



**GOVERNING BOARD
CENTRAL BANK OF SRI LANKA**

07 November 2025

FINANCE BUSINESS ACT DIRECTIONS

No.03 of 2025

LIQUIDITY RISK MANAGEMENT

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| 1. Legal provisions | 1.1 In terms of the powers conferred by Section 12(1) of the Finance Business Act, No. 42 of 2011 read with the Section 133(1) of the Central Bank of Sri Lanka Act, No. 16 of 2023, the Central Bank of Sri Lanka (CBSL) hereby issues these directions on Liquidity Risk Management to Finance Companies (FCs) licensed under the Finance Business Act, No. 42 of 2011. |
| 2. Objectives of the directions | 2.1 Establishing a robust liquidity risk management framework in FCs through formulation of a liquidity risk management strategy, liquidity risk management policy and procedures, liquidity risk governance structure and effective liquidity risk management process to identify, measure, monitor and report, control and mitigate liquidity risk. |
| 3. Applicability | 3.1 These directions outline the key principles and minimum requirements for sound liquidity risk management framework and FCs shall adopt the principles and practices provided in these directions.

3.2 The FCs with assets of Rs. 100 billion and above shall comply with these directions with effect from 01.04.2026 and FCs with assets less than Rs. 100 billion shall comply with these directions with effect from 01.04.2027. |
| 4. Liquidity risk management framework | 4.1 The FC shall establish a robust liquidity risk management framework that is well integrated into its overall risk management framework.

4.2 The liquidity risk management framework shall take into account inter alia the nature, size and complexity of business operations of FC, including the factors such as business model, risk profile, short-to-long-term strategies, products, customer profile, level of off-balance sheet exposures, geographic coverage and currencies in which FC transacts. |



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- 4.3 The liquidity risk management framework shall ensure that FC maintains an adequate level of liquid assets to meet its day-to-day liquidity requirements and remain resilient during periods of financial stress.
- 4.4 The liquidity risk management framework of FC shall at least contain the following elements:
- a) Liquidity risk management strategy, and liquidity risk management policy and procedures;
 - b) Liquidity risk governance structure; and
 - c) Liquidity risk management process.
- 4.5 **Liquidity risk management strategy, and liquidity risk management policy and procedure**
- a) **Liquidity risk management strategy**
 - i. The FC shall develop a liquidity risk management strategy that sets out the general approach to be adopted in managing its liquidity risk consistent with its business goals and liquidity risk tolerance level, in terms of the risk appetite statement approved by the Board of Directors (BoD) of FC.
 - ii. At a minimum, the liquidity risk management strategy shall outline the following:
 - (a) Clear goals and objectives underlying the strategy;
 - (b) Desirable composition and maturity profile of assets and liabilities;
 - (c) Desirable level of diversity and stability of funding sources;



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- (d) Approach to be adopted in the event of liquidity shortfall, including the withdrawal of available liquidity support and the availability of contingency funding options.
- (e) Approaches to day-to-day liquidity management; and
- (f) Key assumptions on the liquidity and marketability of assets, under both normal and stress conditions, including a broader framework for liquidity stress testing.
- iii. The FC shall ensure that its liquidity risk management strategy is forward-looking and aligns with long-term business objectives, while taking into account the business cycle, as well as its impact on the composition and quality of the FC's liquid asset portfolio.
- b) Liquidity risk management policy and procedures**
- i. The FC shall develop and implement a comprehensive liquidity risk management policy, to effectively identify, measure, monitor and report, control and mitigate liquidity risk across various time horizons, including day-to-day requirements.
- ii. This policy shall be well defined, documented, and consistent with the regulatory requirements and best practices, while adequately capturing the liquidity risks arising from the nature, scale and complexity of FC's operations.



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- iii. The policy shall ensure the maintenance of adequate liquidity buffers and facilitate transparent public disclosures.
 - iv. The policy and procedures shall be reviewed and approved by the BoD at least annually, and whenever necessary, taking into consideration the changes in FC's risk profile and evolving market conditions.
 - v. At a minimum, the liquidity risk management policy and procedures of FC shall include:
 - (a) Sound day-to-day liquidity risk management practices;
 - (b) Clear governance structure for liquidity risk management, specifying reporting lines and accountabilities;
 - (c) Liquidity risk management tools for identifying, measuring, monitoring and reporting, controlling and mitigating liquidity risk. These liquidity risk management tools may include, but shall not be limited to, various ratios and limits (e.g.: credit-to-deposit ratio, liquid assets to short term liabilities, liquid assets to external funds, level of liquidable assets, etc.), maturity gap analysis, cash flow projections, stress testing and Early Warning Indicators (EWI). These tools shall align with FC's risk appetite, funding profile, and regulatory requirements, and shall be established based on, at a minimum, forecasts



