

BOX 03

Banking Sector Consolidation for Promoting Resilience and Stability in the Banking Sector

Background

The banking sector in Sri Lanka, which consists of 24 licensed commercial banks and 6 licensed specialised banks with an asset base of nearly Rs. 25 trillion as at end of 2025, dominates the financial system, holding the largest share of the total assets (61%) in the financial system. At present, only 5 licensed banks (LBs) have been designated as Domestic Systemically Important Banks (D-SIBs) in Sri Lanka based on size, interconnectedness, substitutability, and complexity. At the same time, several LBs in Sri Lanka continue to remain relatively small in terms of assets size and capital base. This structural limitation constrains their capacity to absorb financial shocks and to withstand periods of economic stress with resilience. In this context, the presence of larger banks with stronger balance sheets, diversified portfolios, and robust governance and risk management frameworks has become increasingly important. Such institutions would enhance the overall resilience of the banking sector by mitigating the risk of spillovers to the real economy. Moreover, this would also facilitate a stronger presence in Sri Lanka's banking sector in international markets, while further reinforcing public confidence.

Regional Experience on Consolidation of the Financial Sector¹

Drawing on the Asian experience, several countries in the region have undertaken banking sector consolidation as a measure to strengthen their financial systems and support sustained economic growth. For instance, India has pursued consolidation through a series of bank mergers aimed at enhancing efficiency, improving profitability, and strengthening the global competitiveness of its Banks, while contributing to strengthening the national economy. Accordingly,

government-led consolidation efforts in India have reduced the number of public sector banks from 27 in 2017 to 12 by 2020, thereby enabling the larger public sector banks to evolve into stronger, more resilient and more competitive institutions. Nepal Rastra Bank also introduced a merger policy in 2011 resulting in reducing the number of financial institutions in Nepal. Singapore implemented banking sector consolidation in the early 2000's alongside a banking sector liberalization programme. This process reduced 6 local banking Groups into 3 main local banking Groups (i.e., DBS Bank Ltd., Oversea-Chinese Banking Corporation Ltd. and United Overseas Bank Ltd.). It led to a more consolidated banking landscape that remains at present, thereby strengthening the banks' capabilities, building efficient management teams, and enhancing overall operational efficiency and effectiveness. A similar consolidation programme was undertaken by Malaysia in 1997 to streamline its financial sector. By 1998, the number of finance companies was reduced from 39 to 8, and all finance companies eventually merged with commercial banks. By 2000, 50 out of 54 banking institutions in Malaysia were consolidated into 10 banking Groups. Moving on, similar financial sector consolidation efforts have been observed across several other Asian countries including Thailand, South Korea, Indonesia and Philippines particularly in the aftermath of the Asian Financial Crisis.

Sri Lanka has also had its own experience with financial sector consolidation, undertaking a programme in 2014 led jointly by the Central Bank and the Government, as announced in the Government Budget for 2014. The programme primarily targeted non-bank financial institutions, and despite several successful mergers, it was subsequently placed on hold pending further review. However, during 2015, DFCC Bank merged with DFCC Vardhana Bank to form DFCC Bank PLC, while MBSL Savings Bank Ltd., Merchant Bank of Sri Lanka PLC and MCSL Finance Services Ltd. amalgamated to form a Licensed Finance Company, namely, Merchant Bank of Sri Lanka & Finance PLC which is a

1 Sources:

- Annual Report of Central Bank of Sri Lanka, 2014 and 2015.
- Deepthi, C. A., Sindhu, K. P. & John, B. M., 2024. Public Sector Bank Mergers in India since 2020. *Journal of Visual and Performing Arts*, 5(1), pp. 3510-3515. Available at https://www.researchgate.net/publication/395982482_PUBLIC_SECTOR_BANK_MERGERS_IN_INDIA_SINCE_2020
- Nepal Rastra Bank, 2022. Optimal number of banks and financial institutions in Nepal. Available at <https://www.nrb.org.np/contents/uploads/2022/04/Optimal-Number-of-Banks-and-Financial-Institutions-in-Nepal.pdf>
- Speech by Siriwardana, C. J. P., former Assistant Governor of the Central Bank of Sri Lanka on Financial Sector Consolidation – Why and How? at the Central Bank of Sri Lanka 64th anniversary oration, September 2014. Available at <https://www.bis.org/review/r141103g.pdf>

subsidiary of the Bank of Ceylon. Further in 2019, Lankaputhra Development Bank Ltd. was merged with Pradeshiya Sanwardena Bank.

Fragmented Nature of the Banking Sector in Sri Lanka

The current structure of the banking sector of Sri Lanka remains highly fragmented. The 6 largest banks account for nearly 75% of the total banking industry assets, while the remaining 24 banks compete for the residual of 25% market share (Table B 3.1).

