share Option Plan - 2019 as detailed out in the ‘Circular to the Shareholders - Employee Share Option Plan (ESOP) - 2019’ dated January 06, 2020 be established by Commercial Bank of Ceylon PLC subject to and based on the terms and conditions stated therein”.

2. WAIVER OF PRE-EMPTION RIGHTS TO NEW SHARES TO BE ISSUED UNDER THE EMPLOYEE SHARE OPTION PLAN - 2019 TO PARTIES, OTHER THAN EXISTING SHAREHOLDERS - Resolution No. 2

To consider and if thought fit to pass the following resolution by way of an Ordinary Resolution:

“**THAT** the Board of Directors of Commercial Bank of Ceylon PLC [the “Company”] be and is hereby empowered and authorized to allot and issue from time to time new ordinary voting shares under and in pursuance of the Employee Share Option Plan (ESOP) - 2019, established in terms of the ‘Circular to Shareholders - Employee Share Option Plan (ESOP) - 2019’ dated January 06, 2020, subject to and based on the terms and conditions stated therein, and accordingly the pre-emptive rights of the Shareholders in relation to new share issues and the consequent necessity to offer such new shares first to the Company’s Shareholders pro-rata to their existing shareholding and in a manner which would, if accepted, maintain the relative voting and distribution rights of such Shareholders be and is hereby waived in pursuance of Article 9 A of the Company’s Articles of Association”.

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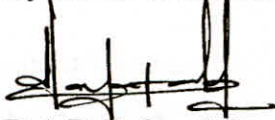
3. APPROVAL UNDER SECTION 99 OF THE COMPANIES ACT NO. 7 OF 2007 & ARTICLE 10 OF THE ARTICLES OF ASSOCIATION - Resolution No. 3

To consider and if thought fit to pass the following resolution by way of a Special Resolution:

“**THAT** the allotment and issue as may occur from time to time of new ordinary voting shares by the Board of Directors of Commercial Bank of Ceylon PLC [the “Company”] under and in pursuance of the Employee Share Option Plan (ESOP) - 2019, established in terms of the ‘Circular to Shareholders - Employee Share Option Plan (ESOP) - 2019’ dated January 06, 2020, subject to and based on the terms and conditions stated therein, be and is hereby approved for purposes of Section 99 of the Companies Act No. 7 of 2007 and Article 10 of the Articles of Association of the Company; and

THAT accordingly the Company’s Management be and is hereby authorized to take all necessary steps to give effect to the above”.

By Order of the Board of Commercial Bank of Ceylon PLC



R.A.P. Rajapaksha
Company Secretary

January 06, 2020
Colombo

Notes :

- (i) A Shareholder entitled to attend, speak and vote at the meeting is entitled to appoint a Proxyholder to attend, speak and vote in his/her stead and a Shareholder who is entitled only to attend and speak at the meeting is entitled to appoint a Proxyholder to attend and speak on his/her behalf. A Proxyholder need not be a Shareholder of the Company.
- (ii) A form of Proxy is sent along with this Notice. The completed Form of Proxy should be deposited at the Registered Office of the Company, “Commercial House”, No. 21, Sir Razik Fareed Mawatha, Colombo 01, not less than 48 hours before the time appointed for the holding of the Meeting.