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derived from historical data, results of stress testing and operational liquidity needs;

- (d) Contingency Funding Plan (CFP) to address potential liquidity shortfalls and manage liquidity stress events effectively;
- (e) Mechanisms for independent review, such as internal audits, to assess the effectiveness of the liquidity risk management framework, including policy and procedures and the level of compliance with the policy and procedures; and
- (f) Risk reporting.

4.6 Liquidity risk governance structure

- a) The FC shall have a robust liquidity risk governance structure for successful implementation of an effective liquidity risk management framework.
- b) The BoD / Board Integrated Risk Management Committee (BIRMC) shall play a crucial role in overseeing the prudent management of liquidity risk of FC. The responsibilities of the BoD / BIRMC shall include at a minimum:
 - i. Developing a documented liquidity risk management strategy that clearly articulates FC's risk appetite;
 - ii. Approving and reviewing the policy and procedures relating to liquidity risk management;
 - iii. Ensuring that FC has adequate resources and systems to identify, measure, monitor and report, control and mitigate all sources of liquidity risk;
 - iv. Overseeing the implementation and maintenance of a robust Management Information System (MIS) that



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- commensurates with the FC's scale, complexity, and risk profile, and effectively supports day-to-day as well as short, medium, and long-term liquidity risk management strategies.
- v. Ensuring effective communication of the liquidity risk management strategy, policy and procedures across FC and adherence by all relevant staff in FC to such strategy, policy and procedures;
 - vi. Monitoring FC's overall liquidity risk profile and performance in a timely manner; and
 - vii. Regularly reviewing stress testing results on liquidity risk conducted by FC.
- c) The responsibilities of the Asset and Liability Management Committee (ALCO) of FC shall include at a minimum;
- i. Adopting the liquidity risk management strategy set out by BoD/ BIRMC;
 - ii. Developing the liquidity risk management policy and procedures and implementing such policy and procedures with the approval of BoD;
 - iii. Ensuring that all relevant officers responsible for managing liquidity risk understand the strategy, policy, procedures and processes on liquidity risk management;
 - iv. Ensuring the effective contribution of the risk management, and treasury functions to liquidity risk management, while maintaining a clear segregation of duties relating to the treasury function (i.e. front office, middle office and back-office functions);



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- v. Ensuring the development, implementation, and continuous enhancement of MIS to support effective liquidity risk identification, monitoring, and reporting in line with the liquidity risk management strategy and the oversight requirements of the BoD;
- vi. Establishing effective internal controls, and a reporting framework relating to the liquidity risk management process; and
- vii. Ensuring that EWIs are monitored at least on a quarterly basis under normal conditions, and more frequently during periods of market stress or elevated liquidity risk, to facilitate timely identification of emerging vulnerabilities.

4.7 Liquidity risk management process

The FC shall have a sound process for identifying, measuring, monitoring and reporting, controlling and mitigating liquidity risk. This process shall include a robust framework for comprehensively projecting cash flows arising from assets, liabilities and off-balance sheet items over an appropriate set of time horizons. At a minimum, the liquidity risk management process shall formalize FC's approach to the followings:

a) Identification

- i. The FC shall have a process for identification of the liquidity risk arising from both on- balance sheet and off-balance sheet positions, including contingent liabilities, loan commitments, and other contractual obligations, that could impact FC's cash flows and funding requirements under various scenarios.



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- ii. The FC shall evaluate each major on-balance sheet and off-balance sheet product, considering embedded options and other contingent exposures, that may affect FC's sources and uses of funds.
 - iii. The FC shall design, implement, and regularly review a set of EWIs to proactively identify the emergence of liquidity risk and take timely corrective action to safeguard FC's liquidity position. These indicators may include, but not limited to, significant decline in liquid asset ratios, unusual increase in deposit withdrawal rates, rising funding costs, deterioration in asset quality, and increasing cash flow mismatches.

b) Measurement

- i. The FC shall use stock-based and flow-based approaches to measure the liquidity risk. The stock-based approach shall focus on assessing the adequacy of stock of liquid assets relative to potential cash outflows. The flow-based approach shall track and project cash flow mismatches over different time horizons to evaluate the timing and extent of liquidity needs.
- ii. The FC shall analyze the cash flows categorized into different time periods based on;
 - (a) **Contractual maturity**, which reflects the legally agreed-upon repayment dates of assets, liabilities, and off-balance sheet items; and
 - (b) **Behavioral maturity**, of on-balance sheet and off-balance sheet items, which considers the expected timing of cash flows based on the



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actual behavior of customers and counterparties, historical trends, and other relevant factors that may cause deviations from contractual terms.