Accordingly, the fragmented nature of the sector constrains the ability of most LBs to effectively cater to financial consumer needs and contribute to broader economic growth, due to operating inefficiencies, resource constraints, lapses in information technology systems and limited market share. This increases the need for large banks with stronger balance sheets, governance and risk management frameworks to enhance the overall resilience of the banking sector to withstand both internal and external shocks which potentially transmit vulnerabilities across the financial system.

Measures implemented during the year 2025

The Governing Board granted its approval to issue the Framework for Banking Sector Consolidation to LBs in October 2025. Accordingly, the Central Bank via letter dated 12.12.2025 informed locally incorporated small sized banks regarding the bi-annual evaluation based on a scoring system. Afterwards, the Central Bank issued the Framework for Banking Sector Consolidation to LBs on 23.01.2026, directing LBs to pursue appropriate

strategies for banking sector consolidation to ensure the safety and soundness of the banking sector in Sri Lanka. The salient features of the Framework issued to LBs are given below.

- Locally incorporated small sized LBs will be evaluated bi-annually based on a scoring system that consists of self-assessment and a regulatory assessment. Quantitative and qualitative criteria have been specified for the self-assessment conducted by LBs such as capital, profitability, assets quality, liquidity and concentration as quantitative criteria and catering to underserved customer segments, business model sustainability, adequacy and effectiveness of Management Information Systems as qualitative criteria. Further, management of risk, adequacy of resources and regulatory and macro-economic environment of LBs are considered for the regulatory assessment.
- In this regard, the Central Bank, among other measures, will implement necessary actions to direct mandatory consolidation for LBs which persistently score less than a pre-determined threshold as per the scoring system.
- Furthermore, the Framework provides LBs to pursue consolidation strategies proportionate to the asset size of each bank and provides broader guidance on consolidation including, obtaining approval of the Board of Directors and Shareholders, seeking the approval of the Central Bank, addressing the potential concerns relating to human resource management, safeguarding depositors and fair market conduct, among others.

Table B 3.1
Composition of the Banking Sector as of 31.12.2025

Category	Assets Size	Number of Banks	Market Share
Large Banks	Above Rs. 3 Tn	3	50.0%
	Rs. 2 Tn – Rs. 3 Tn	1	9.6%
	Rs. 1 Tn – Rs. 2 Tn	2	15.3%
Medium Banks	Rs. 400 Bn – Rs. 1 Tn	5	16.3%
Small Banks	Rs. 200 Bn – Rs. 400 Bn	4	5.0%
	Rs. 100 Bn – Rs. 200 Bn	2	1.3%
	Below Rs. 100 Bn	13	2.5%
Total		30	100%

- This aims to enable expansion through mergers and acquisitions, alongside fortifying governance and risk management strategies, advancing technological capabilities, fostering innovation and improving access to capital, with a view to strengthening the resilience and stability of LBs.

Recently, CBSL facilitated the transfer of the retail business portfolio of a bank incorporated outside Sri Lanka to a domestic private bank. Further, the Government of Sri Lanka has approved restructuring of 2 state owned, small specialised banks and CBSL will facilitate such initiatives with a view to strengthening the soundness of the banking sector in Sri Lanka.

Expected benefits of the banking sector consolidation

The strategies encouraged under the Framework for Banking Sector Consolidation are expected to facilitate the absorption of small sized local LBs, particularly those facing challenges related to capital, business model sustainability and operational efficiency, by larger and stronger banks. However, the Framework does not encourage further expansion of large banks via consolidating two or more large banks.

Accordingly, it is expected to establish well-capitalised banks with sufficient buffers and sound risk management mechanisms capable of absorbing unexpected losses and potential threats, thereby strengthening the overall resilience of the banking sector.

Furthermore, banking sector consolidation is expected to support efficient financial intermediation, by enhancing cost efficiency of LBs and contributing to lower interest margins through greater economies of scale. It is also expected to promote strategic investments in technology driven/ digitalised financial services which enable the banking sector to better serve the unserved and underserved markets. In addition, consolidation would support the expansion of financial products and services while improving operational efficiency across the banking sector.

Role of the Central Bank in implementing the Consolidation and Way Forward

The Central Bank will evaluate the proposals for consolidation and other information provided by the respective LBs from a regulatory perspective and grant necessary approvals in terms of the Banking Act No. 30 of 1988 (as amended). Besides this, the Central Bank will facilitate the banking sector consolidation efforts by providing certain regulatory guidance, where appropriate.

Accordingly, it is expected that banking sector consolidation will facilitate financially and operationally sound banks, thereby strengthening the resilience and stability in the banking sector while supporting inclusive and sustainable growth of the economy.