- iii. The FC shall establish tolerance levels/prudential limits for cash flow mismatches across the time periods, approved by the BoD/BIRMC of FC, considering its risk appetite, assets and liability profile, market conditions, etc.
- iv. The FC shall document the assumptions used in cash flow projections and liquidity risk management. The FC shall conduct variance analyses/back testing at least semi-annually to validate the assumptions used in behavioral analysis and refine the assumptions/behavioral analyses to enhance accuracy of the predictions about future behavior of on-balance sheet and off-balance sheet items.

c) Monitoring and reporting

- i. The FC shall monitor its liquid assets position, including intraday liquidity, on an ongoing basis by reviewing mismatch reports and tracking short-term and cumulative mismatches across all time buckets.
- ii. The FC shall monitor its expected daily gross liquidity inflows and outflows to ensure that FC has adequate liquidity to meet its funding requirements throughout the day, and reliable funding mechanisms to meet operational and unexpected liquidity needs.



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- iii. The FC shall establish an internal reporting mechanism to provide regular updates to BoD/BIRMC/ALCO and relevant senior management on liquidity risk exposure and compliance with internal prudential limits. This reporting mechanism shall deliver accurate, timely, and forward-looking information that supports day-to-day liquidity risk management and facilitates the monitoring of compliance with FC's established policies, procedures and limits.
- iv. The FC shall perform stress tests on liquidity risk in the context of stressed macro-economic and financial conditions, on a quarterly basis or more frequently, as necessary, depending on the circumstances. Stress test results shall be used to adjust FC's liquidity risk management strategies, policies and risk profiles and to formulate effective CFPs.
- v. The FC shall have formal CFP outlining strategies for addressing liquidity shortfalls during emergencies. The CFP shall clearly set out policies for managing a range of stress scenarios, clear lines of responsibility, and clear invocation (a process for activating CFP) and escalation (a process for progressively enhancing the response and decision-making authority as liquidity stress intensifies from low to moderate or high risk) procedures.

d) Control and mitigation

- i. The FC shall set appropriate limits to control its liquidity risk, in line with its liquidity risk appetite. Such limits shall also be relevant to the business of FC in terms of



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the concentration of exposure to the activity, nature of financial products, currencies and markets served. The FC shall regularly review such limits and corresponding escalation procedures.

- ii. The FC shall use the limits set in accordance with direction 4.7 d) (i) for managing day-to-day and intraday liquidity positions of FC. Breaches of liquidity risk limits shall be escalated to higher levels of senior management, BIRMC and BoD, with each level required to propose and implement appropriate corrective measures to address such breaches.
- iii. The FC shall carry out regular reviews and independent assessments through its dedicated internal audit or risk management functions to ensure compliance with the approved liquidity risk management policy, internal procedures, and applicable regulatory requirements. These reviews shall also evaluate the effectiveness of the liquidity risk management process and its alignment with the FC's overall risk appetite and strategic objectives.

5. Disclosure

- 5.1 The FC shall provide key elements of its liquidity risk management framework and relevant information to stakeholders enabling them to make an informed decision about the soundness of its liquidity risk management framework and liquidity profile, under the management report in annual report of FC or website of such FC.
- 5.2 The FC shall include key liquidity risk indicators and relevant updates in the FC's quarterly and half-yearly financial statements to ensure stakeholders have timely and up-to-date information.



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- 6. Reporting on Material Developments**
- 6.1 The BoDs of FC shall report to the Director, Department of Supervision of Non-Bank Financial Institutions of any material developments in FC, such as drastic decline in liquid assets, a liquidity crisis or any other factor that could harm FC's ability to meet financial obligations, that may adversely impact the FC's liquidity risk profile and measures implemented/ to be implemented by FC to minimize such impacts.

A handwritten signature in black ink, appearing to read 'Nandalal Weerasinghe', with a long horizontal stroke extending to the right.

Dr. P Nandalal Weerasinghe
*Chairman of the Governing Board and
Governor of the Central Bank of Sri Lanka*